Recent Reforms to Corporate Legal Structures for Social Enterprise in the UK: Opportunity or Confusion?

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ABSTRACT

This paper considers the definitions of social enterprise generally used in the UK. It goes on to examine the problems with the main corporate legal structures for social enterprise available in the UK in the early twenty first century. It considers the main reforms and changes to the law in the area introduced between 2000 and 2006 and concludes with some observations on the remaining problems and issues to be addressed in the light of that analysis.

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1. Definitions and Implications for Legal Structure

It is customary to begin discussions such as this with a definition and, in the case of this paper, some definition is needed to allow us to consider the implications for legal structure of any attempt to encourage or facilitate the development of social enterprise in the UK.

1 Emphasis in this paper is on incorporated entities. A partnership - incorporated or not - can be used for business. Unincorporated associations are not suitable for business but might be used as part of a wider social enterprise structure. However, without the application of trust devices, it is difficult to prevent the conversion of such structures into non-social enterprise form. More practically, most social enterprises will want to have the benefit of limited legal liability of members and directors for business debts. That is available only if a corporate form is used.

2 Both company law and industrial and provident society law are matters reserved for the UK Parliament under the Scottish and Welsh devolution arrangements. In each case, Northern Ireland currently has its own legislation which is virtually identical to that in Great Britain. The Company Law Reform Bill 2006 will replace Northern Irish Company Law statutes and extend to the whole UK when it is in force. This will not affect the position in respect of IPS’s.
GHK, Johnson, and Spear examine the definitional issues in their excellent literature review for the UK Social Enterprise Unit\(^3\).

At European level, they note that the EMES\(^4\) definition of four economic criteria and five social criteria provides a useful framework for differentiating definition of the concept across Europe. They point out that the UK definition places less emphasis on democratic control than the definitions of both social enterprise and the social economy developed by the European Commission\(^5\). However, the latter does omit reference to equal voting rights from its text on both foundations and “social enterprises” when listing and describing “social economy organisations” while including it in its description of co-operatives, mutual societies, and associations. It acknowledges that social enterprises can be charities and private companies or unincorporated and does not define those legal forms by reference to voting rights.

The UK definition to be found in the 2002 Social Enterprise Strategy document is wide:

“A social enterprise is a business with primarily social objectives whose surpluses are principally reinvested for that purpose in the business or in the community, rather than being driven by the need to maximise profit for shareholders or owners.”\(^6\)

It also explicitly acknowledges the wide range of legal vehicles available for use by social enterprises in the UK:

“Social enterprises are diverse. They include local community enterprises, social firms, mutual organisations such as co-operatives, and large scale operations operating nationally or internationally. There is no single legal model for social enterprise. They include companies limited by guarantee, industrial and provident societies, and companies limited by shares; some organisations are unincorporated and others are registered charities.”\(^7\)

The strategy’s approach to legal structure was to note the strength of the diversity of the sector and the consequent complexity of the legal framework while welcoming the Industrial and Provident Societies Act 2002 and pointing to the imminent publication of the PIU Review of the legal framework for the voluntary sector\(^8\).

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\(^4\) [http://www.emes.net/](http://www.emes.net/)


\(^7\) Ibid.

\(^8\) Ibid pp 10, 45-47.
Social Enterprise London, in its 2003 publication “Keeping It Legal”\(^9\), gives a more “hands on” indication of the links between the nature of social enterprise and legal structure. It highlights the advantages and disadvantages of incorporating with limited liability, the issue of whether charitable status is to be sought, methods of achieving stakeholder participation, mechanisms to facilitate investment, tax implications and the means of expressing and protecting the social ownership and nature of the organisation – particularly distinguishing the trust based model from the member controlled organisation\(^10\).

This is elaborated by the classification of the vision of social ownership into three models. In the “service model” control rests with a small management committee or board who probably contribute little capital rather than with beneficiary members and the aim is to provide services for others. In the “single stakeholder model” of the employee controlled business, consumer co-operative or credit union a membership elects the board, there is the possibility of some capital contribution by members, and perhaps some distribution of profits to members within limits. A “multi-stakeholder model” combines a number of groups in one structure such as employees and customers or voluntary and community groups.

Similarly, “Keeping It Legal” points to need for the flexibility to use different legal entities together in group or integrated structures. This may allow charitable activities to be carried out by a charity while other entities trade or for the use of subsidiaries to ring fence the risks attached to particular projects or activities. Similarly federations can be built from the bottom up or umbrella organisations may set up local entities. In addition to the use of legal entities, contractual arrangements such as franchising and licensing may be needed for business models, logos, or brand names \(^11\).

GHK, Johnson and Spear, also point to the desirability of maintaining maximum flexibility as to the legal structure to be used and the importance of facilitating movement from one structure to another as the needs of an organisation may change over time. They find that:

“…the country case studies highlight continued efforts to facilitate innovation, cohesion, partnership and social enterprise sector development across families of organisations through legislative and regulatory change; the aim is to achieve pathways of adaptation rather than multiple legal forms…” \(^12\)

They also note that their country case studies “highlight how different organisational models are pertinent to the achievement of different policy goals….”. The three key policy goals identified for the UK are economic

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\(^11\) Ibid pages 1 to 2
\(^12\) ibid. pages 7 to 8
\(^13\) supra FN1 para 294 at page 66
development, social cohesion and public service delivery. A key suggestion in the Literature Review which does not find its way into the final report is the observation:

“it is important to stimulate innovation by providing pathways for conversion between various legal forms, for instance so that a company limited by guarantee can easily convert into a society for the benefit of the community without facing a large tax bill. Such pathways should not be used as ways to circumvent restrictions placed on the distribution of assets, for example, by charities or Community interest Companies (CICs).”

In the full report submitted to the UK SBS and the Social Enterprise Unit by GHK as the Review of the UK Social Enterprise Strategy, policy on legal structure is referred to only by advocating the “development of the Community Interest Company (CIC)” with a view to easing the transfer of community assets and allowing organisations such as development trusts to expand their activities. The report also passes on the rather vague concern expressed by some in the sector that more “support for potential candidates” would be required if the CIC structure were to take off. In addition, the section on access to finance for social enterprises implies, by the absence of any reference to the matter, that available legal structures do not cause problems in this respect. However, this is a point on which there are differences of detail and clarity between what is permitted to the CIC by the CIC Regulations and what the FSA might permit in the case of a co-operative or community benefit IPS. Liaison on this would be desirable so that any differences are logically justified and not merely arbitrary or coincidental.

The next section of this paper examines the problems that affected UK corporate legal structures for social enterprise in the late twentieth century.

2. Problems with Twentieth Century Structures.

A range of commentators, including the present author, have highlighted the key problems with the corporate legal structures available in the UK for co-operatives and other social economy organisations. Those criticisms can be summarised.

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13 Ibid at paras 290-291 at page 66
14 Ibid para 58 at page 15
16 Ibid paras 37, 97, 106 and 209 at pp 10, 27, 29 and 51-52.
17 Ibid paras 133 to 154 on pages 35 to 41.
The company law regime did not provide a cheap and easy way of preventing a company, set up to operate as a co-operative or other social enterprise, from converting to a “for profit” business owned and controlled by investors to whom profits and surplus assets could be distributed. Entrenchment in a company constitution was legally possible but members objecting to a change in violation of that would have to go to the courts to object – a costly and time consuming business. If they had no substantial financial stake in maintaining the co-operative nature or social purpose of the business, this was unlikely to happen.

Moreover, if more sophisticated means of transferring the business or assets out of the company and into another entity which allowed distribution and gave power to investor owners were used, legal objection might be impossible. This did not apply to sectors in which a regulator had statutory power to prevent such changes, e.g. housing associations and charities with the Housing Corporation and Charity Commission respectively having the necessary powers. But a non-charitable “community benefit” social enterprise, or a co-operative which allowed limited distribution of assets or profits would only be protected if it was, for example, a housing association. This made it necessary to use a structure other than a simple registered company to be sure that non-charitable social enterprises would maintain their identity and not be converted out of the social enterprise format.

The company structure could be made impregnable and effectively unchangeable by the use of one or more trust or contractual devices so that those with the power to make the change were effectively prohibited from doing so. The classic example of this approach is the employee owned John Lewis Partnership. Trusts are also commonly used by charities. However, this is not a simple structure to establish and needs to be tailored to particular needs. That makes it expensive and cumbersome and unlikely to facilitate the development of social enterprise. It is a structure ill suited, without careful adaptation, to stakeholder participation.

For co-operatives and businesses set up for the benefit of the community (charitable or not), the other available business structure was and is the industrial and provident society (IPS). In essence, this form of legal structure is policed to allow registration only of co-operatives or community benefit societies and to prevent or restrict conversion out of co-operative or community benefit form. The regulator up to 2001 was the Registrar of Friendly Societies. Since that time it has been the Mutual Societies team in the

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Financial Services Authority\textsuperscript{19}. However, this legal structure was not without its problems.

Company Law has been the subject of frequent and substantial revisions. Since World War II there have been major Companies Acts in 1948, 1967, 1985 and 1989, and the Insolvency Act 1986 followed by the Enterprise Act 2002\textsuperscript{20} as well as numerous less substantial changes. There will soon be a new consolidating Companies Act 2006\textsuperscript{21} when the Company Law Reform Bill receives the Royal Assent this Autumn. These changes have developed the law to regularly update the whole system. This has included:

- accounting requirements – including substantial exemptions and relaxations for small business;
- technical, but troublesome, issues about the capacity of the company to do business and the role and powers of its agents;
- improved informality in respect of meetings and other procedures in small companies;
- better procedures for the protection of minority shareholders;
- the reform insolvency rules with a view to rescuing more businesses and penalising delinquent directors; and
- addressing problems about corporate governance and self dealing by directors.

Some changes implemented the EU Company Law Harmonisation Directives in the UK. Others responded to perceived problems with national law – often as a result of particular “scandals”. However, none of those changes extended to industrial and provident societies.

The Industrial and Provident Societies Act 1965 was and remains the main legislation in that field. It consolidated the Act of 1893 with relatively minor later changes. The 1893 Act was itself a consolidating measure. As a result, industrial and provident societies are governed by a legal framework little changed since the 1870's. In one sense that, like London’s sewers, is testimony to the wisdom and skill of our Victorian ancestors.

However, most of the company law reforms in the late twentieth century were to make life easier for businesses. Industrial and provident societies are businesses and they were not included. As a result they suffered real or perceived competitive disadvantage.

Of course, some measures could be adopted by societies voluntarily – they could comply with the stricter company law accounting requirements if they chose (and lenders would insist on it for societies with businesses on a large scale). However, in that area, the smaller societies could not exempt

\textsuperscript{19} http://www.fsa.gov.uk/Pages/Doing/small_firms/MSR/index.shtml
\textsuperscript{20} http://www.opsi.gov.uk/acts/acts2002/20020040.htm
\textsuperscript{21} http://www.publications.parliament.uk/pa/cm200506/cmbills/190/2006190.htm
themselves from the legal requirements about accounts that applied to them but not to companies of the same size. Similarly, measures to discipline directors might be difficult to replicate in the rules of a society and, in practice, hard to include if those involved in drafting the rules are to be the early directors. The insolvency rescue procedures of administration and voluntary arrangements do not extend to them.

To make matters worse, even the key advantage of the IPS structure, the “policing” element to prevent conversion out of a co-operative or community benefit (bencom) format, was far from perfect. The majority required to convert a society – whether co-operative or bencom – into a company was 75% of those voting without reference to the turnout and the mechanism of the decision – by ballot or at a meeting, for example – was left to the society’s own rules. This allowed a minority to convert the society to a shareholder owned, profit distributing company if the majority were apathetic and the society was not regulated by the Housing Corporation or the Charity Commission, who had power to prevent it.

So, the major problems by the late twentieth century were that the up to date business structure did not secure the social enterprise nature of the business and the structure that did achieve that (albeit imperfectly) was less useful for business purposes. It is also worth noting that, because of the doctrine of all post 1979 UK Governments that regulation must be paid for by those regulated, the cost of establishing an industrial and provident society has to reflect, at least broadly, the cost of the policing and the relatively small number of registered societies. On the other hand, the cost of registering a company reflects the economy of scale allowed because of their much greater numbers and the EU requirement that such costs should not discourage the establishment of businesses in other member states. The full use of electronic registration processes by the registrar of companies also makes registration cheaper and easier than is the case for registration of societies which remains in the age of paper, if not the fountain pen.

3. The Solutions of 2000 to 2006

In terms of legal structures for UK social enterprises and the problems outlined above, three major developments changed the situation and paved the way for continuing reform and development. They were: two Private Members Bills which became, respectively, the Industrial and Provident Societies Act 2002 and the Co-operatives and Community Benefit Societies Act 2003 which both dealt with some of the problems surrounding the IPS structure and the publication of the PIU Report “Private Action, Public

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22 [http://www.opsi.gov.uk/acts/acts2002/20020020.htm](http://www.opsi.gov.uk/acts/acts2002/20020020.htm) Both Acts were the direct result of the work of the Co-operative Party [http://www.party.coop](http://www.party.coop), the political wing of the UK Co-operative Movement which is in permanent electoral alliance with the Labour Party. For their brief account of this see: [http://www.party.coop/images/theprivatemembersbills.pdf](http://www.party.coop/images/theprivatemembersbills.pdf)
Benefit” leading to the Companies (Audit, Investigations and Community Business) Act 2004 and the Charities Bill currently before Parliament. The latter make the use of the new CIC company structure and a wholly new legal structure for charities possible.

*Industrial and Provident Societies Act 2002*

The “Gareth Thomas Bill” which became the Industrial and Provident Societies Act 2002 achieved two things. First, it amended section 52 of the IPSA 1965 so that for the conversion of an industrial and provident society into a company both the existing 75% majority of those voting and a turnout of at least 50% of those eligible to vote would be required. That plugged the most obvious loophole in the protection from conversion enjoyed by social enterprises using the IPS form. However, it maintained the possibility of conversion for any IPS, whether a co-operative or a bencom. The Bill, as originally proposed, would have empowered HM Treasury (the sponsoring department for IPS Law) to create an “asset lock” by regulation applicable to any bencom IPS. This inappropriately named device would have ensured that value (rather than literally a particular form of “asset”) was locked in to the community benefit purpose if the society’s rules provided for this. This part of the Bill was dropped on the basis that government awaited the PIU Report (“Private Action Public Benefit”) and would prefer to deal with the issue in the light of its findings. The second achievement of the Act as it emerged from the legislative process was to empower HM Treasury to use regulations to update IPS legislation to bring it in line with Company Law after any change in company legislation. The one restriction on this was that those parts of the IPSA 1965 which define the essential nature of a co-operative or a bencom cannot be changed on this basis. This power has been used to relax the accounting rules applicable to IPS’s with limited turnover and the passage of the consolidating and reforming Company Law Reform Bill 2006 will provide further possibilities for its use.

The possibility of the conversion of a business structure from social enterprise into investor owned and controlled business was revisited by both the Co-operatives and Community Benefit Societies Act 2003 and the “Private Action, Public Benefit” Report of the then PIU (now Strategy Unit) of the Cabinet Office.

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26 http://www.publications.parliament.uk/pa/cm200506/cmbills/083/2006083.htm
It is worth noting that, at the time of the Gareth Thomas Bill in 2001-2002 it was conceded, to ease the Bill’s passage, that the availability of an “asset lock” was appropriate for a “bencom” IPS which was dedicated, by definition and from its establishment, to pursuing the interests of a community other than its own members but not for a co-operative which was focused on member benefit. The rationale for this was that the members who controlled a co-operative must have the right, if they wished to do so, to change its legal form to an investor controlled business – so long as they followed appropriate procedures and decided to do so by a special majority (75%) which also met a turnout requirement (50%). Now that a model for a Co-operative CIC exists, this argument may appear less convincing in the IPS context.

Co-operatives and Community Benefit Societies Act 2003

This position was maintained in the Co-operatives and Community Benefit Societies Act 2003 which empowered the Treasury to develop the “asset lock” only for bencoms and not for co-operatives. This Act achieved a number of improvements in the legislation governing the IPS structure and benefited from the fact that it was introduced by Mark Todd MP after the publication of “Private Action, Public Benefit” when the Government was ready to accept the “asset lock” principle in the proposed CIC company structure and also apply it to the IPS bencoms. In addition to empowering Government to introduce the asset lock for bencoms, the Act dealt directly with some of the areas in which IPS law had fallen behind company law. The 2003 Act brought the IPS provisions about the capacity of the society and its agents to act and the formalities for executing documents into line with those applicable to companies. This levelled the playing field for the IPS sector in those respects.

From 6th April 2006 the new asset lock regulations for “bencom” industrial and provident societies have been in force and available for use. They implement the provisions of the Co-operatives and Community Benefit Societies Act 2003 to "lock in" the value of the assets and resources of I & P societies registered as "bencoms" to benefit groups other than their own members. This means that by amending their rules or incorporating a rule from the time of registration, any bencom, except a registered social landlord or a charity, may, by unalterable rule, prevent the payment of any amounts of value out to members or others except to pay members, or their successors on death or bankruptcy, the nominal value of any withdrawable shares plus interest. Otherwise any surplus has to go to another society with a similar restriction, a community interest company, a registered social landlord, or a charity - all of which lock value in for their purposes.

The FSA is given power to enforce such restrictions on surplus distribution by enforcement notice and can order restitution from society officers if the society suffers loss. It can also seek a court order to prevent or end violation of such a rule.

29 The Community Benefit Societies (Restriction on Use of Assets) Regulations 2006 SI 2006/264 http://www.opsi.gov.uk/si/si2006/20060264.htm
“Private Action, Public Benefit” and the CIC

The publication of “Private Action, Public Benefit” represented an important development and rationalisation of Government policy in this area. Dunn and Riley point out, the unifying theme of the paper is public benefit and that takes the form of both a redefinition of “charity” for legal purposes to require some element of “public benefit” and the proposals for reform of the legal structures available both for charities and other not-for-profit enterprises.

The report recommended reform of industrial and provident society law to rename these societies as co-operatives or community benefit societies and to allow the imposition of an asset lock for the latter. It also suggests that the modernisation of IPS Law to bring it into line with company law as envisaged in the 2002 Act should be pursued. The name and main provision of the 2003 Act developed these proposals but, as Dunn and Riley point out they do not ensure that there will always be an asset lock for bencoms or prevent the shrinkage or marginalisation of the IPS structure due to the creation of the CIC which uses the familiar company structure and is available, as recommended, only to non-charitable social enterprises.

The most significant outcome of “Private Action, Public Benefit” to date has been the CIC. The legislation and the guidance and information provided by the regulator provide full detail about the operation of this structure. In outline, it involves the use of the existing company structure with the added assurance from the regulator that the assets and profits are to be dedicated to community benefit. The CIC structure is not available as the main structure for use by a charity but can form part of a group which includes a charity – for example the trading wing.

To establish a CIC it must be established that the CIC will serve to benefit the community and not party political purposes, the financial interests of a small defined group such as its own employees, directors, or the members of a particular organisation. It can use all the available company forms of PLC, private company or company limited by guarantee. While dividends or interest can be paid to those who invest capital, there is a “cap” on the amount of such return. The intention is that this will allow capital to be raised from

31 This is reflected in clause 3 of the Charities Bill currently before Parliament
http://www.parliament.the-stationery-office.co.uk/pa/cm200506/cmbills/083/06083.1-7.html
33 http://www.cicregulator.gov.uk/guidance.shtml
those who support social enterprise with the assurance of the familiar company form but also that the gains from the business will not be returned purely or mainly to investors.

Surplus value on dissolution can only be transferred to another asset locked body. Establishment of the CIC is by assuring the regulator in a statement of the community benefit purpose and that the company is not owned or controlled by a political party or political campaigning organisation as well as producing a company constitution which meets the requirements of the regulator on these issues and the issue of limited return on capital. An annual statement published to stakeholders by the CIC will show how it has carried out the purpose and allow stakeholders to complain to the regulator if they feel the rules have not been followed. The regulator has enforcement and investigation powers to ensure compliance with the CIC rules. The company will otherwise have to comply with all the rules as to accounts and reports and other matters applicable to any other company of its size and type e.g. PLC private company or SME.

This means that very similar devices for the maintenance of assets within a particular social enterprise form are now available whether a bencom (but not co-operative) IPS or a CIC is used. Detailed choices can be made between the two structures which each have their own separate regulator (FSA and CIC Regulator respectively).

A particularly interesting development within this area has been the development by Co-operativesUK, with the approval of the CIC regulator, of a model constitution for a co-operative CIC. This is rich in irony since an IPS registered as a “bona fide co-operative” is not permitted to use the “asset lock” under the 2003 Act and 2006 Regulations.

The co-operativesUK model is for a company limited by guarantee and includes in the objects of the company a commitment to abide by the ICA Co-operative Values and Principles. An explicit link is also made between the co-operative principle of limited return on capital and the cap imposed by the CIC Regulations. A membership “involved in the co-operative by virtue of using its services or by participating in its activities” with whom the company will “actively engage” is contemplated (Model Articles paras 7(a) & 8). Control, and election of directors, is by one member, one vote. The model emphasises the importance of a participating membership base while acknowledging the role and claims of other stakeholders. Co-operativesUK is currently working on a model for a Co-operative CIC company limited by shares.

Other Developments

A number of other developments in the period have addressed or raised issues surrounding legal structures for social enterprise.

34 http://www.congress.coop/live/welcome.asp?id=1003
Since 1996, use has been made of the general power conferred on Government to use regulations to reduce or relax the regulatory burden imposed on the IPS sector. This has been used for credit unions and, in 1996, to reduce the minimum number of members required to form an IPS, introduce some relaxation of the accounting requirements for small societies, and extend the time within which annual returns were to be submitted and charges on a society’s assets registered.

More recently, the power to update IPS law to bring it into line with company law under the IPSA 2002 (“the Thomas Power”) was used to relax the accounting and audit requirements for I & P societies with a modest turnover with effect from 6th April 2006 for years of account ending two months or more after that date.

This means that non-charitable industrial and provident societies need not appoint an auditor and have their accounts audited if their assets do not exceed £2,800,000 and its turnover does not exceed £5,600,000. This does not apply to credit unions, registered social landlords, insurance societies or societies holding deposits other than withdrawable share capital. Where this applies and the society's turnover is more than £90,000 per annum they will have to have an accountant's report (cheaper than a full audit) prepared on their revenue accounts and balance sheet. For charitable societies, the figures for not needing a full audit are £2,800,000 in assets and £250,000 turnover under this change but will rise when the Charities Bill is passed to £500,000 turnover.

The European Union’s European Co-operative Society Statute (SCE) Regulation and Directive will soon affect UK Law both directly and indirectly. The SCE bears considerable resemblance to the European Company (SE). The direct effect of the EU legislation will be the right of existing co-operatives or individuals with links in one or more other EU member states to establish a European Co-operative Society (probably from 18th August 2006). The detail of this is beyond the scope of this paper. It is

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perhaps more interesting to consider the indirect influence of this European legislation and legal structure on purely domestic UK legal forms. For example, the SCE can have either a unitary or a two tier board structure – the latter is possible in the UK by adaptation of the constitution of an IPS or a company but built into the SCE. Will this make more people consider the use of the two tier structure?

It is also the case that the EU Regulation allows for the constitution of the SCE to provide for “non-user investor members” who could have limited voting rights as well as a capital stake and return. This is controversial within the co-operative movement. It is allowed for an SCE if national law permits it for national co-ops. In the UK that is a matter for the FSA in deciding what constitutes a “bona fide co-operative” under IPSA 1965. At the time of writing, informal consultations have begun in the FSA about the possibility of allowing some such concept for UK co-operatives.

This could lead to greater flexibility in terms of investment in co-operative IPS’s. In the light of the possibility of dividend and interest on investments within limits in the CIC structure, this is an important development. Perhaps it will allow some of the technical unevenness between the IPS and CIC structures to be ironed out and thus improve the level of flexibility and the ease of comprehension and use that applies across the two legal forms.

The Company Law Reform Bill 2006 as originally presented to Parliament in November 2006 would have replaced about two thirds of the existing UK company legislation. In the House of Commons Second Reading debate on 6th June 2006, the Minister suggested that the Government were now willing to draft and add to the Bill as it goes through the legislative process clauses to consolidate within it the remaining one third of the existing legislation. That would mean that the Bill when passed wholly replaced all existing primary company legislation in the UK as well as codifying the general duties of company directors which, until now, have been based on case law.

The codification would include all the CIC provisions currently in the 2004 Act and, if the Act consolidates all of company law, that allows widespread use of the “Thomas” power to assimilate IPS Law to it. This might open up extensive reform of IPS Law by regulations and an opportunity to iron out unnecessary or inconvenient differences between IPS rules and those applicable to CIC’s. It also raises the issue of how the codified general duties of company directors might apply to IPS directors. Are they appropriate and would they in fact apply or will IPS directors still be subject to the previous case law based duties which, for example seem to give less emphasis to the consideration of the interests of a range of stakeholders? Finally, the new Bill makes the entrenchment of provisions in a company constitution easier although, outside the CIC sector, that would still leave people to enforce such provisions in the courts without the aid of a regulator.
The Charities Bill (also currently before Parliament) establishes a new legal form for charities, the Charitable Incorporated Organisation (CIO) as recommended in “Private Action, Public Benefit”. This is intended to allow a form of incorporation to reflect the “foundation” structure without separate trustees and members and to allow incorporation with the Charity Commission to reduce the range of regulators involved.\(^\text{39}\)

4. Do The Solutions Work and What’s Needed Next?

In this section the changes in UK law are considered in the light of the factors featured in the first section.

The UK Government’s definition of a social enterprise emphasises that they are businesses with primarily social objectives and surpluses principally reinvested in the business or the community. This presents a convenient twofold division for the analysis of the effectiveness of the current UK legal forms as they exist in 2006. This may throw up some lines for further research or reform.

**Business Needs**

This heading can be dealt with briefly. Some remaining differences between the company and IPS forms may raise issues here. That includes:

- aspects of the accounting rules which remain more liberal for small companies,
- issues about governance including dealing with director self dealing,
- capital maintenance rules, and the £20,000 shareholding limit for IPS shareholders who are not other IPS’s.
- Should co-operatives be able to have non-user investor members? If so, on what terms?
- How liberal should the IPS regulator be about classes of share capital and the rights attached to them?
- How much of the improved company law package reflected in the Company Law Reform Bill 2006 is consistent with a social enterprise whether co-operative or community benefit organisation?
- How should the duties of directors of social enterprises be defined and does this need different rules form those to be found in the Company Law Reform Bill codification?

Subject to these issues great progress has been made since 1997 towards acknowledging and dealing with the business needs of social enterprises using the IPS or company structure.

**Social Purpose**

Under this heading we have both the brand assurance issue of preventing the misuse of assets dedicated to community or co-operative use and the more

\(^{39}\) http://www.parliament.the-stationery-office.co.uk/pa/cm200506/cmbills/083/06083.1-7.html
detailed issue about distributions of profits and reward for loan or share capital. In addition there is the need to define the difference between the “service model” and the “stakeholder model” and the relationship between those factors where more than one is involved.

The CIC and the asset lock now available for bencom IPS’s are very helpful in this respect. They acknowledge the need to prevent the use of the assets for private gain or benefit if they are dedicated to public or community benefit. However, there remain differences between the two forms. For the IPS this is an option and it is exercised by amending or initially drafting the rules to include the lock. For the CIC it is a defining aspect of the form. There will exist bencom IPS’s with a prohibition on distributions of assets or profits but no “asset lock” rule. Some companies limited by guarantee will, similarly, not be registered as CIC’s but will prohibit distributions. Indeed, some may already have entrenched this under the existing law or will do so under the 2006 Bill when it becomes law. Those which are charities have a regulator to enforce this. The others do not.

This arises from the desire to make forms available for use but not to impose them. That is probably a sound approach but it does lead to complexity, a difference in approach by people depending on the quality of the legal advice or other information they receive and potential confusion in the public mind. Add to that differences between the approach of the FSA to IPS’s and the CIC Regulator on CIC’s, not to mention the Charity Commission for CIO’s or other charities, and the complexity grows.

On stakeholder involvement, there are interesting questions about how this affects the division between a co-operative and a benefit of the community organisation in the IPS context. For the CIC this is again interesting – especially with the emergence of the co-operative CIC. It is important to avoid sterile debates about terminology without losing sight of the importance of clarity if we are to understand the difference between serving members and serving a wider cause or constituency. The role of “democratic control” and one member one vote could be quite central here. Can the combination of different structures in groupings bound by contract or cross holdings have a role?

However, within this complex range of forms, comfort can perhaps be taken from the undoubted diversity and flexibility of choice available. As GHK, Johnson and Spear suggested flexibility and fluidity are important and perhaps the most urgent area for research with a view to policy development and reform is the need to:

“..stimulate innovation by providing pathways for conversion between various legal forms,”

The legal and fiscal processes and options involved in changing to or from a bona fide co-operative or community benefit IPS or a CIC or a non-CIC company need to be explored. There is also a need to explore the role of
groups and contractual or other arrangements in that context while always preserving the security of the social purpose and the assets devoted to it.

Complexity can give rise to flexibility or confusion or both in equal measure. It is important to make the system flexible, rational and user friendly. That is our challenge.

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