

**Prime Minister's Community Business Partnership**  
**Impact Investing and Partnerships working group – Hybrid legal models expert roundtable**

Tuesday 29 March 2016 (9.30am to 12.30pm), Perpetual Offices, Sydney

**Participants**

Angela Perry (Facilitator) - Impact Investing and Partnership Working Group, Prime Minister's Community Business (Partnership)	Adam Levin - Jackson McDonald
Ben Gales - Partnership	Alan Greig - Legal Models Working Group
Melanie Cooper - Partnership	Andrew Perry - Legal Models Working Group
Colleen McGann - Partnership	Michelle Goldman - School for Social Entrepreneurs
Patrick McClure - Member, NSW Government Social Impact Investment Expert Advisory Group	Mike Connell - Silver Chef (telecon)
Mele-Ane Havea - B Lab Australia & New Zealand Ltd	David Brookes - Social Traders (telecon)
Prashan Paramanathan - Chuffed	Libby Ward-Christie - Social Traders (telecon)
	Amber Cerney - EY (telecon)
	Kym McConnell - DSS
	Jen Gallagher - DSS

The *impact investing and partnerships* Working Group of the Prime Minister's Community Business Partnership (the Partnership), convened a roundtable meeting of experts on Hybrid Legal Models, to discuss models that could assist the growing social benefit, impact investing sector.

The Partnership comprises leaders from the business and community sectors and advises Government on practical strategies to promote philanthropic giving and investment in Australia. The Partnership is chaired by the Prime Minister, with the Minister for Social Services as Deputy Chair. More information is at [www.communitybusinesspartnership.gov.au](http://www.communitybusinesspartnership.gov.au).

**Why is a hybrid legal model needed?**

Mission or purpose led organisations that use commercial means to address social issues do not fall neatly into either "for-profit" or "not-for-profit" categories. As such a new legal form is being advocated that recognises the hybrid nature of such organisations.

The legal structure of an organisation has a number of implications including:

- Its ability to access capital, e.g. a not-for-profit that is not able to distribute dividends to shareholders cannot raise equity finance only debt
- the organisation's tax treatment, e.g. a charities receive tax exemptions that a private or public company cannot
- access to philanthropic and government grant funding / pro bono support, many grants are only available to charities with DGR1
- perceptions around mission integrity – not-for-profits and charities are often perceived to be mission orientated whereas public and private companies are seen as "profit focused" irrespective of how the organisations operate in practice; this can impact on an organisations ability to win contracts, recruit staff, and benefit from community support.

**Current position**

Many not-for-profits (NFPs) report difficulty in accessing the capital they need, in particular:

- start-up organisations in the first years of operation which do not have secure ongoing funding; and
- organisations that wish to expand into innovative areas.

Lack of access to equity for charitable organisations is a global issue. Providing access to equity capital could potentially reduce reliance on debt capital and may be appropriate for start-up social enterprises. Social entrepreneurs want to make money but want to achieve a social outcome also. There is great demand for shared value or blended value models.

The terminology: 'charitable' 'for-profit', 'not-for-profit' is limiting and inadequate for emerging social entities.

Currently most NFPs cannot raise equity capital (with some exceptions i.e. cooperatives and companies limited by shares, both are rare) or through convoluted expensive legal mechanisms. That is, it can be done within the existing legislative framework but is sub-optimal. This is a particularly strong barrier for smaller start-ups. For social enterprises there are some inhibitors to this within the current framework.

Social impact investment from philanthropic sources is also considered to be an untapped source of capital. However, the market is yet to develop with a key barrier identified as fiduciary duty of boards including superannuation funds, charitable trusts and foundations, which require trustees to preserve and grow their income producing capital base.

A barrier that cannot be overcome without legislative change is the potential risk to Directors that have a 'for-purpose' organisation. Currently, they are required to consider the highest bidder for shareholders at a change of control event regardless of the purpose of the organisation as in their Constitution or Rules. If they have two bidders, one that fits their purpose and one that doesn't, the decision must be made on price not purpose.

*Roundtable participant "If you seek legal advice on shareholder value – greatest return to shareholders will prevail regardless of the constitution – can't write yourself out of the requirements of the Directors at point of control – this is the nub of the issue in Australia."*

Moving from a not-for-profit to a for-profit structure to improve access to equity capital is also an expensive and cumbersome process. A for-profit structure may also risk its social purpose and would need to consider an 'asset lock' or 'mission lock' i.e. ensuring funding or capital provided for a social good purpose could not be utilised for private profit later. This can be achieved but it is complex and requires structures like a trust or golden share.

*Roundtable participant: "simplified replicable trust docs can be cheap – but if more complex, costs rise".*

These costs can be up to \$50,000 which is prohibitive for smaller organisations.

#### CASE STUDY – Chuffed

- Started in a not-for-profit structure;
- Philanthropy – not enough;
- Need to raise equity as the most appropriate type of capital for this kind of start-up.
- Converted to for-profit but wanted to preserve the mission;
- No obvious way to preserve mission so had to create own via constitution and align Director's duties with mission;
- Purpose sat alongside all other stakeholder interest;
- To achieve this, need unanimous shareholder vote to change constitution – so always had a veto – ensures mission lock;
- Raised \$1.1 million commercial money;
- Purpose very important in the model - wanted entity to stay true - not diluted after several rounds of equity raising;
- Director's duties at change of control still would prevent the purpose being taken into account in a takeover situation.

Internationally, new legal forms such as a Community Interest Companies (CICs) and low profit Limited Liability Companies (L3Cs) have emerged to meet the needs of NFPs that seek to source equity capital. Under these structures, financial returns are often capped to ensure 'mission lock' i.e. social returns are not compromised in the pursuit of profit maximisation. There have been concerns raised about the ability of investors to withdraw their capital, although it should be noted that a CIC share is not within the asset lock.<sup>1</sup>

Further, some are hesitant to make equity investments:

*Roundtable participant: "UK killed equity investment in their community interest model by putting in an asset lock - people will opt out".*

This statement reflects the question of legitimate anxiety over aspects of legal models which might raise barriers to investment, but there was also debate over the evidence base for this this. The UK CIC model provides a contrast to the US Benefit Corporation model. The roundtable discussion opened up the possibility of combining these in a 'tiered' approach. Whether or not that approach is taken, there is a need to carefully examine evidence for and against the notion that asset locks discourage investors across the board.<sup>2</sup>

*PARTICIPANT FEEDBACK PROVIDED POST ROUNDTABLE*

*"CIC is booming, and the equity percentage of the new incorporations is growing. 90 per cent of the services spun out of healthcare into employee owned CICs. For example, BCorp wouldn't be of utility in that type of process, nor useful (as the asset lock is) in transferring local assets to community ownerships.*

*(I) take the point that not much equity investment has taken place yet, but that was due to share being hobbled. We have solved that. There is a way to go but equity CIC numbers have jumped and the process of standardisation of process is being dealt with...most of the social equity investment in the UK has gone into CIC! (for 2010-2012)*

*The total amount of actual equity investment is ridiculously small, but it is through the CIC (that) we will build it. We can standardise products and services, for example in the UK it is now technically possible to launch a CIC ISA account.... ...There is a roadmap on equity and it won't be long before it is widely seen as successful, in much the same way as for the first 5-6 years of CIC we had to respond to negative interpretations of the facts, when in fact things were moving along incredibly nicely.*

*B-Corp is perhaps more akin to our 'Social Enterprise Mark', both are unregulated certification processes. A means of getting normal corporates to be more social, not a social company."*

Australia needs to consider a new and appropriate model that fits the current systems and nuances here.

*Roundtable participant "no other jurisdiction has Australia's franking system – this adds complexity".*

<sup>1</sup> *Office of the Regulator of Community Interests Companies: Information and Guidance Notes*, Chapter 6 pp 3-4, states that "A CIC is a limited company with all the usual duties and obligations....For example, a CIC may take on a commercial venture with the purpose of generating profits to support its objects. If the venture fails and makes losses the CIC must still meet its contractual obligations in regard to the venture even if this means depleting its assets or selling some of them to meet its debts." - Department of Business Innovation & Skills (May 2016)

<sup>2</sup> *Office of the Regulator of Community Interests Companies: Information and Guidance Notes*, Chapter 6.5.1, p 11, states that "Regulation 24 prevents a CIC from distributing its assets through the redemption or purchase of its own shares unless the payments are set at, or below, the paid up value of the shares. This supplements the asset lock provisions in the Articles of Association of a CIC."

#### CASE STUDY - Silver chef

- 25 years certified B Corp;
- Strong purpose;
- Needed to raise equity to support their growth strategy - recently raised \$30 million;
- As more equity is raised, the foundation's stake is diluted;
- Investors, employees and customers are well aware of the purpose. It is a publically listed company trading on ASX;
- If someone took over company, shareholder interests would prevail;
- A golden share would deter investment;
- B-Corp is a great strength;
- Dividends go to alleviating poverty;
- Section 301 law changes in UK of great interest – other interests other than shareholder primacy has to be taken into account;
- You must compete for investor funds. Investors want purpose and a financial return.

#### Are new hybrid legal structures needed? Or is clearer ASIC guidance enough?

*Roundtable participant "For-profit sector = no heart. Hybrid structures and new alliances allow different ways of sharing profits that can be made in delivering social outcomes"*

The key issues were identified as:

- clarity for the consumer, investor and the organisation is critical; and
- a diverse flourishing economy requires diverse legal forms.

*Roundtable participant: "Legal frameworks in other countries enable investment Australia won't be able to compete for the investment. We need to consider longer term objectives".*

There are different objectives to meet in relation to legal models:

- For purpose, mission lock and asset lock;
- For purpose and mission lock;
- For purpose and asset lock;
- For purpose; and
- For profit.

ASIC Guidance for Directors would provide a clear position of Director's liabilities in considering other positive outcomes besides the shareholder interest.

#### CASE STUDY - B-Corp

- B-lab – for profit and social impact;
- To enable the power for this business legal change is needed;
- Theory of change –
  - We believe if business is properly enabled it can contribute to solving social problems;
  - Unlock the power of business;
  - US model is a good starting point and very inclusive;
  - US – Benefit Corporation
    - Purpose embedded in the constitution;
    - Directors' duties are expanded – stakeholder not just shareholders;
    - Mandatory reporting obligations – annual impact report;
- A new corporate form is needed – Clayton Utz advise asset guidance is not sufficient;
  - Addressing this concern re different interpretation of Directors duties;
  - Make Directors comfortable that they don't need to profit maximise – this needs more than ASIC guidance.

*Roundtable participant: "Bring ASIC to the circle. Their role is in relation to the Corporations Act. We are grappling with changing culture and purpose within the confines of the law. We need some way of collaborating with ASIC to bring the issues more to the forefront".*

*Roundtable participant: "We need to licence a cultural shift"*

### **Summary from B-Corp**

In the United States, a new type of for-profit company limited by shares known as the 'Benefit Corporation' has developed. A Benefit Corporation places both profitmaking and the public good at the forefront of the purpose of the corporation. The Benefit Corporation has been enacted in more than half of all US states since first starting in Maryland in 2010.

The three key elements of the Benefit Corporation are as follows:

1. The purpose of the corporation is expanded to include having a positive impact on society and the environment;
2. The duties of the directors are expanded to require directors to consider the interests of all of the corporation's stakeholders; and
3. The corporation is subject to a new requirement to report on the pursuit of its expanded purpose.

B Lab is the not-for-profit behind the development of the Benefit Corporation legal form in the United States and sees the amendments as:

- necessary in the context of a change of control to allow directors to make decisions that might not be the most financially advantageous to shareholders but are consistent with its expanded purpose;
- desirable in the general course of business, in order to:
  - validate directors' decisions that are consistent with the corporation's expanded purpose and motivated by creating value for stakeholders (not only maximising profits for shareholders)
  - provide protection for directors and officers from claims by shareholders that the company failed to maximise profits
  - hold directors accountable to make decisions that take into account stakeholders through clear reporting requirements
  - promote a change to corporate norms of behaviours in favour of more responsible profit maximisation

In Australia, the Board of B Lab Australia & New Zealand (the local office of B Lab) has set up a Working Group comprising companies, investors, lawyers and academics, including Professor Ian Ramsay of Melbourne University, Clayton Utz Lawyers and Australian Ethical Investments. The Working Group has investigated the application of a Benefit Corporation structure in the Australian legal context and has concluded that for similar reasons to the US, the introduction of a like structure would be beneficial in Australia.

It is important that any changes to the law apply to all companies not just 'social enterprises'.

*Roundtable participant: "We are not just trying to grow a niche sector i.e. social enterprise but more broadly for all companies. Adopted so quickly in UK and Italy and Argentina – driven by the 'millennials'"*

Legislation may be needed in particular to ensure changes to Directors duties, but other issues related to asset and mission lock may just need clarity and guidance.

*Roundtable participant: "The Canadian model did not rely on new law but amendments to existing law- 2 pages of amendments only were needed" {Note this document was tabled at the roundtable}.*

Simplified templates and investment in shared intellectual capital can assist with costs. In the UK, Braithwaite and Bracewell bore the set up costs in the early work.

*Roundtable participant: "Social purpose/fundraising can take many different paths – can burn money quickly with a lot of advisors – many factors come in to play. Components can be simplified – for example for PAF and PuAFs, the tax office produced a model trust deed – template. It was expensive at first but now just \$2,000 to use".*

Justice Connect has a national website for templates governance and so on but this is not perfect. Noting that in any case, Justice Connect addresses not-for-profit legal models and not hybrid legal models, there was a suggestion that a major law firm could help with the drafting a new legal model pro bono. There is precedent in the UK for this, with the law firm Bates Wells Braithwaites having led the way in drafting the CIC model, and just very recently launching a major legal services support suite: [Get Legal: http://getlegal.bwbllp.com/](http://getlegal.bwbllp.com/).

Standard templates that apply to the sector are available on-line through Australian Venture Capital Limited (AVCAL).

*Roundtable participant: "fundraising costs have come down over time – incremental costs caused though the uncertainty .i.e. moving from charity to PTY + advice in getting for-purpose in the your constitution. These costs disappear when you have an accepted way of doing this".*

Need a clear definition of 'social' and 'benefit'.

*Roundtable participant: "internationally there is no word in front of 'benefit' – general public benefit, not 'social' or 'environmental'".*

While the ACNC only covers charities, not listed companies, there is no appetite for new regulator – need to work within existing structures.

### **Summary conclusions:**

- Desire to create a new hybrid legal model;
- More work to do but the considerable work already done should be utilised;
- The ideal would be a new structure that has at a minimum purpose as part of the governing rules, entities can then also add a mission lock if it is appropriate and an asset lock if it is appropriate;
- Three key issues:
  - Director's duties at point of control – broader stakeholder interest – ASIC guidance not sufficient – need legislation amendment;

- Cost and complexity – helpful to have standard templates and products draw parallels with PAFs and PuAFs and fair shares – enormous benefit;
- Need for a new model in Australia – world has moved on now in an era of ‘blended value’ but our legal and regulatory framework does not facilitate this. May be feasible but how it can be achieved needs more work – tiered solution. Need this to be mainstream – not pigeonholed in the ‘charitable sector’. Need to be inclusive if possible, (using variation across tiers), of lessons from both CICs in the UK and Benefit Corporations in the US.

### **Next steps**

- Prime Minister’s Community Business Partnership members to feed back to wider group;
- Partnership to consider how to support others that are already leaning on this agenda; that is, not re-invent the wheel but give a voice to what has already been done;
- Subject to Partnership support, continue to draw on expertise and advice of this group going forward;
- This is a start to discussions, not an end point;
- A hybrid model with three tiers is the right way to go. We need to reconvene to assess the best way to achieve this.