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27 February 2017

## Submission in response to Social Impact Investing Discussion Paper

We are pleased to take up the opportunity to provide responses to the Social Impact Investing Discussion Paper (**Discussion Paper**).

### About Not-for-profit Law

Not-for-profit Law is an Australia-wide program of the charity Justice Connect. Not-for-profit Law provides free and low cost legal assistance to not-for-profit community organisations and social enterprises. Not-for-profit Law provides services directly (in the form of legal information, advice and training) and brokers referrals for pro bono assistance from its member law firms and barristers. Prior to 2013, Not-for-profit Law was known as PilchConnect.

By helping those involved in running not-for-profits and social enterprises to navigate the full range of legal issues that arise during the lifecycle of their organisation, Not-for-profit Law saves their time and resources. This allows them to focus on achieving their mission, whether that is helping vulnerable people, environmental conservation, or working towards social cohesion.

Not-for-profit Law advocates for an improved legal and regulatory framework for the not-for-profit and social enterprise sector, and to ensure law reform considers the impacts of regulation on small-medium organisations. Effective and appropriate regulation supports efficient and well run not-for-profits and social enterprises; a thriving sector benefits all Australians.

**Not-for-profit Law provides advice to many social enterprises, with a particular focus on not-for-profit organisations seeking to start or scale a social enterprise. We also provide advice to social enterprises and not-for-profits seeking impact investing.** We have recently received funding from the Victorian Legal Services Board to build our existing legal resources for social enterprises and not-for-profits seeking impact investing. As part of this project, we will work with non-legal professional providers to match the pro bono commitments made to social enterprises by lawyers. We also run education programs for lawyers to build their capacity to advise social enterprises and not-for-profits on common legal concerns regarding social enterprises, impact investing and fundraising.

In addition to advising social enterprises, **we have lived experienced as we run our own social enterprise:** Not-for-profit Law's [Customised and In-house Training](#).

### About this submission

We are an active member of the Law Council of Australia's Not-for-profit Legal Practice and Charities Committee and have contributed to and endorse the Law Council of Australia's submission in response to the Discussion

Paper. Our submission is intended to supplement that submission, with a focus on the questions most relevant to our client evidence base, in-house expertise and our organisational experience:

- **Part 1 – question 1:** we provide submissions about the importance of intermediaries, the need to define social enterprise, the need to improve marketplaces for impact investing, and the need to extend crowd sourced equity fundraising to proprietary companies;
- **Part 2 – questions 3, 4, 28:** we provide submissions about legal structures for social enterprise, social investment tax relief and pro bono targets for non-legal professional services; and
- **Part 3 – question 29:** we submit that precedent constitutions are unlikely to have a catalysing effect, and suggest a range of other areas where social enterprises and not-for-profits require additional support.

## Summary of recommendations

We recommend that the Federal Government:

1. provide a package of funding to support the work of intermediaries providing free and low cost assistance to social enterprises and not-for-profits seeking to become impact investment ready, and to those providing a linking role between investors and impact investment ready enterprises.
2. either define “social enterprise” or provide guidance on appropriate use of the term.
3. continue to prioritise its work creating an appropriate framework to support crowd sourced equity fundraising through its *Corporations Amendment (Crowd-sourced Funding) Bill 2016* (Cth).
4. prioritise extending access to crowd sourced equity fundraising to proprietary companies, as the vast majority of for-profit social enterprises are structured as proprietary companies.
5. Address issues regarding the legal structural framework for social enterprises by:
  - a) preparing a modification to directors’ duties under the *Corporations Act 2001* (Cth) that addresses concerns about the potential conflict between directors’ duties and social purpose-based decision making; and
  - b) draft legislation for a hybrid legal structure (we do not consider that the benefit corporation is a hybrid legal structure) for consultation that has both classic not-for-profit features and the ability to issue shares and make distributions to investors, informed by the United Kingdom (**UK**) Community Interest Company (**CIC**).
6. investigate the potential of a Social Investment Tax Relief Scheme to increase private impact investing in Australia.
7. support a clearing house for non-legal professional services to democratise access to pro bono non-legal professional services for social enterprises.
8. set pro bono targets for non-legal professionals such as accountants and management consultants to improve the ecosystem for social enterprises and not-for-profits.

## Part 1: Addressing consultation question 1

1. What do you see as the main barriers to the growth of the social impact investing market in Australia? How do these barriers differ from the perspective of investors, service providers and intermediaries?

## Lack of marketplaces to connect impact investors with impact investment ready not-for-profits and social enterprises

The impact investing market place is fragmented. It is very difficult and inefficient for social enterprises and not-for-profits to locate and to connect with impact investors. Similarly, we imagine many impact investors are frustrated at the difficulty of identifying impact investment-ready social enterprises or not-for-profits.

Whether or not a social enterprise succeeds in attracting impact investing can depend on how personally well connected those involved are with potential funders. This hampers the sector's growth, and means access to funding is often based on ad hoc networks rather than the potential for the social enterprise to have impact and be financially sustainable.

### No definition of 'social enterprise'

In our work with start-up social enterprises, it is very clear there is no common understanding of the phrase 'social enterprise'. Is it fair that a company providing 5% of profits towards a social purpose can call itself a 'social enterprise' when another organisation is reinvesting 100% of profits towards its (social purpose) mission? There are cases (some publicly reported on) where businesses have labelled themselves 'social enterprises', yet never directed funds towards their (social purpose) mission, often because they failed to generate any 'profit' for distribution. A business that never distributes profits towards purpose, but that labels itself as a 'social enterprise', is unfairly disadvantaging both its non-social enterprise competitors and its genuine social enterprise competitors.

A definition of the term 'social enterprise' would aid the development of social enterprises and impact investing by both clarifying the currently confused public and investor understanding of the term, and by lessening misuse of the term. We also consider that a regulator should take responsibility for oversight of the use of the term to increase and preserve public trust and confidence in social enterprise.

We note the work undertaken to create a definition of 'social enterprise' as part of the Finding Australia's Social Enterprises (FASES) research,<sup>1</sup> and consider that the definition suggested in this research is a valuable starting point. We recommend that the Federal Government consider either legislating a definition, or providing guidance via the Australian Competition and Consumer Commission around appropriate use of the term 'social enterprise' (based on the grounds that to use the term 'social enterprise' where profits of an enterprise are not being substantially directed to purpose is misleading to consumers and investors). Similar work has been undertaken to improve use of terms such as 'free range' and 'organic'.

There are areas of complexity that sit alongside the question of a definition of 'social enterprise', such as whether businesses labelling themselves as social enterprises should be required to make their accounts publically available so that the public can understand where pre-profit costs are allocated (such as to salaries or payments to related companies) in order to assess whether the amount of revenue that is classified as "profit" (and therefore allocated towards purpose) is appropriate. This submission does not seek to address these nuanced issues, but notes that they warrant further consideration.

## Lack of appropriate and cost-effective structuring options for not-for-profit social enterprises

This issue is discussed further in Part 2 of this submission.

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<sup>1</sup> The 2010, 2015 and 2016 FASES Reports can be access on the Social Traders website at: <http://www.socialtraders.com.au/about-social-enterprise/fases-and-other-research/social-enterprise-in-australia/>

## Need for free and low-cost professional services support

In our experience, fledgling social enterprises struggle to afford and access the professional services necessary to establish a viable business (especially beyond legal services) and to undertake sufficiently rigorous business analysis to be considered 'impact investment ready'.

As an intermediary actively providing free legal assistance to social enterprises and not-for-profits seeking to access impact investing, we note there is very little targeted government funding of intermediaries. The Discussion Paper notes that Justice Connect's Information Hub website contains some helpful information, but not sufficient levels of information. Until late last year, Justice Connect had not received any funding towards supporting social enterprises. But, understanding the importance and challenges faced by the emerging social enterprise sector, we invested a portion of our untied funding towards free legal support for them.

Our [Social Enterprise Guide webpage](#)<sup>2</sup> was accessed by 5,099 unique users in the last 12 months. Research estimates there are around 20,000 social enterprises in Australia, which means up to a quarter of the market is already using our resources. Our social enterprise webinars (held both for social enterprises and for lawyers assisting social enterprises) are attended by hundreds of people each year.

We have now received some funding to support Victorian social enterprises from the Victorian Legal Services Board granting program, and will create further resources on impact investing via this grant. We strongly encourage the Federal Government to consider a package of targeted funding to intermediaries that provide free or low cost assistance to social enterprises, including Justice Connect's Not-for-profit Law service, to improve the supports available to social enterprises and not-for-profits seeking to become impact investment ready. We make further submissions in relation to non-legal professional services requirements of social enterprises later in this paper.

## Constraints on crowd sourced equity fundraising

There is growing appetite in for-profit social enterprises to undertake crowd-sourced equity fundraising (**CSEF**), where a wide public offering is made of low-value shareholdings to non-sophisticated investors (eg packages worth \$2,000 each) in a similar way to crowd funding campaigns.<sup>3</sup> There are a number of platform providers in Australia ready to facilitate such fundraising exercises. For-profit social enterprises face difficulties running CSEF campaigns as they can only be undertaken by a public company, and they often enliven significant regulatory disclosure burdens necessitating extensive professional advice. Many submissions have been made by sector colleagues to the Federal Government about the importance of reducing barriers to undertaking CSEF. We support the work being done to make CSEF more widely available and urge the Federal Government to extend access to low-disclosure CSEF to proprietary companies.

## Recommendations

We recommend that the Federal Government:

1. provide a package of funding to support intermediaries providing free and low cost assistance to social enterprises and not-for-profits seeking to become impact investment ready, and to those facilitating marketplaces to connect impact investors and impact investment ready enterprises and not-for-profits.
2. either define 'social enterprise' or provide guidance on appropriate use of the term.
3. continue to prioritise its work creating an appropriate framework to support CSEF through its *Corporations Amendment (Crowd-sourced Funding) Bill 2016*.

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<sup>2</sup> Accessible at [www.nfpalw.org.au/socialenterprise](http://www.nfpalw.org.au/socialenterprise).

<sup>3</sup> See for example, the successful crowd equity fundraising undertaken by Zookal: <http://www.startupsmart.com.au/advice/legal/first-equity-crowdfunding-deal-in-australia-for-2016-raises-more-than-675000/>

4. prioritise extending access to CSEF to proprietary companies, as the vast majority of for-profit social enterprises are structured as proprietary companies.

## Part 2: Addressing consultation questions 3, 4, and 28

3. Are there any Australian Government legislative or regulatory barriers constraining the growth of the social impact investing market?

4. What do you see as the role of the Australian Government in developing the social impact investing market?

28. Have you faced a legal impediment as a director of a social enterprise from making a decision in accordance with the mission of the enterprise, rather than maximising financial returns, that only a change in the legal structure could resolve? If so, what amendment to Commonwealth legislation, regulation or ASIC guidance would you consider is needed to address this problem?

## Legal structure for social enterprise

### Framing a productive and constructive conversation about legal structures for social enterprises

The question of whether a new legal structure is required for social enterprises is a complex. The answer should be informed by an understanding of the experiences of social enterprises operating under current legislative frameworks, and the potential benefits as well as risks of new legal structures. The Discussion Paper has touched on the question of legal structure, but the questions asked in the Discussion Paper, and framing of those questions do not get to the heart of the issues that need to be discussed.

Overseas experience shows that the debate about the necessity for, and the composition of any special structure for social enterprise is influenced by the framing of that debate.

*Debate has suffered from a fractured understanding of foundational issues related to the meaning of ‘social enterprise’ and the limitations of existing legal forms in facilitating it.*

Keren Raz <sup>4</sup>

We make the following comments on how the legal structures issue is framed in the Discussion Paper:

- we respectfully disagree with the Discussion Paper’s conclusion that “Many of the benefits of the internationally adopted social enterprise legal structures are already available in the current structures present in Australia.”<sup>5</sup> We refer to the Law Council of Australia’s submission and our comments under the heading ‘Does Australia need a legal structure (or multiple) for social enterprises?’ below;
- referring to “overseas legal structures” collectively is problematic given that each structure has almost entirely distinct characteristics (the UK CIC and US Benefit Corporation are discussed further below);
- the assumption that “mission lock” and “asset lock” are the defining characteristics of overseas legal structures over-simplifies hybrid legal structures – overseas legal structures address a range of issues and concerns in different ways, more broader than by addressing mission lock and asset lock; and

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<sup>4</sup> Raz, K. G. (2012). "Toward An Improved Legal Form For Social Enterprise." Review of Law & Social Change 36(2): 283-309, page 283

<sup>5</sup> Discussion Paper, page 32.

- suggestions that private providers could “expand the standard products on offer to cover a wider range of social enterprise structures” assumes that a wide range of structures can be accommodated under our current legislative framework – a conclusion with which we respectfully disagree.

We agree that the two issues posed by the Prime Minister’s Community Business Partnership (**the Partnership**)<sup>6</sup> are important questions (although we note that legally it is problematic to transition from a not-for-profit to a for-profit structure).

We agree that modifications to directors’ duties to clarify that directors may consider social purposes in their decision-making as well as the best interests of the company and shareholder interests is important. We suggest that a change to directors’ duties in the *Corporations Act 2001* (Cth) (**Corporations Act**) could be made on an ‘opt-in’ basis, so that companies could state in their constitution that directors may consider other interests listed in the constitution in their decision-making, consistent with provisions regarding directors’ duties in the modified Corporations Act.

We note that the Discussion Paper has not asked a question that addresses the first of the issues raised by the Partnership, namely that “putting in place the legal structures necessary to establish a NFP entity that can raise equity capital, or to transition a growing entity from a NFP to for-profit structure, is unreasonably expensive”. We believe the most useful questions to be asking about legal structuring frameworks and social enterprise are:

- what are the needs and strategies of social enterprises and not-for-profits in Australia that hope to access impact investing?;
- in what ways are these needs and strategies hampered by legal structuring options available under current legislative frameworks?; and
- what opportunities are available to ameliorate barriers related to legal structure?

### Does Australia need a legal structure (or multiple) for social enterprises?

The question of whether or not there is an appropriate legal structure for social enterprise is a challenge for both not-for-profits and for-profits. Research shows that most social enterprises (around 75%) currently operate under a not-for-profit structure.<sup>7</sup>

There are benefits and downsides to both for-profit structuring and not-for-profit structuring. Start-up social enterprises face an almost impossible decision between structuring as a not-for-profit and a for-profit. Often, entrepreneurs seek to use grant funding in the start-up phase, and then scale through equity investment. There is no off-the-shelf legal structure that neatly accommodates this approach.

Financing options available to enterprises are greatly impacted by choice of legal structure, and within the not-for-profit structure options are further impacted by whether an organisation is eligible for DGR endorsement. For-profit enterprises can access equity investment but are ineligible for most grants. Not-for-profits are eligible for more grants, but cannot issue shares. Only DGR endorsed not-for-profits (a small sub-set of not-for-profits) are eligible for distributions from private ancillary funds and public ancillary funds.

For established not-for-profits running profitable social enterprises, equity investment is attractive path to scaling activities. However, not-for-profits cannot issue shares. The only way a not-for-profit can issue shares is by setting up a subsidiary proprietary company (a ‘Pty Ltd’) to house investable activities and issue shares to investors and share in distributions with investors. For smaller not-for-profits this is time consuming and technically challenging.

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<sup>6</sup> Discussion Paper, page 32.

<sup>7</sup> Barraket, J., Mason, C. and B. Blain (2016). *Finding Australia’s Social Enterprise Sector 2016*. Social Traders, Melbourne, page 15.

While it is true that debt investments are a potential alternative path to accessing impact investing for not-for-profits, this option is not suitable for many not-for-profits that lack assets appropriate to provide as security and whose balance sheets would be dramatically affected by taking on significant debt (the exact same drivers are at play when businesses seek equity investment rather than debt).

### Case study: Social Change Central

Social Change Central (**SCC**)<sup>8</sup> is an online hub for social enterprises that launched in 2016 with a mission to ensure that Australia's social enterprises get the critical support they need. Using a membership subscription model, it brings together the growing number of social enterprises and intermediaries into one platform and collates the most up-to-date opportunities for social enterprises available in Australia and internationally.

SCC is itself a social enterprise. In its start-up phase, it considered its legal structuring options. It had available to it opportunities for not-for-profit grants, small business grants and had an individual investor interested in the model.

SCC spoke to Not-for-profit Law about its structuring options, and quickly realised that there was no off-the-shelf structure that would enable the organisation to access each of its funding options. If it structured as a not-for-profit, it would not be able to take equity investment from its investor without creating a complex hybrid structure, which was cost prohibitive. If it structured as a for-profit, it was immediately limiting the range of philanthropic and grant funding that would be available to support it.

Ultimately, SCC decided to structure as a proprietary company. This was not an easy decision for the founders, and SCC would have benefited from an option to adopt an off-the-shelf hybrid legal structure that blended the features and funding avenues of a not-for-profit and a for-profit. SCC's funding options will continue to be constrained by its proprietary company structure into the future unless it invests in covering the substantial costs associated with setting up a bespoke hybrid structure.

**Hybrid corporate group structures can be established, however the legal and other professional costs associated with such a structure are prohibitive.** The administrative burden is also higher for a corporate group than single entity. An example of a bespoke corporate group structure being used by a not-for-profit to facilitate equity investment is provided by STREAT Enterprises (see summary next page).

There are important constructionist and institutional arguments about the role that legal structure plays in shaping awareness and conception of entities. Social enterprise hybrids operate without a clearly identified institutional space. Legal history shows that when new legal structures are created, radical changes to the way business, investing and organising occurs. The relatively recent introduction of the limited liability company and the introduction of the incorporated association structures both led to significant changes in the organisation and activities of society.

Not only could a legal structure help define and create legitimacy for social enterprises, the existence of a structure can influence behaviour. Research into UK CICs suggests that "organisational legal form has an effect on the

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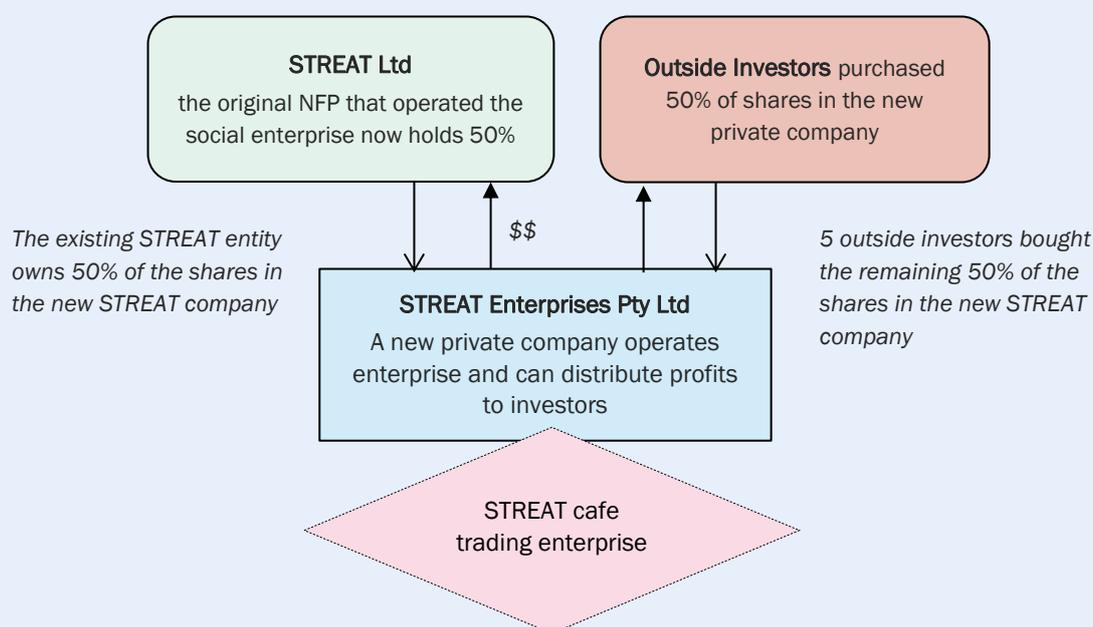
<sup>8</sup> Social Change Central can be accessed at <https://www.socialchangecentral.com/>

decisions and behaviours that organizations undertake... [and make] certain decisions regarding revenue sources both more feasible and preferable".<sup>9</sup>

### Case study: STREAT Enterprises (extract from Not-for-profit Law Social Enterprise Guide, [www.nfplaw.org.au/socialenterprise](http://www.nfplaw.org.au/socialenterprise))

STREAT Ltd is a Melbourne-based not-for-profit social enterprise that operates café businesses and employs young homeless Australians. In 2012, STREAT bought 2 cafes and a coffee roasting business from another social enterprise. In doing so, it changed its legal structure to form a hybrid model, which involved both a private company and a not-for-profit entity.

STREAT initially operated as a not-for-profit social enterprise entity. However potential to receive equity investment led to the need to add a for-profit arm to the organisation:



This hybrid structure was beneficial for STREAT for three main reasons:

- it enabled STREAT Ltd to remain a public benevolent institution and keep its DGR endorsement while offering equity investment opportunities
- it gave STREAT access to funding and set it up for future funding opportunities by enabling the sale of shares in STREAT Enterprises; and
- it transferred liability for trading and ownership of the cafes and coffee roasting business to a subsidiary vehicle (protecting STREAT Ltd from risks of the business).

Note in such a hybrid structure, the Pty Ltd pays company tax, but can distribute **franked dividends**. If STREAT Ltd is income tax exempt, it can receive franking refund on dividends.

<sup>9</sup> Florek, N. E. (2013). "Enabling social enterprise through regulatory innovation: a case study from the United Kingdom." *Journal of Sustainable Finance & Investment* 3(2): 155-175, page 169.

**A carefully designed new hybrid legal structure would enable a social enterprise like STREAT to easily set up under an off-the shelf structure that accommodates its mission-driven characteristics and its revenue generating activities in one structure that has a whole menu of funding options available to it** (noting that it is unlikely that an organisation using a new hybrid legal structure would be eligible to be DGR endorsed).

### *Overseas structure examples – benefit corporation*

The benefit corporation structure was first created in 2010. As at April 2015 2,144 corporations had adopted benefit corporation structure<sup>10</sup> (there is no register of benefit corporations so there is not readily available data on the number of benefit corporations). This figure is small when contrasted with the millions of corporation in the United States (over one million in the state of Delaware alone).

*To the extent a ‘benefit corporation’ election is intended to confer special branding status in the marketplace, the unregulated nature of the election, and the possibility of greenwashing<sup>11</sup> for-profit activities under the benefit corporation label, is a significant problem.*

J. William Callison<sup>12</sup>

Although some have referred to the US benefit corporation structure being a structure for ‘social enterprise’, in our view, the benefit corporation represents a modified for-profit structure, It maintains most characteristics of a for-profit with clarifications that ensure that directors may look to interests more broadly than those of shareholders, and requires some minimal reporting on ‘benefit’. It does not require that directors do anything more than ‘consider’ a list of extra interests.

Concerns regarding the benefit corporation model are well documented in literature,<sup>13</sup> and include:

- there are no mechanisms to enforce adherence to a mission or purpose, beyond a limited action that could be compel directors to ‘consider’ (but not necessarily prioritise) interests beyond profit;
- that reporting requirements are minimal, reports are not reviewed by a regulator, and are not required to take a particular form, meaning that the social impact performance of benefit corporations cannot be compared side by side;
- that the structure that enables those companies that adopt it to clearly identify themselves to the public as a ‘different’ kind of corporation that behaves differently in the world, when ultimately there are only limited differences between a benefit corporation and any other corporation; and
- the ‘benefit corporation’ status of a company can be revoked at any point by simply removing reference to being a benefit corporation from the company’s constitution. This provides little security to investors or consumers that the company will continue operate as a benefit corporation.

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<sup>10</sup> Berrey, E. (2015). *How Many Benefit Corporations Are There?*. Viewed 24 February 2017 at [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2602781](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2602781).

<sup>11</sup> The term “greenwashing” refers to a halo-effect that a company can create through its use of language and promotion around its social impact that is unwarranted when the actual impact of the organisation is properly investigated.

<sup>12</sup> Callison, J. W. (2012). "Putting New Sheets On A Procrustean Bed: How Benefit Corporations Address Fiduciary Duties, The Dangers Created, And Suggestions For Change." *American University Business Law Review* 2(1): 85-114, page 109.

<sup>13</sup> Reiser, D. B. (2013). "Theorizing Forms For Social Enterprise." *Emory Law Journal* 62(4): 681-739. Reiser, D. B. (2011). "Benefit Corporations-A Sustainable Form Of Organization?" *Wake Forest Law Review* 46(3): 591-625. Raz, K. G. (2012). "Toward An Improved Legal Form For Social Enterprise." *Review of Law & Social Change* 36(2): 283-309. Tyler, J., Absher, E., Garman, K. and A. Luppino (2015). "Producing Better Mileage: advancing the design and usefulness of hybrid vehicles for social business ventures." *Quinnipiac Law Review* 33(2): 235-337. Achermann, C., B. Forde and M. Ouzas (2014). *Benefit corporations - a case study of the US and lessons for Australia*. Sydney, B Lab.

Despite criticisms of the benefit corporation structure, we note that it has provided an important first step towards enabling directors of for-profits to consider broader interests and impacts, and much can be learnt from what is, and is not, working in the benefit corporation experience. The parts of the model legislation that address expanding the range permitted of considerations for directors are useful to inform an approach to resolving concerns around shareholder primacy issues in Australia as recommended above (a problem that should not be conflated with the problem of creating a legal structure for hybrid social enterprises).

### Overseas structure examples – community interest company (CIC)

The UK CIC structure has had significant uptake since its creation with over 11,000 organisations adopting the structure. The CIC framework provides three different legal structuring options designed to accommodate different types of social enterprise:

- a CIC based on a company limited by guarantee (a not-for-profit structure);
- a CIC based on a non-public company limited by shares (a modified for-profit structure); and
- a CIC based on a public company limited by shares (a modified for-profit structure).

For the two for-profit structures, there are asset locks that prevent distribution of assets from the company upon winding up, similar to asset locks in place on not-for-profits, but the companies can issue shares and deliver returns to investors that are subject to a cap. The dividend cap has been criticised as being too restrictive and was recently lifted to 35%. We consider this cap is still too low, and if a similar structure we implemented in Australia, a higher cap should be considered to ensure that the structure can attract investors.

For each CIC structure, it must at all times pass a “community interest” test, which ensures that public purpose is being prioritised by the company. CICs must also report annually to a specialist regulator on their activities, and the regulator has investigatory powers. The existence of the specialist regulator is an important driver of the growth of the CIC structure, with the regulator both helping to create public trust and confidence in the CIC structure and supporting CICs with resources and brand-building activities.

The for-profit CIC is the closest structure overseas to a truly *hybrid* structure, that we consider comes closest to addressing the current unmet needs of social enterprises in Australia. We therefore urge the Federal Government to consider the CIC as the starting point for a model for a legal structure for social enterprises, noting that some features (such as the dividend cap and reporting framework) could be improved upon in an Australian context.

### Recommendations

We recommend that the Government undertake two separate pieces of work to improve the legislative framework and structuring options available for social enterprises:

1. prepare a modification to director’s duties under the Corporations Act that addresses concerns about the potential conflict between directors’ duties and purpose-based decision making (this could be available to companies on an ‘opt-in’ basis via a constitutional amendment that clarifies that directors can consider other interests as allowed by the amended Corporations Act); and
2. draft model legislation for a hybrid legal structure (we do not consider that the benefit corporation is a hybrid legal structure) for consultation that has both classic not-for-profit features and the ability to issue shares and make distributions to investors informed by the UK CIC structure.

In undertaking any further consultation around the question of a legal structure for social enterprise, the Federal Government should ensure that social enterprises, not-for-profits, and technical advisors are included in conversations about the key features of the structure. We have observed that it is difficult to ask a non-lawyer (especially a non-lawyer who does not have significant experience of legal structuring and corporate law) how a

legal structure is constraining them, or what they would like to see in a legal structure as they may not have the legal literacy to identify and articulate problems and opportunities. Legal structuring reforms for social enterprises in the UK and the USA were largely led by lawyers with deep professional insight into the limitations of legal structures and opportunities to change them.

## Social Investment Tax Relief

The UK's Social Investment Tax Relief Scheme is showing signs of success, and is being accessed by small-medium social enterprises. See for example the Freedom Bakery case study.<sup>14</sup> The tax relief has acted as a catalyst for debt-based impact investing from individuals in a sense similar to crowd-funding.

*I tried looking at other options and then SITR came into my sight. I have 7 investors who all get a 30% tax relief. It's a four year loan, with interest on the principle rather than per annum. So effectively, the tax relief has enabled me to borrow £48,000 at an equivalent rate of 1.75% p.a. There's no way I would have got that anywhere else other than through SITR.*

Matthew Fountain, Founder and Managing Director of The Freedom Bakery, 10 December 2015<sup>15</sup>

In particular, for not-for-profit social enterprises that cannot access equity funding, a similar scheme would encourage small-scale, potentially crowd-based, private lending to support growth and scale. Not-for-profit Law strongly supports deeper consideration of a similar social investment tax relief scheme for Australia.

## Recommendation

We recommend that the Federal Government investigate the potential of a Social Investment Tax Relief Scheme to increase private impact investing in Australia.

## Pro bono incentives for non-legal professionals

As Australia's largest pro bono clearing house, and only dedicated pro bono service for charities and not-for-profits, we often speak to not-for-profits and social enterprises who need legal help to structure their enterprise or to become impact investment ready. However, legal needs rarely arise in isolation and while we can often find lawyers to assist not-for-profits and social enterprises, they present with myriad other needs. In particular, we have observed needs for the following services:

- business modelling;
- tax advice;
- accounting advice;
- outcomes evaluation and economic contribution analysis services;
- management consulting services; and
- human resources consulting.

In order to grow the number of investment-ready social enterprises and not-for-profits, organisations require access to appropriate professional services. It is our observation that while the legal profession makes a significant and

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<sup>14</sup> Fountain, M (2016) *DIY Social Investment: A social entrepreneur's guide to creating your own social investment through social investment tax relief (SITR)* Longdon: Flip Finance. Viewed 24 February 2017 at <https://www.the-sse.org/wp-content/uploads/2016/05/SocialEntrepreneurGuidetoSITRFinal.pdf>.

<sup>15</sup> Ibid.

coordinated pro bono contribution to social enterprises, the approach of other professional services is uncoordinated, ad hoc, and provided in lower volumes to small-medium enterprises.<sup>16</sup>

Large not-for-profits and social enterprises may be able to leverage their private networks to access pro bono professional services, however, small-medium social enterprises are often less well networked. Small-medium enterprises, particular community based enterprises, make an important contribution to the sector, and should be assisted to equitably access pro bono services. Two changes would improve the coordination of and volumes of pro bono non-legal professional services contributed to social enterprises:

- a central triage point and non-legal professional services clearing house for social enterprises and not-for-profits that require non-legal pro bono professional services in relation to social enterprise activities or impact investing more broadly. Importantly, a clearing house function democratises access to pro bono services and breaks down access barriers; and
- Federal Government-led pro bono targets for non-legal services that mirror legal pro bono targets.

As a major procurer of non-legal professional services, the Federal Government is in a strong position to encourage increased provision of pro bono professional services to social enterprises and not-for-profits seeking to participate in impact investing by providing targets and incentives. Even an aspirational target, such as the National (legal) Pro Bono Aspirational Target<sup>17</sup> could yield results, especially if firms were required to report against the target in their tendering with Government.

## Recommendations

We recommend that the Federal Government:

1. support a clearing house for non-legal professional services to democratise access to pro bono non-legal professional services.
2. set pro bono targets for non-legal professionals such as accountants and management consultants.

## Part 3: Addressing consultation question 29

29. Would making a model constitution for a social enterprise assist in reducing the costs for individuals intending to establish a new entity? What other standard products or other industry-led solutions would assist in reducing the costs for individuals intending to establish a social enterprise?

Under current legislative frameworks, social enterprises require highly tailored advice to set up their enterprise because the current legal framework does not neatly accommodate social enterprise. There is therefore no single constitution, or even suite of constitutions, that could meet the needs of the many different types of social enterprises with varied structures, approaches, governance, and levels of hybridity.

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<sup>16</sup> We note and support the work of the NSW Expert Advice Exchange (EAX). We are represented on its matter selection panel. Its approach is a positive step towards increasing pro bono contributions of professional services to social enterprises and not-for-profits seeking to become impact investment ready. We note that it does not operate as a clearing house that meets the needs of enterprises and not-for-profits as and when they arise (which is the way the Not-for-profit Law operates); and advice can only be received in rounds (currently only a few rounds per year). We also note that in respect of legal services, Not-for-profit Law already operates a pro bono clearing house across Australia involving many of the same law firms at the EAX. The EAX's linking of non-legal professionals with social enterprises and not-for-profits makes a valuable contribution to the sector. Read more about the EAX here: <http://www.osii.nsw.gov.au/initiatives/expert-advice-exchange>

<sup>17</sup> Read more about the national legal pro bono target on the Pro Bono Centre website: <http://probonocentre.org.au/provide-pro-bono/aspirational-target/>.

Based on our experience advising social enterprises and our own experience setting up our social enterprise, drafting a constitution or other legal governing documents is only one of many costs associated with starting up a social enterprise, and in fact is one of the lower costs. Other legal issues for start-ups often involve questions of how to best accommodate hybridity within either a not-for-profit or for-profit legal structure, the design of bespoke corporate group arrangements, tax advice, and then non-legal advice around business modelling, accounting and evaluation. Accessing the advice required to navigate either bending a for-profit structure or a not-for-profit structure to be appropriate for a social enterprise is a greater legal barrier to start-ups than constitutional drafting.

A special legal structure (or range of legal structures) that accommodates true hybridity for social enterprises is likely to reduce start-up expenses for social enterprises above and beyond the potential of any industry-led precedent document solution. In the absence of any legislative reform with respect to legal structures for social enterprises, the provision of further funding to Justice Connect would enable the Not-for-profit Law service to develop further dedicated resources for social enterprises such as further guidance on creating corporate group hybrid structures to enable blended not-for-profit and for-profit features. These resources would be housed on the Information Hub which already receives high traffic from social enterprises.

## In conclusion

We appreciate the opportunity to respond to the Discussion Paper and would welcome any opportunity to discuss our submission further.

Yours sincerely



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