EUROPEAN SOCIAL ENTERPRISE LAW

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PREFACE

This thesis is the result of my own work. It includes nothing that is the outcome of work done in collaboration with others. I further confirm that no part of this thesis has been submitted or is being submitted for any such degree, diploma or other qualification at the University of Cambridge, or any other University or similar institution. This thesis does not exceed the prescribed word limit for the degree of Doctor of Philosophy in Law.

Portions of this thesis have been published. Parts of Chapters 2, 3 and 4 appear in 'British Social Enterprise Law' (2021) 21 *Journal of Corporate Law Studies* 595. Some of Chapter 5 is reflected in 'The Social Enterprise Company in Europe: Policy and Theory' (2020) 20 *Journal of Corporate Law Studies* 495. Finally, Chapter 6 is the basis for 'A Social Enterprise Company in EU Organisational Law?' (2021) 23 *Cambridge Yearbook of European Legal Studies* 193.

ABSTRACT

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European Social Enterprise Law

This thesis considers a relatively recent phenomenon in the area of comparative corporate law and governance – the social enterprise corporation. It makes four original contributions to the legal literature. As we shall see in due course, although European social enterprise law features the five basic legal characteristics that are often associated with the traditional corporation, it also includes additional legal and institutional mechanisms that, collectively, make it and traditional corporate law markedly distinct from each other. To date, the reasons for this divergence have been overlooked in the legal literature. Using Denmark and the UK as a case study, the first contribution I make is to put forward a comparative theory that explains why European social enterprise law is different. In addition to the legal literature missing an analysis of the social enterprise corporation's origins, it is also lacking a complete analytical model of its anatomy. Therefore, the second contribution I make is to provide a comprehensive blueprint of Danish and British social enterprise law, as representative of European social enterprise law more broadly. In so doing, I argue that there are four major thematic distinctions between it and traditional corporate law that relate to corporate purpose, the board of directors, shareholders and certain protective mechanisms designed to ensure the private commercial pursuit of public benefit. I also make some other peripheral, but not less important, distinctions that have not been considered by legal commentators. Likewise, legal commentators have not considered the extent to which European social enterprise law is compatible with contemporary investment models and trends. Thus, the third contribution I make is to answer whether European social enterprise law is amendable and responsive to the norms of the current investment landscape. Another conspicuous gap in legal knowledge is that no study has explored whether there is an EU dimension to social enterprise regulation. As such, the fourth, and final, contribution I make is to consider where this area of the law may be headed in future.

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INTRODUCTION

This thesis considers a relatively recent phenomenon in the area of comparative corporate law and governance – the social enterprise corporation. In so doing it makes four original contributions to the legal literature.

As we shall see, although social enterprise law can rightly be understood as a subsystem of traditional corporate law, they are markedly distinct landscapes. More specifically, whilst the social enterprise corporation does feature the five basic legal characteristics that are often associated with the traditional corporation, it also includes additional legal and institutional mechanisms that alter its nature and how it operates. Collectively, it is these additional legal and institutional mechanisms that make the social enterprise corporation conceptually and practically unique. To date, no commentator has attempted to provide an account of the reasons for this divergence. Therefore, the first contribution I make in this thesis is to put forward a theory that explains why European social enterprise law is different from traditional corporate law. I undertake this task in Chapters 2 and 3, focusing in particular on Denmark and the UK. These jurisdictions have been selected for straightforward reasons. Namely, there were no real language barriers with respect to accessing the relevant materials. Likewise, whilst there are well over a dozen European jurisdictions that offer a social enterprise corporate form (see Chapter 6), confining the analysis to two jurisdictions makes the discussion more manageable. Additionally, although the finer details are more complex, Denmark and the UK illustrate stable market economies but somewhat divergent versions of the welfare state. However, they were similarly influenced by neoliberalism, at least insofar as it resulted in loosely uniform social enterprise legal regimes. This makes for an interesting analysis because it is not obvious that loosely uniform social enterprise legal regimes would derive from these, generally, divergent conditions. That is, one would expect to find jurisdiction-specific peculiarities in both legal regimes that reflect the broader socio-political environment, but this is not the case to any significant degree.

In Chapter 2, I lay out the methodological techniques that underpin the analysis. The basic thrust is that, whilst social enterprise law is separate from traditional corporate law, it does showcase a loose uniformity of its own across jurisdictions. However, I argue that this loose

uniformity is not because of agency costs considerations. For example, if we take agency costs in an Anglo-American setting, the issue is how the rules applicable to corporations can be better calibrated to align mangers' and shareholders' incentives and interests. In the social enterprise law context, however, directors do not owe duties to the corporation for shareholders' private benefit, nor do shareholders have any special rank in the firm. These, as well as other points we shall address, indicate that agency costs considerations were not what was driving the uniformity we see in European social enterprise law.

This presents a methodological difficulty. The customary framework for comparative corporate law and governance studies is functionalism, which designates the reduction of intra-firm agency costs as the central problem, and views the corporation as an institutional response to that problem. That there is no indication that the uniformity we see in European social enterprise law was the product of the usually assumed policy desire to moderate the scope for value-reducing forms of opportunism amongst different corporate constituencies means that we need to look elsewhere for a suitable methodological lens. I argue that what was shaping social enterprise law and governance systems in Europe are political exigencies emanating from within the domestic welfare state. To acknowledge this point is to effectively concede that a politically compatible methodology is necessary to explain why European social enterprise law and governance systems are conceptually and practically distinct, relative to their traditional counterparts, and have come to take roughly standardised forms across the selected jurisdictions.

I argue that the work of Christopher Bruner is a fitting methodological framework from which to theory build. This is because the Brunerian method is premised on the idea that welfare state structures are not simply reactions to corporate law and governance systems, but in fact can represent a crucial explanation for how and why they come to take the forms that they do. This argument overlaps well with the proposed hypothesis that the catalysts shaping social enterprise law and governance systems in Europe are political exigencies emanating from within the domestic welfare state.

However, whilst the theory offered in Chapters 2 and 3 is an extension of the Brunerian method, it is not a boilerplate duplication. Said differently, the theory proposed here is not the same as how Bruner employed it in his original study. Therefore, towards the end of Chapter 2, I show where I depart from Bruner's original contribution.

Bruner rejects an economically oriented, functionalist account because he detected longstanding differences in the levels of shareholder orientation across Australia, Canada, the UK and the US. This cuts across the functionalist assumption that different countries will, generally, converge on an economically efficient regulatory response to agency costs. Bruner also elects to avoid using functionalism since he uncovered credible evidence that the hypothesised divergences permeated from outside the jurisdictions' corporate law and governance systems and connected to certain historical, cultural, social and political dynamics. By default, functionalism is not equipped to deal with these kinds of factors; it largely elides them and takes for granted that socio-political conditions are homogenous and static from country-to-country. He then uses a specific independent, or explanatory, variable – the welfare state and related structures impacting social welfare protections available to non-shareholders, notably employees – to show that the degree of shareholder orientation and the scope of welfare state protections mirror a broader political equilibrium.

Although I also reject functionalism's tenet that corporate law and governance rules are a regulatory response to agency costs, I diverge with Bruner on the point that various regulatory systems can develop a range of loosely similar institutional solutions to problems encountered by societies across jurisdictions. There is a uniformity to European social enterprise law, despite the fact that this uniformity is not the product of a policy desire to moderate agency costs. Consequently, consistent with the functionalist methodology, I am more concerned with analytically modelling the underlying uniformity of the social enterprise corporation in Denmark and the UK.

But, aside from the five basic legal characteristics that are said to capture the essence of the traditional corporation, European social enterprise law does include additional legal and institutional mechanisms that ultimately make it and traditional corporate law conceptually and practically distinct from each other. Therefore, like Bruner's argument that the divergences observed in his study originate from socio-political factors, I also argue that extra-corporate welfare state considerations are a crucial element of the explanation for both why social enterprise law and governance systems emerged and why they have come to take their current, similar forms. The difference between us is that our independent, or explanatory, variables are distinct. My independent, or explanatory, variable is not the welfare state and related structures impacting social welfare protections available to non-shareholders, but rather the broader political economy developments in the Danish and UK welfare states relating to the third

sector, and social enterprises in particular. In my view, focusing on the broader political economy developments as they relate to the third sector allows us to access the deeper and more complex policy dynamics in motion that spurred the emergence and structure of the social enterprise corporation. As such, Chapters 2 and 3 are propped up by a partial functionalist approach that replaces the standard functionalist procedure in which the independent, or explanatory, variable is the reduction of agency costs with how political developments in the Danish and British welfare states relate to the third sector.

What I am not willing to concede, however, is that Danish and UK socio-political conditions are homogenous and static, as is usually taken for granted when operating the functionalist methodology. The Danish and British welfare state regimes are different. Nonetheless, in both Denmark and the UK, we find jurisdictionally distinct, but thematically similar, political determinations regarding a neoliberal governmental agenda of wanting to transfer some responsibility for the implementation and financing of social welfare policy from the state to other corners of society. Here we can locate a relational link between the welfare state, the third sector and the social enterprise corporation that explains not only why it emerged in the first place but also why it takes a similar form in each country.

In Chapter 3, I then map the political drivers that spurred the social enterprise corporation. Although occurring in different welfare state environments, the political processes that wrought the social enterprise corporation in Denmark and the UK feature a combination of active governmental and ideological forces attempting to harness social enterprises, and the third sector more broadly, to meet certain social welfare objectives through corporate rule making. In essence, a bespoke corporate organisational unit for social enterprises was politically determined as essential to spin off some level of centralised public responsibility to non-state actors for the implementation and financing of social welfare policy.

Additionally, that the social enterprise corporation emerged in periods of welfare state restructuring in both jurisdictions meant that there was a policy desire for private capital – once committed to such a firm pursuing a social welfare purpose – to remain in the third sector to support its financial stability independent of government subsidisation. However, with the human condition being what it is, there was no guarantee that private ordering altruism could be counted upon to achieve that end. Naturally the entire project would be in jeopardy if private capital could be siphoned out of the third sector at will. This political economy had an explicit

impact upon the social enterprise corporation's organisational architecture and regulatory infrastructure. Whilst not documented in the legal literature until now, this is why we observe a range of additional legal and institutional mechanisms in Danish and British social enterprise law that are not found in the traditional corporate law of either jurisdiction. The collective function of these modifications is to limit private ordering within the context of internal firm governance, especially with respect to taking self-interested financial decisions that could undermine the public interest.

To date, the legal literature is missing a complete analytical model that adequately reflects the relational link between welfare state politics and the influence it had on the social enterprise corporation's structure and function. Thus, continuing with the focus on Denmark and the UK, the second contribution I make in this thesis is concerned with filling this gap in legal knowledge. Our point of departure is that the social enterprise corporation is a relatively new and unfamiliar type of corporate innovation with its own rules, which diverge from those governing the traditional corporation. Again, the five basic legal characteristics that are often associated with the traditional corporation are to be found in its 'DNA', but European social enterprise also includes additional legal and institutional mechanisms, which, collectively, make it and traditional corporate law conceptually and practically distinct from each other. The purpose of Chapter 4 is to offer a full and systematic treatment of the social enterprise corporation that highlights how it is distinguishable from traditional corporate law, and, at various points, draw attention to how political economy has had an impact upon its organisational design.

Among other things, I contend that there are four major distinctions between the social enterprise corporation and the traditional corporation. The first major distinction concerns the theme of corporate purpose. A traditional corporation can either generate societal value indirectly or depart from the pro-shareholder position, either in whole or in part, and select a corporate purpose that more directly produces specific public benefit. However, this choice is purely contractual. The social enterprise corporation is a very different creature – the Danish and British regulatory regimes both explicitly communicate that creating societal value in the public interest is a mandatory and irreversible legal requirement. A social enterprise corporation cannot be formed without the specification of proposed activities to be carried on for public benefit, and the state has broad discretion to determine whether the stated activities would do so.

The second major distinction concerns the board of directors. Since the activities to be carried on for public benefit is a firm's purpose, the board of directors has a differently constituted duty of loyalty that is not owed to the corporation for shareholders' private benefit, but rather to the firm itself as a separate socio-institutional entity.

This reality, in effect, blunts the economic and non-economic entitlements that shareholders would otherwise enjoy in a traditional corporation, which is the third major distinction that disconnects the social enterprise corporation from the traditional corporation. Shareholders in a social enterprise corporation are more like bond-holders or quasi-donors, with their central function being a custodial role in which they ought to monitor firm performance and the board of directors. If shareholder action does not conform to the corporate purpose statement and the overall requirement to create societal value in the public interest, it is voidable.

The fourth major distinction is that, unlike the traditional corporation, the social enterprise corporation features mandatory and irreversible protective mechanisms that are designed to limit pecuniary self-interest and the extent to which private ordering for that purpose is permissible. In Denmark and the UK, these include a state regulator, a corporate purpose statement, a new directorial duty of loyalty, a limitation on midstream profit distribution to shareholders, forfeiture of capital at the end of a social enterprise corporation's lifecycle (the level of which depends upon the jurisdiction), a constraint on directorial remuneration, extra reporting obligations, a public benefit reserve fund and a residual asset transfer rule.

In Chapter 5, the analysis moves on to consider another important gap in legal knowledge. More specifically, commentators have not considered the extent to which European social enterprise law is compatible with contemporary investment models and trends. Thus, the third contribution I make is to answer whether European social enterprise law is amendable and responsive to the norms of the current investment landscape. I argue that the Danish and UK regulatory frameworks seem to be amenable and responsive to the norms of the current investment landscape at the early stage of investor involvement. However, I argue that the position alters when social enterprise corporations mature and require access to deeper capital pools later on. At this juncture, the financial preferences of investors change, which invites a tension between societal value creation and the pursuit of financial profit. I suggest that this tension is of greatest concern in conversion and winding up scenarios.

Whilst European social enterprise law does include rules that cover conversion and winding up scenarios to safeguard societal value creation, the strict nature of the legislation and its prioritisation of social good is not consistent with the preferences and financial return expectations of later stage investors. This creates another problem – it does not appear likely that the necessary trust can be cultivated between a social enterprise corporation and its private capital providers, which impedes the flow of capital. On the one hand, social entrepreneurs, even those keen to access deeper capital pools, will not want to imperil their social value objectives, and, on the other hand, investors will not want to compromise their investment goals by subjecting themselves to a rigid regulatory regime.

True, there are good reasons for this approach in terms of discouraging the situation in which a firm's participants traded on a pro-social platform for the duration of a social enterprise corporation's lifecycle and then attempted to convert to a traditional corporation or wind up in order to bypass the legal limits on profit distribution. However, this ought not detract from the practical reality that the legislation could better balance the prioritisation of firms' social impact fidelity with going some way towards meeting the expectations of interested market actors that inhabit the current investment landscape. The social enterprise corporation must be attractive to these actors, otherwise the organisational form's role of subsidising public welfare, as envisaged by policymakers, will fall short of redirecting and locking in more private capital in the long-term.

In this regard, I argue that the regulatory frameworks' conversion and winding up legal mechanisms should be adjusted with a yearly 'drawn-down' scheme. The draw-down scheme could potentially appeal to a broader demographic of investors interested in both social value creation and long-term financial returns that promote sustainability objectives. This might lessen the conflict between European social enterprise law and contemporary investment models and trends at the later stage, and help to redirect and lock in more private capital towards the subsidisation of public welfare.

Another conspicuous gap in legal knowledge is that no study has explored whether there is an EU dimension to social enterprise regulation. As such, the fourth, and final, contribution I make is to consider where this area of the law may be headed in future. To help do this, the analysis focuses on the most recent policy activity in this area – the European Parliament's July 2018 non-legislative resolution proposing to the European Commission a directive for facilitating

social enterprise corporations' cross-border activities. Here, I expand the jurisdictional focus beyond Denmark and the UK, to consider the full range of Member States that feature social enterprise regulation.

Although the European Commission declined to legislate on the European Parliament's non-legislative resolution, I argue that there is good reason to think that this is not the end of the story. Even if this prediction is wrong, however, I show that there are discernible political and socio-economic reasons to surmise that Member States would likely be receptive to reassessing and ultimately endorsing a Union level instrument for social enterprises' cross-border activities at some future point. Thus, a central claim in Chapter 6 is that we can likely expect some degree of harmonisation of European social enterprise law to occur through Union level coordination.

However, neither the European Parliament nor the European Commission attempted to visualise the consequences of harmonisation. I conclude Chapter 6 by analysing some regulatory issues that would be problematic if the European Commission were to legislate based upon the contents of the European Parliament's non-legislative resolution. The suggested solution involves enlarging the number of provisions within the non-legislative resolution that constrain asset distribution in Member States' domestic regulatory frameworks. However, for the reasons we establish in Chapter 5 regarding successfully attracting market actors (in this case to form social enterprises and engage in cross-border activities), I argue that any forthcoming regulatory proposal ought to also include a draw-down scheme.

At a minimum, uploading this suggested solution into a forthcoming regulatory proposal would, at least theoretically, result in a 'good' legal instrument that reduces the possibility of suboptimal outcomes, but does not outright strip Member States of the prerogative to have flexibility in setting their own domestic rules. A forthcoming regulatory proposal including the suggested solution could build legitimacy and confidence between the EU and Member States, leading to an increased likelihood of timely political agreement if, and when, the European Parliament's non-legislative resolution is eventually resuscitated.

Chapter 7 closes out this thesis with some concluding remarks.

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METHODOLOGY

European social enterprise law features the five basic legal characteristics that are often associated with the traditional corporation – separate legal personality, limited liability, transferable shares, delegated management under a board structure and investor ownership. Notwithstanding that the five basic legal characteristics are to be found in its DNA, European social enterprise law also includes additional legal and institutional mechanisms, which, collectively, make it and traditional corporate law markedly distinct from each other. To date, the reasons for this divergence have been overlooked in the legal literature. The purpose of the following two Chapters is to put forward a theory that explains why European social enterprise law is different. In this Chapter, I deal with methodological techniques that underpin the analysis.[1]

The basic premise is that, although there is a loose standardisation in European social enterprise law, it is obvious, even on the most cursory of glances, that the regulatory regimes' common architecture cannot be explained through an economically oriented, functionalist theoretical framework. This is because studies utilising orthodox functionalism in the extent comparative corporate law and governance literature take the reduction of intra-firm agency costs as the central problem. That is, commentators typically view the corporation as an institutional response defined across the globe by the challenge of managing agency costs that arise from participants' misalignment of incentives and interests within the firm. To be sure, if we think about the idea of agency costs within the Anglo-American context, for example, the issue is how corporate law and governance systems can be better programmed to align managers' incentives and interests with shareholders' incentives and interests. But, as we shall see more fully in Chapter 4, in the social enterprise law context directors do not owe duties to the corporation for shareholders' private benefit, and shareholders have no special rank in the firm. In other words, there is no indication that the uniformity we see in European social enterprise law was catalysed by the usually assumed policy desire to moderate the scope for value-reducing forms of opportunism amongst different corporate constituencies. Instead, the evidence suggests that the drivers shaping social enterprise law and governance systems in Europe are political exigencies emanating from within the domestic welfare state.

[1] Some of the contents of this Chapter features in J S Liptrap 'British Social Enterprise Law' (2021) 21 *Journal of Corporate Law Studies* 595.

To acknowledge this point is to effectively admit that a politically compatible methodological framework is necessary to explain why European social enterprise law and governance systems are conceptually and practically distinct landscapes and have come to take roughly standardised forms across jurisdictions. But which one? Below I turn to look more closely at the work of Christopher Bruner. Bruner's work provides fertile ground because it shows how welfare state structures are not simply reactions to corporate law and governance systems, but in fact can represent a crucial explanation for how and why they come to take the forms that they do. This overlaps well with the proposed hypothesis that the drivers shaping social enterprise law and governance systems in Europe are political exigencies emanating from within the domestic welfare state. Therefore, I argue that the Brunerian method offers great promise as a methodological framework from which to theory build.

Chapter 3 then utilises the Brunerian method to analyse and map the domestic political processes from which European social enterprise law arose. However, as mentioned in Chapter 1, I test this notion by focusing only on political economy developments in Denmark and the UK. For this reason, this Chapter will make several references to these jurisdictions.

2.1 The Brunerian Method

The leading theory about how welfare state politics can catalyse the production of corporate rules is found in Bruner's analysis of the common law jurisdictions of Australia, Canada, the UK and the US. Bruner attempts to elucidate why shareholders in Australia, Canada and the UK are 'far more powerful and far more central to the aims of the corporation than are shareholders in the United States'.[2] Said another way, Bruner explores 'why the otherwise similar corporate governance systems of Australia, Canada, the United Kingdom, and the United States diverge in terms of their relative degrees of shareholder orientation'.[3]

Bruner first rules out an economically oriented, functionalist account. Bruner makes this methodological choice because functionalism predicts that

[2] C Bruner, *Corporate Governance in the Common-Law World: The Political Foundations of Shareholder Power* (Cambridge University Press 2014) 4.
[3] ibid 111.

> legal harmonization will increasingly occur as an empirical matter, and that convergence on superior ways of tackling common problems [ie, in this case agency costs] naturally ought to be favored. On this view comparative legal analysis is an expression of globalization itself, simultaneously reflecting and systematizing the growing consciousness of foreign law, while aiming ultimately 'to discover which solution of a problem is the best'.[4]

However, Bruner shows that the jurisdictions 'vary considerably in the relative degrees of shareholder-orientation that they exhibit – both with respect to power (i.e., the capacity of shareholders to make decisions affecting corporate governance) and purpose (i.e., the degree to which their interests are prioritized over other competing interests)'.[5]

Related to the empirical absence of legal harmonisation, another problem with functionalism for Bruner's study is that the assumption that various regulatory systems tend to develop a range of broadly similar institutional responses to shared problems also must take for granted that socio-economic conditions are the same across jurisdictions. In this way, 'appeals to history, culture, and politics will ultimately reveal the outer boundaries of the explanatory domain of any functionalist legal analysis'.[6]

This

> inevitably sacrifices nuance for parsimony…Historical, cultural, social, and political drivers of a given country's legal system are effectively airbrushed out of the picture to achieve the predicate universality. The comparative corporate literature building on the 'law and economics' movement exemplifies this tendency, bringing the economist's penchant for grand simplifying assumptions to bear on the analysis of corporate governance systems…[P]roponents…typically characterize the corporation as a purely private endeavor defined…by the challenge of managing 'agency costs' – notably those arising from misalignment of shareholder and management interests and incentives.[7]

But for Bruner

> evaluating economically oriented theories of corporate governance requires examining the degree to which they in fact identify a true common problem…[E]ven the staunchest advocates of the functionalist approach to comparative law express misgivings about how to react when purportedly

[4] ibid 14.
[5] ibid 22. See generally also Chapter 3.
[6] ibid 16-17.
[7] ibid 112.

> straightforward comparisons break down. Recall, for example, that notwithstanding their high degree of confidence that functionalist equivalents can be found among virtually any legal systems, Zweigert and Kötz ultimately acknowledge that one may sometimes have to 'rethink the original question' in increasingly abstract terms to achieve comparability of function. This, however, may ultimately bleed into highly contextual study of a nation's history, culture, and politics…This, however, is simply tantamount to conceding that the functionalist assumption of a common *legal* problem will not always remain tenable – and, correlatively, that a given country's unique history, cultural, and politics will reveal the outer boundaries of the functionalist's explanatory domain.[8]

Therefore, owing to the fact that Bruner 'catalogued substantial differences among a set of corporate legal systems often said to be among the most similar of any in the world, including vast divergences in the degree to which shareholders are empowered to advance their own interests, and even the degree to which their interests are embraced as defining goals of corporate law', which cannot be explained through orthodox economic analysis, he concludes that a political theory of comparative corporate law and governance is necessary 'to explain the sorts of divergences that I explore'.[9] Said slightly differently, Bruner proposes that the jurisdictional divergence 'can be explained only by placing each country's corporate governance system in its broader social and political context'.[10] Bruner believes that this 'permits a more nuanced examination of why the divergence in shareholder-orientation has arisen among these otherwise similar systems, and how corporate governance has changed over time within them'.[11]

Bruner's core claim is that

> greater regard for the interests of employees in other regulatory domains [ie, state-based social welfare protection] has tended to insulate certain corporate governance systems from political pressure to show regard for employees and other 'stakeholders', permitting more exclusive focus on shareholders without precipitating backlash – a key political determinant of the relatively higher degree of shareholder-centrism exhibited in Australia and the United Kingdom, and to a lesser…degree in Canada as well. Conversely, weaker regard for the interests of employees…has tended to result in greater political pressure being brought to bear on corporate governance to do so, inhibiting exclusive focus on shareholders – a key political determinant of the relatively lower degree of shareholder-centrism exhibited in the United States.[12]

[8] ibid 114.
[9] ibid 115.
[10] ibid 111.
[11] ibid 23.
[12] ibid 22-23.

This claim is underpinned by the use of a specific independent, or explanatory, variable – the 'welfare state and related structures impacting social welfare protections available to non-shareholders, notably employees.[13] In this manner, Bruner argues that the

> host of social and political variables affecting a given country's willingness to adopt and maintain structures managing social risk – not least among them, prevailing views on distributional justice – can have a substantial impact on the governance of its large-scale corporate enterprises. Indeed, it is not an overstatement to say that the…foundations of shareholder power effectively lie outside corporate law itself – even among the major common-law systems so often caricatured in the comparative literature as generically and monolithically 'shareholder centric'.[14]

Bruner then investigates the social welfare policies in each jurisdiction. Evidence is offered that the degree of shareholder orientation and the scope of welfare state protections mirror a broader political equilibrium. To illustrate, in the US, social welfare protections – principally access to healthcare – have been historically associated with gaining and holding employment, whereas the UK welfare state, since the late 1940s, has provided such protections through government programmes. These arrangements, Bruner argues, shaped the arc of the jurisdictions' corporate law and governance systems in important aspects. The rise of the UK's shareholder-centric takeover regime had its roots in 1960s Labour elites' confidence that the welfare state could offset the negative effects of job loss on the working class.[15] Differently, in the US, the ascendance of a stakeholder-centric takeover regime in the 1980s flowed from an alliance of managerial and labour interests, which had drawn sizeable clout from political apprehensions over worker welfare and the loss of health care and other benefits flowing from the employment relationship.[16]

Bruner submits that these political dynamics are also present in Australia and Canada, which adopted welfare state structures and reached political equilibria generally aligning with those in the UK. In Australia, the courts reacted to hostile takeovers in the 1970s and 1980s in a manner similar to the US approach, which afforded managers the latitude to institute takeover defences.[17] Bruner suggests that this finding lends itself to the idea that state-based social welfare protection was politically contested and lacking within this period. However, in 2000,

[13] ibid 141.
[14] Ibid 27.
[15] ibid 156.
[16] ibid 171.
[17] ibid 189.

Bruner claims that the state implemented stronger shareholder-centric measures in the sphere of hostile takeovers and curtailed managers' ability to utilise takeover defences.[18] This brought the Australian position in closer association with the UK. It was not obstructed by the concerns of the previous decades, because, by the mid-1990s, state-based social welfare protection had been securely established.[19] In Canada, a fairly robust social welfare apparatus had existed before efforts were made to modernise its corporate law and governance system further towards a shareholder-centric axis in the 1960s and 1970s. Bruner surmises that this reality composed an integral part of the backdrop socio-political conditions necessary for the relevant legal reforms to take place.[20]

2.2 Extracting the Brunerian Method

Whilst the subject matter of this thesis has nothing to do with divergences in shareholder orientation in a comparative context, it is nonetheless possible to extract the Brunerian method and apply it to draw a relational link between social enterprise law and broader political economy developments in Denmark and the UK. However, if such a feedback effect exists between particular corporate law and governance and welfare systems, then the 'scholar must…marshal evidence that the connection is…[more] than simply a potentially unexplained correlation'.[21] For Bruner, the 'mechanism' had to tie 'an increase or decrease in shareholder orientation to the robustness of a country's social welfare system'.[22]

On the mechanism issue, David Skeel, for example, argues that, whilst not detracting from the 'undeniable logic to his thesis',[23] in some places there is an 'absence of crisp…connection'.[24] For example, with Canada, Skeel proposes that the 'story muddies considerably. Canada has far more extensive social welfare protections than the United States, which suggests that its corporate governance should be more shareholder-oriented. On its face, however, Canadian corporate law seems to protect stakeholders as well as shareholders. This suggests that Canada may combine social welfare protections and stakeholder governance, a combination that should

[18] ibid 192.
[19] ibid 183.
[20] ibid 205, 212.
[21] D A Skeel, Jr, 'Corporate Governance and Social Welfare in the Common-Law World' (2014) 92 *Texas Law Review* 973, 982.
[22] ibid.
[23] ibid 994.
[24] ibid 985.

not be sustainable' if Bruner is correct.[25] Likewise, in the UK, Skeel notes that several 'important shareholder-empowering U.K. rules predate the post-World War II expansion of the United Kingdom's social welfare system. The principal development in the past generation was the United Kingdom's adoption of a similarly shareholder-oriented stance toward hostile takeovers starting in the 1960s. These doubts suggest that the relationship between social welfare and shareholder orientation is not pristine'.[26]

These 'nagging doubts', as Skeel calls them, inevitably complicate, at least in some way, the stated relationship between shareholder orientation and welfare state structures in the jurisdictions.[27] Marc Moore lodges comparable criticisms. A

> final criticism concerns the strength of the causative link that Bruner seeks to draw between corporate and broader political economy developments in the studied countries. For example, whilst the existence of a chain of cause and effect between US federal government initiatives on corporate governance and social welfare reforms respectively is plausible enough, the notion that Delaware's state courts are responsive (whether explicitly or implicitly, consciously, or subconsciously) to considerations of national health and social security policy is a much trickier descriptive claim to sustain.[28]

However, both commentators conclude that Bruner's work is still significant. Moore argues that the work is 'monumental' and of

> scholarly craft. It is impeccably researched, beautifully written, and its claims are both forceful and highly persuasive. It is an absolute must for anyone seeking to form a holistic understanding of how corporate law and governance relate to their broader socio-institutional context…One can only hope that future research in the field will advance this fascinating line of enquiry yet further.[29]

Skeel makes a similar statement –

> I do not believe that the connections he identifies are imaginary. Any future scholar who purports to provide an explanation of comparative corporate governance will need to consider how social welfare legislation may be shaping what he or she sees in the corporate governance of a particular

[25] ibid 984.
[26] ibid 983.
[27] ibid.
[28] M Moore, 'Corporate Governance in the Common-Law World: The Political Foundations of Shareholder Power' (2015) 74 *Cambridge Law Journal* 370, 373.
[29] ibid.

> country. It is hard to imagine a more compelling demonstration that…scholars need not only to continue looking outside the United States but also to venture beyond the narrow confines of corporate law.[30]

What we can distil from Moore and Skeel is that the Brunerian method arguably offers great promise in the right circumstances, but it must be handled with care. For a given study to effectively implement the Brunerian method, it must be able to formulate a defensible response to the 'what is the mechanism?' inquiry. Therefore, what I do in Chapter 3 is construct a narrative model that satisfies the mechanism requirement and substantiates a 'crisp connection' between social enterprise law and the Danish and British welfare states. However, before delving into that discussion, I want to be clear about two things. First, it is worth stating in explicit terms why I think the Brunerian method is appropriate for this study. Second, whilst the theory offered here is an extension of the Brunerian method, it is not a boilerplate duplication. In other words, there are methodological variances in how I am applying the Brunerian method that diverge from Bruner's original contribution. Therefore, it is necessary to highlight where I depart from Bruner's framework.

(a) A Preliminary Matter

As a preliminary matter – and to reiterate what was said in the introductory remarks of this Chapter – a political rationale is necessary because European social enterprise law is not concerned with how corporate law and governance systems can be better programmed to align managers' incentives and interests with shareholders' incentives and interests. That is, there is no indication that the uniformity we see in European social enterprise law was catalysed by the usually assumed policy desire to moderate the scope for value-reducing forms of opportunism amongst different corporate constituencies. As such, European social enterprise law does not promote a 'system which ensures…management pursues the welfare of shareholders and maximises their returns'.[31]

For example, the Danish corporate law and governance system emphasises the protection of creditors, and, to some extent, other non-shareholder constituencies – notably employees

[30] Skeel (n 21) 994.
[31] P Ireland, 'Shareholder Primacy and the Distribution of Wealth' (2005) 68 *Modern Law Review* 49, 50.

through worker participation in the boardroom of larger firms.[32] However, unless otherwise provided for by a particular traditional corporation's articles of association, directors must formulate a strategy that promotes the best interests of the firm, which, normally, mirrors the welfare of shareholders.[33] As Caspar Rose and Carsten Mejer note, originally, the 'Danish corporate governance system was oriented towards protecting the rights of different stakeholders', however 'this view has been challenged in particular due to increasingly integrated international capital markets, forcing the largest listed Danish firms to adopt…Anglo-American corporate governance policies' that promote shareholders' interests.[34] The same is true in the UK. In the context of the traditional corporation, the Companies Act 2006 stipulates that, in the exercise of corporate decision-making power, directors must act in the way that they consider, in good faith, 'would be most likely to promote the success of the company for the benefit of its members as a whole'.[35] Pointed out by David Kershaw and Edmund Schuster, for 'section 172(1) a "company's purpose" – the reason it exists – is to further shareholders' interests'.[36]

A Danish social enterprise corporation's board of directors has a differently constituted duty of loyalty. This new duty of loyalty is not owed to the corporation for shareholders' private benefit, but rather to the firm itself as a separate socio-institutional entity committed to carrying on activities for public benefit.[37] Likewise, a British social enterprise corporation's board of directors has the same new duty of loyalty.[38] These empirical details, as well as many others we shall address, strongly indicate that European social enterprise law does not fit within the 'modern economics-inspired tradition of corporate law scholarship' in which managers are styled as 'agents' and shareholders as 'principals'.[39] This is a critically important insight

[32] LBK nr 1089 af 14/09/2015, Lov om aktie- og anpartsselskaber §§ 120(2), 140 (Danish Companies Act). See generally also C Rose and I M Hagen, 'The Perceived Influence of Employee Board Members on Decisions in Denmark and Norway' (2019) 25 *European Journal of Industrial Relations* 247.
[33] See eg S Friis-Hansen and J V Krenchel, *Dansk Selskabsret – Kapitalselskaber* (5th edn, Karnov Group 2019) 50-52; P K Andersen, *Aktie- og Anpartsselskabsret – Kapitalselskaber* (15th edn, Djøf Forlag 2021) 69ff; J S Christensen, *Kapitalselskaber – Aktie- og Anpartsselskaber* (5th edn, Karnov Group 2017) 249-250.
[34] C Rose and C Mejer, 'The Danish Corporate Governance System: From Stakeholder Orientation Towards Shareholder Value' (2003) 11 *Corporate Governance: An International Review* 335, 335-336.
[35] UK Companies Act 2006, s 172(1) (CA 2006).
[36] D Kershaw and E Schuster, 'The Purposive Transformation of Company Law' LSE Law, Society and Economy Working Papers 4/2019 (2019) 1, 6 <https://ssrn.com/abstract=336267>.
[37] Lov nr 711 af 25/06/2014, Lov om registrerede socialøkonomiske virksomheder, § 5(1) (Danish Social Enterprise Law).
[38] Office of the Regulator of Community Interest Companies, *Corporate Governance* (2016) 9 <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/605421/13-712-community-interest-companies-guidance-chapter-9-corporate-governance.pdf>.
[39] S Deakin, 'The Corporation as Commons: Rethinking Property Rights, Governance and Sustainability in the Business Enterprise' (2012) 37 *Queen's Law Journal* 339, 344.

because, as Klaus Hopt argues, 'modern economic theory' has 'developed the principal-agent problem as its basic question' and 'company law reform initiatives in all industrialized countries have tried to address this problem'.[40] Therefore, like Bruner, I accept the inevitability of a political rationale to explain Danish and British social enterprise law – and European social enterprise regulatory frameworks more broadly.

2.3 The Appropriateness of the Brunerian Method

The question then becomes why the Brunerian method? The reason is that it permits a more nuanced evaluation of Danish and British social enterprise law that has gone undetected in the legal literature. In terms of Denmark, we find one study that deals with the background to the introduction of legal rules for recognising social enterprises. As Karsten Engsig Sørensen and Mette Neville argue, when

> looking at the reasons for increased interest in social enterprises, many point to the financial crisis as one of the most important causes. This is confirmed by the Danish government's Action Plan for the Social Responsibility of Business Undertakings 2012-2015, which points out that the crisis has increased the need to focus on the responsibilities, including social ones, of undertakings, investors, consumers and public authorities in relation to the challenges of climate change, the limits to natural resources and respect for human rights.[41]

Unfortunately, although this account gives us an inkling into the drivers that increased the focus on social enterprises, it says nothing about why the Danish social enterprise corporation takes the form that it does. That is to say, it does not emphasise why Danish social enterprise law diverges from the rules that govern the traditional corporation.

The British experience is similar, albeit more illuminating. Before social enterprise law emerged in the UK, a single study was published that analysed the attendant policy documentation.[42] It argues that British social enterprise law was a modernisation that would

[40] K J Hopt, 'Comparative Company Law' in M Reimann and R Zimmerman (eds), *The Oxford Handbook of Comparative Law* (Oxford University Press 2006) 1161, 1166.
[41] K E Sørensen and M Neville, 'Social Enterprises: How Should Company Law Balance Flexibility and Credibility?' (2014) 14 *European Business Organization Law Review* 267, 273. See generally also Regeringen, *Ansvarlig vækst – Handlingsplan for virksomheders samfundsansvar 2012-2015* (2012) <https://www.regeringen.dk/aktuelt/tidligere-publikationer/ansvarlig-vaekst-handlingsplan-for-virksomheders-samfundsansvar-2012-2015/>.
[42] See generally Cabinet Office, *Private Action, Public Benefit: A Review of Charities and the Wider Non-Profit Section* (2002)

correct two supposed shortcomings in existing organisational forms – in particular the company limited by guarantee – then available to social entrepreneurs. First, there was a deficiency in existing organisational forms that prevented the misuse of assets earmarked for public benefit. Whilst it was contractually possible to install provisions that protected assets and ensured that they were dedicated to a firm's chosen social purpose, their self-imposed nature could be privately countermanded and, therefore, did not send the right 'signal' to the public.[43] Second, the existing organisational forms did not oblige a firm's participants to select a genuine social purpose at the point of registration, nor were there any regulatory devices in place to monitor that the chosen social purpose was thereafter pursued.[44]

This account of British social enterprise law seems sound. The study was, above all, right to argue that

> it is crucial to not-for-profits that they are…able to signal clearly to the public their assets are…locked in, for by so doing they should be able to engender greater trust from those whose support they hope to win. Donors will likely be happier to contribute their time, labour or money to organisations that are constrained in this way. And others will probably be happier to purchase the goods or services supplied by not-for-profits, knowing that they have, compared to for-profits, less incentive to act opportunistically.[45]

Relative to Denmark, if we were to *prima facie* accept the above explanation, it would at least partly clarify why British social enterprise law includes additional legal and institutional mechanisms that make it and traditional corporate law distinct from each other. The logic would be that the legal modifications exist to correct supposed shortcomings in existing organisational forms then available to social enterprises to promote more trustworthiness.

However, notwithstanding that the British study is arguably more useful, I do not think either work delivers a complete picture. The Brunerian method reveals why. Using the broader

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<https://webarchive.nationalarchives.gov.uk/ukgwa/+/http:/www.cabinetoffice.gov.uk/media/cabinetoffice/strategy/assets/strat%20data.pdf>; Department of Trade and Industry, *Enterprise for Communities: Proposals for a Community Interest Company* (2003) <https://webarchive.nationalarchives.gov.uk/ukgwa/20070603164510/http://www.dti.gov.uk/cics/pdfs/condoc.pdf>.

[43] A Dunn and C A Riley, 'Supporting the Not-for-Profit Sector: The Government's Review of Charitable and Social Enterprises' (2004) 67 *Modern Law Review* 632, 647.

[44] ibid 649.

[45] ibid 647-648. See generally also H B Hansmann, 'The Role of Nonprofit Enterprise' (1980) 89 *Yale Law Journal* 835.

political economy developments in the Danish and UK welfare states relating to the third sector – and social enterprises in particular – as my independent, or explanatory, variable, I demonstrate that there were deeper and more complex policy dynamics in motion. These revolved around the perpetuation of a neoliberal governmental agenda of wanting to transfer some responsibility for the implementation and financing of social welfare policy from the state to other corners of society. Danish and British social enterprise corporations were politically determined as necessary vehicles for 'spinning off' some of this responsibility to non-state actors.

More will be said about this political determination in the next Chapter, but for now it is enough to say that we get an express glimpse of this deeper political economy in the Danish case by reference to the policy documentation preceding the emergence of the social enterprise corporation. The policy documentation counsels the government to prepare a national strategy aimed at promoting the development of social enterprises in Denmark, which includes five broad recommendations. Of importance to this Chapter, one of the recommendations is that national legislation ought to introduce a clear legal framework for social enterprises that defines, legitimises and regulates them in a way that creates a common identity. The thinking is that, with the measures in place, it would strengthen the interaction between the public sector and the third sector, and partly coordinate public administrative practices in relation to streamlining procurement contracting and spinning off state responsibility to social enterprise corporations *vis-à-vis* making social welfare contributions through their private business activities.[46]

The situation in the UK also includes a parallel political determination. British social enterprise law launched in 2005 under New Labour. Whilst New Labour had made several commitments to increase the number of social enterprises, there were serious questions regarding their organisational capacity to be efficient players in the public services marketplace and within the government's wider welfare reform agenda.[47] Leading commentators like Alex Nicholls and Simon Teasdale, thus, maintain that the impetus for the social enterprise corporation seems to have been that a bespoke organisational form for social enterprises 'could play a major role in

[46] Udvalget for socialøkonomiske virksomheder, *Anbefalingsrapport fra udvalget for socialøkonomiske virksomheder* (2013) 24 <https://www.ft.dk/samling/20121/almdel/ULØ/bilag/202/1283155.pdf>.
[47] See eg Department of Trade and Industry, *Social Enterprise: A Strategy for Success* (2002) 62 <https://webarchive.nationalarchives.gov.uk/ukgwa/20040117000834/http://www.dti.gov.uk/socialenterprise/>.

reforming and innovating public services'.[48] This argument corroborates other studies suggesting that British social enterprise law was a political 'rebranding' of what social enterprise meant at the time, intended to improve firms' organisational capacity to navigate the competitive procurement landscape and innovate in service delivery in line with governmental expectations.[49] To be sure, the subsequent Coalition government placed an even greater emphasis on social enterprise corporations' supposed ability to act as vehicles for spinning off state responsibility for public services and contribute to public sector deficit reduction by delivering 'more for less'.[50]

Furthermore, that the social enterprise corporation emerged in periods of welfare state restructuring in both jurisdictions meant that there was a desire for any private capital – once committed to such a firm pursuing a social welfare purpose – to remain in the third sector to support its financial stability independent of government subsidisation. However, with the human condition being what it is, there was no guarantee that private ordering altruism could be counted upon to achieve that end. Naturally, the entire project would be in jeopardy if private capital could be siphoned out of the third sector at will. This political economy had an explicit impact upon the social enterprise corporation's organisational architecture and regulatory infrastructure. Whilst not documented in the legal literature, this is ultimately why we observe a range of additional legal and institutional mechanisms in Danish and British social enterprise law that are not found within the traditional corporate law of either jurisdiction. For example, this is why the Danish and British social enterprise corporations feature protective mechanisms like a cap on midstream profit distribution[51] to shareholders and a rule requiring capital forfeiture[52] at the end of a firm's lifecycle. The collective function of the above rules – as well as others that we will consider more in Chapter 4 – is to limit private ordering within the context of internal firm governance, especially with respect to taking financial decisions that could undermine the public interest. Once private actors commit their capital to a social enterprise corporation, it is, to a greater or lesser extent, committed to creating public benefit in perpetuity.

[48] A Nicholls and S Teasdale, 'Neoliberalism by Stealth? Exploring Continuity and Change within the UK Social Enterprise Policy Paradigm' (2017) 45 *Policy & Politics* 323, 336.
[49] See eg J Defourny, 'From Third Sector to Social Enterprise: A European Research Trajectory' in J Defourny, L Hulgård and V Pestoff (eds), *Social Enterprise and the Third Sector: Changing European Landscapes in a Comparative Perspective* (Routledge 2014) 25.
[50] Nicholls and Teasdale (n 48) 335.
[51] For Denmark, see Danish Social Enterprise Law, §5(5)(d). For the UK, see UK Company (Audit, Investigation and Community Enterprise) Act 2004, s 30 (CA 2004); UK Community Interest Company Regulations 2005, SI 2005/1788, regs 17-20 (CIR 2005).
[52] For Denmark, see Danish Social Enterprise Law, §10. For the UK, see CIR 2005, reg 23(3).

2.4 Diverging from Bruner's Original Contribution

A final point we should address is that, whilst the theory offered in this thesis is an extension of the Brunerian method, it is not a boilerplate duplication. Put differently, it is not methodologically the same as how Bruner employed it in his original framework. In this way, it is advantageous to explain where I depart from Bruner's contribution.

Bruner rejects an economically oriented, functionalist account because he detected longstanding differences in the levels of shareholder orientation across the selected jurisdictions, which cuts across the assumption that different countries will, broadly construed, converge on an economically optimal regulatory response to agency costs. Bruner also elects to avoid using functionalism since he uncovered credible evidence that the hypothesised divergences emanated from outside the jurisdictions' corporate law and governance systems and linked to certain historical, cultural, social and political dynamics. Functionalism is not equipped to deal with these sorts of factors; it largely airbrushes them out of the picture and takes for granted that socio-political conditions are homogenous and static from country-to-country. He then uses a specific independent, or explanatory, variable – the welfare state and related structures impacting social welfare protections available to non-shareholders, notably employees – to evidence that the degree of shareholder orientation and the scope of welfare state protections mirror a broader political equilibrium.

Whilst I must also reject functionalism's tenet that corporate law and governance rules are a regulatory response to agency costs, I diverge with Bruner and accept the assumption that various regulatory systems can develop a range of loosely similar institutional solutions – described as 'functional equivalents' – to problems encountered by societies across jurisdictions.[53] More specifically, although there is no indication that European social enterprise law was catalysed by the usually assumed policy desire to moderate the scope for value-reducing forms of opportunism amongst different corporate constituencies, it nonetheless has a certain uniformity to it. Consequently, to the extent that I adopt a functionalist methodology, it is in line with the approach taken in, for example, *The Anatomy of Corporate Law: A Comparative and Functionalist Approach* (*Anatomy*), where the authors are more

[53] K Zweigert and H Kötz (trs T Weir), *Introduction to Comparative Law* (3rd edn, Oxford University Press 1998) 40.

preoccupied with unearthing the 'underlying uniformity of the corporate form'.[54] The authors emphasise the five 'basic legal characteristics of the business corporation', including 'legal personality, limited liability, transferable shares, delegated management under a board structure, and investor ownership'.[55] As I stated above, the five basic legal characteristics are to be found in the DNA of European social enterprise law, albeit subject to several caveats that ultimately make it and traditional corporate law conceptual and practically distinct from each other. To be clarified in Chapter 4, whilst there does not appear to be a completely uniform policy approach, it is still the case that these additional legal and institutional mechanisms are roughly standardised and can be found across jurisdictions, thus making it, generally, acceptable to follow the formula in *Anatomy*.

But, like Bruner's argument that the divergences observed in his study originate from socio-political factors, I, too, argue that extra-corporate welfare state considerations are a crucial element of the explanation for both why social enterprise law and governance systems emerged and why they have come to take their current, similar forms. The difference between us here is that our independent, or explanatory, variables are not the same. My independent, or explanatory, variable is not the welfare state and related structures impacting social welfare protections available to non-shareholders, but rather the broader political economy developments in the Danish and UK welfare states relating to the third sector, and social enterprises in particular. In my estimation, focusing on the broader political economy developments as they relate to the third sector allows us to reach the deeper and more complex policy dynamics that spurred the emergence and structure of the social enterprise corporation.

Therefore, this study is supported by a partial functionalist approach that includes a socio-political independent, or explanatory, variable. Instead of using the standard functionalist procedure in which the independent, or explanatory, variable is the reduction of agency costs, and the national legal rules governing corporate activity are viewed as the dependent variable, or what the researcher is tasked with appraising, my independent variable is how political developments in the Danish and British welfare states relate to the third sector.

[54] J Armour, H Hansmann, R Kraakman and M Pargendler, 'What is Corporate Law?' in R Kraakman et al (eds), *The Anatomy of Corporate Law: A Comparative and Functionalism Approach* (3rd edn, Oxford University Press 2017) 1.
[55] ibid 1ff.

Critically, though, in partially accepting the utility of a functionalist approach, what I am not saying is that Danish and UK socio-political conditions are homogenous and static, as is usually taken for granted when operating the functionalist methodology. It was discovered decades ago that countries' welfare states cluster into different regime types.

Broadly, Denmark has a 'social democratic' regime type. Documented by, for example, Gosta Esping-Andersen, social democratic welfare regimes do not

> tolerate a dualism between state and market, between working class and middle class…[Instead the welfare state promotes]…an equality of the highest standards, rather than an equality of minimal needs as was pursued elsewhere. This implied, first, that services and benefits be upgraded to levels commensurable to even the most discriminatory tastes of the new middle classes; and, secondly, that equality be furnished by guaranteeing workers full participation in the quality of rights enjoyed by the better off. This formula translates into a mix of highly de-commodifying and universalistic programs that, nonetheless, are tailored to differentiated expectations. Thus, manual workers come to enjoy rights identical to those of salaried white collar employees or civil servants; all strata and classes are incorporated under one universal insurance system; yet, benefits are graduated according to accustomed earnings. This model crowds out the market and, consequently, inculcates an essentially universal solidarity behind the welfare state. All benefit, all are dependent, and all will presumably feel obliged to pay.[56]

Differently, the UK features a 'liberal' regime type. Noted by Esping-Andersen, liberal welfare regimes offer

> means-tested assistance, modest universal transfers, or modest social insurance plans…These cater mainly to a clientele of low income, usually working class, state dependents. It is a model in which, implicitly or explicitly, the progress of social reform has been severely circumscribed by traditional, liberal work-ethic norms; one where the limits of welfare equal the marginal propensity to demand welfare instead of work. Entitlement rules are therefore strict and often associated with stigma; benefits are typically modest. In turn, the state encourages the market, either passively by guaranteeing only a minimum, or actively by subsidizing private welfare schemes. The consequence is that this welfare regime minimizes de-commodifying effects, effectively contains the realm of social rights, and erects a stratification order that blends a relative equality of poverty among state welfare recipients, market-differentiated welfare among the majorities, and a class-political dualism between the two.[57]

[56] G Esping-Andersen, 'The Three Political Economies of the Welfare State' (1989) 26 *Canadian Review of Sociology* 10, 26.
[57] ibid 25.

Therefore, we can say that the Danish welfare regime, generally, crowds out the market and provides generous entitlements through a universal insurance system that covers the total population, albeit the protections are graduated according to earnings. The UK welfare regime offers less coverage and is means-tested, and the state envisions some role for the market subsidisation of welfare programmes.

This difference in regime type might lead one to wonder how a broadly uniform social enterprise corporation materialised. In other words, how did distinctive welfare state environments and circumstances result in a similar formulation of social enterprise law? It is easier to see how social enterprise law fits into the UK context. Social enterprise corporations are private businesses that are designed to subsidise and improve the availability of social welfare goods and services for public benefit. This reality intersects with the idea that the UK regime is more receptive to the market subsidisation of welfare programmes, and, indeed, is something that we can plainly detect in the political process from which the social enterprise corporation emerged. Again, the social enterprise corporation was introduced in the UK to play a role in reforming and innovating public services provision within the government's wider welfare reform agenda. But arguing that the Danish social enterprise corporation was also engineered to privately subsidise and improve the availability of social welfare goods and services is a much trickier positive claim to substantiate because the welfare regime is more generous, has broader coverage and is less market-oriented.

The solution to this puzzle is that, even though the Danish and British regime types are empirically different, 'we must recognize that no single case is pure'.[58] The Danish welfare state does blend social democratic and liberal elements together. This intersection between social democratic and liberal elements is where we find jurisdictionally distinct, but thematically similar, political determinations regarding a neoliberal governmental agenda of wanting to transfer some responsibility for the implementation and financing of social welfare policy from the state to other corners of society. Although the neoliberal governmental agenda is less pronounced in Denmark and has not informed welfare state restructuring in a way that would require us to second-guess its overall characterisation as a social democratic welfare regime, neoliberal thinking has, nevertheless, influenced active labour market policy. As argued by, for example, Lars Hulgård and Thomas Brisballe, the third sector and social

[58] ibid 27.

enterprises in particular have had an important role to play in the welfare state 'towards the so-called "active line", which has contributed to strengthening the link between active labour policies and the social enterprise model'.[59] Hulgård and Brisballe go on to argue that Danish social enterprises 'especially those offering a variety of work-integration projects, are actors in the "official" [governmental] aim of changing passive systems into active ones, in both labour market policy and social policy'.[60]

There is a cross-reference to the argument that social enterprises can contribute to active labour market programmes within the policy documentation that heralded the social enterprise corporation. The policy documentation argues that Danish society faces a number of challenges, one of which is that many people are believed to be on the edge of, or excluded from, the labour market. In the view of the policy documentation drafters, social enterprises have a special potential for contributing to solving this societal problem. Specifically, the assumption is that social enterprises can upgrade and include vulnerable people in work, and, thereby, contribute to more groups gaining a foothold in the ordinary labour market and realising a more dignified life.[61] This is important for the Danish welfare state since it is a

> fusion of welfare and work. It is, at once, a welfare state genuinely committed to a full employment guarantee, and a welfare state entirely dependent on its attainment. On the one side, it is a model in which the right to work has equal status to the right of income protection. On the other side, the enormous costs of maintaining a solidaristic, universalistic and de-commodifying welfare system means that it must minimize social problems and maximize…[tax] revenue…This is obviously best done with most people working, and the fewest possible living off social transfers.[62]

However, the policy documentation is clear that, at the time of writing in 2013, the third sector organisational forms then available to social enterprises did not accommodate socially conscious equity capital providers' investments, which had the effect of stunting the expansion and diversification of undertakings that might otherwise relieve some of the pressure on the Danish welfare state.[63] Thus, the policy documentation recommends that regulatory intervention should introduce a new corporate vehicle capable of taking equity capital

[59] L Hulgård and T Brisballe, 'Work Integration Social Enterprises in Denmark' EMES European Research Network Working Paper No. 04/08 (2004) 1, 8 <https://www.ess-europe.eu/sites/default/files/publications/files/perse_wp_04-08_dk.pdf>.
[60] ibid 9.
[61] Udvalget for socialøkonomiske virksomheder (n 46) 6.
[62] Esping-Andersen (n 56) 26.
[63] Udvalget for socialøkonomiske virksomheder (n 46) 6.

injections for the purposes of developing a social investment market that privately subsidises, among other things, work integration services for the hard-to-employ.[64] To be examined further in Chapter 3, this is where we can firmly locate a relational link between the welfare state, the third sector and the social enterprise corporation that explains not only why it emerged but also why it takes a form similar to its UK equivalent.

2.5 Concluding Remarks

In summary, this Chapter has sought to expound upon the methodological techniques that underpin the analysis. The utilisation of orthodox functionalism is not an appropriate methodological framework because it designates the reduction of intra-firm agency costs as the central problem, and views the corporation as an institutional response to that problem. For example, if we think about agency costs within an Anglo-American corporate law and governance setting, the issue is how the rules applicable to corporations can be better calibrated to align managers' incentives and interests with shareholders' incentives and interests. However, in the social enterprise law context, directors do not owe duties to the corporation for shareholders' private benefit, and shareholders have no special rank in the firm. Therefore, there is no indication that the uniformity we see in European social enterprise law was driven by the usually assumed policy desire to moderate the scope for value-reducing forms of opportunism amongst different corporate constituencies. Differently, the evidence suggests that the drivers shaping social enterprise law and governance systems in Europe are political exigencies emanating from within the domestic welfare state. To acknowledge this point is to effectively admit that a politically compatible methodological lens is necessary to explain why European social enterprise law and governance systems are conceptually and practically distinct landscapes, relative their traditional corporate law counterparts, and have come to take roughly standardised forms across jurisdictions.

I argued that Bruner's work is a fitting methodological framework from which to theory build. This is the case since the Brunerian method is premised on the idea that welfare state structures are not simply reactions to corporate law and governance systems, but in fact can represent a crucial explanation for how and why they come to take the forms that they do. This argument overlaps well with the proposed hypothesis that the catalysts shaping social enterprise law and

[64] ibid 43ff.

governance systems in Europe are political exigencies emanating from within the domestic welfare state. However, whilst the theory offered in this thesis is an extension of the Brunerian method, it is not a boilerplate duplication.

Bruner rejects an economically oriented, functionalist account because he detected longstanding differences in the levels of shareholder orientation across Australia, Canada, the UK and the US. This cuts across the functionalist assumption that different countries will, generally, converge on an economically efficient regulatory response to agency costs. Bruner also elects to avoid using functionalism since he uncovered credible evidence that the hypothesised divergences permeated from outside the jurisdictions' corporate law and governance systems and connected to certain historical, cultural, social and political dynamics. By default, functionalism is not equipped to deal with these kinds of factors; it largely elides them and takes for granted that socio-political conditions are homogenous and static from country-to-country. He then uses a specific independent, or explanatory, variable – the welfare state and related structures impacting social welfare protections available to non-shareholders, notably employees – to show that the degree of shareholder orientation and the scope of welfare state protections mirror a broader political equilibrium.

Although I also reject functionalism's tenet that corporate law and governance rules are a regulatory response to agency costs, I diverge with Bruner on the point that various regulatory systems can develop a range of loosely similar institutional solutions to problems encountered by societies across jurisdictions. There is a uniformity to European social enterprise law, despite the fact that this uniformity is not the product of a policy desire to moderate the scope for value-reducing forms of opportunism amongst different corporate constituencies. Consequently, consistent with the functionalist methodology, I am more concerned with analytically modelling the underlying uniformity of the social enterprise corporation.

But, aside from the five basic legal characteristics that are said to capture the essence of the traditional corporation, European social enterprise law does include additional legal and institutional mechanisms that ultimately make it and traditional corporate law conceptually and practically distinct from each other. Therefore, like Bruner's argument that the divergences observed in his study originate from socio-political factors, I also argue that extra-corporate welfare state considerations are a crucial element of the explanation for both why social enterprise law and governance systems emerged and why they have come to take their current,

similar forms. The difference between us is that our independent, or explanatory, variables are distinct. My independent, or explanatory, variable is not the welfare state and related structures impacting social welfare protections available to non-shareholders, but rather the broader political economy developments in the Danish and UK welfare states relating to the third sector, and social enterprises in particular. In my view, focusing on the broader political economy developments as they relate to the third sector allows us to access the deeper and more complex policy dynamics in motion that spurred the emergence and structure of the social enterprise corporation. As such, this study is propped up by a partial functionalist approach that replaces the standard functionalist procedure in which the independent, or explanatory, variable is the reduction of agency costs with how political developments in the Danish and British welfare states relate to the third sector.

What I am not willing to concede, however, is that Danish and UK socio-political conditions are homogenous and static, as is usually taken for granted when operating the functionalist methodology. The Danish and British welfare state regimes are different. The UK welfare regime is more receptive to the market subsidisation of welfare programmes, and, indeed, this is something that we can plainly detect in the political process from which the social enterprise corporation emerged. However, arguing that the Danish social enterprise corporation was also engineered to privately subsidise and improve the availability of social welfare goods and services is a much trickier positive claim to make out because the welfare regime is more generous, has broader coverage and is less market-oriented. The solution to this puzzle is that, even though the Danish regime type is empirically different, it does blend social democratic and liberal elements together in the area of active labour market policy. This intersection between social democratic and liberal elements is where we find jurisdictionally distinct, but thematically similar, political determinations regarding a neoliberal governmental agenda of wanting to transfer some responsibility for the implementation and financing of social welfare policy from the state to other corners of society. Here we can locate a relational link between the welfare state, the third sector and the social enterprise corporation that explains not only why it emerged in the first place but also why it takes a form similar to its UK counterpart.

To verify the explicit impact of Danish and British welfare state politics, we will now turn to consider the jurisdictional processes within which the social enterprise corporation is embedded and from which it was birthed.

|3|

WELFARE STATE POLITICS AND CORPORATE RULE MAKING

In the last Chapter, I dealt methodological techniques. Applying those methodological techniques, the aim of this Chapter is to advance a theory that properly explains European social enterprise law.[65] Orthodox functionalism, although the default methodological framework for comparative corporate law and governance studies, is not appropriate because it identifies the reduction of intra-firm agency costs as the central problem, and views the corporation as an institutional response to that problem. However, in the social enterprise law context, directors do not owe duties to the corporation for shareholders' private benefit, and shareholders have no special rank in the firm. As such, there is no indication that the uniformity we see in European social enterprise law was driven by the usually assumed policy desire to moderate the scope for value-reducing forms of opportunism amongst different corporate constituencies. Rather, the evidence suggests that the drivers shaping social enterprise law and governance systems in Europe are political exigencies emanating from within the domestic welfare state.

Building off the work of Bruner, I argue that, whilst there is a uniformity to European social enterprise law, it is not the product of a policy desire to reduce agency costs to manageable levels. Instead, I argue that extra-corporate welfare state considerations are a crucial element of the explanation for both why social enterprise law and governance systems emerged in the first place and why they have come to take their current, similar forms. To draw out the hypothesised relational connection, my independent, or explanatory, variable is the broader political economy developments in the Danish and UK welfare states relating to the third sector, and social enterprises in particular. Again, I am confining the analysis to Denmark and the UK. In any event, I am focusing on the broader political economy developments as they relate to the third sector because it arguably allows us to access the deeper and more complex policy dynamics in motion that spurred the emergence and structure of the social enterprise corporation in both jurisdictions. Consequently, as a methodological point, this study is propped up by a partial functionalist approach that replaces the standard functionalist procedure in which the independent, or explanatory, variable is the reduction of agency costs with how developments in the Danish and British welfare states relate to the third sector.

[65] Some of the contents of this Chapter features in Liptrap (n 1).

However, the Danish and British welfare state regimes are different, and, although the Danish social enterprise corporation takes a form similar to its UK counterpart, the political roads from which they emerged are not the same. What ties them together is jurisdictionally distinct, but thematically similar, political determinations regarding a neoliberal agenda of wanting to transfer some responsibility for the implementation and financing of social welfare policy from the state to other corners of society. This is where we can locate a relational link between the welfare state, the third sector and the social enterprise corporation that explains not only why it emerged but also why it takes a similar form in both countries.

As we shall see more clearly below, the social enterprise corporation is nested within, and is a manifestation of, particular political processes that are jurisdictionally specific. The political processes include historical phases (that, roughly, correspond to changes in government), events and policies. To appreciate how the social enterprise corporation is bonded to the Danish and UK welfare states, we need know about these processes.

A final remark before we move on is in order. Arguing that the Danish social enterprise corporation was engineered to privately subsidise and improve the availability of social welfare goods and services – notably by providing sheltered labour markets for the hard-to-employ (and those facing labour market exclusion more broadly) – is a much tricker positive claim to make out because the welfare regime is more generous, has broader coverage and is less market oriented. This not so with the UK social enterprise corporation. The UK welfare regime is more receptive to the market subsidisation of welfare programmes, and, indeed, this is something that we can plainly detect in the political process from which the social enterprise corporation emerged. Therefore, we shall spend more time considering the former.

3.1 Denmark

(a) The First Historical Phase

In Denmark, the first historical phase took place during the period of 1982 to 1993, which saw *Socialdemokratiet* (Social Democrats) replaced by a *Konservative Folkeparti*-led (Conservative People's Party) coalition under Poul Schlüter.

The nature of the political rhetoric in the 1980s might suggest that neoliberal ideology was influencing many areas of policymaking. For example, in the mid-1980s, a Conservative People's Party minister, Palle Simonsen, proclaimed that the Party had demonstrated its commitment to a so-called welfare society, and made efforts to restrain the role of the state.[66] Similarly, around the same time, *Venstre* (Liberal Party) argued that the institutionalisation and professionalisation of the welfare state had weakened private and voluntary contributions, which made the welfare state feel cold, formal and lacking the human warmth that ought to embody a well-functioning social security system. Thus, the Liberals pledged to change the welfare state into a welfare society.[67]

In the Danish context, 'welfare society' during this time was an ideologically charged term that denoted neoliberal criticisms. Whereas the 'welfare state' terminology had 'its breakthrough in the Golden Age [ie, the 1960s and 1970s] – characterized by an expansion of social rights – the term "welfare society" aligned very well with an era characterized by retrenchment, workfare and welfare reform'.[68]

Of course, we know today that Denmark's welfare system is considered one of the most generous in Europe (at least on paper), and the expectation is that welfare goods and services ought to be delivered professionally by public sector actors and institutions.[69] Allied to this, there is a sentiment amongst citizens that market mechanisms in the welfare state sphere are, generally, inappropriate and unreliable. Indeed, there is empirical evidence to suggest that attempts by Danish politicians to engage in welfare retrenchment can lead to punishment at the ballot box.[70] The same was true during the 1980s. The government 'tried to implement cutbacks

[66] P Simonsen and J Wagner, *Den danske model: en bog med Palle Simonsen om Danmark efter genopretningen* (Nyt Nordisk Forlag 1986) 47.
[67] Venstre, *Fra velfærdsstat til velfærdssamfund: Et liberalt reformoplæg* (1985) 5
[68] J H Petersen and K Petersen, 'The Concept of "Welfare State" in Danish Public and Political Debates' in N Edling (ed), *The Changing Meanings of the Welfare State: Histories of a Key Concept in the Nordic Countries* (Berghahn 2019) 184.
[69] However, although this is a point beyond the scope of this Chapter, it is important to note that some commentators challenge the extent to which the modern Danish welfare state can really be practically differentiated in terms of its generosity from its European counterparts. See eg B Greve, 'Denmark: Still a Nordic Welfare State After the Changes in Recent Years?' in K Schubert, P de Villota and J Kuhlmann (eds), *Challenges to European Welfare Systems* (Springer 2016) 175-176 (arguing that 'it seems that the Danish welfare state model is no longer so profoundly different from other welfare states in the North-West of Europe, thereby following a pattern where the difference in Europe is more likely on an East/South and North/West axis than the more historical division as indicated by Esping-Andersen').
[70] S Lee, C Jensen, C Arndt and G Wenzelburger, 'Risky Business? Welfare State Reforms and Government Support in Britain and Denmark' (2017) 50 *British Journal of Political Science* 165, 166.

in welfare provision, especially unemployment benefits and social assistance'.[71] But since the Social Democrats and trade unions, at least initially, opposed these cuts

> the coalition was obliged to leave the system of unemployment protection basically intact. The period until 1993 was characterised by constant growth in the duration of unemployment benefits. Moreover, most active schemes aimed at renewing unemployment benefit entitlement and never really linked the receipt of a benefit to the obligation to take a job offer or to be trained. Until 1992-93, the generous unemployment system with long periods of entitlement, easy access and high replacement rates was maintained and came close to a basic income system.[72]

Therefore, we can say that the welfare society rhetoric was more political posturing, rather than a substantive discursive weapon being employed to justify curbing social welfare protections.

However, as we shall see below, in 1993 and beyond a number of welfare reforms were implemented along neoliberal lines and the conditions necessary to legitimise those policies emerged in the first historical phase. Unlike the UK experience, though, where there was a macro-level paradigm shift from Keynesian social democracy to neoliberalism, the Danish context is narrower and more specific in its scope, in the sense that neoliberal ideas did not pervade social welfare policymaking across the board. Argued by Christian Albert Larsen and Jørgen Goul Andersen, a broad shift from Keynesianism to neoliberalism 'did not take place in the Danish case – actually the Danish Social Democrats in the 1990s did not…dismiss Keynesian fiscal policy nor did subsequent Liberal-Conservative governments'.[73] The shift in policy was, therefore, finer and connected to an appreciation that, like in other Nordic welfare states, the 'common…challenges are that they are in one way or another related to labour force participation. The Nordic welfare state…is preconditioned by high levels of employment…The Nordic model is an employment model simultaneously demanding modesty (among actual receivers of benefits), generosity (among actual contributors) and a strong willingness to work'.[74]

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[71] A Daguerre, *Active Labour Market Policies and Welfare Reform: Europe and the US in Comparative Perspective* (Palgrave Macmillan 2007) 86.
[72] ibid. See also eg J Goul Andersen, 'Work and Citizenship: Unemployment and Unemployment Policies in Denmark, 1980-2000' in J Goul Andersen and P H Jensen (eds), *Changing Labour Markets, Welfare Policies and Citizenship* (Policy Press 2002) 66.
[73] C A Larsen and J Goul Andersen, 'How New Economic Ideas Changed the Danish Welfare State: The Case of Neoliberal Ideas and Highly Organized Social Democratic Interests' (2009) 22 *Governance: An International Journal of Policy, Administration, and Institutions* 239, 241.
[74] J H Petersen, 'Nordic Model of Welfare States' in P Letto-Vanamo, D Tamm and B O Gram Mortensen (eds), *Nordic Law in European Context* (Springer 2019) 32.

In this way, if unemployment rates are too high, it potentially impacts upon the Danish welfare state's main source of funding and, by extension, the country's strategy of 'flexicurity', which emphasises a 'complementarity between a generous welfare state, a competitive labour market, and entrepreneurial activity'.[75] This was precisely the perceived fear held by policymakers in the 1980s. More specifically, from 1983 to 1987

> Denmark experienced the first significant decline in unemployment since the oil crises in the 1970s. The official unemployment rate declined from 10.5% to 7.9%...However, this economic boom ended with very high wage increases in 1987 that was followed by…years of low growth and increasing unemployment; unemployment peaked at 12.4% in 1993. The wage explosion in 1987 was interpreted as evidence that employment had declined below the level of structural unemployment, which by definition means accelerating wage increases and thereby lower competitiveness. Even though this interpretation was…problematical at best, it became a common understanding among researchers and decision makers…that the level of structural unemployment was about 8% or more and…that only reforms that altered the structures of the labor market could bring unemployment below that level. The aftermath of the 1987 wage negotiations made it clear that if unemployment fell below the level of structural unemployment, it would only generate wage inflation, reduced competitiveness, and even more unemployment.[76]

The notion that structural unemployment was the root problem became a point of consensus within Danish policy circles. It came to be

> taken for granted that the high levels of unemployment was not a matter of insufficient demand for labor power but primarily a matter of structural problems on the Danish labor market. Thus, the only efficient way to combat unemployment was to implement various supply-side policies that could reduce the structural level of unemployment. Without such policies traditional Keynesian demand-side policies aimed at lowering unemployment would only generate inflation…The unemployed would remain unemployed due to insufficient qualifications (relative to minimum wages), insufficient work incentives (relative to unemployment benefits), and other sorts of mismatch problems (wrong qualifications, low geographical mobility, etc.). The logic is that firms would simply compete by bidding up wages for those workers already employed and fit for available jobs. The result is (wage-driven) inflation.[77]

[75] A Daemmrich and T Bredgaard, 'The Welfare State as an Investment Strategy: Denmark's Flexicurity Policies' in A Bardhan, D Jaffee and C Kroll (eds), *The Oxford Handbook of Offshoring and Global Employment* (Oxford University Press 2013) 159.
[76] Larsen and Goul Andersen (n 73) 247.
[77] ibid 245.

It is within this context that the need for introducing structural reforms in the labour market gained acceptance, initially amongst the government, but also, gradually, amongst Social Democrats, the *Radikale Venstre* (Social Liberal Party) and the trade unions. Different from the 1970s, where government elites thought that unemployment was a temporary problem that could be addressed by counter-cyclic interventions, in the 1980s it was assumed that unemployment was not simply a temporary, cyclical issue, but instead a permanent fixture in the level of unemployment. The government adopted new economic thinking that was based upon a departure from Keynesian policies and on a stronger emphasis on competitiveness. We can, broadly, locate a reorientation of official labour market discourses after 1987. Before then, the *Arbejdsministeriet* (Ministry of Labour) published a number of reports that addressed employment policies from a sociological perspective. The *Pejlingsrapport* of 1987 (Bearing Report) is particularly noteworthy because it was the 'last report to be written by sociologists. From now on the economists took over'.[78] After 1987, the Ministry of Labour abandoned the earlier sociological lens and issued reports that identified structural unemployment, insufficient wage dispersion and high unemployment benefits as the main problems facing the Danish economy and the welfare state. The 1988 report by the *Økonomiske Råd* (Economic Council) is also important.[79] Albeit a preliminary and tentative account, it was produced by a younger generation of 'supply-side' economists that were inspired by Asser Lindbeck and Donald Snower's theory of 'insider-outsider' problems.[80]

Briefly, the insiders – those already employed – and the employers themselves are the arbiters of the wage. Since the insiders are already employed they are in a superior position and have no real incentive to expand the total number of available jobs to accommodate those who are not. That is, the insiders are primarily interested in maximising their own wages, and lack the incentives to encourage job expansion by holding wages down and inviting outsiders to gain employment. For firms, they have strong inducements to engage only with the insiders. This is because there is a considerable cost associated with replacing those specific workers. This labour turnover cost includes, for example, severance pay, hiring process expenditures and firm-specific training. Allied to this, since the rate of unemployment has no real impact on trade union monopoly and on employers regarding wage setting, the natural rate of

[78] J Torfing, 'Workfare with Welfare: Recent Reforms of the Danish Welfare State' (1999) 9 *Journal of European Social Policy* 5, 14.
[79] See generally Det Økonomiske Råd, *Dansk Økonomi* (1988).
[80] See generally A Lindbeck and D Snower, *The Insider-Outsider Theory of Unemployment* (Massachusetts Institute of Technology Press 1988).

unemployment rises with the actual rate. Thus, the unemployed face labour market exclusion due to the fact that they are necessarily not relevant to the employment bargain. Overall, the effect is that the particular labour market does not see any wage underbidding despite the willingness of the unemployed to work for lower pay. This is a market failure, from the standpoint that the wage is not being set according to the needs and preferences of particular labour market actors.

We can spot Lindbeck and Snower's influence on the policy paradigm easily enough. Anne Daguerre, for example, claims that experts

> argued that there was a structural rate of unemployment that reflected the degree of mismatch between supply and demand for labour. Unemployment…was…seen as the…product of structural defects in the labour market and in the unemployment benefit system. The fact that most unemployed people were the low-skilled, youth, women and ethnic minorities reinforced the idea that the Danish labour market created an insider-outsider phenomenon with high levels of hidden unemployment. According to Goul Andersen…'the problem definition of structural unemployment was accepted by nearly all actors in the field: the major parties and interest groups…It became an institutional truth that further improvements of unemployment were impossible unless structural unemployment was reduced'…[T]here was a growing consensus on the need to reform the system because high levels of unemployment exerted tremendous pressures on the unemployment benefit system. Moreover, because the Scandinavian model is based on high labour market participation, escalating unemployment weakens the normative foundations of the welfare state. In this sense, the high unemployment represents a double crisis of sustainability and legitimacy.[81]

Therefore, as Mette Anthonsen, Johannes Lindvall and Ulrich Schmidt-Hansen note, the 'government and labour market organisations shared a common understanding of the need for reform and a desire to participate in reform'.[82] This seems to be why there was no real disputation with the government's line of reasoning – that the wage explosion of 1987 brought with it a structural unemployment crisis – in its 1989 white paper.[83] Here, a group of labour market economists were invited to participate in writing the report. The economic plan was the government's central strategic attempt to reach a more neoliberal policy orientation.[84] This is

[81] Daguerre (n 71) 88. See also Goul Andersen (n 72) 62-63.
[82] M Anthonsen, J Lindvall and U Schmidt-Hansen, 'Social Democrats, Unions and Corporatism: Denmark and Sweden Compared' (2005) *Nordic Political Science Association* 1, 7.
[83] See generally Arbejdsministeriet, *Hvidbog om arbejdsmarkedets strukturproblemer* (1989).
[84] C A Larsen and J Goul Andersen, *Magten på Borgen: en Analyse af Beslutningsprocesser i større Politiske Reformer* (Aarhus Universitetsforlag 2004) 87.

the same logic that was utilised by the Economic Council in 1988, and it is also found in reports from the contemporaneous *Socialkommissionen* (Social Commission).[85] The Social Commission

> reports became an important reference point in the policy debates in the 1990s. It concluded that without structural reforms, increasing demand for labor power (even if driven by exports) would not lead to lower unemployment. Moreover, due to the loss of human capital, more and more workers would become unemployable and therefore the level of structural unemployment would become higher and higher – a phenomenon known as 'hysteresis' in the economic literature. Thus, the prediction for the future was even higher levels of structural unemployment, which gave the impression of a real crisis. Furthermore, policymakers were presented to a link between structural unemployment and social problems. The Social Commission described a 'lost generation' of people who had never been included at the labor market and would become less and less employable.[86]

Due to the fact that Denmark is a 'corporatist' jurisdiction in which substantial employment reforms must secure the blessing of the trade unions, it might be expected that, as well-organised centres of socio-political power, they would react negatively to policy proposals that sought to undermine the unemployment protections of their worker-members. Indeed, as mentioned above, this is exactly what happened. Larsen and Goul Andersen show that, together with the 'Social Democrats, the unions had fought to maintain relatively generous unemployment benefits, not least a very long duration period. Combined with a public opinion that did not blame the unemployed…the resistance to change had been so strong that the…government from 1982 to 1993 had not dared to make fundamental changes in the unemployment insurance system'.[87] Therefore, even though cross-political agreement eventually consolidated in the first historical phase on the diagnosis that structural employment existed and was a major problem for existing labour market policies, it is clear that there could have been marked disagreement about what treatments ought to be implemented to combat structural employment.

[85] See generally eg Socialkommissionen, *Reformer: Socialkommissionens samlede forslag* (1993).
[86] Larsen and Goul Andersen (n 73) 247-248. See generally also O J Blanchard and L H Summers, 'Hysteresis and the European Unemployment Problem' in S Fischer (ed), *National Bureau of Economic Research Macroeconomics Annual* (Massachusetts Institute of Technology Press 1986).
[87] Larsen and Goul Andersen (n 73) 249. See generally also C A Larsen, 'The Institutional Logic of Welfare Attitudes: How Welfare Regimes Influence Public Support' (2008) 41 *Comparative Political Studies* 145.

Nevertheless, the trade unions, to a greater or lesser extent, came to accept the government's views on the matter. Acceptance by the trade unions was formally secured through a 1992 report prepared by the *Zeuthen-udvalgets* (Zeuthen Commission).[88] The Zeuthen Commission

> was a classic corporatist committee with representatives from the unions, the employers, the ministries, the municipalities, and labour market experts. In this forum the diagnosis of structural unemployment was by and large accepted…[T]he consensus about unemployment being structural was the most important achievement of the committee, alongside the agreement to expand activation and have regional corporatist bodies to guide and adapt the efforts to regional variations in supply and demand for labour power.[89]

For the Zeuthen Commission the

> involvement of the labour movement gave the Commission the caution that was needed to legitimate its own reform proposals. The…Commission recommended enhancing the qualifications of the workforce…[T]he priority was to maintain the system of contractual wage bargaining at the local branch level. They opposed the strategy that consisted of topping up low wages with social benefits. [They] wanted to avoid a situation where people on activation programmes would compete with the local workforce for a lower wage than the one negotiated with the employer. But trade unions were not opposed to helping people back into work; on the contrary, the right to work was a popular theme. A new emphasis on individual responsibilities, strong work tests, and additional requirements in terms of accepting job or training offers were acceptable as long as the reform was not accompanied by lower minimum wages or lower unemployment benefits.[90]

From here, all the 'important parties could accept a stronger focus on activation policy and the regionalization of the system'.[91] Consequently, the possibility of a political conflict diffused, and there was a transition to determining what the exact policy prescriptions ought to be and how they should be socially legitimised. Ultimately, active labour market policies became the functional equivalent to neoliberal solutions in the Danish context. Activation programmes for the unemployed – for example, job search courses, education modules and job training – were thought to work in two ways, at least from the outlook of government policymakers. In terms of the qualification effect, instead of addressing the incongruity between minimum wages and qualifications by lowering benefits and wages, the point was to increase productivity, in

[88] See generally Zeuthen-udvalgets, *Rapport fra Udredningsudvalget om arbejdsmarkedets strukturproblemer* (1992).
[89] Larsen and Goul Andersen (n 73) 249.
[90] Daguerre (n 71) 88-89.
[91] Anthonsen, Lindvall and Schmidt-Hansen (n 82) 7. See also Goul Andersen (n 72) 69.

particular to requalify the unemployed. However, policymakers increasingly came to favour the motivational, or deterrence, effect of requiring the unemployed to participate in activation programmes on a mandatory basis.

This reasoning did not necessarily sit well with the trade unions, but an activation strategy to combat structural unemployment was the lesser evil. This is because

> it was not directly an argument for reductions in the duration period of unemployment benefits…[I]t [only] delivered the background for a new line of reasoning…The unions had their doubt about this…logic, and the Zeuthen Commission could not reach any consensus about changing the duration of benefits. The main confederation of unions…also had its worries about mandatory participation in activation measures and attached sanction mechanisms, but it was calmed by the fact that the unions, jointly with the employers, were planned to supervise and influence the regional implementation of these policies.[92]

This explains why the new paradigm was adopted – before the actual policy instruments were developed and long before the effects were better understood – fairly quietly and not via dramatic political conflicts. Naturally, however, the soft consensus still generated some opposition amongst the left-wing parties, radical trade unions and within the general public. The issue was that the link between structural unemployment and the assumption that it could be corrected through activation was not totally clear, and, consequently, a discourse built up around whether it was fair to treat the unemployed more harshly. The government defended against the apprehensions and criticisms by two methods (which were also adopted in the second historical phase by the subsequent Social Democratic-led coalition government). The first was a 'rights and obligations' discourse. The argument was that 'entitlements to unemployment benefits had always been accompanied by the duty to search actively for a job and to be mobile across branches'.[93] The second was a 'passive versus active' discourse. It was argued that more had to be 'done to help those unemployed than just providing economic security. This "doing more" had an appeal to the critical left-wing segments, and it created the idea of a win-win situation; active labor market policy would both alleviate the problem of structural unemployment and the social and psychological problems connected to not being at the labor market'.[94]

[92] Larsen and Goul Andersen (n 73) 250.
[93] ibid.
[94] ibid.

This was convincing rhetoric. Above all, it gave credence to the Social Commission's above-mentioned lost generation argument, and, as we shall see, it presented the later Social Democratic-led coalition government with a way to justify a gradually more tough treatment of the unemployed. This is a critical point. Policymakers in the first historical phase paved the way for the implementation of activation policies, and, although political discussions highlighted the need to educate the unemployed rather than herd them into low-paid working arrangements, the government also injected, and normalised, the need to tighten unemployment benefits into the welfare reform debate. True, these policies were officially spurned by the Social Democrats in the first historical phase, but they soon changed course once they recaptured power in January of 1993.

(b) The Second Historical Phase

This brings us to the second historical phase, which covers 1993 to 2001 and includes a change of government in which a Social Democratic-led coalition under Poul Rasmussen ousted the previous administration. As foreshadowed above, this phase of the political process is marked by the implementation of activation policies and a tightening of unemployment benefits through particular welfare reforms. The Social Democrats largely recycled the previous government's policy discourse regarding rights and obligations. The new government instituted another Social Commission to identify structural problems in the labour market and extant employment policies, and to make reform recommendations.[95] The Social Commission cited three problems – a low level of labour market participation, notably among younger people, overly generous unemployment benefits and skills deterioration. The Social Commission argued for a reduction in social assistance and capping access to unemployment benefits from nine years to five years. More to the point, it proposed a bold recasting of the welfare system into a 'workfare' system, which essentially stands for the idea that, to enjoy access to welfare benefits, the able-bodied unemployed must work (eg in a public service job or participate in job training) rather than simply take a 'handout' from the government. As we discussed, the Social Democrats had at first rejected such a change based upon the notion that this was alien to the Danish socio-political tradition. But the Social Commission was

[95] Socialkommissionen (n 85) 7, 15-18, 28.

> adroit enough to justify this dramatic change by referring to constitutional principles. The Commission argued that the establishment of binding reciprocity between rights and obligations represented a correct reading of the Constitution of 1953…The Commission argued that welfare rights were connected to the duty of abled-bodied adults to work. The Social Commission report was crucial in the dissemination of ideas for activation. It also proposed a specific workfare strategy based on the need to enhance the flexibility and the skills of the labour force in order to improve the competitiveness of the economy. Sheltered jobs in intermediate labour markets were to be offered to those who were not job-ready. These proposals were based on the concept of social inclusion and were thus congruent with the universalistic, generous model of welfare, which remained at the heart of the Danish welfare system.[96]

Overall, according to commentators like Robert Cox, the implementation of an activation framework was packaged to the public as a return to the traditional roots of the Danish welfare state.[97] This is a finding that other commentators have also reached – the activation dialogue was approached in such a way that, facially, it seemed to accord with Danish universalistic social welfare conventions.[98]

To reiterate, the previous government was only able to initiate a shift, albeit a clearly important one, in social welfare policy discourse, but this did not lead to actual changes to unemployment policies. Changes did not happen until the Social Democrats implemented them in the second historical phase. However, it is worth saying that the Social Democrats did not cut the substance of the benefits, rather they shortened the duration for which they were available. Thus, in 1993 the *Lov om en aktiv arbejdsmarkedspolitik* (Act on Active Labour Market Policy) reduced the maximum duration of unemployment benefits from nine years to seven years.[99] Active labour market policy was decentralised to regional administrative bodies, and the possible role of the social partners in managing the system was kept, as envisioned in earlier negotiations. The reform also required the unemployed to accept a workfarist *individuel handlingsplan* (individual action plan), which formed the basis of activation for each person in question, whether that be making a personal commitment to, for example, education or job training in

[96] Daguerre (n 71) 90.
[97] R H Cox, 'The Social Construction of an Imperative: Why Welfare Reform Happened in Denmark and the Netherlands but not in Germany' (2001) 53 *World Politics* 463, 481.
[98] See eg Torfing (n 78) 17ff. See generally also eg J Andersen and D Etherington, 'Flexicurity, Workfare or Inclusion? The Politics of Welfare and Activation in the UK and Denmark' Centre for Labour Market Research – Aalborg University, Working Paper No. 8 (2005).
[99] Lov nr 434 af 30/06/1993 om en aktiv arbejdsmarkedspolitik.

exchange for the receipt of social assistance.[100] In 1996, the duration of unemployment benefits was again cut from seven years to five years, with a right and obligation to activate after two years. In 1999, the duration of unemployment benefits was adjusted from five years to four years. There was a duty to activate after one year.[101]

The Social Democrats argued that activation was about improving the qualifications of the unemployed in order to upgrade their skills, and, thus, the collective competitiveness of the Danish labour force in the context of a globalising economy. The trade unions accepted this argument. That is, in exchange for leaving benefit levels and wages intact, the trade unions accepted the introduction of activation policies, characterised by stricter controls on access, a shorter duration of unemployment benefits and the rights and obligations rhetoric. However, Larsen and Goul Andersen argue that the policies showcased a classic 'retrenchment strategy', where, although it was difficult to see whether the first reform as a whole represented a harsher policy towards the unemployed, the latter two reforms' 'move toward tighter conditionality…was unambiguous…Eligibility was restricted, requirements to mobility and active job-seeking were tightened substantially, state control with the implementation was increased, and the duration period was reduced'.[102] Therefore, there was a well-defined shift towards the duty to work or to be activated; to look for a job or to be placed within a mandatory activation programme. This is the point at which it becomes necessary to mention this study's independent, or explanatory, variable that relationally links Danish social enterprise law to the welfare state – the third sector.

The Danish 'third sector' is a socio-economic construct situated between the 'public' and 'private' sectors. It has traditionally consisted of, for example, mutual benefit and philanthropic societies.[103] It has also included farmers' cooperatives, *folkehøjskoler* (folk high schools) and voluntary social services to support those with disabilities.[104] More recently, a large population

[100] J Torfing, *Det stille sporskifte i velfærdsstaten: en diskursteoretisk beslutningsprocesanalyse* (Aarhus Universitetsforlag 2004) 34; K Dahl, D Boesby and N Ploug, 'Welfare Systems and the Management of Economic Risk of Unemployment: Denmark' Danish National Institute of Social Research Working Paper (2002) 1, 21-22.
[101] Goul Andersen (n 72) 70. For a more comprehensive treatment of the main policy changes vis-à-vis activation that took place in the 1990s see eg J Goul Andersen and J J Pedersen, 'Continuity and Change in Danish Active Labour Market Policy: 1990-2007' Centre for Comparative Welfare Studies – Aalborg University, Working Paper No. 2007-54 (2007) 1, 11.
[102] Larsen and Goul Andersen (n 73) 252.
[103] L S Henriksen and P Bundesen, 'The Moving Frontier in Denmark: Voluntary-State Relationships since 1850' (2004) 33 *Journal of Social Policy* 605, 611.
[104] S Bengtsson and L Hulgård, 'Denmark: Cooperative Activity and Community Development' in C Borzaga and J Defourny (eds), *The Emergence of Social Enterprise* (Routledge 2001) 66, 69, 75-77.

of Danish third sector organisations can be found within the fields of sport, culture and recreation.[105] Workers' cooperatives – which develop model workplaces and establish working arrangements for those who have difficulties finding employment – are particularly important for the purposes of this Chapter.[106] I shall return to say something more about them below.

For the moment, it ought to be said that, broadly, before the Second World War, Danish social welfare policy featured two periods. In the first period, lasting from about 1850 to 1890, there was a dual model in place that distinguished

> between the deserving and the underserving poor…[This] served as a guideline for a system consisting of two mutually exclusive sectors: through private and philanthropic initiatives it was the duty of citizens to support the deserving, while the hopeless and underserving were assigned to the residualist public poor relief system. This division of labour was a logical consequence of the liberal ideology according to which one had to be able to support oneself in order to be a genuine citizen. Limited state activity and the spirit of help…therefore defined a space in which…[third sector] initiatives such as mutual benefit societies and philanthropic societies could flourish and act as the first line of defence.[107]

This changed in the second period, which lasted from 1890 to roughly 1940. Here, there was a steady decay of the distinction between the deserving and the non-deserving poor. The

> right to social assistance and social services increasingly came to be identified with particular situations in a person's life (growing old, for example) rather than the moral qualities of the person. At the same time the sanctions that hitherto had followed public poor relief were…removed. Increasing public responsibility created a new context for…[third sector] organisations in which public and private initiatives began to work in tandem rather than as 'parallel bars'.[108]

This is especially so with respect to philanthropic initiatives that centred on Christian traditions and inventing new social services that provided food, clothes and shelter for the worse off. Lars Sov Henriksen and Peter Bundesen argue that a 'new partnership…emerged at the beginning of the twentieth century in which government paid for these services provided by' third sector

[105] L Torpe and T Kjeldgaard, *Foreningssamfundets sociale kapital: Danske foreninger i et europæisk perspektiv* (Magtudredningen 2004) 72.
[106] Bengtsson and Hulgård (n 104) 67.
[107] Henriksen and P Bundesen (n 103) 611.
[108] ibid.

organisations.[109] That is, these initiatives did not cooperate directly with public authorities, but they often received public financial support from them. However, the social reform of 1933 – in which the Social Democratic government tried to engineer a coordinated national social welfare policy – meant that central administrative oversight ought to outweigh these public-private initiatives. With this reform

> one could now speak of a horizontal solidarity mediated by government. Instead of the former solidarity, where homogenous groups pooled resources, the individual citizen gradually came to be seen as both a recipient of and a contributor to the common public pool. State responsibility was directed toward not only particular groups at risk, but also to the wider population. The majority of the working-class population was lifted out of the former public poor relief, and most forms of social assistance were now established as a right…In stark contrast to the earlier period, the…new social democratic ideology saw the right to social assistance as a prerequisite for upholding one's…dignity.[110]

However, this did not

> mean that government saw no future role for the…[third sector]. Quite the contrary, the reform explicitly laid down that services could be contracted out to private and voluntary associations who could perform tasks, which were financed and controlled by government. In this respect the reform formalised and institutionalised the public-private partnership, which had begun earlier in the century…With this reform a new era began in which…[third sector] organisations…became instruments of the state. In the 1930s, there still existed a relatively balanced partnership in which government recognised voluntary action as an essential part of social policy. [T]he strength of the state was its capacity to collect and distribute economic resources, whereas the strength of philanthropy was its sense of duty and commitment to help and support the individual in need.[111]

After the Second World War, though, there was a mounting assertion by the state to be 'responsible for solving social problems as well as providing services'.[112] This engendered a fresh context in which third sector organisations ceased to be integral. This also happened in the UK around the same period. The Social Democratic-led governments in the 1930s developed ideas of a 'coordinated social policy in order to prevent the rise of social problems in general. Not only were particular at risk groups the target of social policy, but rather the

[109] ibid 612.
[110] ibid 613.
[111] ibid.
[112] ibid 614.

whole population'.[113] This is most noticeable in the implementation of a universalistic welfare state in which citizens, by virtue of their citizenship, were entitled to benefits and services.[114]

Within the health insurance and unemployment insurance spheres in particular

> changes were made in the 1960s which took the Danish system in the direction of a citizenship state: these areas now became partly tax-financed and coverage was made universal…The…introduction and implementation of a universalistic welfare system in which all citizens (to a certain degree) are dependant, all benefit, and all pay – that is, a system in which all citizens have social rights to services and benefits – naturally stood in sharp contrast to the…earlier philanthropy. The principle also stood in contrast to…the earlier period, with the tendency to focus on particular groups of the population leaving others behind, as well as the inadequacy of this system to generate enough resources to secure a general coverage of the population as such.[115]

The professional and specialised expertise required to operate this universalistic system had consequences for third sector organisations.

With respect to professionalisation, in most areas of social welfare policy 'doctors, teachers, social workers and psychologists set the agenda. Instead of the amateurish approach of [third sector] organisations, services were now demanded which built upon professional knowledge'.[116] For example, the treatment of alcoholism and mental health problems was professionalised in the 1950s. Doctors came to dominate these issues because medical treatment was available to help those suffering from alcoholism and mental health deficiencies. For third sector organisations

> this meant that they had to adapt their worldviews as well as their activities and institutions to professional norms and standards…[Third sector] organisations that were running institutions could choose either to adapt to the norms and standards (in many cases this was done by employing professional staff) or close down. Especially in the latter part of this period, this trend was radicalised when many institutions were taken over by local or regional authorities, or turned into so called self-governing (*selvejende)* institutions because they were no longer allowed to be owned by private organisations.[117]

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[113] ibid.
[114] J Goul Andersen, 'Den universelle velfærdsstat er under pres: men hvad er universalisme?' (1999) 56-57 *Tidsskriftet Grus* 40, 51.
[115] Henriksen and Bundesen (n 103) 615.
[116] ibid.
[117] ibid 616.

Regarding specialisation

> [a]s a consequence of…professionalisation and growing public responsibility, the social welfare system became extremely specialised and segmented in the post-war period. From a legal perspective this could be seen by the fact that laws applying to particular groups governed more and more areas. Different groups of disabled people, such as the blind, the deaf, and the mentally ill, were given their own laws in this period. From the perspective of social services this could be seen by the many specialised institutions which emerged in the post-war period.[118]

The effect of this specialisation phenomenon was that many third sector organisations reoriented their approach and were characterised by a

> growth of membership-based interest and pressure group organisations: the prime example would be the specialisation of so-called diagnosis-based associations and organisations for disabled people which took place from the 1960s and intensified in the 1970s and 1980s. Many of these organisations tried to draw public attention to particular problems, improve treatment capacities for their members and stimulate research. A survey of national [third sector] organisations showed that about 30 per cent of the total population of organisations were formed in the period from 1964 to 1983. The study also showed that the area with the highest organisational growth rate was [public awareness] organisations for handicapped people and people with ill health.[119]

Enlarged state responsibility and professional steering, coupled with specialisation, did not translate, however, to the idea that there was no room for third sector organisation welfare provision. Indeed, many third sector organisations in particular fields specialised in running self-governing institutions in conjunction with public authorities in the 1950s and 1960s.

There was also problems with specialisation and segmentation in the 1960s and the solution was to decentralise the social welfare system towards local and regional municipalities. This took effect in the 1970s when 'both a new division of labour between state and local authorities was implemented (1970), and another social reform was implemented (1976). The new Social Assistance Act made the local and regional municipalities responsible for both administration and provision of almost all social services. With this so-called "one-string system", local government responsibility and transparency were combined with coordination and

[118] ibid.
[119] ibid. See also eg J Anker, 'De frivillige sociale organisationer' Socialforskningsinstituttet Rapport 95/12 (1995) 1, 32-34.

expertise'.[120] For some earlier third sector organisations these reforms signalled their end and a transfer of their functions to local and regional public authorities, but for others it meant that new partnerships were introduced. Instead of coordination with the central government, third sector organisations now had to cooperate with local and regional state bodies, which put them in a position to stop contracting with third sector organisations if the quality of the work performed was not adequate.

Ultimately, however, whilst there were some other fields in which third sector organisations had a presence (such as shelters and services for the homeless and the poor, and juvenile homes)

> we can say that with the expansion of the social democratic welfare state traditional philanthropy came to be heavily constrained. Gradually government became the dominant actor as regards both the financing and the provision of welfare services, and voluntary organised services now had to follow standards and procedures determined by the state…The ideal became a universalistic welfare state in which public organisations run by professional experts should act as the first line of defence.[121]

The efficacy of a comprehensive public welfare system, which, broadly, marked the post-war period, swiftly came under attack at the beginning of the 1980s. This also occurred in the UK, but on a much broader scale. As we know from the first historical phase, neoliberal ideology was being employed to argue that the welfare state had weakened private and voluntary contributions, which made the welfare state feel cold, formal and lacking the human warmth that ought to embody a well-functioning social security system. Thus, there was an attempt to replace the ideology of the welfare state with the ideology of the welfare society. Here, the nub of the argument was that a wider range of societal actors – like local communities, third sector organisations and self-help movements – were just as responsible for the provision of welfare and the welfare of the citizen.

Henriksen and Bundesen argue that this larger policy development had an important impact upon third sector discourse. Namely, the third sector came to be understood as a

> construction of a new sphere for civil commitment. It was argued that the drawbacks of the professionalised and standardised public system, besides the financial burdens, were the loss of

[120] Henriksen and Bundesen (n 103) 617.
[121] ibid.

> spontaneous networks for mutual help and feelings of duty and commitment because the state had taken over the responsibilities which formerly belonged to the family and the community. This sense of duty and responsibility therefore had to be reinvented in order to secure the cohesion of society.[122]

They go on to suggest that one of the first politicians to promote this line of criticism

> was the Danish Minister of Social Affairs, Ritt Bjerregaard (1982), in a speech given at an OECD conference in 1980 on social policy. She was primarily worried about the expansion of the social welfare bureaucracy, which she thought represented a goal displacement of social policy. The original function of social policy, namely to meet clients' needs and reduce conflicts between the 'haves' and 'have nots', had been replaced by a tendency to expand the number of social workers, consultants…[and] researchers as well as the number of institutions and treatment facilities in order to secure the growth of the 'system' itself. This had two consequences: first, clients were turned into passive objects from which nothing was expected; and second, in a longer perspective, the system would lose its legitimacy. Slowly, the welfare state came to be seen not as a part of the solution but as part of the problem.[123]

In order to correct the problem, clients, and citizens in general, had to be viewed not as passive objects of policy but as active participants. State resources, therefore, had to be funnelled into popular movements, grass roots' initiatives, informal networks and organised groups of clients, instead of into the state welfare machinery directly. The rebuilding of local action was the new objective of social welfare policy. Rather than functioning as an auxiliary resource, the new function of the third sector was to restore civic engagement and societal cohesion. Third sector action metamorphosised into a solution to the bureaucratic and paternalistic organisation and deployment of the Danish welfare state. This represented a major shift in perceptions of the third sector – what 'formerly had been interpreted as an obstacle to securing adequate, reliable, and professional services for all, now came to be interpreted as a necessary…resource in the building of a future welfare society'.[124]

From the middle of the 1980s onwards, the Danish government instituted a range of societal development programmes that had third sector organisations in mind. But before discussing

[122] ibid 618.
[123] ibid 619.
[124] ibid.

the ones relevant to this Chapter, I want to say a few words about the steps taken by the Danish government to weave third sector organisations into the official welfare state apparatus.

It suffices to say that, by the time the Social Democratic-led coalition government had implemented the relevant active labour market policies in the 1990s, a national board was established in order to secure contracts and communication lines between state and third sector organisations, and a centre for social work was opened to offer advice and information to third sector organisations interested in procurement contracting.[125] Likewise, after the first active labour market policy was introduced in 1993 that reduced the maximum duration of unemployment benefits from nine to seven years, the government sought to revise the *Alt om Bistandsloven* 1976 (Social Assistance Act).[126] The reform was motivated by the impression that the legislation was not consistent with the times. New and more complex societal issues had manifested and more flexible regulatory frameworks for dealing with them was seen as a necessity. A greater emphasis was placed on individual responsibility and clients' influence on service provision, the cultivation of which called for a readjustment of the division of labour and responsibilities between the state and the citizen.

Vis-à-vis a readjustment of the division of labour and responsibilities between the state and the citizen, it was by then well-established that there was a positive governmental attitude towards third sector organisations. In the preparatory notes to the reform, it was argued that third sector contributions were not simply a supplement to public efforts, but rather an important, and unique, contributory source that could advance the welfare society project.[127]

In tandem with the preparatory notes, the government also created a special committee to report on the role and position of third sector organisations in the future of the welfare society. In this context, specific attention was paid to improving the conditions for third sector action, and forecasting the possibility of closer coordination between the state and third sector organisations. It was argued that third sector organisations could contribute to, and inspire, new forms of social welfare task solving.[128]

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[125] A la Cour and H Højlund, 'The Emergence of a Third-Order System in the Danish Welfare Sector' in R Hull, J Gibbon, O Branzei and H Haugh (eds), *The Third Sector* (Emerald 2011) 89-90.
[126] See generally eg H-E Kolding and J Stubkjær, *Alt om Bistandsloven: Loven Med Bemærkninger og Cirkulærer* (2nd edn, Aktuelle Bøger 1976).
[127] Socialministeriet, *Rapport fra udvalget om bistandslovens serviceydelser m.v.* (1996) 14.
[128] Socialministeriet, *Frivilligt socialt arbejde i fremtidens velfærdssamfund: Udvalget om frivilligt socialt arbejde* (1997) 174.

The positive political attitude regarding third sector organisations created the conditions necessary for the addition of some key provisions in the new *Lov Om Social Service* (Social Service Act), which took effect in 1998.[129] The Act provided that local and regional public bodies ought to cooperate with third sector organisations. Naturally, the point was to encourage coordination and the building of partnerships between the state and third sector organisations, but the legislation also stated that local and regional public bodies should set aside a certain amount of funds to support relevant organisations' social welfare activities. In this regard, the aim was to extend third sector organisations' ability to offer social welfare provision.

This post-war revival of a space for third sector action within the welfare state context has linkages to the idea of a public-private partnership that was prevalent until the 1930s in Denmark, but it is clear from the policy discourse that the partnership unfolding in the 1990s was not the same as the old one. Notably, third sector organisations were an important facet within the new communitarian view of a stronger civil society solving problems for itself. Jørn Henrik Petersen and Klaus Petersen, for example, argue that the 1990s 'saw the welfare society as cooperating with the "third sector", thus making a distinction between state and civil society. It looks as if a more conscious use of "welfare society" replaced "welfare state" – a distinction between "the old" and "the new", emphasizing the interplay of state, municipalities…[third sector] organizations and the family'.[130]

This brings us to the experimental societal development programmes relevant to this Chapter. There is much more we could discuss in relation these societal development programmes, but, broadly, it is worth highlighting that the objectives and the grant policies of these programmes were geared towards local and decentralised initiatives. A large share of the grants were passed along to local initiatives operated by third sector organisations, as well as projects that strengthened the joint problem-solving capacity between local and regional public bodies and third sector organisations. Although the legislative mandate that local and regional public bodies ought to cooperate with third sector organisations was not formalised and brought into effect until 1998, there is evidence that the earlier social reform of 1976 kickstarted richer public-private cooperation. New forms of social enterprises were emerging in the mid-1980s, on a cross-sectoral basis, to develop programmes at the local and regional levels to facilitate

[129] Lov nr 454 af 10/06/1997, Lov om social service.
[130] Petersen and Petersen (n 68) 183.

bottom-up redistributive solutions to emerging social welfare problems. I shall mention two of them.

First, during this period a variety of new social projects grew as local bottom-up initiatives, with the *Sociale Udviklingsprogram* (1988-1992) (Social Development Programme) probably being the most conspicuous.[131] Although the bottom-up initiatives, broadly, had a direct link with the Danish third sector folk high school tradition, the new types of social enterprises that had surfaced did not directly relate to the historical workers' cooperative movement.[132] Instead, 'they were to a large extent heavily supported by public resources, if not even initialized with the direct support and commitment of actors from the public sector'.[133] From 1985, 'several pilot and action programs within the field of social policy and urban policy…facilitated and expanded the establishment as well as the dissemination' of this new brand of social enterprise 'into a broad array of social service and community development areas'.[134] With respect to the Social Development Programme in particular, it was the largest of the bottom-up initiatives, and it facilitated the development of many new social enterprises, but it did not have a specific focus. Differently, the Social Development Programme occurred as a way of experimenting with a new social enterprise model – and the role of third sector organisations more widely – in fighting social exclusion. The government used the

> Free School and Folk High School movements as a frame of reference for legitimizing the programme: 'People cannot understand that we do not have a more explicitly formulated goal with the Social Development Program. They really cannot understand that we just say: it is free. It is similar to the Danish free-school system, where public authorities give money to parents who then establish schools themselves. When…[speaking] about the Danish Social Development program abroad, people are often expressing astonishment that we dare doing it this way. That we believe so much in people that we almost dare to set up a cash box in the town square'.[135]

In contrast with public authorities encouraging the formation of new forms of social enterprises and harnessing them to combat social exclusion, the second societal development programme that ought to be mentioned built off this experience and involved a progression from the social

[131] Bengtsson and Hulgård (n 104) 71-73. See generally also eg L Hulgård, *Værdiforandring I velfærdsstaten: det sociale Udviklingsprogram (SUM) i weberiansk belysning* (Roskilde Universitet 1995).
[132] T J Hegland, *Fra de tusind blomster: til en målrettet udvikling* (Alfuff 1994) 9ff.
[133] Hulgård and Brisballe (n 59) 7.
[134] ibid.
[135] ibid 8. See generally also eg L Hulgård, *Værdiforandring I velfærdsstaten: et weberiansk perspektiv på sociale forsøgsprogrammer (*Sociologi 1997).

exclusion context to labour market activation. There is clearly an important interrelationship and complementarity between the decentralisation of the social welfare system to local and regional public bodies, the increased focus on involving third sector organisations in that decentralisation agenda and the implementation of the active labour market reforms. However, this second societal development programme has a more straightforward connection with the active labour market reforms themselves. This was, briefly, noted already in Chapter 2.

Hulgård and Brisballe, for example, argue that this second societal development programme influenced social enterprises' formation and activities through the 'welfare state transition towards the so-called "active line", which…contributed to strengthening the link between active labour policies and the social enterprise model'.[136] The 1993 active labour market policy reform and its successors were a collective 'breakthrough in Danish labour market policy, both in contents and due to the adoption of new management structures'.[137] The reforms were a transition from passive to active labour market policy, which was coordinated through local and regional public actors. The 1993 active labour market reform initiated a sequence of events that

> provided even more regional freedom and independent economic means that enabled the implementation of independent regional labour market strategies. A formerly rule-governed activation system was replaced by a more 'need-oriented' approach. Where certain types of activation measures, before the…[first] reform, were offered at specific points in the individual's unemployment period, diverse activation offers…[could] now be made at all points during unemployment according to the specific needs of the unemployed and of the labour market.[138]

The basic ingredient of this new form of labour activation was the

> elaboration of the personal 'action plan', which operates as a 'contract' between the unemployed and the AF (the employment service system). In order to encourage initiatives and increase motivation among the unemployed to upgrade their skills, the right to a new unemployment period through activation was removed. Where activation was formerly used as a means to earn a renewed right to unemployment compensation, the activation process now…[offered] only the possibility of education.[139]

[136] Hulgård and Brisballe (n 59) 8.
[137] ibid.
[138] ibid.
[139] ibid.

After a fixed amount of time in the unemployment compensation system, which progressively shrunk with each reform, the unemployed were then transferred to the municipal social system level, where payments were lower and more conditional. Besides 'making the system more flexible the aim of the reform[s] was to combat long-term unemployment, by giving the most vulnerable to long-term unemployment an activation offer very early in their period of unemployment'.[140]

Ultimately, whilst this is only a sketch, the main point is that these new forms of social enterprises offered work integration services for the unemployed. By 'work integration social enterprise', what we should think about is a business enterprise that trains, and absorbs into employment, persons that are, either potentially or as a matter of course, excluded from the labour market. Thus, work integration social enterprises' central objective is to assist poorly qualified unemployed people back into work, and into society more generally, through productive activities and socio-economic inclusion. How this fed into the labour activation reform architecture is that work integration social enterprises would organise work integration schemes that were then sold to public authorities. The work integration schemes coupled the work integration itself with the production of goods or services by the participants, and there was also a gradual supplementation of job training and (re)qualification education to achieve greater socio-economic integration into the labour market.[141]

These new forms of social enterprises offering work integration services for the unemployed became entrenched

> actors in the 'official' aim of changing passive systems into active ones, in both labour market policy and social policy. The employment service system (AF)…[was] one of the main actors of this shift…Each unemployed person became entitled to a 'personal plan' that…[formed] the basis of activation measures (education, job training, etc.). The plan is made in agreement with the public employment service. This new more active approach was combined with the following key changes: the limitation of the duration of unemployment benefits…the suppression of the possibility to retain unemployment insurance through participation in job training and…a tightening of the criteria for job availability, e.g. the widening of …[geographical] mobility.[142]

[140] ibid.
[141] See generally eg M Nyssens, 'European Work Integration Social Enterprises: Between Social Innovation and Isomorphism' in Defourny, Hulgård and Pestoff (n 49) 211.
[142] Hulgård and Brisballe (n 59) 9.

The entrenchment of these new forms of social enterprises within the official aim of changing a passive unemployment system to an active one – with rights and obligations imposed on those seeking social assistance – is important because it firmly established and demonstrated that non-public entities could be used within reform implementation.

(c) The Third Historical Phase

This carried over into the third historical phase, which we can roughly situate between the period of 2001 to the Danish social enterprise corporation's introduction in 2015. However, it is important to say that, within this third historical phase, a change of government occurred twice. First, in 2001 the Social Democratic-led coalition government lost the general election, and was replaced by a Liberal Party-led coalition government under Anders Fogh Rasmussen. Second, the Liberal Party-Led coalition government was unseated in 2011 by another Social Democratic-led coalition government, with Helle Thorning-Schmidt serving as prime minister. As a background matter associated with Fogh Rasmussen's premiership, the welfare society language gained even more ground. In the '2000s the temporality of the welfare state/welfare society…[increased]. This was partly a result of the success of the Liberal Party claiming issue-ownership…[over] welfare policies through the successful reframing of the welfare society as the new and up-to-date welfare state'.[143] But it was also a result of the paradigmatic policy shift towards labour market activation and workfare. For example, in a 2002 New Year's Speech, Fogh Rasmussen argued that the Twentieth Century saw the development of the Danish welfare state, but that the Twenty-First Century included new challenges that required the development of a modern welfare society.[144] Indeed, nearly a decade earlier, Fogh Rasmussen claimed that welfare provision ought not be solely the state's responsibility. On the contrary, citizens had to develop their own welfare and take personal accountability for their socio-economic situations.[145] Even though the Social Democrats played a central role in welfare state restructuring in the second historical phase, Fogh Rasmussen was able to develop a narrative in which the Social Democrats appeared backward-looking and out of touch. That is, the Social Democrats were made to look as though they were the party that wanted to bring a renewed commitment to the welfare society project to a halt.

[143] Petersen and Petersen (n 68) 183.
[144] A Fogh Rasmussen 'Nytårstale 1 januar 2002' <https://www.regeringen.dk/aktuelt/statsministerens-nytaarstale/anders-fogh-rasmussens-nytaarstale-1-januar-2002/>.
[145] See generally eg A Fogh Rasmussen, *Fra Socialstat til Minimalstat: En liberal strategi* (Samleren 1993).

Whilst these details are only of contextual concern, they are nevertheless important because of how and why the Liberal Party-led coalition government secured control. We can say that, generally, there was a high degree of consensus between the main political parties regarding labour activation in the 1990s. However, immigration became a hotly contested issue within the Danish polity. During the 2001 election cycle, Fogh Rasmussen had pledged to create a political contract with voters based on a platform with clear promises to tighten asylum and immigration rules. The Social Democratic-led coalition government, ultimately, lost the 2001 election because of voters' dissatisfaction with immigration policy. Fogh Rasmussen's above welfare society rhetoric is noteworthy since it drove, among other things, further active labour market policy reforms. Although these were, in the immediate sense, designed to target non-Western immigrants and curb what was perceived as welfare state tourism, to avoid potential criticisms from abroad, the government instituted blanket reforms that impacted both Danes as well as foreigners. Argued by Goul Andersen

> until 2010 the…government…continued a pro-welfare policy, albeit with stricter conditionality and sanctions for the unemployed, with a promise not to raise any taxes and with more use of vouchers for welfare services. However, the government imposed severe cuts in benefits for various target groups where non-Western immigrants constituted a majority, including much lower social assistance ('start help') for people arriving from non-EU countries and granted permission to stay after 1 July 2002.[146]

Whilst our main concern here is touching on the further active labour market policy reforms and how they relate to the Danish social enterprise corporation, we need to canvass some of the political dynamics in play at the time to get a complete picture.

In essence, 'working-class support for the Social Democratic party eroded. This left a political space for the re-politicisation of ethnic issues, which gained increased political salience in the late 1990s. This trend mainly benefited the anti-immigration party' – the *Dansk Folkeparti* (Danish People's Party), a nationalist and right-wing populist political party.[147] The Danish People's Party was formed in 1995 and 'promotes the notion of ethnico-pluralism as an

[146] J Goul Andersen, 'The Welfare State as a Victim of Neoliberal Economic Failure?' in S Ólafsson, M Daly, O Kangas and J Palme (eds), *Welfare and the Great Recession: A Comparative Study* (Oxford University Press 2019) 193-194.
[147] Daguerre (n 71) 93.

alternative to the old frame of biological racism'.[148] This doctrine, first laid down by the French New Right, 'legitimates the notion of ethnic separation and cultural differentialism'.[149] Accordingly, African immigrants, for example, 'belong to a culture which is radically different from that of Western Europe. As integration would lead to cultural extinction either for the host country or the immigrants themselves, it was best to stay "separate and equal" and to stop immigration'.[150]

The Danish People's Party 'became the natural ally of Liberal and Conservative forces, which could not govern without its support in Parliament. The…[Danish People's Party] criticised activation policies for being too expensive and supported universal and popular programmes such as healthcare, pension and family policies'.[151] Again, although the political consensus had been quite high with respect to labour market activation policies in the preceding years, labour activation took on a new hew as it came to be bundled together with socio-cultural controversies related to the Danish People's Party anti-immigration stance.

The Danish People's Party caricatured immigrants as a danger to homogeneity and the Danish cultural way of life. This anti-immigration discourse relied

> heavily on welfare chauvinism: essentially, social programmes should benefit Danes rather than foreigners. The idea, according to which foreign women kept having children at the expense of the social assistance system, echoed the declarations of President Ronald Reagan against 'welfare queens' in 1986. In particular, asylum-seekers were presented as a heavy drain on scarce public resources. But what contributed to the increasing hegemony of welfare chauvinism is the fact that established parties followed suit. The Liberal Party campaigned against immigration in 1998 and the Social Democrats became increasingly divided over the issue.[152]

In 2001, Fogh Rasmussen 'pledged to crack down on foreigners trying to cheat the system. Denmark must not be the social security office for the rest of the world'.[153] It is in this context that the Liberal Party-led coalition government struck a sort of 'confidence and supply'

[148] ibid. See also eg J Rydgren, 'Explaining the Emergence of Radical Right-Wing Populist Parties: The Case of Denmark' (2004) 27(3) *Wester European Politics* 474, 478.
[149] Daguerre (n 71) 93.
[150] ibid 93-94.
[151] ibid 94.
[152] ibid. See also eg Rydgren (n 148) 492.
[153] J F Handler, *Social Citizenship and Workfare in the United States and Western Europe: The Paradox of Inclusion* (Cambridge University Press 2004) 169.

agreement with the Danish People's Party, which led to the above-mentioned election promises to tighten asylum and immigration rules.

In this way, the defeat of the Social Democrats and the victory of the Liberal Party-led coalition 'led to a return to conflict politics. The new government had a clear neo-liberal agenda', but its room to manoeuvre was constrained and guided by 'the welfare chauvinist platform of its main supporter in Parliament', the Danish People's Party.[154]

When the Danish People's Party provided political support to the Liberal Party-led coalition government from 2001

> xenophobia entered the mainstream political arena. As part of its electoral commitment to tighten immigration and asylum policies, the new government promised to dramatically reduce the amount of social assistance for foreigners. In order to avoid potential criticisms from international organisations, the government targeted Danes as well as foreigners and proposed that 'only persons who have resided in Denmark for at least seven out of the preceding eight years are entitled to cash benefits'. The basic idea behind the proposal was that the level of benefits was so generous that immigrants and asylum-seekers came to Denmark for welfare tourism purposes.[155]

The idea – that too many immigrants lived on benefits and that the levels of social assistance were too attractive to so-called 'Third World' immigrants – had also 'gained prominence within the Social Democratic Party'.[156] For example, in 2002 a Social Democratic Party think tank, *Tænketanken om Udfordringer for Integrationsindsatsen i Danmark* (Think Tank on Challenges for Integration Efforts in Demark), published a report arguing that immigrants were a welfare burden. The argument ran that increased immigration would create a further net burden on the welfare state, due to the lower labour market participation of immigrants relative to their Danish counterparts.[157] The cross-party consolidation of the view that immigrants had a poorer work ethic, therefore, legitimised the proposals, which we shall consider below, to lower the levels of social assistance.

[154] Daguerre (n 71) 95.
[155] ibid. See also eg Regeringen, *En ny udlændingepolitik* (2002) 7.
[156] Daguerre (n 71) 95.
[157] Tænketanken om Udfordringer for Integrationsindsatsen, *Indvandring, integration og samfundsøkonomi* (2002) 8.

Allied to this, another issue was that an influx of immigrants clashed with traditional Danish family values, as well as the cultural emphasis on gender equality and communitarian work ethic. According to an interview conducted by Daguerre with a former senior civil servant

> the debate focused on the degree of persuasion and/or coercion which could be used to oblige immigrants to earn their benefits: 'There has been a debate going on…concerning immigrant women whose husbands prefer them to stay home. They do not show up to activation classes. The government takes the view that if they are not available for the labour market, you can remove their benefits. It is right to remove the benefit because if you did not do that, you would implicitly agree that a man can decide whether the woman works or not'.[158]

Similarly, in 2003, a government minister in charge of refugee and immigrant integration, Bertel Haarder, contended that native Danes were attuned to a more progressive form of social control. They worked to uphold familial and community bonds, and to provide a good example for their children. Immigrants, in Haarder's view, however, did not have the same social conventions. They existed in a sub-culture outside the Danish 'tribe', which led to the perception that they were quick to gain social benefits without making any effort to offset some of the costs of maintaining the system's structural integrity.[159]

Thus, the proposal to lower social assistance was underpinned by a political motivation to restrict and deter opportunistic immigration and asylum-seeking. The intention was to

> send a signal to immigrants in order to deter them from going to Denmark. The Minister of Employment, Claus Hjort Frederiksen (Liberal), was in charge of the reform process together with the Ministry for Integration and the Ministry of Justice. An Intergovernmental Group composed of representatives from these three departments was set up to formulate feasible reform proposals. Civil servants had very little room for manoeuvre…[a]s the government had promised to implement concrete changes within 100 days of its nomination…The Interdepartmental Group defined the amount of the new benefit, Start Help, on the basis of the educational allowance for young people. The rationale was that the amount of cash necessary for young people in education or training should suffice for single adults. The legislation introduced a new benefit, Start Help, for immigrants and refugees during their first seven years in Denmark. Danes who lived out of the country for seven of the previous eight years were also affected by the reform.[160]

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[158] Daguerre (n 71) 96.
[159] H Stenum, 'Denmark' in J Niessen, Y Schibel and C Thompson (eds), *Current Immigration Debates in Europe: A Publication of the European Migration Dialogue* (Migration Policy Group 2005) 21.
[160] Daguerre (n 71) 96.

To reiterate, the inclusion of Danes in the reform was a 'technical device used by lawyers to render the new policy acceptable by international law standards. However, there was no doubt that asylum-seekers were the primary targets of the reform'.[161]

The legislative proposal was given legal effect by the Danish Parliament in July 2002. The introductory benefit, or Start Help, was, depending on the person, about 45-55 per cent lower than the typical social assistance amount offered in normal circumstances. The discriminatory aspects of the 2002 reform did not escape the attention of the international community. The reform 'prompted several criticisms from international organisations such as the International Labour Organisation, the United Nations…and the Council of Europe'.[162] The Danish government contended that

> the reform contributed to the reduction in the numbers of asylum-seekers in 2003. The number of individual asylum-seekers declined by 24.3 per cent between 2002 and 2003, from 6086 applicants in 2002 to 4593 in 2003. While Denmark experienced a decline in numbers, Norway, Sweden and Switzerland received large numbers of asylum seekers in 2003. The government claimed that the declining numbers of asylum-seekers was primarily the result of the clear signal that had been sent to economic migrants and others that abused the asylum system. Part of this signal was the introduction of Start Help in 2002. This alongside restricted access to family reunification and political rhetoric was considered to be the likely reason for an overall decline. In this respect, there is little doubt that the reform managed to send a signal to migrants.[163]

Coupled with the welfare chauvinist reform, the government also made additional workfarist adjustments that reinforced it. Hjort Frederiksen, for example, announced that he would fight against bureaucracy wherever it was an impediment to the realisation of flexible solutions in the labour market. The first step

> in this direction was to bring together active labour market policy and the cash benefit system into a single department, the Ministry of Employment. Until 2001 there was an institutional separation between the two functions, that is between the Ministry of Social Affairs and between the Ministry of Labour. This administrative reform expressed the intention of making the benefits system part of the labour market strategy. It also enabled the unifying of the treatment of job seekers irrespective of their status.[164]

[161] ibid 97.
[162] Daguerre (n 71) 97-98.
[163] ibid 98. See also eg European Council on Refugees and Exiles, *Country Report: Denmark* (2003) 38.
[164] Daguerre (n 71) 98.

This move represented a more aggressive pursuit of neo-liberal strategy and rhetoric with respect to the unemployed (and immigrants) that we do not find in the previous Social Democratic-led coalition government. In particular, the present government believed that there was a relationship between what were regarded as high benefit levels and a large volume of voluntary unemployment. For example, in his October 2002 address to Parliament, Fogh Rasmussen stated that one in every four people of working ability was not employed, which he saw as a disheartening statistic. He argued that passive benefits had to be revamped in order to get more people into the labour market. There was a direct reference to immigrants in Fogh Rasmussen's remarks. He suggested that far too many immigrants were living, passively, through the collection of welfare benefits, and that, if immigrants achieved the same level of employment as the native population, 50,000-60,000 jobs would be created. Therefore, he concluded that any barrier to correcting this situation ought to be removed.[165]

Granted, social assistance benefits were not as difficult to retrench, relative to unemployment benefit levels, because three quarters of dependents on social assistance benefits at the time were immigrants or second-generation Danes and popular-political opinion had swung in favour of retrenching the former. However, in the Spring of 2002, the Ministry of Employment had initialised a new debate paper – *Flere i Arbejde* (More People at Work).[166] Over the summer of 2002, negotiations were held with the social partners, and, in October 2002, another labour market reform was accepted in Parliament with agreement secured from the main political parties.[167] The *Lov om en aktiv beskæftigelsesindsats* (Active Employment Efforts Act) came into force in 2003.[168]

When the law came into force, the difference of treatment between people covered by social insurance and people falling under social assistance was eliminated.[169] All unemployed individuals were, thus, to be covered by a single regulatory framework. Whilst the social partners were, generally, comfortable with this change, they took exception to the lowering of social assistance. In their view, the lowering of social assistance suggested a strong

[165] A Fogh Rasmussen, *Tale ved Folketingets åbning*, 1. Oktober 2002 <https://danmarkshistorien.dk/leksikon-og-kilder/vis/materiale/anders-fogh-rasmussens-v-tale-ved-folketingets-aabning-2002/>.
[166] See generally Regeringen, *Flere i arbejde: Et debatoplæg* (March 2002).
[167]Beskæftigelsesministeriet, *Aftale om 'Flere i arbejde*' (October 2002) <https://bm.dk/media/6562/forlig_endelig_aftaletekst.pdf>.
[168] Lov nr 419 af 10/06/2003, Lov om en aktiv beskæftigelsesindsats.
[169] For a useful discussion of this administrative merger see generally eg P M Christiansen and M B Klitgaard, 'Institutionel Kontrol med Arbejdsmarkedsforvaltningen' (2008) 10 *Tidsskrift for Arbejdsliv* 24.

governmental position being taken in which it was assumed that recipients of social assistance were voluntarily remaining unemployed and abusing the Danish welfare system. The

> principle aim of the reform was not to enable people in low-paid jobs to earn more money, but to ensure that welfare recipients received less and therefore would take a job much more quickly. The implementation of a lower ceiling was the expression of a negative activation policy centred on sticks rather than carrots. As a senior official explained: 'It is quite simple: lower benefits equals more people into jobs. We expected these new rules to press people to find a job. If this is not the case I must go back to the University and get a new degree in economics.[170]

When we look to the substance of the More People at Work policy that was sewn into the Active Employment Efforts Act, it is clear that it was designed to complement the Start Help immigration scheme. For example, all unemployed people were to be activated within six months, which was a six-month reduction in duration compared to the last major labour activation reform in 1999. Similarly, there was a new duty to take an appropriate job from the first day an individual was receiving either social assistance or unemployment benefits. There were also harsher controls installed, with more intensive oversight contact requirements between an individual and the employment service system during the activation period, notably so-called *ressourceforløb* (work test sessions) where the specific job centre would assess work capacity. Additionally, with respect to families where both spouses received social assistance, the level of public support lowered after six months.[171] Ultimately, the government augmented the workfarist components of the previous labour activation reforms that were implemented by the Social Democrats in the 1990s. It 'considerably strengthened the work availability criteria and…reinforced financial incentives to take up a job as part of a make-work-pay strategy'.[172]

Below we shall fast-forward to the 2007-2008 economic and financial crisis to discuss the adoption of additional structural reforms to the unemployment insurance system that connect with the labour activation policies of the 1990s. Importantly, the Liberal Party-led coalition government 'used the burning platform of the crisis to adopt' the pertinent reforms, but they had 'been prepared before the crisis, all aiming at increasing labour supply'.[173] Therefore, it is worth taking a moment to consider what had happened beforehand.

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[170] Daguerre (n 71) 99.
[171] Goul Andersen and Pedersen (n 101) 19.
[172] Daguerre (n 71) 99.
[173] Goul Andersen (n 146) 202.

The purpose of the Active Employment Efforts Act was to increase employment by about 50,000 to 60,000 before 2010. To realise this vision, the government laid down key goals in a 2005 policy platform – *Nye Mål* (New Goals).[174] The key goals related to, for example, placing up to 25,000 more refugees, immigrants and their descendants into jobs by 2010, lowering the average age of youths finishing education by one year and getting more disabled and elderly people into the labour market.

With respect to youths finishing education earlier, for example, what was clear is that the government was attempting to hasten the

> phasing out of the Human Capital approach…Young people are now encouraged to finish education quickly so that they can be available for paid work sooner. This represents a clear departure from the Human Capital approach. Of course, social inclusion remains at the heart of activation policies but the overall rationale of the reforms is to reduce welfare dependency by increasing the number of people in the labour market.[175]

It was obvious that the Liberal Party-led coalition government was intent on reducing access to, and the amount of, unemployment benefits. In the spring of 2003 the government

> drew up ambitious plans for changes in the rules of unemployment benefits. In particular, the plan stipulated that a person should have to be unemployed for two days a week in order to qualify for supplementary unemployment benefits compared with the current one day. It was also proposed that temporary agency and casual workers should no longer be entitled to supplementary unemployment benefits on a permanent basis.[176]

Both the social partners and the opposition parties strongly combatted the proposal. The 'government proposal was widely seen as a clear breach of the promise [not to tamper with unemployment benefits and conditionalities] as the coalition had pledged not to reduce unemployment benefits. In November 2003, the opposition grew so strong that the government withdrew the proposal'.[177]

[174] Regeringsgrundlag, *Nye mål* (2005) <https://www.b.dk/upload/webred/pdf/nyemaal.pdf>.
[175] Daguerre (n 71) 100.
[176] ibid. See generally also eg Beskæftigelsesministeriet, *Sektoranalyse til Strukturkommissionen* (March 2003).
[177] Daguerre (n 71) 100.

However, in the autumn of 2003, the government set up a special *Velfærdskommissionen* (Welfare Commission), its purpose being to analyse the future challenges of the Danish welfare system, and, through its proceedings, instigate a comprehensive public debate. The Welfare Commission was made up of

> independent experts from universities and private firms…The Commission released its main report on 7 December 2005. According to the Commission, the Danish economy…[faced] three challenges: first an increasing ageing of the population combined with a decreasing workforce. Second, an increasing level of wealth that…[induced] households to choose leisure instead of work…[that] created an excessive demand for public services. Third, a process of globalisation that…[necessitated] investment in knowledge, industrial development and infrastructure. The Commission…[focused] on how economic changes and policy affects the behaviour of individuals. Agents are assumed to behave in a rational fashion. The…model…[was] thus firmly rooted in a utilitarian economic paradigm, which…[spoke] volumes about the political assumptions and preferences of the Welfare Commission itself.[178]

The political assumptions and preferences of the Welfare Commission were, arguably, all neoliberal in their approach. The main

> priority of the current government…[was] to increase labour supply, since…at least half a million Danes of working age…[were thought to be] dependent on social benefits such as unemployment, social assistance and sick leave. Ideally, receipt of such benefits is temporary, but for a large minority of individuals welfare dependency…allegedly…[became] a permanent way of life because of…weak attachment to the labour market. The problem…[was assumed] particularly severe among the low skilled and immigrants, as the rate of labour market participation…[was] only about 50 per cent as compared to 77 per cent for non-immigrants. Clearly, the Commission….[saw]…immigrants as a net welfare burden, which in turn….[threatened] the sustainability of the Danish welfare state. It…[was] thus crucial that immigrants, young people and the low skilled should enter the labour market as quickly as possible.[179]

With regard to the actual policy recommendations, the Welfare Commission suggested higher barriers for gaining access to unemployment insurance, as well as a shortening of the duration of unemployment benefits to 2.5 years, which, if passed into law, would have meant a 1.5-year

[178] ibid. See also eg A N Gjerding, 'The Danish Welfare Commission: Main Assumptions and Overall Proposals' Aalborg University Working Paper (2006) 1, 2. See generally also eg Velfærdskommissionen, *Fremtidens velfærd og globaliseringen* (2005); Velfærdskommissionen, *Fremtidens velfærd – sådan gør andre lande* (2005); Velfærdskommissionen, *Demografi, velstandsdilemma og makrøkonomiske strategier* (2005); Velfærdskommissionen, *Fremtidens velfærd – vores valg* (2005).
[179] Daguerre (n 71) 101. See also eg Gjerding (n 178) 9.

reduction, relative to the last labour activation reform in 1999. The Welfare Commission also urged for the introduction of more stringent economic sanctions for failure to cooperate with the public employment service. Likewise, the Welfare Commission thought that the economic difference between unemployment benefits and low-paid jobs ought to be widened so that low-skilled workers would have greater incentives to take up a job more quickly. Regarding young unemployed adults from 18-30 years of age, the Welfare Commission also considered that they should see their social benefits decrease to nudge them to engage in active job seeking. The focus here on searching for a job rather than improving educational qualifications was aligned with the 'Work First' approach of the government. As a final example, the Welfare Commission argued that a range of social benefits could be excised, and those remaining targeted at the most destitute.[180] On the whole, the Welfare Commission's recommendations implied a new chapter in welfare state restructuring, in a neoliberal direction, further away from the original Danish universalistic model.

The Welfare Commission's recommendations were, unsurprisingly, met with 'great criticism from the opposition parties and the labour movement. Even the government…[seemed] to have been taken aback by the scope of the proposals. As the Prime Minister had repeatedly promised that he would not implement radical changes should the Social Democrats and the trade unions oppose policy change, the government' seemed like it would adopt a more moderate stance if it decided to legislate at all.[181] This is not what happened. The government's reform proposals, presented in April 2006, had been

> greatly influenced by the Commission's conclusions and recommendations. For a person below 30 years without a professional education, unemployment benefits…[would] be cut to half after six months, while a person receiving social assistance…[would] have only two-thirds of the adult rate. Benefit eligibility…[was to] be conditional on accepting education offers and on not dropping out without acceptable reason. Moreover, municipalities…[were not to] have passive benefit spending reimbursed by central government for those below 30 who…[had] received social assistance for more than three years.[182]

Due to large public protests in the spring of 2006, the government was obliged to retreat from the welfare reform proposals. However, to reiterate, the 2007-2008 crisis made the return to a

[180] Gjerding (n 178) 14.
[181] Daguerre (n 71) 102.
[182] ibid 102.

welfare retrenchment agenda politically palatable, which 'legitimize[d] the path-breaking welfare reforms of the government'.[183]

The nature and severity of the 2007-2008 crisis had a number of implications for the Danish financial sector, the real economy and the social welfare system that are beyond the boundaries of this Chapter. What we are particularly interested in is how the government responded in the area of unemployment insurance.

Importantly, the 2007-2008 crisis did not cause the unemployment rate to skyrocket in Denmark. Rather, gross unemployment increased from about 2.6 per cent in 2008 to 6.1 per cent in 2010. The

> immediate increase in unemployment was much lower than the decline in employment. In the first place, the working-age population declined; secondly, many students and pupils gave up trying to find a part-time job; this group used to have exceptionally high employment rates in Denmark, but served as a 'reserve army' during the crisis. A total of 180,100 jobs were lost from 2008 to 2012 but unemployment only increased by 88,100 persons according to official figures and by 117,250 according to the EU definition, including those who were not eligible for unemployment benefits/social assistance (or had become ineligible).[184]

If we consider the financial hardship profiles for Denmark, the highest levels of financial hardship were experienced by low-income individuals and single-parent families. Both groups suffered increased hardship during the latter part of the 2007-2008 crisis, and this situation improved only slightly by 2015. Immigrants followed behind low-income individuals and single-parent families with respect to their financial hardship level, but the increase in hardship level was less than the other two groups. Households with children under 18 years of age and disability pensioners also experienced a sharp jump in hardship levels, as did people with low educational attainment. The figures are important because these groups progressively depended more upon social assistance, which was compounded by more people receiving unemployment benefits.

[183] Goul Andersen (n 146) 194.
[184] ibid 199.

Until 2010, the government responded by prioritising public consumption to 'keep the wheels turning'.[185] The government also allowed citizens to dip into their mandatory pension savings via a specific tax rebate. To stimulate aggregate demand, the government also implemented wider tax reliefs in 2009. But the government's approach radically altered by 2010, which triggered an austerity strategy from May 2010 onwards. The government was 'convinced that recovery was under way and decided to halt and reverse the economic stimulus…This led to immediate cuts in public consumption; in five out of six subsequent quarters the quarterly growth rate was negative…From that time on, much political rhetoric was borrowed from the crisis of the 1980s'.[186] Although I considered the supposed structural unemployment crisis of the 1980s, there were other causes for concern that now deserve our attention. Namely, in the 1980s 'Denmark suffered from too high a level of private consumption, permanent budget deficits and current account deficits, and escalating state and foreign debt'.[187]

This matters because the government employed the same kind of rhetoric that was prevalent in the 1980s, and used the 2007-2008 crisis as a focusing event through which it became possible to adopt the kinds of structural reforms that had been tabled earlier, mainly aimed at increasing labour supply. As we shall contemplate below, this holds true also for the Social Democratic-led coalition government that took office in 2011.[188]

The first reform we ought to address is the reform of unemployment benefits in May 2010. The duration of unemployment benefits was cut from 4 to 2 years. This reform, generally, mirrored the earlier Welfare Commission's proposal to shorten the duration of unemployment benefits to 2.5 years. Relative to the last labour activation reform of 1999, the 2010 reform cut the duration of unemployment benefits in half, and doubled the amount of time an individual had to work in order to qualify for the benefit from 26 to 52 weeks.

The Social Democrats and the *Socialistisk Folkeparti* (Socialist People's Party) criticised the reform. However, there were some Social Democrats who thought that it did not go far enough.

[185] ibid 201.
[186] ibid 201-202.
[187] ibid 202.
[188] This is outside the scope of this Chapter, but the Social Liberal Party made its participation in the Social Democratic-led coalition government of 2011 conditional on maintaining the strategy of the outgoing government. The then leader of the Social Liberals, Margrethe Vestager, famously stated that, if more people fell to the wayside because of further reductions to the social protection system, 'this is just how it is'. See eg M Z Teglskov, 'Vestager står bag årets citat: Sådan er det jo' *Politiken* (11 December 2012) <https://politiken.dk/debat/art5423509/Vestager-står-bag-årets-citat-Sådan-er-det-jo>.

For example, Mette Frederiksen, a spokesperson for the party, argued that passive cash benefits had to be completely removed, and that welfare recipients ought to be inserted into social enterprises offering work integration schemes.[189] Indeed, in the 2011 election campaign, the Social Democrats

> accepted…[the May 2010 unemployment benefits reform] as the price of government power. Unemployment protection had been cut before but not during a recession. According to…[the] government, dropout from unemployment benefits to social assistance (or not support at all) would be small. It turned out it was 10-20 times higher than expected. This forced the government to postpone implementation by one year. As the problem continued, various temporary benefits on a social assistance level were invented to prevent people from losing rights to benefits altogether…After the 2015 election the Social Democrats, the Liberals [who regained governmental control in June 2015]…and the Danish People's Party were keen to close the issue by a compromise that offered somewhat better opportunities for requalification through temporary and part-time jobs. This closed the case politically and in the media…[but a] full assessment of the impact is currently lacking.[190]

The second regulatory intervention worth noting is the flexible job reform of 2012 that linked to disability pension. With the 2012 reform we can, again, see a political opening for reaffirming the welfare utility of the new forms of social enterprises offering work integration services for the unemployed. Whilst we have not substantively touched on disability reform in our discussion of Danish welfare state restructuring as yet the

> criteria for disability pension…[had] been tightened on several occasions since the 1980s when pensions were sometimes granted on the basis of 'social' criteria; municipalities had perverse incentives as pensions were financed by the state – unlike social assistance. The next 20 years witnessed a series of reforms to change incentive structures and tighten eligibility criteria. Most importantly, a reform in 2003 installed the principle of ability to work (*arbejdsevne pricippet)* instead of lost ability to work (*tab af erhversevne*). Focus was shifted towards the remaining resources of the individual who could be employed in an 'inclusive' labour market. As an alternative for people with reduced work capacity, so-called flexible jobs had been introduced in the 'active social policy' reform of 1999 in order to make labour markets more inclusive. The scheme initially subsidized employers and enabled them to employ flexijob workers on ordinary conditions, in principle with the same income as ordinary employees. While the scheme contributed to a reduction

[189] M Gerlach, 'Gør op med passiv for-sørgelse' *Politik* (6 April 2010) <https://www.dr.dk/nyheder/politik/s-goer-op-med-passiv-forsoergelse>.
[190] Goul Andersen (n 146) 203. See generally also eg J Goul Andersen, 'Medborgerskab under pres' in J Guldager and M Skytte (eds), *Socialt Arbejde: Teorier og perspektiver (*2nd edn, Akademisk Forlag 2017) 88.

> of disability pension grants, it was expensive and there was suspicion of abuse. Changes had been under way for years but the crisis became a vehicle for reform.[191]

In June 2012, the Social Democratic-led coalition government, with the agreement of the other major parties, reformed disability pension and flexible jobs, which was an effort to activate and integrate people with reduced capacity into sheltered labour markets – the domain of the new forms of social enterprises offering work integration services for the unemployed. Subsidies for flexible jobs became a 'subsidy for the employee, albeit with a low ceiling. This made the scheme attractive to people with low incomes. Disability pension claimants became subject to work test sessions…where the job centre would assess their work capacity. The new scheme…[was thought to improve] opportunities for those who have some capacity and want to find a job within their capabilities'.[192]

The final legislative change of import is the social assistance reform of 2013. Unemployed people 'above 30 years of age and people below 30 with a completed education were subjected to a requirement to work in return for social assistance after three months – having a benefit job (*nyttejob*)' in municipal activity, which, similar to the above, was a familiar area in which public bodies contracted with the new forms of social enterprises offering work integration services for the unemployed.[193] This was 'aimed at those ready for a job in order to motivate them, positively or negatively, to find work…More generally, incentives to enrol…were strengthened and control and sanctions were intensified. The reform took a step away from emphasis on social rights towards paternalistic help and control'.[194]

Whilst there were other reforms – for example, in the areas of tax and limiting public consumption – the point is that successive governments 'followed practices from the 1980s' and 'used the crisis as a vehicle for implementing structural reforms that were planned before the crisis and aimed at increasing labour supply'.[195] Goul Andersen argues that this marked

> a huge change. Up to about 2000 Denmark used to have a very generous social protection system aimed at securing full citizenship for everybody regardless of employment and health status. Denmark probably held a world record for avoiding social marginalization…Although rules were

[191] Goul Andersen (n 146) 204.
[192] ibid 205.
[193] ibid 206.
[194] ibid.
[195] ibid 208.

> tightened in the 1990s…From 2002 conditions were gradually tightened for immigrants and poverty increased. But structural reforms aimed at increasing labour supply were radicalized by the crisis…Welfare for the poor has become increasingly weak, a development accompanied by a negative political rhetoric. Even though reforms to some extent succeeded in bringing people back to work, a corollary is the formation of an underclass of 'underserving poor' – initially mostly an ethnic underclass, but increasingly extended to include people of Danish origin. In this sense one could say that some of the most vulnerable people are kicked out of the welfare system.[196]

Consequently, there was, again, a clear shift towards workfare, at both the level of policy discourse and policy outcomes, in which the emphasis was on the duty to activate, rather than a right to activation, and stronger work requirements and sanction regimes. Like the previous Liberal Party-led coalition government, the Social Democratic-led coalition government did not shy away from arguing for a strong focus on duties instead of rights. For example, a Social Democratic minister, Karen Hækkerup, argued in favour of a welfare society supporting initiative, independence and energy; a welfare society in which people became active citizens, not passive recipients of welfare benefits. Hækkerup contended that people had to contribute and assume personal responsibility for both themselves and others within the community. It was not the state's responsibility to care for the whole citizenry through taxation – civil society and third sector organisations also had a collectively pivotal role to play.[197]

When we turn to consider the tabling speech for the legislation introducing the Danish social enterprise corporation in 2014, the same language is visible. This signifies that the hypothesised connection between the social enterprise corporation and the Danish welfare state is something much more than 'simply a potentially unexplained correlation'.[198] Manu Sareen, a Social Liberal government minister, argued that a special vehicle for social enterprises was necessary because, consistent with previous governments' experience with work integration social enterprises in the midst of earlier welfare reforms, such firms had a unique potential for upgrading and including vulnerable people in the labour market and, therefore, contributing to socio-economic inclusion through non-governmental means.[199] As briefly noted in Chapter 2, the Danish social enterprise corporation was proposed because, despite the government's faith

[196] ibid 208-209.
[197] K Hækkerup, 'Prioritering skal sikre velfærden' *Jyllands-Posten* (15 March 2012).
[198] Skeel (n 21) 982.
[199] M Sareen, *Skriftlig fremsættelse: Forslag til lov om registrerede socialøkonomiske virksomheder* (26 February 2014) <https://www.ft.dk/samling/20131/lovforslag/l148/20131_l148_fremsaettelsestale.htm>.

in social enterprises, no national legislation had, by that point, existed that provided a clear legal framework and a common identity.

This not only made it harder to streamline procurement contracting and spinning off state responsibility to social enterprises, but the policy documentation shows that the government was also not satisfied with the size of the wider third sector at the time.[200] The government had a vision that the third sector would, in future, not just need to solve important societal challenges related to strengthening the employment competences of vulnerable groups, but a larger sub-set of cultural, environmental, health and social problems. Therefore, the third sector had to be scaled. Scaling in particular had been a problem for the Danish third sector because the organisational forms in historical and more recent usage – like the worker's cooperative, *produktionskollektiver* (production communes), a*rbejdsfællesskaber* (collective workshops) and *opholdssteder* (social residences)[201] – did not facilitate outside equity investor participation. This prevented the development of social investment markets and alternative capital opportunities that could ease public sector responsibility. A social enterprise corporation capable of taking outside equity investments was, therefore, recommended, as was the development of social investment markets.[202]

However, with the human condition being what it is, there was no guarantee that private ordering altruism could be counted upon to achieve that end. Naturally, the entire project would be in jeopardy if private capital could be siphoned out of the third sector at will. This political economy had an explicit impact upon the social enterprise corporation's organisational architecture and regulatory infrastructure. This account is nowhere to be found in the legal literature. It will be recalled that there is only one study that deals with the background to the introduction of legal rules for recognising social enterprises in Denmark.

Therein, Sørensen and Neville, very briefly, consider some of the drivers that increased the focus on social enterprises within the context of the 2007-2008 crisis, but they say nothing about the political economy that caused Danish social enterprise law to emerge and diverge from the rules that govern the traditional corporation.[203] This political economy is critical

[200] Udvalget for socialøkonomiske virksomheder (n 46) 6.
[201] Bengtsson and Hulgård (n 104) 73, 75-76.
[202] Udvalget for socialøkonomiske virksomheder (n 46) 43.
[203] Sørensen and Neville (n 41) 273.

because it ultimately explains why we observe a range of additional legal and institutional mechanisms in Danish social enterprise law that are not found within its traditional corporate law counterpart. For example, this is why the Danish social enterprise corporation features protective mechanisms like a cap on midstream profit distribution[204] to shareholders and a rule requiring capital forfeiture[205] at the end of a firm's lifecycle. The collective function of the above rules – as well as others that we will consider more in Chapter 4 – is to limit private ordering within the context of internal firm governance, especially with respect to taking financial decisions that could undermine the public interest. Once private actors commit their capital to a social enterprise corporation, it is, to a greater or lesser extent, committed to creating public benefit in perpetuity.

A closing thought is a statement Skeel made in relation to Bruner's original study. Although Skeel had 'nagging doubts'[206] about some of the details of the hypothesised relationship between shareholder orientation and welfare state structures in the selected jurisdictions, he nevertheless accepted that any 'future scholar who purports to provide an explanation of comparative corporate governance will need to consider how social welfare legislation may be shaping what he or she sees in the corporate governance of a particular country'.[207] This is because Skeel did not, in the end, believe that the connections Bruner identified 'are imaginary'.[208] I, likewise, do not take the view that the relational connections I have identified are fanciful. In addition to the evidence that we have already discussed, Danish social welfare policy academics have made the same types of connections between changes in the welfare state and the social enterprise corporation's introduction.

Christian Franklin Svensson, for example, argues that, among other things, the social enterprise corporation was introduced to help vulnerable citizens into the labour market. Svensson worries that the government idealises social enterprise corporations, which, in his estimation, can be characterised as the 'emperor's new clothes' in an agenda to both minimise the state's role in welfare provision and dismantle social democracy. Svensson notes that, whilst the official policy rhetoric is centred on a supposed lack of public resources and a perception that the state cannot meet welfare needs, underneath social enterprise corporations' development of welfare

[204] Danish Social Enterprise Law, §5(5)(d).
[205] ibid §10.
[206] Skeel (n 21) 983.
[207] ibid 994.
[208] ibid.

initiatives, the fact remains that they take advantage of speculative strategies and make use of current opportunities in a tension field between financial earnings and creating societal value in the public interest. Therefore, he posits that the public ought to be critical of social enterprise corporations, as they could lead to a further breakdown in the Danish welfare model that they themselves are both a part of and dependent upon.[209] Whilst I remain neutral with respect to what the social enterprise corporation could mean for the preservation of Danish social welfare values, Svensson's evaluation is ultimately another piece of compelling evidence indicating that there is indeed a 'crisp connection' between it and broader political economy developments in Denmark. We shall now move on to consider the UK case.

3.2 The UK

(a) The First Historical Phase

The first historical phase in the UK began with the election of a Conservative government in 1979. With the Conservative government of 1979 came the advance of the 'New Right' and a macro-level paradigm shift from Keynesian social democracy to neoliberalism.[210] These circumstances favoured legitimating 'New Public Management' discourses that 'stressed…market mechanisms to increase efficiency in service provision'.[211] In a word, taking stock of the foregoing state-centric welfare apparatus suggested that government stifled community action and crowded out innovative responses to societal needs. The overriding ideological assumption was that non-state actors and entities, situated in market settings, were better positioned to effectively allocate resources, respond locally and improve programme outcomes.[212] The Conservative government was, therefore, committed to departing from centralised public responsibility for social welfare policy to a 'welfare mix'[213] model in which government was not welfare state guarantor, but rather regulator and market maker, with

[209] C S Svensson, 'Socialøkonomiske virksomheder udfordrer velfærdsstaten' *Altinget* (23 October 2017) <https://www.altinget.dk/civilsamfund/artikel/phd-socialoekonomiske-virksomheder-er-ikke-en-mirakelkur>.
[210] P A Hall, 'Policy Paradigms, Social Learning, and the State: The Case of Economic Policymaking in Britain' (1993) 25 *Comparative Politics* 275, 283.
[211] J Defourny and M Nyssens, 'Conceptions of Social Enterprise and Social Entrepreneurship in Europe and the United States: Convergences and Divergences' (2010) 1 *Journal of Social Entrepreneurship* 32, 35.
[212] H Haugh and A M Peredo, 'Critical Narratives of the Origins of the Community Interest Company' in R Hull, J Gibbon, O Branzei and H Haugh (eds), *The Third Sector* (Emerald 2011) 12.
[213] M Taylor, 'Government, the Third Sector and the Contract Culture: The Experience So Far' in U Ascoli and C Ranci (eds), *Dilemmas of the Welfare Mix: The New Structure of Welfare in an Era of Privatization* (Kluwer 2002) 77ff.

provision open to 'public sector, third sector and for-profit sector providers compet[ing] in the market'.[214] By the 1980s, the 'writing was on the wall…with a wide range of legislation, privatizing services and introducing internal markets into others'.[215]

Within this paradigm shift, there was a rediscovery of the third sector by policymakers.[216] This is important, as, like our discussion of the Danish case, the third sector is the mechanism through which the social enterprise corporation is relationally bonded to the UK welfare state. Defined by the UK government, the third sector is a socio-economic construct existing between the public and private sectors comprising 'non-governmental organisations which are value-driven and which principally reinvest their surpluses to further social, environmental and cultural objectives'.[217] It includes 'voluntary organisations, charities and social enterprises, cooperatives and mutuals'.[218] As Rory Ridley-Duff and Mike Bull note, what unites third sector organisations is their 'ability to mobilise collective responses to social issues, engage moral and social reasoning to support business activities, and to generate surpluses that support social value creation'.[219]

Not unlike the Danish position before the 1930s, prior to 1910, third sector organisations were a vital private source of welfare provision.[220] However, thereafter, a 'golden age' of welfare system building took place in the UK, and the third sector was demoted to 'junior partner in the welfare firm'.[221] Since the 'third sector lost control to central government of key strategic components of the welfare system', it was, to a greater or lesser extent, forgotten.[222] From the 1960s onwards, though, there was public disillusionment with state-centric welfare in some quarters. New forms of mutual aid developed in response – including social enterprises – as welfare consumers self-organised for better goods and services.

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[214] Defourny and Nyssens (n 211) 35-36.
[215] M Taylor, 'The Welfare Mix in the United Kingdom' in A Evers and J-L Laville (eds), *The Third Sector in Europe* (Edward Elgar 2004) 133.
[216] The third sector is synonymous with the 'social economy', which is an alternative term preferred in some policy circles and by some commentators. See eg C Borzaga and E Tortia, 'Social Economy Organisations in the Theory of the Firm' in A Noya and E Clarence (eds), *The Social Economy: Building Inclusive Economies* (OECD 2007) 23ff. See also Chapter 6.
[217] National Audit Office, *Building the Capacity of the Third Sector* (2009) 5 <https://www.nao.org.uk/report/building-the-capacity-of-the-third-sector/>.
[218] ibid.
[219] R Ridley-Duff and M Bull, *Understanding Social Enterprise: Theory and Practice* (2nd edn, Sage 2016) 31.
[220] G Smith and S Teasdale, 'Associative Democracy and the Social Economy: Exploring the Regulatory Challenge' (2012) 41 *Economy and Society* 151, 158.
[221] D Owen, *English Philanthropy 1660-1960* (Harvard University Press 1964) 527ff.
[222] J Kendall, 'The UK: Ingredients in a Hyperactive Horizontal Policy Environment' in J Kendall (ed), *Handbook on Third Sector Policy in Europe: Multi-Level Processes and Organised Civil Society* (Edward Elgar 2009) 68.

As Marilyn Taylor, for example, argues

> parents set up pre-school provision for their children; people with chronic illnesses set up self-help groups; disabled people organized themselves to transform a medical model of dependency; black and ethnic minority organizations organized themselves to tackle entrenched racism and fight for their own services and facilities; and public housing tenants organized themselves against poor services and large-scale housing developments which they felt were destroying their communities.[223]

This was on display when the social democratic welfare consensus fully destabilised in 1979. The connection was made by a new generation of policymakers that a functional overlap existed as between the state's interest in transferring policy responsibility to non-state actors and entities and third sector organisations' tendency to generate bottom-up redistributive responses to welfare needs. Put differently, policy thinking started to centre on the notion that the third sector could be harnessed and steered towards operating as a partial surrogate for the state. Indeed, the Conservative government was at least moderately successful in adapting the third sector to function in this way. We can infer this because, in this period, the bulk of the financing for the third sector came from government contracting, which more than doubled from 1979 to 1987, and increased again in the early 1990s. Furthermore, much to the dismay of many third sector interest groups, there was an awareness that the state's ambition was to narrow the type of resources available to third sector organisations and herd them towards 'becom[ing] [welfare implementation] agents…with their goals and operating values distorted' in an agenda to 'roll back' the frontiers of state welfare.[224]

However, it is useful for what we will discuss below to say that the Conservative government did not necessarily prioritise the third sector or the private sector in overall policy terms. With respect to privatisation policies, for example, whilst third sector service-providing agencies were given a significant brief in the welfare mix – especially in the areas of social housing and social services – the clear intention was to transfer service delivery responsibility to both third sector and private sector organisations.[225]

[223] Taylor (n 215) 132.
[224] ibid 133. See also eg D Billis, 'From Welfare Bureaucracies to Welfare Hybrids' in D Billis (ed), *Hybrid Organizations and the Third Sector: Challenges for Practice, Theory and Policy* (Palgrave Macmillan 2010) 10.
[225] Taylor (n 215) 133.

(b) The Second Historical Phase

The policy stance changed in the second historical phase when the New Labour government came to power in 1997. In an effort to reduce the perception of marketisation and privatisation, New Labour attempted to distance itself from the previous government's faith in the private sector. New Labour promised to focus more on social democratic principles and greater social equality. Over the next decade, New Labour looked to the third sector and treated it as a governmental partner, which, according to many commentators, personified the 'Third Way'[226] pledge of combining social justice with market dynamism.[227]

However, underneath this façade was the goal of further rebalancing the welfare mix away from public provision through the third sector.[228] As liberalisation by stealth, this seemingly new approach did not depart from the previous government's idea that markets were the appropriate means through which economic and societal relations ought to be managed, and that a mixed economy was the preferred framework for delivering welfare goods and services.[229]

Social enterprises were at the heart of this policy architecture.[230] Social enterprises are distinguishable from other third sector organisations as they are thought to combine 'elements of…social purpose, market orientation, and the financial performance standards of [private sector businesses]'.[231] Importantly, when social enterprises initially surfaced in the UK they essentially only took an 'entrepreneurial non-profit' form that did not contemplate outside equity investor participation, which is something we will further consider.[232]

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[226] See generally A Giddens, *The Third Way: The Renewal of Social Democracy* (Polity Press 1998).
[227] P Alcock, 'From Partnership to the Big Society: The Third Sector Policy Regime in the UK' (2016) 7 *Nonprofit Policy Forum* 95, 100-105.
[228] E Carmel and J Harlock, 'Instituting the "Third Sector" as a Governable Terrain: Partnership, Procurement and Performance in the UK' (2008) 36 *Policy and Politics* 151, 161-163.
[229] M Harris, 'Third Sector Organizations in a Contradictory Policy Environment' in Billis (n 224) 31.
[230] For example, in 2001 a designated policy unit – the Social Enterprise Unit – was established within the then Department of Trade and Industry to provide coordination and support for social enterprises. By 2006, social enterprises had achieved such a high policy profile that it occasioned the institution of a new 'Office of the Third Sector' (later renamed the 'Office for Civil Society') within the Cabinet Office. See generally, Office of the Third Sector <https://webarchive.nationalarchives.gov.uk/20060715135306/http://www.cabinetoffice.gov.uk/thirdsector/>.
[231] G Galera and C Borzaga, 'Social Enterprise: An International Review of its Conceptual Evolution and Legal Implementation' (2009) 5 *Social Enterprise Journal* 210, 212.
[232] J Defourny and M Nyssens, 'Fundamentals for an International Typology of Social Enterprise Models' (2017) 28 *Voluntas* 2469, 2480-2481; R Spear 'United Kingdom: A Wide Range of Social Enterprises' in Borzaga and Defourny (n 104) 254ff. When the European Commission funded a project to define a set of criteria to identify organisations likely to be social enterprises in each of the countries forming the EU in the mid-1990s, social

Policy interest consolidated around social enterprises in New Labour's first period in office, with the publication of *Enterprise and Social Exclusion*. Curbing social exclusion was framed as the premier welfare policy priority. The argument was that, due to their perceived aptitude for producing goods and services in areas characterised by market failure,[233] social enterprises were particularly well suited to tackling area-based social exclusion and acting as a conduit through which the social democratic principles of greater equality and social justice might be achieved outwith direct state intervention.[234]

The social enterprise corporation launched in 2005. Again, if we were to accept the legal explanation put forward by Dunn and Riley that we canvassed in Chapter 2, the logic would be that the additional legal and institutional mechanisms exist to correct the supposed shortcomings in existing organisational forms then available to social enterprises to promote more trustworthiness.[235] However, the legal explanation ignores the welfare state politics surrounding the social enterprise corporation. In New Labour's second and third periods in office, the conception of the problem social enterprises might solve progressed from social exclusion to reforming public services, specifically health care.[236] Whilst New Labour had made several commitments to increase the number of social enterprises, there were serious questions regarding their organisational and fund-raising capacity to be efficient players in the public services marketplace and within the wide welfare reform agenda.[237]

It is submitted that these are the specific political circumstances that led to the social enterprise corporation. The social enterprise corporation is a novel 'hybrid' organisational unit that

enterprises only existed as 'not-for profit private organizations'. See, J Defourny and M Nyssens, 'Social Enterprise in Europe: Recent Trends and Developments' (2008) 4 *Social Enterprise Journal* 202, 204.

[233] S Teasdale, 'What's in a Name? Making Sense of Social Enterprise Discourses' (2012) 27 *Public Policy and Administration* 99, 103.

[234] HM Treasury, *Enterprise and Social Exclusion* (1999) 105 <https://webarchive.nationalarchives.gov.uk/20100407170806/http://www.hm-treasury.gov.uk/ent_ee_eses99.htm>. However, whilst this may, at first impression, have signified a greater commitment to social justice than the previous government, it was nonetheless an implicit recognition that 'most of Thatcher's/Major's economic and social policy legacy should be preserved'. See Nicholls and Teasdale (n 48) 333. See generally also H Haugh and M Kitson, 'The Third Way and the Third Sector: New Labour's Economic Policy and the Social Economy' (2007) 31 *Cambridge Journal of Economics* 973.

[235] Dunn and Riley (n 43) 647, 649.

[236] According to New Labour, there was a need to deliver public services in a different way, using the skills and expertise of users and frontline workers. It was assumed that social enterprises could contribute to this agenda by innovating new user-led public services models. See eg Office of the Third Sector, *Social Enterprise Action Plan: Scaling New Heights* (2006) 13 <https://webarchive.nationalarchives.gov.uk/20080728130947/http://www.cabinetoffice.gov.uk/third_sector/social_enterprise/action_plan.aspx>.

[237] See eg Department of Trade and Industry (n 47) 62.

deliberately combines features traditionally associated with the public, private and third sectors together.[238] Relative to the then existing organisational forms available to social enterprises, the most ground-breaking dimension of the social enterprise corporation is that it plainly contemplates outside equity investor participation and offers limited distribution of profit – corporate attributes then unknown to the third sector. Leading social enterprise commentators like Alex Nicholls and Simon Teasdale, thus, maintain that the impetus for the social enterprise corporation seems to have been that a hybrid vehicle contemplating outside equity investor participation 'could play a major role in reforming and innovating public services by taking private investment'.[239] This argument corroborates other studies highlighting that the social enterprise corporation was a political 'rebranding' of what social enterprise meant at the time, intended to improve firms' organisational and fund-raising capacity to navigate the competitive procurement landscape and innovate in service delivery in line with governmental expectations.[240]

To be sure, whilst we ought to be mindful that, like its Danish counterpart, the social enterprise corporation was only an additional organisational option that could be selected on a voluntary basis by those hoping to take part in the market for welfare service providers, in New Labour's final period in office it 'became the…form towards which other third sector organisations were encouraged to move'.[241] This was paired with regulatory adjustments that tethered funding mechanisms to the social enterprise corporation (rather than to other third sector organisational forms), for example the Social Enterprise Investment Fund and the Social Investment Wholesale Bank.[242] The more immediate strategy was to use the social enterprise corporation to attract and lock in private 'investment to capitalise and grow the social enterprise market'.[243]

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[238] J Battilana and M Lee, 'Advancing Research on Hybrid Organizing – Insights from the Study of Social Enterprises' (2014) 8 *Academy of Management Annals* 397, 400.
[239] Nicholls and Teasdale (n 48) 336.
[240] See eg J Defourny, 'From Third Sector to Social Enterprise: A European Research Trajectory' in Defourny, Hulgård and Pestoff (n 49) 25.
[241] Nicholls and Teasdale (n 48) 334.
[242] See generally eg Department of Health, *Social Enterprise Investment Fund* (2007) <https://webarchive.nationalarchives.gov.uk/20100407163940/http://www.dh.gov.uk/en/Managingyourorganisation/Socialenterprise/SocialEnterpriseInvestmentFund/index.htm>; Dormant Bank and Building Society Accounts Act 2008; Office of the Third Sector, *Social Investment Wholesale Bank: A Consultation on the Functions and Design* (2009) <https://web.archive.org/web/20090725193447/http://www.cabinetoffice.gov.uk/media/224319/13528%20social%20bank%20web%20bookmarked.pdf>. Note that the Social Investment Wholesale Bank was later renamed 'Big Society Capital'.
[243] Nicholls and Teasdale (n 48) 336. See generally also eg A Nicholls, 'The Institutionalization of Social Investment: The Interplay of Investment Logics and Investor Rationalities' (2010) 1 *Journal of Social Entrepreneurship* 70.

But a no less important aspect of this policy scheme was the intention to also make the 'third sector more sustainable along a social enterprise model' to aid in the wider welfare reform agenda.[244] As a complement to the legal explanation, this is also why we observe a range of additional legal and institutional mechanisms, which, collectively, make it and traditional corporate law different from each other. As with the Danish version, the social enterprise corporation's organisational architecture and regulatory infrastructure were calibrated to lexically prioritise private action for public benefit and lock in capital within the third sector.

Of course, a sceptic might still disagree with this analysis and prefer the legal explanation of the social enterprise corporation. The fatal problem for the legal explanation, however, is that it does not tell the whole story and account for the deeper policy dynamics in motion. Especially in New Labour's last half decade in power, the 'third sector…could be identified and delineated in [neoliberal] and political terms' that a 'range of agencies within the state…were jointly creating'.[245] Third sector organisations had little choice but to act 'essentially as a deliverer of public services through…market participation rather than developing in other directions'.[246] This matters for present purposes because the social enterprise corporation materialised from this political milieu, where the social enterprise concept was not merely tweaked but '[re]defined by the state' through the social enterpriser corporation.[247]

(c) The Third Historical Phase

Indeed, although there is not space to exhaustively probe it in this Chapter, we can view the election of the Coalition government in 2010 as the start of a third historical phase. Whilst this phase is subsequent to the social enterprise corporation's arrival, it registers more forceful bids by the government venturing to wield social enterprises as a policy tool. That this did not end with New Labour further signifies that the hypothesised connection between the social enterprise corporation and the UK welfare state is something much more than 'simply a potentially unexplained correlation'.[248]

[244] Nicholls and Teasdale (n 48) 334.
[245] J Kendall, 'Bringing Ideology Back In: The Erosion of Political Innocence in English Third Sector Policy' (2010) 15 *Journal of Political Ideologies* 241, 250. See also Carmel and Harlock (n 228) 156.
[246] Kendal (n 245) 250.
[247] Teasdale (n 233) 115. See also A Nicholls, 'The Legitimacy of Social Entrepreneurship: Reflexive Isomorphism in a Pre-Paradigmatic Field' (2010) 34 *Entrepreneurship Theory and Practice* 611, 623.
[248] Skeel (n 21) 982.

Following the 2007-2008 crisis, the Coalition government positioned the crisis as a consequence of high public spending in New Labour's 'Big State'.[249] This hurtled economic and welfare policy into a period of austerity in which the objective was a dramatic reduction in welfare spending to moderate public sector deficits.[250] Welfare reform and reining-in public spending were bundled together with the 'Big Society' programme, which claimed that social justice required a smaller state and a greater role for communities in solving their own problems.[251] In this context, the 'nanny state' was the issue, seen as preventing markets and society from correctly functioning.[252]

Whilst the Big Society programme was engineered to optimistically colour the Coalition government's focus on localised, non-state solutions to welfare and other social problems, it was in reality attempting to camouflage a 'substantial privatisation and a shift of responsibility from state to citizen' to a 'level of intervention below that in the United States'.[253] This involved a ceremonial preservation of New Labour's welfare mix model, but it was to be significantly restructured and reduced in size.[254]

Due to the Coalition government's agenda, there were clear normative differences with respect to what the third sector and social enterprise corporations symbolised. Rather than a partnership, the third sector and social enterprises became objects of policy. With social enterprise corporations in particular, the Coalition government placed an even greater emphasis on their supposed ability to act as vehicles for spinning off state responsibility for public services and contribute to deficit reduction by delivering 'more for less'.[255] Moreover, where there were instances in which New Labour was prepared to make grants available to third sector organisations, the Coalition government's approach fixated on strengthening civil society by

[249] See generally eg D Cameron, *Economy Speech* (2013) <https://www.gov.uk/government/speeches/economy-speech-delivered-by-david-cameron>.
[250] See generally eg L Mitton, 'The Financial Crisis as Game Changer for the UK Welfare State' in Schubert, de Villota and Kuhlmann (n 69) 743.
[251] Ridley-Duff and Bull (n 219) 38-42; Kendall (n 243) 253-256; Alcock (n 227) 105-110.
[252] See generally eg D Cameron, *Big Society Speech* (2011) <https://www.gov.uk/government/speeches/pms-speech-on-big-society>. See generally also R Macmillan, 'Decoupling the State and the Third Sector? The "Big Society" as Spontaneous Order' (2013) 4 *Voluntary Sector Review* 185.
[253] P Taylor-Gooby and G Stoker, 'The Coalition Programme: A New Vision for Britain or Politics as Usual?' (2011) 82 *The Political Quarterly* 4, 14.
[254] Nicholls and Teasdale (n 48) 333 (noting that the 'new administration set out a policy programme of public sector reform promising to: reduce the role of the state; broaden the mixed economy of welfare; and strengthen civil society such that it was capable of delivering solutions to social problems that could not be fixed by top-down government').
[255] ibid 335.

removing state subsidisation, which was perceived as producing dependency.[256] Government 'was willing to pay for social enterprises…to deliver public services, but they should not receive direct grants or subsidies. Instead social enterprises needed to operate more fully by market principles, be free from government interference, and seek more private funding'.[257] On those grounds, the Coalition government introduced social investment tax relief to incentivise outside equity investor participation in social enterprise corporations.[258]

3.3 Concluding Remarks

To summarise the discussion, because I detected certain key aspects of Danish and British social enterprise law that directly problematise the utility of relying on orthodox functionalism to rationalise the emergence and unique structure of the social enterprise corporation in both jurisdictions, this Chapter has been preoccupied with contributing an explanatory theory that is, generally, founded upon the Brunerian method, albeit with some important modifications.

The basic theory is that, whilst the Danish and British welfare states are different, the social enterprise corporation in both jurisdictions takes a similar form. That is, the political roads from which the social enterprise corporation emerged are not the same in both countries. The thread that ties them together, and engendered the adoption of a similar social enterprise corporate form, is jurisdictionally distinct, but thematically similar, political determinations regarding a neoliberal agenda of wanting to transfer some responsibility for the implementation and financing of social welfare policy from the state to other corners of society. Using the broader political economy developments as they relate to the third sector, and social enterprises in particular, as my independent, or explanatory, variable, this is where we can locate a relational link between the welfare state and the social enterprise corporation that shows not only why it emerged but also why it assumes a functionally parallel form in both countries.

[256] This direction of travel was enshrined in the Public Services (Social Value) Act 2012, which signalled an end to government subsidisation and the institution of a more level playing field upon which social enterprises would be expected to compete at arm's length for public contracts. See generally S Teasdale, P Alcock and G Smith, 'Legislating for the Big Society? The Case of the Public Services (Social Value) Bill' (2012) 32 *Public Money and Management* 201.
[257] Nicholls and Teasdale (n 48) 336-337.
[258] Social investment tax relief was given legal effect through the Finance Act 2014. See generally eg HM Treasury and Department of Business Innovation and Skills, *Consultation on Social Investment Tax Relief* (2013) <https://www.gov.uk/government/consultations/consultation-on-social-investment-tax-relief>.

Neoliberalism made its way into the political discourses in Denmark and the UK via different routes, and influenced welfare policy trajectory in jurisdictionally specific ways. In Denmark, at least not until the 2007-2008 crisis, there was not a macro-level paradigm shift from Keynesianism social democracy to neoliberalism. The Danish context is narrower and more specific in scope, in the sense that neoliberal ideas did not pervade social welfare policymaking across the board. Rather, due to what was perceived as a structural unemployment crisis in the late 1980s, it became an institutional truth that further demand-side policies aimed at lowering unemployment would only result in more (wage-driven) inflation. This was problematic because, like other Scandinavian welfare states, high levels of unemployment exert a great deal of pressure on the unemployment benefits system, the integrity of which is itself based upon high labour market participation. Thus, the thinking at the time was that the only efficient way to combat the structural unemployment crisis was to implement supply-side policies, in this case labour activation reforms, which became the functional equivalent to neoliberal solutions in the Danish context. Neoliberalism entered the UK political discourse in a different, more overt fashion. Whereas in Denmark neoliberalism linked, more closely, to active labour market policy, in the UK there was a macro-level paradigm shift from Keynesian social democracy to neoliberalism that affected the British welfare state as a whole. Indeed, the 1980s in the UK was marked by a wide range of legislation that privatised welfare goods and services and introduced internal markets on a much larger scale.

This is a noteworthy jurisdictional distinction because it interacted with the notion of the third sector, and social enterprises in particular, in specific ways. Both countries had pre-Second World War experiences in which third sector organisations played a role in social welfare protection, but, thereafter, the state gradually erected a central welfare apparatus in which the public sector became welfare state guarantor and private entities were, to a greater or less extent, pushed to the periphery. In Denmark, the political attitude softened from the 1980s onwards, and the Danish government implemented a number of policies signalling the revival of a space of action for third sector organisations within the welfare state context that had linkages to the public-private partnership that was prevalent until the 1930s. However, the partnership was not the same as the old one. There was a neoliberal undertone in the welfare society policy discourse that saw the third sector as a tool for rejuvenating civil society and reconstituting a new communitarian view in which citizens had to take an active role in solving socio-economic problems for themselves. As for social enterprises, new forms initially emerged and were harnessed to, broadly, combat social exclusion, but later there was a

progression from the social exclusion context to labour market activation. There were three major labour market activation reforms in the 1990s and, gradually, social enterprises offering work integration for the unemployed became entrenched actors in the governmental aim of changing a passive unemployment benefits system into an active one.

In the UK, after the social democratic welfare consensus fully destabilised in 1979, there was a sort of rediscovery of the third sector by a new generation of policymakers. Policy thinking started to centre on the idea that the third sector could be harnessed and steered towards operating as a partial surrogate for the state. In the 1980s and early 1990s, a large portion of third sector financing came from government contracting, and, in its ambition to roll back the frontiers of state welfare through, for example, privatisation, the Conservative government gave third sector service-providing agencies a significant brief, notably in the areas of social housing and social services. It was not until after the New Labour government came to power in 1997 that we can detect a policy interest in social enterprises specifically. But one did emerge, which placed social enterprises at the heart of New Labour's commitment to further rebalance welfare away from public provision through the third sector. What we can definitively say is similar about the Danish and British contexts is that social enterprises were, at least initially, brought to bear on curbing social exclusion in both jurisdictions. New Labour framed curbing social exclusion as the premier welfare policy priority; however, in New Labour's second and third periods in office, the conception of the problem social enterprises might solve progressed from social exclusion to reforming public services, specifically healthcare.

This is where our story re-orientates to its otherwise divergent path. In the early 2000s in Denmark, owing to the anti-immigration and anti-asylum position of the Danish People's Party, which eventually gained some cross-party legitimacy, the government implemented a welfare chauvinist reform that was coupled with, and reinforced by, an additional workfarist adjustment. The More People at Work policy that was sewn into the Active Employment Efforts Act was designed to complement the Start Help immigration scheme. Shortly thereafter, the Liberal-Party led coalition government again attempted to reduce access to, and the amount of, unemployment benefits, but the social partners and the opposition parties strongly combatted the reform proposal, which forced the government to withdraw. The later Welfare Commission then made further policy recommendations in relation to unemployment insurance, which the government attempted to bring forward for implementation in 2006.

Whilst the government was not successful in the spring of 2006, the 2007-2008 crisis made a return to a welfare retrenchment agenda politically palatable and legitimised a number of austerity measures designed to increase labour supply, one of which was the May 2010 unemployment benefits reform that cut the duration of unemployment benefits from 4 to 2 years. When the Social Democratic-led coalition government returned to office in 2011, they continued to emphasise strong workfarist requirements and sanctioning regimes. Importantly, there was also a reaffirmation of the welfare society rhetoric in which it was argued that people had to become active citizens, not passive recipients of welfare benefits. The contention was that people had to contribute and assume personal responsibility for both themselves and others within the community. It was not the state's responsibility to care for the whole citizenry through taxation – civil society and third sector organisations also had a collectively pivotal role to play.

In the tabling speech for the legislation introducing the Danish social enterprise corporation in 2014, the same language is visible, which signifies that the hypothesised connection between the social enterprise corporation and the Danish welfare state is not imaginary. The argument was that a special vehicle for social enterprises was necessary because, consistent with previous governments' experience with work integration social enterprises in the context of earlier welfare reforms, such firms had a special ability to upgrade and include vulnerable people in the labour market and, therefore, contribute to socio-economic inclusion through non-governmental pathways. The Danish social enterprise corporation was proposed because, despite the government's faith in social enterprises, no national legislation had, by that point, existed that provided a clear legal framework and common identity. This not only made it more difficult to streamline procurement contracting and spinning off state responsibility to social enterprises, but the policy documentation is clear that the government was not satisfied with the size of the wider third sector at the time. This conflicted with the government's vision that the third sector would, in future, not just need to solve important societal challenges related to strengthening labour supply, but a larger sub-set of cultural, environmental, health and social problems. Therefore, the third sector had to be scaled through a social enterprise corporation model. Scaling in particular had been a problem for the Danish third sector because the organisational forms in historical, and more recent, usage did not facilitate outside equity investor participation, which prevented the development of social investment markets and alternative capital opportunities that could ease public sector responsibility. A social enterprise corporation capable of taking outside equity investments was, therefore, recommended, as was

the development of social investment markets. This account is nowhere to be found in the legal literature. This political economy is critical because it ultimately explains why Danish social enterprise law emerged and why it diverges from the rules that govern the traditional corporation.

When the conception of the problem social enterprises might solve progressed from social exclusion to reforming public services in the UK, New Labour had made several commitments to increase the number of social enterprises, but there were serious questions regarding their organisational and fund-raising capacity to be efficient players in the public services marketplace and within the wide welfare reform agenda. At its most basic level, the social enterprise corporation was a regulatory intervention calculated to liberalise the third sector and nudge such organisations towards being more business-like and capable of navigating the competitive procurement landscape. Also, providing a bespoke corporate organisational unit for social enterprises capable of attracting outside equity investor participation was a potential avenue for policymakers to cultivate a social investment market and filter capital into the third sector. Therefore, like in Denmark, the UK social enterprise corporation's organisational architecture and regulatory infrastructure can be categorised as politically devised to ensure that, once committed, such private capital remained in the third sector to support its sustainability within the welfare reform agenda. Whilst not documented by the legal literature, this is why the social enterprise corporation emerged and why it includes additional legal and institutional mechanisms that make it and traditional corporate law conceptually and practically distinct from each other. As if this analysis were not convincing enough, when we consider the Coalition government's election in 2010, and its more forceful bids to wield social enterprises as a policy tool, the possibility that the hypothesised connection between the social enterprise corporation and the UK welfare state is merely a potentially unexplained correlation utterly dissipates. This is not least because the Coalition government introduced social investment tax relief to incentivise outside equity investor participation in social enterprise corporations, in an attempt to partially remove state subsidisation regarding their delivery of public services.

Again, we have been able to reach these conclusions through a modified application of the Brunerian method, which, on this occasion, allowed us to get at the deeper policy dynamics in motion that catalysed the social enterprise corporation in both jurisdictions. Having engaged in this exercise in political analytics and contributed a political rationale to the legal literature, we are now in a suitable place to analytically model the social enterprise corporation.

|4|

ANALYTICALLY MODELLING EUROPEAN SOCIAL ENTERPRISE LAW

In the preceding two Chapters, I put forward a politically-oriented theory to explain European social enterprise law. This was necessary because, within the social enterprise corporation, directors do not owe duties to the corporation for shareholders' private benefit, and shareholders have no special rank in the firm. As a default matter, these empirical findings do not square at all well with the orthodox functionalist account of the corporation. Orthodox functionalism designates the reduction of intra-firm agency costs as the central problem, and views the corporation as an institutional response to that problem. Therefore, there is no indication that the uniformity we see in European social enterprise law was driven by the usually assumed policy desire to moderate the scope for value-reducing forms of opportunism amongst different corporate constituencies. This prompted the formulation of an alternative theoretical rationale. Building off the work of Bruner, I was able to uncover credible evidence that, rather than conventional economic considerations, the drivers shaping social enterprise law and governance systems in Europe are political exigencies emanating from within the domestic welfare state. I tested this claim through a case study of political economy developments in Denmark and the UK, where there is a clear relational connection between welfare state politics and the social enterprise corporation in both jurisdictions.

Thus, in a nutshell, we can summarise the discussion so far as being concerned with mapping the political drivers that spurred the social enterprise corporation. The political processes that wrought the social enterprise corporation in Denmark and the UK feature a combination of active governmental and ideological forces attempting to harness social enterprises to meet certain social welfare objectives through corporate rule making. In essence, a bespoke corporate organisational unit for social enterprises was politically determined as essential to spin off some level of centralised public responsibility to non-state actors for the implementation and financing of social welfare policy.

Although this is a significant insight in its own right that commentators have overlooked, it is also important because this political economy had an explicit impact upon the social enterprise corporation's organisational architecture and regulatory infrastructure. To date, the legal literature is missing a complete analytical model that adequately reflects the relational link between welfare state politics and the influence it had on the social enterprise corporation's

structure and function. This Chapter is concerned with filling this key gap in legal knowledge. Our point of departure here is that the social enterprise corporation is a relatively new and unfamiliar type of corporate innovation with its own rules, which diverge from those governing the traditional corporation. True, the five basic legal characteristics that are often associated with the traditional corporation are to be found in its DNA, but European social enterprise law also includes additional legal and institutional mechanisms, which, collectively, make it and traditional corporate law conceptually and practically distinct from each other. The purpose of this Chapter is to offer a full and systematic treatment of the social enterprise corporation that showcases how it is distinguishable from traditional corporate law, and, at various points, draw attention to how political economy has had an explicit impact upon its organisational design.[259]

Among other things, below I argue that there are four major distinctions between the social enterprise corporation and the traditional corporation. These concern the themes of corporate purpose, the board of directors, shareholders and certain protective mechanisms designed to ensure the private commercial pursuit of public benefit.

But ahead of our analysis, it is worth stating generally why the social enterprise corporation is at odds with the traditional corporation. The basic idea is that the social enterprise corporation is not nearly as contractually customisable. As Brett McDonnell suggests,

> not every rule will work well in the specific circumstances of each corporation. Moreover, those setting the basic rules may not always choose wisely in how they set the rules. For both of these reasons…[the orthodox law and economics commentary] advocates allowing corporations to opt out of the rules that would otherwise apply to them in circumstances where those involved in the corporation do not believe the standard answer is best for them. That is to say…the rules of corporate law should be default rather than mandatory.[260]

However, we already got a sampling of the social enterprise corporation's contractual uncustomasibility earlier in this thesis. Recall that the social enterprise corporation features

[259] Some of the contents of this Chapter features in Liptrap (n 1).
[260] B McDonnell, 'Sticky Defaults and Altering Rules in Corporate Law' (2007) 60 *Southern Methodist University Law Review* 383, 387.

mandatory and irreversible protective mechanisms like a cap on midstream profit distribution to shareholders and a rule requiring capital forfeiture at the end of a firm's lifecycle.[261]

Allied to this, the utility of the default rules provided by the state is judged by how well they stimulate economic efficiency, which is essentially synonymous with the promotion of shareholders' interests.[262] As we shall see, the social enterprise corporation is anything but economically efficient in this orthodox sense. In this respect, it is advantageous to echo the above point that the social enterprise corporation does not promote a system in which directors are required to pursue the welfare of shareholders and maximise their returns – directorial loyalty is owed to the corporation itself as a separate socio-institutional entity committed to carrying on activities for public benefit.[263]

Through our application of the Brunerian method, we know why policymakers introduced a corporation of this kind. Policymakers departed from the standard view about corporate rule making and the sacrosanctity of shareholders to attend to what they estimated to be superseding needs of public policy. On the one hand, whilst not detracting from social enterprises' supposed capacity to address gaps in social welfare coverage, the social enterprise corporation was politically determined to be a required regulatory intervention. Whilst only an additional organisational option that could be selected on a voluntary basis, a main motivation for introducing the social enterprise corporation was to lock in private capital to support the third sector's financial stability in the midst of welfare reform. On the other hand, however, with the human condition being what it is, there was no guarantee that private ordering altruism could be counted upon to achieve that end. Naturally, the entire project would be in jeopardy if private capital could be siphoned out of the third sector at will. Although not documented by the legal literature, this political economy is why the social enterprise corporation features additional legal and institutional mechanisms that we do not find in the traditional corporation. The collective function of the additional legal and institutional modifications is to limit private ordering within the context of internal firm governance, especially with respect to taking self-interested financial decisions that could undermine the public interest. Once private actors commit their capital to a social enterprise corporation, it is largely committed to creating public benefit in perpetuity.

[261] See Chapter 2.3.
[262] Ireland (n 31) 50.
[263] See Chapter 2.2(a).

4.1 A Preliminary Matter

However, a preliminary matter that we ought to consider before discussing the first major distinction between the social enterprise corporation and the traditional corporation – the theme of corporate purpose – is the concept of 'hybridity', which I briefly mentioned in Chapter 3. As we shall see, the social enterprise corporation is a hybrid organisational unit. This means that it is neither purely a 'for profit' corporation nor a 'non-profit' corporation, but rather something in between.[264] More specifically, the social enterprise corporation is similarly formed to pursue quasi-public purposes, and this requires the customary constraints on corporate capacity and fetters on self-interest (such as those we would find in a charity or a similar non-profit organisational form). But the constraints and fetters are not as absolute like in a non-profit corporation. Broadly similar to the traditional corporation, it is also possible for a social enterprise corporation to, for example, take private investments and distribute dividends, but, because of the public interest focus, there are limits on how much capital a firm's participants can extract through distributions and contractual arbitrage. There is also more public oversight in a social enterprise corporation due to the public interest dimension. Ultimately, it is through hybridity that the social enterprise corporation features an amalgamation of legal concepts and mechanisms deriving from both areas of corporate law, and it is this lexical fusion that makes the form a unique addition to jurisdictions' organisational menus.

With this in mind, hybridity, loosely conceived, is an abstraction from biology that denotes the synthesis of existing, disparate elements into one entity that leads to a 'novel speciation'.[265] In this way, a hybrid entity is not a *de novo* object created from original parts. Instead, a hybrid entity is made up of already-existing elements that have been drawn together and recombined in some way for a purpose that is different from the initial intention – this process is what makes it a novel speciation. Thus, hybrid entities are 'intermediate forms'[266] or 'heterogeneous arrangements, characterized by mixtures of pure and incongruous origins, (ideal)types,

[264] R Ridley-Duff and M Bull, *Understanding Social Enterprise: Theory and Practice* (3rd edn, Sage 2019) 77.
[265] Battilana and Lee (n 238) 400. See generally also A Evers, 'Hybrid Organisations: Background, Concept, Challenges' in S P Osborne (ed), *The Third Sector in Europe: Prospects and Challenges* (Routledge 2008); D Billis, 'Towards a Theory of Hybrid Organizations' in Billis (n 224) 46.
[266] B Schmitz and G Glänzel, 'Hybrid Organizations: Concept and Measurement' (2016) 24 *International Journal of Organizational Analysis* 18, 20.

"cultures", "coordination mechanisms", "rationalities", or "action logics"'.[267] In due course, it will become obvious that the social enterprise corporation repurposes specific elements associated with for profit and non-profit organisational forms and houses them in a single organisational unit.

A particularly significant consequence of hybridity is that the social enterprise corporation blends the institutional logics of the distinct sectors from which its component parts have been taken. That is, by virtue of the social enterprise corporation being comprised of specific elements that come from different sectors, the associated institutional logics of the different sectors manifest and express themselves simultaneously within the enterprise itself. An 'institutional logic' is an overarching norm, or set of norms, that dictates the values and objectives of an institutional field; it is the standard mode of operation that makes an entity's behaviour predictable.[268]

Economic forces dictate the logic of for profit business organisations, in particular the traditional corporation. The institutional logic of the private sector centres on the efficient allocation of resources, selling products and services to the market to maximise financial returns and hierarchical control based on the size of share ownership and voting power in the general meeting.[269] Non-profit (and third sector) organisations pursue socio-economic (and environmental) goals for community, and by extension public, benefit and are typically not 'owned'. They are either managed by their members, trustees or individuals and institutions within a wider social fabric. Non-profit organisations, in the majority of instances, collect financial resources from, for example, membership fees, donations, government and private grants, as well as from commercial trading initiatives. Moreover, they are usually legally prohibited from distributing residual earnings to those with a managerial interest (however, in cooperatives, for example, profit distribution is proportionally limited and predicated on the work performed or the services rendered by members). Profits are typically reinvested back into the particular firm, or used to pursue social development objectives within a community

[267] T Brandsen, Wim van de Donk and Kim Putters, 'Griffins or Chameleons? Hybridity as a Permanent and Inevitable Characteristic of the Third Sector' (2005) 28 *International Journal of Public Administration* 749, 750.
[268] S J Woodside, 'Dominant Logics: US WISEs and the Tendency to Favor a Market-Dominant or Social Mission-Dominant Approach' (2018) 14 *Social Enterprise Journal* 39, 39.
[269] A-C Pache and F Santos, 'Inside the Hybrid Organization: Selective Coupling as a Response to Competing Institutional Logics' (2013) 56 *Academy of Management Journal* 972, 980.

or target demographic – for example, drug users, the elderly, homeless individuals or the unemployed.[270]

Notionally, if a hybrid firm's participants were left to pick and choose, through private ordering, what legal mechanisms would underpin the entity, then it would be reasonable to think that the chosen elements and the combination of different institutional logics would align with the participants' preferences within the firm. This would then result in a wide variety of hybrid entities across a given population, featuring disparate assortments of elements that blur the boundaries between distinct sectors with different institutional logics in myriad ways.

However, this is not the position with respect to the social enterprise corporation. We need only refer to the analysis in Chapter 3 to understand why this is the case. In Denmark, although social enterprises were making discernible contributions in relevant social policy areas, no national legislation had, by that point, existed that provided a clear legal framework and a common identity. This not only made it harder to streamline procurement contracting and spinning off state responsibility to social enterprises, but the government was also not satisfied with the size of the wider third sector at the time. The government had a vision that the third sector would, in future, not just need to solve important societal challenges related to strengthening the employment competences of vulnerable groups, but a larger sub-set of cultural, environmental, health and societal problems. Therefore, the third sector had to be scaled. Scaling in particular had been a challenge for the Danish third sector because the organisational forms in historical and more recent usage did not facilitate outside equity investor participation. This prevented the development of social investment markets and alternative capital opportunities that could ease public sector responsibility. A social enterprise corporation capable of taking outside equity investments was, therefore, recommended, as was the development of social investment markets.

We saw a parallel story unfold in the UK context. In the UK, when the conception of the problem that social enterprises might solve progressed from combatting social exclusion to reforming public services, specifically health care, New Labour had made several commitments to increase the number of social enterprises, but there were serious questions

[270] R Chaves and J L Monzón, 'Beyond Crisis: The Social Economy, Prop of a New Model of Sustainable Economic Development' (2011) 6 *Service Business* 5, 9.

regarding their organisational and fund-raising capacity to be efficient players in the public services marketplace and within the wider welfare reform agenda. Consequently, at its most basic level, the social enterprise corporation was a regulatory intervention calculated to liberalise the third sector and nudge such organisations towards being more business-like and capable of navigating the competitive procurement landscape. Also, providing a bespoke corporate organisational unit for social enterprises capable of attracting outside equity investor participation was a potential avenue for policymakers to cultivate a social investment market and filter capital into the third sector.

These circumstances marked an ideational shift in the policy dialogue in both jurisdictions in which the bottom-up mobilisation and continued growth of social enterprises, and third sector organisations more broadly, was seen as a public good in and of itself, but their future scaling with public sector support was not viewed as politically feasible. This played a major role in the agenda to take the skeletal template of the traditional corporation, and code it to operate pursuant to non-profit principles and objectives for public interest purposes (with public oversight components) through social impact investments and other private contributions.

In this way, what emerged was a hybrid organisational unit with particular cross-sectoral elements that correspond with the jurisdictions' specific political economy dynamics – it has an inflexible structure that is meant to support those dynamics and discourage contractual customisation that is motivated by pecuniary self-interest. In other words, the goal of hybridity in the social enterprise law context is not to facilitate organisational diversity that aligns with market actors' motivations and personal preferences, but rather to keep a firm's participants incentivised and focused on societal value creation in the public interest as a public-sector surrogate. Again, this is because the social enterprise corporation was ultimately developed as a vehicle to spin off centralised public responsibility to private actors for, for example, poverty reduction, job creation, local development and the provision of public interest and social welfare goods and services. We will now consider the four major distinctions between the social enterprise corporation and the traditional corporation.

4.2 Corporate Purpose

The first major distinction between the social enterprise corporation and the traditional corporation is the theme of corporate purpose. As a normative matter, the ultimate goal of the

law that applies to the traditional corporation is to maximise shareholder returns. This is the orthodox viewpoint, and, in general, it is seen as the best means by which social welfare may be achieved.[271] The logic is that shareholders as a group serve a risk-bearing role, and, as the so-called 'residual claimants', they have a direct pecuniary interest in ensuring that a corporation's economic activities are beneficial, not just for themselves, but also for other constituencies that contract or otherwise deal with a given business enterprise.[272] The shareholder wealth maximisation norm – that is, the institutional logic of the private sector – can also be rationalised as a corporation's 'purpose', or the reason it exists.

At variance with the traditional corporation, the law that governs the formation and behaviour of the social enterprise corporation operates in line with the third sector's institutional logic of maximising 'social value' directly through firm production. Social value is an admittedly unreliable concept, but it can be, broadly, thought of as the benefit to people or communities 'whose urgent and reasonable needs are not being met by other means', whether public or private.[273] Social value creation might include, for example, alleviating poverty, providing wider access to healthcare or education or facilitating employment opportunities and competence training for individuals in marginalised groups that are necessarily excluded from the labour market – for example, the disabled or the long-term unemployed. To be discussed in more depth, this is not to say that the social enterprise corporation does not also allow some economic value to be generated and appropriated by a firm's employees, managers and shareholders. But, of foremost concern, the regulatory frameworks treat the economic surplus produced from trading as, predominantly, a means to social ends in an attempt to guarantee firms' commitment to societal value creation and organisational sustainability over time. In the space below, I try to tease out how the corporate purpose of social value creation is expressed in Danish and British social enterprise law.

(a) Denmark

The starting point for rationalising Danish (as well as British) social enterprise law is to decouple the firm and the corporation. The 'firm' is the underlying socio-economic structure

[271] Armour, Hansmann, Kraakman and Pargendler in R Kraakman et al (n 54) 23.
[272] M Moore and M Petrin, *Corporate Governance: Law, Regulation and Theory* (Red Globe Press 2017) 32-35.
[273] R Young, 'For What it is Worth: Social Value and the Future of Social Entrepreneurship' in A Nicholls (ed), *Social Entrepreneurship: New Models of Sustainable Change* (Oxford University Press 2006) 56.

through which production is organised, and the 'corporation' is the institutional edifice supplied by a given jurisdictional system of law that facilitates its activities.[274] To become a Danish social enterprise corporation, a firm's participants must be comfortable with operating a business enterprise that conforms to a variation of what some commentators refer to as 'circular' or 'doughnut' economic principles, which is the basic economic system that characterises the third sector.[275] This is striking since the institutional edifice offered imposes quite robust specifications on how the underlying socio-economic structure itself must be internally organised and for what purposes.

Kate Raworth, for example, argues that a doughnut system is one in which an economy is shaping like a doughnut, with a social 'foundation' and an ecological 'ceiling', which 'create the inner and outer boundaries of the Doughnut'.[276] Underneath the social foundation 'lie shortfalls in human well-being, faced by those who lack life's essentials such as food, education and housing'.[277] Above the ecological ceiling lies an 'overshoot of pressure on Earth's life-giving systems, such as through climate change, ocean acidification and chemical pollution'.[278] However, between these 'two sets of boundaries lies a sweet spot – shaped unmistakably like a doughnut – that is both an ecologically safe and socially just space for humanity'.[279]

Any firm that features a corporate purpose requiring engagement in commercial activities outside the sweet spot, therefore, would be acting in contravention of the doughnut system. The doughnut system requires firms to have an overarching corporate purpose that does not create economic value through the further erosion of societal and planetary boundaries. Instead, the chosen corporate purpose ought to overlap with creating economic value that is consistent with correcting these deficits through firm-productive processes for public benefit. Analogically, the same is true of firms that aspire to achieve social enterprise status in Denmark. To determine eligibility, firms must submit a corporate purpose statement at the point of registration.

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[274] S Deakin, 'Tony Lawson's Theory of the Corporation: Towards a Social Ontology of Law' (2017) 41 *Cambridge Journal of Economics* 1505, 1510.
[275] See generally eg M Geissdoerfer, P Savaget, N M P Bocken and E J Hultink, 'The Circular Economy – A New Sustainability Paradigm?' (2017) 143 *Journal of Cleaner Production* 757.
[276] K Raworth, *Doughnut Economics: 7 Ways to Think Like a 21st Century Economist* (Chelsea Green Publishing 2017) 42 (for a visual representation of the see page 38).
[277] ibid 39.
[278] ibid.
[279] ibid.

I will say more about the determination of eligibility just below, but it is important to preface by highlighting that, upon formation of a social enterprise corporation (and throughout its lifecycle), a firm is required to choose (and maintain) the pursuit of a corporate purpose that aligns with the Danish legislation's statutory definition of social value to the satisfaction of a designated public oversight body – in this case the *Erhvervsstyrelsen* (Danish Business Authority). The Danish Business Authority essentially acts as a gatekeeper-monitor and has discretionary power to decide whether a firm's chosen corporate purpose aligns with the jurisdiction's statutory definition. The legislation does not spell out in exact terms what the chosen corporate purpose ought to be, and, as such, the Danish Business Authority has 'Chevron' discretion in deciding applications. Chevron discretion is an American administrative law principle that tells courts, in reviewing a particular public body's actions, to defer to the public body's construction of statutory provisions that the particular legislature delegated to it to administer.[280]

Returning to consider the registration context, by 'corporate purpose' what I do not mean is a one sentence mission statement that functions as a heuristic to, for example, generate greater customer loyalty or enhance employee commitment and productivity.[281] As, first and foremost, a management concept, whilst this formulation of corporate purpose may act as a pillar around which corporations could improve their social acceptance and reputation, and hopefully create more economic value, it suffers from weak enforceability as a matter of law.[282] Many of these mission statements are aspirational and vague, providing neither ascertainable standards for determining whether a corporation is meeting its identified goals nor a mechanism for holding corporate insiders accountable. Argued by Holger Fleischer, for example, mission statements have been likened to 'cheap talk' because they do not lead to binding consequences in law.[283] Thus, a corporation's 'articulation of its purpose' in this context is 'something akin to a…New Year's resolution – identifying an area in which the corporation hopes to do better. Unfortunately…absent some form of legal compulsion, a corporation's commitment to pursue

[280] See generally eg C Green, 'Deconstructing the Administrative State: *Chevron* Debates and the Transformation of Constitutional Politics' (2021) 101 *Brigham Young University Law Review* 619.
[281] Kershaw and Schuster (n 36) 12.
[282] See eg A Edmans, *Grow the Pie: How Great Companies Deliver Both Purpose and Profit* (Cambridge University Press 2020) 27-28. See generally also eg C Mayer, 'The Future of the Corporation and the Economics of Purpose' (2021) 58 *Journal of Management Studies* 887.
[283] H Fleischer, 'Corporate Purpose: A Management Concept and its Implications for Company Law' (2021) 18 *European Company and Financial Law Review* 161, 182.

societal value [through a mission statement] is, like a New Year's resolution, easily made, but also easily broken'.[284]

Differently, to gain social enterprise status, as touched on above a firm must make an application to the Danish Business Authority and spell out in its articles of association what its activities will be and the purposes for which any surplus capital will be deployed.[285] The regulatory regime does not go so far as to detail what the proposed activities ought to be, but they must be located within the sweet spot – the realm of advancing a cultural, environmental, health or social aim. In other words, it is not enough that the proposed activities have no negative spillover effects in the particular area of operation (or elsewhere); the proposed activities must involve the active and direct creation of social value in the public interest. Therefore, a social enterprise corporation ought to commit to working for a specific target group or cause, for example by implementing social services programmes for the disabled or by making products that improve conditions for the environment.[286] There is also a preference for social enterprise corporation's to register to work with a specific target group in an employment context, like offering job training and education skills development to people that are hard to employ and face labour market exclusion.[287] Importantly, here we can isolate an explicit connection between the Danish welfare state politics discussed in Chapter 3 and how the legislation rationalises corporate purpose. Recall that the government's vision for the third sector was that, in future, it would not just need to solve important societal challenges related to strengthening labour supply, but a larger sub-set of cultural, environmental, health and social problems. This sentiment is hardwired directly into the social enterprise corporation's organisational design – through hybridity – and is reflected in the types of acceptable corporate purposes that a firm's participants may choose to pursue.

Again, the Danish Business Authority has Chevron discretion in deciding applications. If a would-be social enterprise corporation does not include evidence that it would meet the above broader social expectations of economic organisation, however it elects to define them, then the Danish Business Authority has the prerogative to reject an application on that basis. This gatekeeping function is acutely critical because it indicates that the legislation's requirement

[284] J E Fisch and S D Solomon, 'Should Corporations Have a Purpose?' (2021) 99 *Texas Law Review* 1309, 1338-1339.
[285] Danish Social Enterprise Law, §§ 6, 12.
[286] Udvalget for socialøkonomiske virksomheder (n 46) 15
[287] ibid 16.

that firms have a 'socialt formål' (social purpose) goes well past a mission statement and is closer in proximity to an 'objects' clause. A corporation's objects clause carries a legal, instead of a management, meaning and links to the types of activities that the firm was formed to undertake. In this context, a social enterprise corporation would lack capacity, or power, to unilaterally enlarge the range of activities for which it was founded. Any transactions entered into beyond its capacity would be regarded as *void ab initio*.

There are post-registration enforcement provisions located within the legislation that 'lock in' the chosen corporate purpose and require permission from the Danish Business Authority before it can be altered. For example, if the intention is to modify the chosen corporate purpose, the board of directors has an obligation to notify the Danish Business Authority.[288] Presumably, the Danish Business Authority must be satisfied that the new set of activities would also make some positive contribution within the realm of advancing a cultural, environmental, health or social aim. Likewise, if the choice is made to convert a social enterprise corporation into a traditional corporation without a social purpose (as understood by the Danish Business Authority interpreting and operating the legislation), then the board of directors has a duty to deregister.[289] There are financial penalties for not doing so that protect against 'greenwashing' and giving the false impression that a social enterprise corporation is adhering to high standards of corporate social responsibility when it is not.[290] Known in some circles as 'green sheen', greenwashing is a form of marketing spin in which a corporation attempts, oftentimes deceptively, to persuade the public that its aims, practices and products are more socio-environmentally friendly than they really are. This is done to improve corporate branding and reputation.[291] Ultimately, what the Danish Business Authority is essentially screening for is firms willing to adhere to a variation of the doughnut system and internally organise to actively and directly address socio-environmental problems for public benefit.

This is significant. Today, the general thrust of the dominant economic paradigm is such that corporate rules ought to be treated, not as a method of social coordination, but rather as the 'endogenous outcome of a process of private bargaining between a business firm's various participants, so that the purpose of legal rules is effectively to mimic the market by providing

[288] Danish Social Enterprise Law, § 7.
[289] ibid.
[290] ibid § 17.
[291] See generally eg B L Jacobs and B Finney, 'Defining Sustainable Business – Beyond Greenwashing' (2019) 37 *Virginia Environmental Law Journal* 89.

the set of devices that participants would most likely have chosen themselves in the absence of inhibiting transaction costs'.[292] Allied to this, as McDonnell suggests, corporate rules ought to be default and permissive.[293] Deeply interlaced with this private ordering account is the related notion of shareholder wealth maximisation as the corporate purpose, which stands for the proposition that shareholders should have an exclusive claim over residual revenue streams, both because this is what parties would have decided contractually anyways and it is an economically efficient arrangement.[294] In a word, the logic is that, when corporations are pursuing shareholder wealth, 'all stakeholders [and wider society]…do well when stockholders…are thriving', or so it is assumed.[295] As such, insofar as traditional corporations do create societal value in the public interest, they so do indirectly:

> 'Essentially, the theory goes that where a corporation is efficiently run and thereby generates high profits for its shareholders, the resultant wealth created by its management will – in some way or other – produce a number of 'trickle down' material benefits for the public at large in their overlapping economic capacities as shareholders, consumers, employees and/or beneficiaries of corporation tax revenues. This arguably precludes the need for direct regulatory determination of the social-distributional outcomes of corporate activity. It likewise…precludes the need for direct…articulation of any generally accepted understanding of the public interest in economic organization, or at least one that is independent of the narrow prudential interests of shareholders'.[296]

Increasingly, the Danish corporate law and governance system has, to a greater or lesser extent, come to embrace this formulation. More specifically, the Danish corporate law and governance system does require the articles of association to lay out a corporate purpose statement, but, as a default matter, all that must be stated is that the purpose is to participate in any lawful activity for which corporations may be organised. The scope allowed in the drafting is clearly intended to equip directors with the broadest possible authority to pursue whatever lawful activities they

[292] M T Moore, 'Private Ordering and Public Policy: The Paradoxical Foundations of Corporate Contractarianism' (2014) 34 *Oxford Journal of Legal Studies* 693, 695. See also eg F H Easterbrook and D R Fischel, *The Economic Structure of Corporate Law* (Harvard University Press 1996) 15.
[293] McDonnell (n 260) 387.
[294] D G Yosifon, 'The Public Choice Problem in Corporate Law: Corporate Social Responsibility after Citizens United' (2011) 89 *North Carolina Law Review* 1197, 1200.
[295] B R Cheffins and R Williams, 'Team Production Theory Across the Waves' University of Cambridge Faculty of Law Research Paper 2/2021 (2021) 1, 15-16 <https://ssrn.com/abstract=3751392>. See also eg Armour, Hansmann, Kraakman and Pargendler in Kraakman et al (n 54) 23.
[296] Moore and Petrin (n 272) 21-22).

deem to be in the best interests of the corporation and its shareholders.[297] True, as pointed out in Chapter 2, there is some weight attached to the protection of, for example, creditors and other non-shareholder constituencies – notably employees through worker-participation channels in the boardroom of larger firms. But the fact remains that, unless a traditional corporation's articles of association contractually provides for a modified corporate purpose that includes a societal value creation dimension, directors are expected to devise and execute a strategy that promotes the best interests of the firm, which, typically, mirrors the welfare of shareholders. To restate the point put forward by Rose and Mejer, originally, the 'Danish corporate governance system was oriented towards protecting the rights of different stakeholders', however this 'view has been challenged…due to increasingly integrated international capital markets, forcing the largest listed Danish firms to adopt…Anglo-American corporate governance policies' that call for the prioritisation of shareholder welfare.[298]

That the regulatory regime requires, on a mandatory basis, the active and direct creation of societal value in the public interest means that it discards this private ordering characterisation of corporate rules and shareholder wealth maximisation as the corporate purpose. This is because of the relational link between Danish welfare state politics and the influence it had on the social enterprise corporation's structure and function. But to what extent? For example, so long as directors are engaging in transactions that accord with the chosen corporate purpose, are they free to pursue shareholder wealth? Are shareholders in a position to exercise their control rights over the board of directors for their own ends? In the sections to follow, we shall see that the collective answer to these questions is a resounding 'no', which makes the social enterprise corporation a very different creature compared to its traditional corporation counterpart. The chosen corporate purpose is supreme. Accordingly, not only are there compulsory restraints on corporate capacity, but also similar fetters on self-interest that are designed to ensure the private commercial pursuit of public benefit. This reality has important theoretical and practical consequences for how we understand the functions of a Danish social enterprise corporation's board of directors and shareholders. The same is true for a social enterprise corporation's board of directors and shareholders in a UK context. To set up this analysis, it is necessary to first consider the corporate purpose theme from a UK perspective.

[297] Danish Companies Act, § 28(2).
[298] Rose and Mejer (n 34) 335-336.

(b) The UK

Descriptively, we tend to think about the traditional corporation as a 'legal fiction which serves as a nexus for contracting relationships'.[299] The traditional corporation's 'corporate constitution' is a contractual agreement between the corporation and its members embodied in the articles of association. True, ever since the introduction of the Joint Stock Companies Act 1844 there has always been some degree to which UK corporate law restricts contractibility and detaches specific subject matters from the domain of internal firm governance for reasons of public policy.[300] However, it would be fair to say that the modern balance, generally speaking, favours contractibility.

I argue that the social enterprise corporation's corporate constitution is not the same kind of agreement. Whilst it can be said that the formation process is substantively a private matter for a firm's participants, once registration takes place contractual malleability disappears. A given social enterprise corporation has a life and purpose of its own that is distinguishable from the identities and interests of its human actors. Like in Denmark, this is because of welfare state dynamics – the social enterprise corporation is lexically calibrated to prioritise private action for public benefit through the corporate purpose of social value creation. Thus, similar to the Danish context, the starting point for theorising the British social enterprise corporation is the theme of corporate purpose.

As with the Danish corporate law and governance system, the standard view in the UK is that traditional corporations generate social value indirectly. The Companies Act 2006 does allow a firm and its members to depart from the pro-shareholder position and select a corporate purpose that more directly produces specific public benefit, either at the point of registration or subsequently through an amendment to the articles of association.[301] However, this choice is purely contractual and one that must be made, or undone, inside the corporate structure itself.

The social enterprise corporation is a different creature. The regulatory regime directly communicates that the corporate purpose of social value creation is a mandatory and

[299] M C Jensen and W H Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976) 3 *Journal of Financial Economics* 305, 311.
[300] See eg D Kershaw, 'The Path of Corporate Fiduciary Law' (2012) 8 *New York University Journal of Law & Business* 395, 411.
[301] CA 2006, s 172(2).

irreversible legal requirement. That is, a social enterprise corporation cannot be formed without the specification of proposed activities to be carried on for public benefit. New Labour and the Coalition government pushed for social enterprise corporation's to predominantly deliver public services. It is fruitful to classify this as a time-contingent political preference in the context of welfare reform, rather than representing the only corporate purpose that can be legally pursued. Indeed, after 2013 the Big Society programme was no longer mentioned, and in the 2015 general election the political discussion and policy debate on the third sector dissipated.[302] Although the connection between UK welfare state politics and how the legislation rationalises corporate purpose is not as pronounced, it is nonetheless possible to detect the former's influence on the latter in practice. As noted by, for example, Andrew Johnston and Lorraine Talbot

> the growth of [social enterprise corporations] has been driven by small local initiatives that have always been present in some form or another, combined with the later addition of large health organisations created following government policy to devolve parts of the NHS to semi-private organisations…This…trajectory has occurred because the [social enterprise corporation] became the ideal vehicle with which to devolve health services from the NHS. In 2008 a policy called Transforming Community Services was launched with the aim of devolving more healthcare away from primary care trusts to 'the community'. This reduced the services that fell to the NHS and reduced the number of staff employed by the NHS. A significant and rising percentage (up by 6.0 per cent in 2011/12) of the NHS budget goes to care in a community setting, and this is organised through [social enterprise corporations]: 'the [social enterprise corporation] is increasingly the standard structure for spin-outs from health, youth services, leisure and other public-sector areas, whose budgets can be tens of millions of pounds'…This indicates that…[social enterprise corporations]…are…useful vehicles for state based activities (principally devolved from the NHS) and small community enterprises that previously used [more traditional third sector] legal forms.[303]

[302] Alcock (n 227) 109, 112.
[303] A Johnston and L Talbot, 'Why is Modern Capitalism Irresponsible and What Would Make it More Responsible? A Company Law Perspective' (2018) 29 *King's Law Journal* 111, 137-138. See generally also CA 2004.

Therefore, whilst corporate purpose is not rationalised as solely the delivery of health care public services – as was the policy preference when the social enterprise corporation was first envisaged and implemented – it is nonetheless an observable empirical detail in the real world.

At any rate, the formal legal expectation now is that private actors use the social enterprise corporation to engage in pro-social entrepreneurship and investment for public benefit, broadly construed, within a doughnut-like system. Consistent with the Danish position, an applicant firm must describe in detail what the corporate purpose will be, how it would generate social value and the purposes for which any surplus capital will be deployed. Gaining social enterprise status hinges on public consensus and whether a 'reasonable person might consider that its…proposed activities…are carried on for' public benefit.[304] Whilst the regulatory regime does not go so far as to explicitly articulate what the corporate purpose ought to be, the Regulator nevertheless has wide Chevron discretion. The Regulator must determine whether the proposed corporate purpose would meet the broader social expectations of economic organisation contained in the above test.[305]

The Regulator may take the view that the stated activities would not create social value, however defined, and reject an application on that basis. Applicant firms are, however, permitted to consult with the Regulator with respect to whether the stated activities would create social value before submitting a formal application. For example, a 'company formed by the employees of a business solely for their own profit such as a bulk purchasing discount scheme would not satisfy the test'.[306] Conversely, a 'company formed to provide its members with a service which meets a pressing social need or to provide jobs to disadvantaged people' could satisfy the test 'because its activities would benefit the wider community'.[307] Illustrations of existing social enterprise corporation's engaging in activities to create social value are Ryburgh Community Enterprise and Wellbeing Enterprises. Ryburgh Community Enterprise

[304] There is an identical requirement for converting to a social enterprise corporation from a traditional corporation, but this does not concern the analysis. Office of the Regulator of Community Interest Companies, *Creating a Community Interest Company (CIC)* (2016) 18 <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/605414/13-781-community-interest-companies-chapter-4-creating-a-cic.pdf>.
[305] CA 2004, s 36A(1).
[306] Office of the Regulator of Community Interest Companies (n 304) 19.
[307] ibid.

manages a shop selling produce and non-food items in the local community, whilst Wellbeing Enterprises acts as a corporate mental health consultancy for professionals.[308]

Critically, though, the regulatory regime's lexical prioritisation of social value for public benefit as the social enterprise corporation's *raison d'être* is not simply a muting of the customary pro-shareholder corporate purpose in the Companies Act 2006. In the immediate sense, it is a hybridisation of the traditional corporation that modifies it to operate pursuant to the third sector's institutional logic. But perhaps more pointedly, as noted by the Regulator, the specific corporate purpose to be carried on for public benefit is a social enterprise corporation's 'objects'.[309] This is a significant similarity with the Danish regulatory framework. Designating social enterprise corporations as having objects revives the ghost of corporate capacity. In the context of the traditional corporation, formation under the Companies Act 2006 provides for unrestricted objects and engagement in any business activity or purpose.[310] Whilst it is possible for founders, and successive members by special resolution, to impose business area restrictions on themselves, the vast majority do not elect to do so. The self-imposition of an objects clause necessarily increases transaction costs and inhibits business area diversification.[311]

Therefore, although programming a corporate organisational unit to legally prioritise the creation of social value on a mandatory and irreversible basis is a relatively recent innovation in UK corporate law, we have in a strange sense returned to the historical legal position as stated by Lord Hatherley in *Ashbury Railway Carriage and Iron Company Limited v Riche*:

> you may meet together and form yourselves a company, but in doing that you must tell all who may be disposed to deal with you the objects for which you have been associated…so that the persons dealing with you will know that they are…dealing with persons who can only devote their means to a given

[308] Ryburgh Community Enterprises, *Our History* <https://ryburghshop.co.uk/shop/history/>; Wellbeing Enterprises, *What We Do* <https://www.wellbeingenterprises.org.uk/for-professionals/>.
[309] Model Articles for Community Interest Companies Limited by Shares, Schedule 3 of CIR 2005, art 5. See also Office of the Regulator of Community Interest Companies, *Constitutional Documents* (2016) 5 <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/605416/12-1337-community-interest-companies-chapter-5-constitutional-documents.pdf>.
[310] P L Davies and S Worthington, *Gower: Principles of Modern Company Law* (10th edn, Sweet & Maxwell) para 7-29.
[311] D Kershaw, *Company Law in Context: Text and Materials* (2nd edn, Oxford University Press 2012) 109.

> class of objects, and who are prohibited from devoting their means to any other purpose.[312]

These sentiments, broadly, apply during the social enterprise corporation lifecycle – firms may only engage in transactions (and deploy capital) in conformity with the corporate purpose statement in the articles of association. Furthermore, like in Denmark, alteration of an existing social enterprise corporation's corporate purpose statement does not have legal effect unless permission is secured from the Regulator. The Regulator must be satisfied that the new set of activities will also create social value for public benefit.[313]

What can be distilled from this is that, after the decisive act of registration, operating a social enterprise corporation in the UK has a public nature of its own requiring mandatory restraints on corporate capacity and fetters on self-interest. This is mirrors the Danish position, where the regulatory regime requires the active and direct creation of social value in the public interest, which discards the private ordering characterisation of corporate rules and shareholder wealth maximisation as the corporate purpose. This is because of the relational link between UK welfare state politics and the influence it had on the social enterprise corporation's structure and function, albeit this is something that is less pronounced formally in the UK legislation but is nonetheless empirically verifiable. We shall now consider the board of directors theme.

4.3 The Board of Directors

The board of directors theme is the second major distinction between the social enterprise corporation and the traditional corporation. In analysing the board of directors theme, we shall first look at the UK context. The reason for this is that the Danish legislation does not formally include a bespoke duty of loyalty for directors – but it does so in implicit, practical terms. The UK legislation, by contrast, has an explicit duty. There is more to mention, however for now it is sufficient to underscore that there is evidence that the Danish legislation took some inspiration from the UK regulatory framework in this regard. Thus, to better understand how the Danish legislation works, it is necessary to first get a basic knowledge of the board of director's function from a UK perspective.

[312] (1874-75) LR 7 653, 684 (HL).
[313] CIR 2005, reg 13.

(a) The UK

If we were to consolidate our discussion of the social enterprise corporation so far (in both jurisdictions) we could say that it is a 'single bottom line' organisational unit in which the selected public benefit is supreme.[314] The question then becomes how this affects the board of director's decision-making power.

In the traditional corporation, if the UK Model Articles are adopted without alteration, there is a complete delegation of corporate decision-making power to the board of directors to manage the business and affairs of the firm.[315] Absent an alteration to the corporate constitution,[316] the Companies Act 2006 states that the provisions 'bind the company and its members to the same extent as if there were covenants on the part of the company and of each member to observe those provisions'.[317] The UK courts have, therefore, consistently recognised and enforced this default allocation of power.[318]

Shareholder proponents tolerate this position because the general meeting must, in the end, contractually sanction board autonomy.[319] Additionally, in any event, the assumption is that, in wielding corporate decision-making power, the board of directors should be accountable to shareholders and obliged to prioritise their interests. This reasoning centres on economic efficiency concerns. The 'accountability of corporate power-holders is effectively and appropriately achieved by ensuring that they are held privately accountable to shareholders exclusively: that is, for the notionally "efficient" running of the company's business as reflected in the managerial conformance to the so-called "shareholder wealth maximization" objective'.[320] The Companies Act 2006 expresses this as a directorial duty of loyalty in Section 172(1). It stipulates that, in the exercise of corporate decision-making power, directors must

[314] C Borzaga and G Galera, 'New Trends in the Nonprofit Sector in Europe: The Emergence of Social Enterprises' in E Costa, L D Parker and M Andreas (eds), *Accountability and Social Accounting for Social and Non-Profit Enterprises* (Vol 17, Emerald 2014) 95.
[315] Model Articles for Private Companies Limited by Shares, Schedule 1 of the Companies (Model Articles) Regulations 2008, arts 3, 4.
[316] CA 2006, s 21.
[317] ibid s 33(1).
[318] See generally eg *Gramophone and Typewriter Co v Stanley* [1908] 2 KB 89; *Automatic Self-Cleansing Filter Syndicate Co Ltd v Cunninghame* [1906] 2 Ch 34.
[319] S M Bainbridge, *The New Corporate Governance in Theory and Practice* (Oxford University Press 2008) 33.
[320] Moore and Petrin (n 272) 32.

act in the way they consider, in good faith, would be most likely to promote the success of the corporation for the benefit of its shareholders.

The social enterprise corporation, however, is not about economic efficiency in this orthodox sense; it is about private action for public benefit. We know this by virtue of the corporate purpose statement *qua* objects clause, which, mechanistically, displaces the pro-shareholder corporate purpose in the Companies Act 2006. Noted previously, this means that a social enterprise corporation's board of directors has a differently constituted duty of loyalty. This new duty of loyalty, which is also mandatory and irreversible,[321] is not owed to the corporation for shareholders' private benefit, but rather to the firm itself as a separate socio-institutional entity committed to carrying on activities in the public interest. As the Regulator provides, social enterprise corporations are established for 'purposes other than the benefit of their members' and 'directors must…act in the way they consider, in good faith, is most likely to achieve those other purposes'.[322]

This duty tells directors that a social enterprise corporation's interests are its own and have nought to do with shareholders' interests. Therefore, the board of directors must, to the exclusion of other considerations, frame and execute a strategy in which the corporation engages in productive processes and generates profit, instrumentally, in the pursuit of the chosen corporate purpose. Doing otherwise would be a breach of this new duty of loyalty, and, in a wider sense, a breach of the directorial duty to 'act in accordance with the company's constitution'.[323] To illustrate, let us assume that a social enterprise corporation was formed to deliver social services within the community. Here, the board of directors would be charged with maintaining the corporation's organisational capacity to deliver social services. The corporation's "interests" – in this case the delivery of social services within the community – are wholly its own and have nothing to do with shareholders' interests.

To be clear, this is conceptually distinct from the hypothetical situation in which the law would expect directors to attempt to balance 'team members' competing interests in a fashion that keeps everyone happy enough that the productive coalition stays together', as advocated for by

[321] CA 2006, s 232(1).
[322] Office of the Regulator of Community Interest Companies (n 38) 9.
[323] CA 2006, s 171(a).

team production theory or stakeholder theorists more broadly.[324] That the social enterprise corporation has discrete interests signifies that expecting directors to weight various stakeholders' interests, notably those of shareholders, against the chosen corporate purpose would only add 'to the number of individual interests clamoring for the attention and duties of directors'.[325] Properly construed, directors 'should attend exclusively to the corporation's best interests and to advancing' the institutional purposes for which the firm was formed.[326] From this it can be inferred that a social enterprise corporation's board of directors must act for the corporation *qua* separate entity, with the competing interests of all the various stakeholders being de-prioritised.

In line with successive governments' welfare state reform ambitions and the social enterprise corporation's emergence in the UK, this de-prioritisation of stakeholders' interests through this new directorial duty of loyalty places social value creation at the top of the agenda within the boardroom. It links the corporate purpose of social value creation directly with how the business and affairs of the firm should be managed. However, if certain stakeholders' interests were designated as 'corporately' important, they could become an element of a social enterprise corporation's lexical understanding of societal value creation in the public interest (provided that this choice was authorised by the Regulator). For example, if the activities to be carried on for public benefit involved the provision of subsidised credit facilities to those facing financial exclusion, then the interests of those facing financial exclusion would be elevated above the other stakeholder groups represented in, or otherwise connected to, a specific social enterprise corporation. This is indeed the main function of social enterprise 'microfinance institutions'. More specifically, microfinance social enterprises exist to provide a broad range of tailored financial services – such as credit, insurance and savings – to poor clients who are otherwise excluded from accessing standard financial services.[327]

Apart from these very narrow circumstances in which a class of beneficiary is identified, however, *ad hoc* consideration or prioritisation of certain stakeholders' interests must

[324] M M Blair and L A Stout, 'A Team Production Theory of Corporate Law' (1999) 85 *Virginia Law Review* 247, 280-281. See generally also eg R Phillips, R E Freeman and A C Wicks, 'What Stakeholder Theory is Not' (2003) 13 *Business Ethics Quarterly* 479.
[325] L Johnson, 'Pluralism in Corporate Form: Corporate Law and Benefit Corps.' (2012) 25 *Regent University Law Review* 269, 290.
[326] ibid.
[327] See generally eg M Hudon, M Labie and P Reichert, 'What is a Fair Level of Profit for Social Enterprise? Insights from Microfinance' (2020) 162 *Journal of Business Ethics* 627.

inevitably be shown to serve the chosen corporate purpose. This is fascinating because it inverts the so-called 'enlightened shareholder value' directive in the Companies Act 2006, which permits directors to consider non-shareholder constituencies' interests only when doing so would promote the success of the corporation for shareholders' private benefit.[328] With shareholder wealth maximisation dislodged in the social enterprise law context, however, the difference is that directors may consider stakeholders' interests in *ad hoc* settings only where it could be shown to support the furtherance of the chosen corporate purpose.

We are now in a suitable place to consider the board of directors theme from a Danish viewpoint. Again, the Danish legislation does not formally include a bespoke duty of loyalty for directors, however, for reasons that we shall discuss, I do think it includes such a duty in implicit, practical terms.

(b) Denmark

Like its UK counterpart, the Danish social enterprise corporation is not to be categorised as a nexus of contracts promoting a system in which directors are expected to pursue the welfare of shareholders and maximise their returns. There is but one 'master' in the social enterprise corporation – the chosen corporate purpose. Consequently, it is also accurate to describe it as including a single bottom line mandate. The question then becomes how this informs the board of director's decision-making matrix.

Whilst this is a detail outside the scope of this Chapter, the Danish corporate law and governance system allows a choice between two internal firm governance structures. First, a firm could choose a traditional structure in which it is managed by a board of directors responsible for overall strategic management. This board of directors must appoint an executive board consisting of persons to be responsible for day-to-day management. Second, a firm might choose an alternative structure in which it is managed solely by an executive board. Although this executive board must be appointed by a supervisory board that oversees it, the supervisory board has no responsibility with respect to overall strategic management of a traditional

[328] Kershaw (n 311) 382. See generally also eg R Williams, 'Enlightened Shareholder Value in UK Company Law' (2012) 35 *University of New South Wales Law Journal* 360; J Lowry, 'The Duty of Loyalty of Company Directors: Bridging the Accountability Gap Through Efficient Disclosure' (2009) 68 *Cambridge Law Journal* 607.

corporation's operations. Because this detail does not matter for the analysis, I make no distinction between these two models, and use the phrase 'board of directors' simply to refer to the highest management body.[329]

It would be fruitful to cite a specific duty that signals to directors that the social enterprise corporation is not calibrated with respect to orthodox economic efficiency concerns and associating the 'interests' of the corporation with the welfare of shareholders. However, no duty of this kind can be found in the legislation. All we are told is that a social enterprise corporation must have a social purpose and that, post-registration, directors must either pursue the one chosen or deregister from the scheme. At first blush, this would seem to cast some doubt upon the basic argument that the Danish version has a single bottom line mandate in which the chosen corporate purpose is supreme.

Nevertheless, the policy documentation preceding the legislation clarifies that Danish legislators took inspiration from the UK's social enterprise corporate form.[330] To reiterate, a UK social enterprise corporation's board of directors is freed from the pro-shareholder corporate purpose enshrined in the Companies Act 2006 by way of an express duty that is owed to the corporation itself as a separate socio-institutional entity committed to carrying on activities for public benefit. This duty tells directors that a social enterprise corporation's interests are its own and have nought to do with shareholders' interests. Therefore, a UK social enterprise corporation's board of directors must, to the exclusion of other considerations, frame and execute a strategy in which the corporation engages in productive processes and generates profit, instrumentally, in the pursuit of the chosen corporate purpose.

All else being equal, whilst as a formal matter the Danish legislation does not feature such a duty, there are nonetheless three factors indicating that a social enterprise corporation's board of directors has an equivalent duty in substance, and, by extension, a single bottom line mandate. The first factor is how the chosen corporate purpose is woven into the production process. A social enterprise corporation must select a set of activities within the sweet spot, and actively and directly create societal value in the public interest. In the immediate sense,

[329] See Danish Companies Act, § 111. For an introductory account of internal firm governance structures in a Danish context, see generally eg C Rose, 'Board Composition and Corporate Governance – A Multivariate Analysis of Listed Danish Firms' (2006) 21 *European Journal of Law and Economics* 113.
[330] Udvalget for socialøkonomiske virksomheder (n 46) 25.

that the corporate purpose statement is relationally closer in proximity to an objects clause prevents directors from pursuing trading activities (and collecting financial resources) that are unrelated to it. If a social enterprise corporation is prohibited from pursuing non-purpose related trading activities, then it follows that the regulatory regime employs a 'mission-centric' model where the chosen corporate purpose is embedded within production and the 'goods and/or services generally constitutes in itself the way in which the social mission is pursued…[T]he nature of the economic activity is closely connected to the social mission'.[331]

To illustrate, let us return to the earlier example and assume that a social enterprise corporation was likewise formed to deliver social services within the community. In this context, the economic activity is actually the delivery of such social services. The board of directors would be charged with maintaining the corporation's organisational capacity to achieve ongoing sustainable impact, in the area of social services provision within the community, through financial self-sufficiency. The core determination here is that economic value generation is a tool, an instrument, for generating societal value in a manner that is sustainable over time. This conveys to directors that they must be cognisant that corporations, like living organisms, 'in the end have to find, capture, and consume enough calories to enable them to survive', but that the pursuit of profits should be congruent with, and ultimately tied back to, pursuing the chosen corporate purpose.[332] From this departure point, it seems far more probable that directors do have a UK-like duty informing them that social enterprise corporations are established for purposes other than the benefit of their shareholders and that they must act in the way they consider is most likely to achieve those other purposes. Otherwise, they would not be in a good position to take reasoned decisions, which would not square at all well with the second factor.

This is that, in tandem with a social enterprise corporation needing a corporate purpose that directly creates societal value in the public interest, the legislation requires a 'social håndtering' (social handling) of profits.[333] A social enterprise corporation should chiefly deploy its profits to advance the chosen corporate purpose or reinvest them back into the firm.[334] There is also latitude for redirecting profits towards other social enterprise corporations or charitable

[331] J Defourny and M Nyssens, 'The EMES Approach of Social Enterprise in a Comparative Perspective' (2012) EMES Working Paper No. 12/03 1, 27 <https://emes.net/content/uploads/publications/EMES-WP-12-03_Defourny-Nyssens.pdf>.
[332] M C Jensen, 'Value Maximization, Stakeholder Theory, and the Corporate Objective Function' (2002) 12 *Business Ethics Quarterly* 235, 253.
[333] Danish Social Enterprise Law, § 5(5).
[334] ibid § 5(5)(a).

organisations with a social purpose.[335] To be discussed in Section 4.4, it is only to a limited extent that midstream profits can be distributed to shareholders.[336] Midstream profit distribution to shareholders ought to be consistent with, and must not undermine, a social enterprise corporation's chosen corporate purpose.[337] The chosen corporate purpose, thus, sits atop a hierarchy and subordinates a firm's participants' pecuniary motivations and preferences. If the chosen corporate purpose sits atop a hierarchy with respect to how profits are to be allocated, it must also be the case that it represents the principal reason for their generation.

Therefore, the most likely reading of the legislation is that the obligation to actively and directly pursue societal value creation in the public interest, within the confines of the proposed activities, amounts to a single bottom line mandate, rather than a mandate in which, for example, shareholders' pecuniary interests must be balanced alongside the chosen corporate purpose.

Again, the legislation hints at a third factor demonstrating that this is the appropriate interpretation. A social enterprise corporation's board of directors must prepare and submit an annual report to the Danish Business Authority and, therein, specify how it is fulfilling its social purpose.[338] It seems to me that a description within the annual report showing that a decision was made to, for example, gain more market share or increase profit margins would be susceptible to not just administrative but also judicial scrutiny, especially if it had a tenuous connection to fulfilling the chosen corporate purpose.

We should not assume that this blocks a director from, occasionally, making a trade-off in which the chosen corporate purpose is momentarily subordinated to stabilise financial buoyancy. To return to the example, if the price of the social services were temporarily raised to ease cash-flow problems, it could diminish their availability to members of the community with lesser financial means to pay for them. Granted, an increased price for the social services would necessarily result in a larger midstream profit distribution to shareholders. However, arguably, this would be normatively acceptable in circumstances where the long-run viability of the chosen corporate purpose was preserved or enhanced, provided that directors were able

[335] ibid § 5(5)(b).
[336] ibid § 5(5)(b)-(c).
[337] ibid § 5(5)(d).
[338] ibid § 8(4).

to supply evidence that a given transaction would likely have a net-positive effect down the road. In this way, if a social enterprise corporation later reduced the price of the social services and further increased community access to them, this would, at least *prima facie*, comply with the reporting requirement of explaining how the social purpose is actively being fulfilled.

This is not so different from the inverted enlightened shareholder value directive in the UK context, where the calculation of trade-offs to satisfy financial necessities cannot, on the whole, overwhelm a firm's social obligations and cause it to 'drift', or 'creep', too far into the for-profit encampment.[339] Instinctively, the issue with appearing to drift is that a perception may arise, whether imagined or real, that a social enterprise corporation is neglecting its social purpose, which may cause financial and reputational damage to the firm amongst, for example, key stakeholder groups or the wider public.

Taking the three factors together, it is fair to say that the Danish social enterprise corporation, implicitly, responds similarly to these concerns by imposing a UK-like perimeter around board decision-making through a single bottom line mandate. It does so because of the welfare state reform ambitions of the Danish government – the board of directors is freed from having to consider various stakeholders' interests through a new, albeit implicit, duty of loyalty, which places social value creation atop a hierarchy that subordinates other competing interests.

4.4 Shareholders

What do these insights mean for the general body of shareholders? In a word, the archetypal understanding of shareholders is somewhat turned on its head. As a default theoretical matter, shareholders are viewed as the 'residual risk-bearers', and, therefore, the thinking is that they ought to have special rank in the firm since they 'bear the largest part of the risks associated with corporate activity'.[340] This special rank is commonly equated to the idea of 'shareholder primacy', which encompasses two principles. First, firms ought to maximise shareholders' wealth and in so doing grant them particular residual economic rights. Second, shareholders ought to have exclusive and final jurisdiction over the board of director's corporate decision-

[339] See eg J Finfrock and E Talley, 'Social Entrepreneurship and Uncorporations' (2014) 2104 *University of Illinois Law Review* 1867, 1871; J H Murray, 'Defending Patagonia: Mergers and Acquisitions with Benefit Corporations' (2013) 9 *Hastings Business Law Journal* 485, 507.
[340] J Kay, *The Foundations of Corporate Success: How Business Strategies Add Value* (Oxford University Press 1993) 217.

making power.[341] We noted above that this thinking dominates in the legal commentary because, in economic efficiency terms, keeping directors accountable through a system in which they are required to maximise shareholder wealth is seen as the best means by which social welfare may be achieved.[342] The Danish and British corporate law and governance systems, generally, follow this formula by providing shareholders in a traditional corporation with a suite of economic and non-economic rights.[343]

However, whilst a social enterprise corporation's shareholders still perform a risk-bearing function in the usual way, in both jurisdictions the regulatory regime discards shareholder wealth maximisation as the corporate purpose, and directors have a duty to act in the way they consider is most likely to achieve the corporation's definition of societal value creation in the public interest. These points should make us seriously question whether the social enterprise corporation adheres to the same shareholder primacy reasoning. Below I argue that shareholders in a social enterprise corporation lack primacy as it is normally understood. This is the third major distinction between the social enterprise corporation and the traditional corporation. I discuss the Denmark and the UK in turn.

(a) Denmark

To begin with, part of the first principle of shareholder primacy – shareholder wealth maximisation – is clearly precluded by law. Recall that a Danish social enterprise corporation's board of directors must formulate and execute a strategy in which the corporation engages in productive processes and generates profit, instrumentally, in the pursuit of the chosen corporate purpose. Thus, it would not be correct to posit that social enterprise corporations cannot pursue profit. It is only that the pursuit of profit must be consistent with the corporate purpose statement and ultimately tied back to advancing it. This is important because it signposts that directors are not free to pursue shareholder wealth. It would only be permissible to do so if, like in the UK context, directors could demonstrate that it supported the chosen corporate purpose.

[341] S M Bainbridge, 'Director Primacy: The Means and Ends of Corporate Governance' (2003) 97 *Northwestern University Law Review* 547, 573.
[342] See Section 4.2.
[343] For a useful primer on shareholders' rights, see generally eg J Armour, 'Shareholders' Rights' (2020) 36 *Oxford Review of Economic Policy* 314.

What about residual economic rights? In the traditional corporation, shareholders have conditional rights to a periodic dividend and a share of the firm's surplus assets upon winding up. A social enterprise corporation's shareholders, formally, have these rights, but, to reiterate, from the state's perspective a social enterprise corporation is a kind of publicly embedded social institution. It is accountable for prioritising a chosen goal – to commercially address a neglected socio-economic problem in the public interest – that supersedes the various human participant's private individualities and interests. Therefore, the residual economic rights are attuned to incentivise outside equity investors to adhere to the mantra of private action for public benefit.

Accordingly, in a given year of trading, contributors of equity capital eligible to receive a distribution may only expect a rate of 15 per cent return on investment, and the corporation itself cannot pay out more than 35 per cent of its total post-tax profits.[344] This is not a rule that can be contractually customised; it is mandatory and irreversible upon registration and throughout a social enterprise corporation's lifecycle. This rule strikes a balance between encouraging people to invest, and the principle that the assets and profit of a social enterprise corporation should be primarily devoted to societal value creation in the public interest. If this rule is contravened, the legislation imposes a financial penalty. There are also rules that protect against disguised distributions through, for example, related-party loans or capital reductions.[345]

There is also an important caveat. Danish corporate law requires firms to submit the allocation of income for shareholder approval.[346] This allows the general body of shareholders in a traditional corporation to voice any concerns about dividend payments through their votes at the annual meeting, and also provides an opportunity to verify that a proposed distribution does not exceed the amount that is reasonable in consideration of a particular firm's financial position.[347] However, in addition to the requirement in Danish corporate law that firms have freely available reserves for distribution, the social enterprise legislation also stipulates that dividend payments must be made within the framework of the rules that govern social enterprises.[348] Although the legislation does not expressly make this clear, it seems probable

[344] Danish Social Enterprise Law, §5(5)(d).
[345] ibid §§ 10 and 17.
[346] Danish Companies Act, §180-184.
[347] ibid §179(2).
[348] Danish Social Enterprise Law, §5(5)(d).

that the corporate purpose statement is relevant here. I say this since the chosen corporate purpose sits atop a hierarchy with respect to how profits are to be allocated. Midstream profit distribution to shareholders must be consistent with, and must not undermine, a social enterprise corporation's chosen corporate purpose. Therefore, I argue that the board of directors is also obliged, implicitly, to ask whether paying a dividend would be acceptable in light of the corporate purpose statement. For example, if a social enterprise corporation had not performed particularly well in pursuing the creation of societal value, then it could be inappropriate to declare a dividend, no matter how much profit was made in a particular year of trading. Indeed, even in the circumstances in which a social enterprise corporation had performed well in creating societal value in the public interest, the board of directors could still take the view that declaring a dividend would not be justifiable because of the specific terms of the corporate purpose statement. This relates back to the directorial duty to the corporation as a separate entity, with its own institutional purposes that trump shareholders' interests.

Shareholders' deferred right to a return on their invested capital at the end of a traditional corporation's lifecycle is similarly not entirely intact in the social enterprise law context. If some of a social enterprise corporation's property remains after satisfaction of its liabilities (upon conversion back to a traditional corporation or a winding up), the same restriction on the distribution of dividends applies. That is, a social enterprise corporation cannot distribute more than 35 per cent of its remaining assets to shareholders.[349] This rule is also mandatory and irreversible. I explain what happens to the other assets in our review of the social enterprise corporation's protective mechanisms.[350] For now, it is enough to mention that, once private capital is invested for the purpose of creating societal value in the public interest, it is largely committed to that end in perpetuity.

There is certainly an immediate explanation for these peculiar rules. Specifically, it would be inappropriate for social enterprise corporations to trade on a pro-social platform and then attempt to bypass these legal limitations. Allowing a firm's participants to contractually opt out would create a litany of regulatory complications for maintaining public trust and guarding against greenwashing.[351] But, through our evaluation of the Danish social enterprise corporation's political economy in Chapter 3, we also know about the deeper heritage of these

[349] ibid §10.
[350] See Section 4.5.
[351] See generally eg Hansmann (n 45).

rules. The rules were developed in a period of welfare state restructuring in which the Danish government had a vision that the third sector would, in future, need to be scaled in order to position it to solve a larger set of social problems. Scaling in particular had been an issue for third sector organisations because they did not facilitate outside equity investor participation. This prevented the development of social investment markets and alternative capital opportunities that could ease public sector responsibility for such organisations. A social enterprise corporation capable of taking outside equity investments was, therefore, recommended and given effect through law. However, with the human condition being what it is, the prospect of achieving societal value creation in the public interest through private commercial enterprises would always be in doubt if rigid rules were not in place to limit self-interested private ordering.

Therefore, whilst a social enterprise corporation's shareholders have residual economic rights, they are strictly limited. The regulatory regime is designed to attract outside equity investors with altruistic motivations and preferences, rather than purely self-regarding and pecuniary ones. The economic incentives play only a limited role in influencing their behaviour, and a considerable portion of what amounts to 'incentives' includes the substantive societal value generated by a social enterprise corporation's activities. The return on capital gained from participation is, consequently, not a reward for risk-taking. It is a form of modest compensation for public service. This effectively means that a social enterprise corporation's shareholders are more like 'bond-holders' or 'quasi-donors'.[352]

Do a social enterprise corporation's shareholders have economic primacy then? Taking the above analysis as a whole, I submit that they do not. Aside from the motivation to attract outside equity investors to bear the bulk of the residual risk for a social enterprise corporation's liabilities, the regulatory regime asserts the independent and civically oriented nature of the firm, emancipating it from prioritising shareholders' interests. To be sure, in economic terms, it is nearly a mischaracterisation to refer to a social enterprise corporation's equity capital providers as 'shareholders', as the nature of their pecuniary entitlements sharply deviates from those typically held by the shareholders of a traditional corporation.

[352] S Lloyd, 'Transcript: Creating the CIC' (2010) 35 *Vermont Law Review* 31, 37; J W Yockey, 'Does Social Enterprise Law Matter?' (2015) 66 *Alabama Law Review* 767, 790.

The regulatory regime's economic downgrading of shareholders' interests removes the possibility that their behaviour will 'degenerate into the "lowest common denominator" of…short-term share trading or activism aimed at short-term value maximisation'.[353] Again, this is due to the constraints in place that dictate the level of assets that can be extracted through contractual arbitrage and market-driven events like takeovers. This is a critical insight because the subordination of their economic entitlements pigeonholes – both existing and potential – shareholders into a 'custodial' role in which the central focus should be on monitoring the furtherance of the chosen corporate purpose. That is, with a clear and legally binding statement on corporate purpose, coupled with complimentary legal and institutional mechanisms to support it, the function of shareholders is custodial in nature; their role is to 'ensure that boards…make decisions that further this purpose. This heads off the risk of conflating the interests of the company with the…financial interests of shareholders'.[354] It ensures that directors are held accountable, as 'pro-organisational stewards', for designing and carrying out a strategy that creates long-term and sustainable societal value in the public interest.[355] Thus, when a social enterprise corporation's investors do engage, they are practically limited to 'checking that the board is appropriately constituted and has put in place a competent team of executives and managers; checking that those executives and managers have – with the input from NEDs – established a strategy which will plausibly produce sustainable…[results]; and assessing periodically whether the strategy is delivering what is promised'.[356]

The custodial role does not strip shareholders of the usual non-economic rights they would otherwise hold in a traditional corporation. A social enterprise corporation's shareholders may, for example, still influence the board of director's composition, which includes the right to remove a director at any time without cause, modify the articles of association and directly involve themselves in most management decisions. However, there are manacles on how these non-economic rights must be exercised because of the custodial nature of shareholders in the social enterprise law context. All shareholder action must conform to the chosen corporate purpose and the overall requirement to prioritise societal value creation in the public interest.

[353] A Johnston, R Belinga and B Segrestin, 'Governing Institutional Investor Engagement: From Activism to Stewardship to Custodianship?' (2021) *Journal of Corporate Law Studies* 1, 13 <https://www.tandfonline.com/doi/full/10.1080/14735970.2021.1965338>.
[354] ibid 37.
[355] J Davis, D Schoorman and L Donaldson, 'Toward a Stewardship Theory of Management' (1997) 22 *Academy of Management Review* 20, 39-40.
[356] Johnston, Belinga and Segrestin (n 353) 36.

If shareholder action does not conform accordingly, it is liable to be voided. I further elaborate on this point below.

More broadly, shareholders' jurisdiction over the board of director's corporate decision-making power is not altogether exclusive or final. The Danish Business Authority also holds the non-economic rights held by shareholders, which can be escalated all the way up to administratively de-registering a social enterprise corporation that does not comply with the legislation.[357] The obvious deterrent effect with respect to the Danish Business Authority administratively de-registering a social enterprise corporation is the financial penalty that shareholders must absorb – they lose 65 per cent of firm assets. Related to this, we have established in Section 4.2(a) that the Danish Business Authority shares jurisdiction with the general body of shareholders regarding alteration of the corporate purpose statement – it cannot be altered unless permission is secured from the Danish Business Authority. Indeed, on a particular reading, it would appear as though the Danish Business Authority's jurisdiction (and the principle of publicness) here supplants that of a social enterprise corporation's shareholders.

Moreover, the legislation states that a social enterprise corporation must allow non-shareholder constituencies to participate in the enterprise, and evidence of this must be included in the annual report.[358] Neither the policy documentation preceding the legislation nor the legislation itself explains what this requirement entails. What I do not think that 'participation' would include is access to the boardroom (unless otherwise provided for by law or contract elsewhere), or having a right to vote in the annual meeting. However, it is reasonable to surmise that the participation requirement would not be met if a social enterprise corporation had an identified class of beneficiary that was recognised in the corporate purpose statement, but was not consulted before an application to the Danish Business Authority for it to be amended. For example, if a social enterprise corporation's chosen corporate purpose involved running a subsidised assisted living facility for the elderly, then the elderly therein would need to be consulted on the matter. If they were not, a belief could arise that the specific social enterprise corporation was not meeting the participation requirement, which might in turn occasion the Danish Business Authority to decline considering the application until a consultation took place. It also seems likely that giving non-shareholder constituencies an advisory vote on,

[357] Danish Social Enterprise Law, §2.
[358] ibid §§ 5(4), 8(4).

among other things, important transactions like a change of control, directorial remuneration or midstream profit distribution to shareholders could stimulate 'stakeholder buy-in' and act as a presumption that the participation requirement is being fulfilled. Therefore, notionally, there is at least an argument to be made that non-shareholder constituencies may have a quasi-right to be consulted on issues of internal firm governance, and particular actions might be challengeable before the Danish Business Authority if their input is not received.

Additionally, in any event, suppose that a social enterprise corporation's shareholders intervened in a management decision and instructed the board of directors to take a particular action, such as engaging in a line of business outside the chosen corporate purpose that would increase revenue. What would happen if the board of directors obeyed and the chosen corporate purpose was somehow negatively affected? Of course, Danish corporate law invalidates shareholder resolutions that contravene the articles of association and members of the board who intentionally, or negligently, harm the corporation are liable in damages. But what if the circumstances were, collectively, swept under the rug by shareholders and the board of directors?

Although this is another unspoken detail, the regulatory regime does not preclude non-shareholder constituencies from alerting the Danish Business Authority to a potential breach of this kind. At a minimum, the Danish Business Authority is removed from internal firm governance, and, therefore, it must rely on others to bring to its attention any matters causing concern about a social enterprise corporation's activities. In this way, whilst shareholders clearly have a custodial role to play in drawing such concerns to the attention of the Danish Business Authority, if shareholders fail to take appropriate action the regulatory regime, implicitly, responds by democratising the monitoring function. Thus, arguably, interested non-shareholder constituencies can also satisfy themselves that a social enterprise corporation is continuing to meet its specific definition of societal value creation in the public interest. Whilst this is only an indirect tool, if the Danish Business Authority investigates and later comes to the conclusion that enforcement action must be taken to, for example, invalidate a shareholder resolution or financially penalise a specific director, the democratisation of monitoring does practically position non-shareholder constituencies to usurp shareholders' jurisdiction if and when the circumstances require.

These are but a few instances demonstrating the constraints on shareholders' jurisdiction over the board of director's corporate decision-making power. In claiming that the jurisdiction is not exclusive or final, what I am not arguing is that shareholders' collective function is somehow trivial. However, if shareholders fail in their custodial responsibilities to properly monitor, there is an implicit 'stakeholder monitoring backstop' engineered into the regulatory infrastructure that can bypass shareholder inaction or turpitude. Therefore, all things considered, similar to the finding that a Danish social enterprise corporation's shareholders do not have economic primacy, it would be sensible to argue that they also do not possess absolute governance primacy either, at least not in the way that it is typically conceived.

(b) The UK

When we look at the UK position, the function of shareholders as custodians of the chosen corporate purpose is largely the same, albeit a number of the implicit aspects we find in the Danish context are made explicit through the regulatory regime. The departure point is that, like in Denmark, a social enterprise corporation's board of directors must, exclusively, formulate and execute a strategy in which the corporation engages in productive processes and generates profit, instrumentally, in the pursuit of the selected public benefit. This does not stop a social enterprise corporation from pursuing profit, but the pursuit of that profit must be consistent with the chosen corporate purpose and ultimately tied back to it in some verifiable way. This means that part of the first principle of shareholder primacy – shareholder wealth maximisation – is subdued by the law.

This has the same effect on British shareholders' residual economic rights. A social enterprise corporation's shareholders have residual economic rights, but these must be balanced against the idea that, from the state's perspective, social enterprise corporations are a species of publicly embedded social institution, accountable for prioritising a chosen goal – to create public benefit through attempting to solve particular socio-economic problems. This supersedes the various human participants' combined private interests. Therefore, outside equity investors' residual economic rights are designed to incentivise them to pursue outcomes that generate public benefit.

Thus, like in Denmark, a social enterprise corporation cannot distribute more than 35 per cent of its profit, although there is not a cap on the rate of return on investment.[359] This is another mandatory and irreversible legal modification. As the Regulator suggests, this 'strikes a balance between encouraging people to invest…and the principle that the assets and profit of a…[social enterprise corporation] should be devoted to' creating public benefit.[360]

There is also the caveat that directors must ask whether paying a dividend would be consistent with the corporate purpose statement, however this obligation is more explicit in the UK social enterprise law. In addition to the requirement in the Companies Act 2006 that traditional corporations must have freely available profit for distribution,[361] a social enterprise corporation's board of directors is required to ask whether paying a dividend would be commensurate with the chosen corporate purpose. [362] For example, if a social enterprise had not performed particularly well in pursuing the creation public benefit, then it could be inappropriate to declare a dividend, no matter how much profit was made in the particular year of trading. Even in the circumstances in which a social enterprise corporation had performed well in creating public benefit, the board of directors could still take the view that declaring a dividend would not be justifiable because of the specific terms of the corporate purpose statement. This relates back to the new directorial duty of loyalty to the corporation as a separate entity, with its own institutional purposes that subordinate shareholders' interests.

Shareholders' deferred right to a return on their invested capital at the end of a traditional corporation's lifecycle is likewise not intact in a social enterprise corporation. If some of the property remains after satisfaction of its liabilities, shareholders cannot receive more than the paid-up value of their shares. Said differently, shareholders cannot receive anything beyond the nominal value of their shares and any premium paid to the social enterprise corporation.[363] I explain what happens to these assets in our review of the social enterprise corporation's

[359] CA 2004, s 30; CIR 2005, regs 17-20.
[360] Office of the Regulator of Community Interest Companies, *The Asset Lock* (2016) 8 <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/605418/14-1089-community-interest-companies-chapter-6-the-asset-lock.pdf>.
[361] CA 2006, ss 830-831.
[362] Office of the Regulator of Community Interest Companies, *Annex A: Worked Examples of the Dividend and Performance Related Interest Calculation* (2016) 5 <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/605425/cic-14-1092-community-interest-companies-guidance-annex-a-worked-examples-dividend-and-performance-related-interest-calculation.pdf>.
[363] CIR 2005, reg 23(3). However, it is worth noting the exception to this rule that assets can be returned to shareholders if they are themselves asset-locked bodies, such as another social enterprise corporation or a charity.

protective mechanisms.[364] For now, it is enough to say that, as is the legal position in Denmark, once private capital is invested for the purpose of creating public benefit, it is largely committed to that end in perpetuity.[365] The only real difference with the Danish legislation is the level of assets that can be retrieved at the end of a social enterprise corporation's lifecycle – in Denmark 35 per cent of the assets go back to shareholders, whilst in the UK shareholders can only expect a return of their original capital contributions.

I have already canvassed the logic of these rules above. Specifically, it would be unsuitable for a firm's participants to trade on a pro-social platform and then, for example, voluntarily wind up in order to attempt to avoid the legal limitation on mid-stream profit distribution. The legal explanation by Dunn and Riley that we addressed in Chapter 2 was right to argue that this would engender problems for maintaining public trust in social enterprise corporations.[366] But, through our analysis of the social enterprise corporation's political economy in Britain, we also know about the deeper political dynamics. These rules were developed in a period of welfare state restructuring in which the financial stability of the third sector was in doubt. Thus, equipping social enterprises with a corporate organisational unit capable of raising equity capital was sensible. However, there was still no guarantee that private capital, once committed, would remain within the third sector. This potentially jeopardised the state's ambition to make the third sector more self-sustaining in the welfare mix independent of government subsidisation (especially in the context of the Coalition government's election in 2010). The prospect of achieving this result would always be in doubt if mandatory and irreversible legal modifications like the above rules were not in place to limit self-interested private ordering.

Therefore, in the same way a Danish social enterprise corporation's shareholders have strictly limited residual economic rights, so, too, do shareholders in a British social enterprise corporation. The regulatory infrastructure is programmed to attract outside equity capital providers that are prepared to behave like bond-holders or quasi donors, with altruistic motivations and preferences, rather than purely self-regarding and pecuniary ones. The economic incentives play only a limited role in influencing their conduct, and a considerable

[364] See Section 4.5.
[365] Although this is a point outwith the analysis, it is not possible to convert a social enterprise corporation to a traditional corporation. Any attempt to do so would be a *de facto* winding up.
[366] See n 43.

part of what amounts to 'incentives' includes the substantive public benefit generated by a social enterprise corporation's activities.

Therefore, I argue that shareholders in the UK context lack economic primacy. The main motivation for their involvement is for outside equity investors to bear the lion's share of a social enterprise corporation's financial liabilities and risks. Otherwise, the regulatory architecture asserts the independent and civically oriented nature of the firm, emancipating it from prioritising shareholders' interests. Indeed, in economic terms, what we are dealing with is not 'shareholders' in the normal sense – their economic entitlements are not what one would expect to find in a traditional corporation.

The keen observer will have by now noticed a potential problem. Supposing that a social enterprise corporation's shareholders completely delegated corporate decision-making power to directors,[367] the regulatory infrastructure's economic downgrading of shareholders' interests appears to afford the board of directors a substantial degree of insulation from accountability that is not reflected in the traditional corporation. It could be argued that a social enterprise corporation's board of directors has no 'master'[368] and enjoys 'uncontrolled power'.[369]

Fortunately, whilst the board of directors does have a higher degree of insulation to carry on the selected activities for public benefit, the accountability concern is unfounded. Similar to shareholders' non-economic rights in a traditional corporation, a social enterprise corporation's shareholders may, for example, influence the board of director's composition, which includes the right to remove a director at any time without cause, modify the corporate constitution and require directors to take, or refrain from taking, a specific course of action in future. However, as a default matter, and similar to the Danish context, there are restraints on how these non-economic rights must be exercised. That is, any shareholder action must be in conformity with the chosen corporate purpose and the overall requirement to prioritise the creation of public benefit. If shareholder action does not conform to the corporate purpose statement and the overall requirement to prioritise the creation of public benefit, it is liable to be voided. I further elaborate on this point below.

[367] Model Articles for Community Interest Companies Limited by Shares, Schedule 3 of CIR 2005, art 8.
[368] Easterbrook and Fischel (n 292) 38.
[369] A A Berle, Jr, 'For Whom Corporate Managers Are Trustees: A Note' (1932) 45 *Harvard Law Review* 1365, 1372.

Furthermore, shareholders' jurisdiction over the board of director's corporate decision-making power is not altogether exclusive or final. The Regulator also holds the non-economic rights held by a social enterprise corporation's shareholders. This includes, for example, directorial appointment and removal.[370] Related to this, we have established that the Regulator shares jurisdiction with the general body of shareholders regarding alteration of the corporate purpose statement – the corporate purpose statement cannot be altered unless permission is secured from the Regulator.

Additionally, if a social enterprise corporation has an identified class of beneficiaries, the Regulator will not customarily consider an application to amend the corporate purpose statement unless they have been consulted. Unlike in Denmark, this is an explicit point that the regulatory regime highlights, rather than something that we have to infer. For example, if a social enterprise corporation were registered to engage in commercial activities and generate profit for the public benefit of a particular charity, then that charity would need to be consulted about the proposed change before the Regulator would consider the matter.[371] Therefore, it is possible for non-shareholder constituencies to have a quasi-right to be consulted on matters of internal firm governance, and particular actions may not be feasible without receiving their input.

Additionally, suppose that a social enterprise corporation's shareholders gave an instruction to the board of directors to take a particular future action,[372] such as investing in an affordable emerging energy technology that more efficiently utilises fossil fuels. What would happen if the specific social enterprise corporation's corporate purpose statement allowed for such investments generally, but explicitly forbade transactions involving fossil fuels, and neither the shareholders nor the board of directors obeyed the terms?

The regulatory infrastructure makes it possible for non-shareholder constituencies to alert the Regulator to a potential breach of this kind. The Regulator 'relies on others to bring to the Regulator's attention any matters causing concern about the activities' of a social enterprise

[370] CA 2004, ss 42-51; Office of the Regulator of Community Interest Companies, *The Regulator* (2006) 9-10 <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/605423/13-714-community-interest-companies-guidance-chapter-11-the-regulator.pdf>.
[371] Office of the Regulator of Community Interest Companies (n 309) 6.
[372] Model Articles for Community Interest Companies Limited by Shares, Schedule 3 of CIR 2005, art 9.

corporation.[373] In this way, whilst 'members clearly have a role to play in drawing such concerns to the attention of the Regulator', if shareholders fail to take appropriate action the regulatory infrastructure responds by democratising the monitoring function.[374] Thus, interested non-shareholder constituencies can also satisfy themselves that a social enterprise corporation is continuing to meet its specific definition of creating public benefit.

True, this is only an indirect monitoring mechanism. However, if the Regulator investigates and later comes to the view that an external concern was valid and enforcement action must be taken to, for example, remove an offending director,[375] the democratisation of monitoring does practically position non-shareholder constituencies to commandeer shareholders' jurisdiction when the circumstances require.

These are merely a few examples showcasing the constraints on shareholders' jurisdiction over the board of director's decision-making power. In making the claim that the jurisdiction is not exclusive or final, what I am not suggesting is that shareholders' collective function is somehow unimportant. As custodians of the chosen corporate purpose, the Regulator implores shareholders not to 'abdicate' their responsibility to 'monitor the performance of the…[social enterprise corporation] and the directors', but to instead 'satisfy themselves that the company continues to meet…[its obligations] and fully involves the community in its activities and development'.[376] A social enterprise corporation's shareholders are the first line of defence – the custodians of the commitment to create public benefit. However, if shareholders fail in their responsibility to properly monitor, like in Denmark, there is a 'stakeholder monitoring backstop' engineered into the regulatory infrastructure that can bypass shareholders if they do not take action or otherwise act improperly. Therefore, similar to the finding that a Danish social enterprise corporation's shareholders do not have governance primacy, it would be reasonable to surmise that they also do not possess (absolute) governance primacy in a UK context either.

[373] Office of the Regulator of Community Interest Companies (n 38) 5.
[374] ibid.
[375] CA 2004, s 46(1).
[376] Office of the Regulator of Community Interest Companies (n 38) 5.

(c) An Unresolved Question

Although we shall address this extensively in Chapter 5, it is worth briefly reflecting on an unresolved question. Namely, what equity capital providers would be interested in funding social enterprise corporations if they do not have economic and governance primacy? Whilst there are further investor types that we will consider in more depth, the most likely answer, especially in the early stages of a social enterprise corporation's lifecycle, is a sub-category of 'impact investors' called 'impact-first' investors.[377]

Generally, impact investors are attracted to firms that produce both financial returns and societal benefits. Variations in return expectations reflect both individual appetites for risk and investors' motivations for entering the market. A range of investors – for example, angel investors, charities, community funds, foundations, philanthropists and venture capital funds – utilise impacting investing strategies, with some pursuing a commercial rate of return, and others taking the decision to accept a reduced financial return in exchange for greater social impact. In either instance, however, impact investing attempts to challenge the argument that there is an inverse relationship between financial returns and social impact, striving for 'blended value creation' that generates some combination of both.[378] Argued in the commentary

> impact investing provides a significant opportunity for social entrepreneurs as it aims to catalyse funding for social innovation that tackles persistent social problems…These problems range from domestic issues such as child protection, self-harming behaviour (including drug and alcohol abuse), urban transport, indigenous disadvantage and sustainable use of natural resources, to global issues such as climate change, poverty and social development in post-conflict societies.[379]

[377] See generally eg A Bugg-Levine and J Emerson, *Impact Investing: Transforming How We Make Money While Making a Difference* (John Wiley & Sons 2011); Global Impact Investing Network, *What Is Impact Investing?* <https://thegiin.org/impact-investing/need-to-know/#what-is-impact-investing>.
[378] J Ormiston, K Charlton, M S Donald and R G Seymour, 'Overcoming the Challenge of Impact Investing: Insights from Leading Investors' (2015) 6 *Journal of Social Entrepreneurship* 352, 353. See generally also eg E I-Ping Castellas, J Ormiston and S Findlay, 'Financing Social Entrepreneurship: The Role of Impact Investing in Shaping Social Enterprise in Australia' (2018) 14 *Social Enterprise Journal* 130.
[379] Ormiston, Charlton, Donald and Seymour (n 378) 353.

Impact-first investors are those taking the decision to accept a reduced financial return in exchange for greater social impact.[380] That is, the expectation of a financial return is a secondary consideration. Impact-first investors have two characteristics that suggest they would be comfortable with waiving economic and governance primacy. I will use 'angel investors' to illustrate.[381]

First, angel investors provide firms with 'patient capital', which is another way of describing 'long-term capital'.[382] In the context of pursuing activities to create public benefit, an angel investor would be prepared to inject equity capital into a social enterprise corporation with no expectation of a market rate of return or turning a profit in the short-term. Angel investors 'often share founders' non-financial objectives, and, since they invest their own money rather than that of a fund investor, they are more likely to be comfortable investing for the warm glow and community benefits that social enterprises provide'.[383]

Second, angel investors are not usually motivated by control rights or board positions. Angel investors seem to target firms in industries that they know,[384] and many angel investors are familiar with industries where socially conscious hybrid firms are most active.[385] Rather than prioritise control rights and oversight protections, angel investors negotiate for a more 'hands-on' role with a firm's management.[386] As usually ex-entrepreneurs themselves, angel investors miss the excitement of building a business and enjoy helping other entrepreneurs,[387] which, for them, yields its own 'psychic income'.[388] This is communicated to potential investee firms through the informal contractual frameworks within which angel investors prefer to transact. An angel investor contract negotiates for participation and a consulting relationship with an investee firm in exchange for risk capital. It will seldom include provisions that stipulate particular control rights (or downside provisions that limit financial loss and ensure the

[380] ibid 355.
[381] For a good primer on angel investors see generally eg D M Ibrahim, 'The (Not So) Puzzling Behavior of Angel Investors' (2008) 61 *Vanderbilt Law Review* 1405.
[382] J Austin, H Stevenson and J Wei-Skillern, 'Social and Commercial Entrepreneurship: Same, Different, or Both?' (2006) 30 *Entrepreneurship Theory and Practice* 1, 13-15.
[383] Yockey (n 352) 816. See also Ibrahim (n 381) 1440.
[384] A Wong, M Bhatia and Z Freeman, 'Angel Finance: The Other Venture Capital' (2009) 18 *Strategic Change* 221, 223; S Prowse, 'Angel Investors and the Market for Angel Investments' (1998) 22 *Journal of Banking and Finance* 785, 789.
[385] Yockey (n 352) 817.
[386] Ibrahim (n 381) 1419.
[387] ibid 1408-1409
[388] W E Wetzel, Jr, 'Angels and Informal Risk Capital' (1983) 24 *Sloan Management Review* 23, 31.

extraction of a disproportionate share of the financial gains).[389] Therefore, the fact that shareholders lack governance primacy in a social enterprise corporation would not appear to be a deterrent for angel investors, as well as other impact-first investors with similar preferences.

(d) Resource Flexibility

Before we move on to analysing the social enterprise corporation's protective mechanisms, there is one further point that requires our attention. This is the idea of 'resource flexibility'. Resource flexibility exists when an organisational vehicle provides for a 'menu of funding opportunities…[f]or example, donors and foundations could provide a blend of grants and investments. Another opportunity might be "impact investing", practiced by a growing group of investors…[o]ther funding sources include traditional financing alternatives, such as banks, early stage investors, venture capitalists…and community development financial institutions'.[390]

Critically, whilst the social enterprise corporation's hybrid nature facilitates a customised version of the 'participation of shareholders' characteristic that we normally find in the traditional corporation, the intention was not to estrange third sector actors from being attracted to social enterprise corporations. The challenge for policymakers in both jurisdictions was, therefore, how to design a corporate form that could accommodate outside equity capital providers and third sector actors simultaneously. I say this is a challenge since bringing funders from different sectors into the same firm might result in recurring conflict if their incentives and motivations are not reasonably aligned. And, of course, this consideration had to be factored into the underlying policy motivations for introducing the social enterprise corporation in the first place.

There was a politically inferred barrier to outside equity investor involvement, which was viewed as problematic for policymakers since it necessarily impeded private contributions being funnelled into the third sector. On the one hand, providing interested equity capital providers with access to an organisational vehicle that they recognise made sense – the

[389] Ibrahim (n 381) 1442.
[390] K R Graz, 'Toward an Improved Legal Form for Social Enterprise' (2012) 36 *New York University Review of Law & Social Change* 283, 294-295.

resulting availability of any non-state resources could then be used to widen and improve the production and supply of general interest and social welfare goods and services absent direct state intervention. However, on the other hand, that interested equity capital providers would expect some sort of financial return could endanger participation from traditional third sector actors. Third sector actors interested in funding such a firm would also need assurances that, for example, their donations or grants were put towards the chosen corporate purpose, and societal value creation more broadly. For example, with grant-giving foundations, the dilemma is that '[a]lthough legally permitted to do so, foundations rarely make grants to businesses. Foundations must fulfil extensive…[requirements] to ensure that a for-profit recipient uses the…grants, or equity investments exclusively for the investment purposes specified by the foundation'.[391]

The solution was to endow the social enterprise corporation with resource flexibility, which builds a financial bridge between the private sector and the third sector through hybridity. A fundamental effect of resource flexibility is that it allows a firm to derive its financial inputs from different sectors in an attempt to address the above policy considerations. To comprehend this fully, it is necessary to refer back to the specific proportion of profits set by each regulatory framework that must be ring-fenced to develop and maintain a social enterprise corporation's social value objectives. Denmark and the UK both set the proportion of profits at 65 per cent per annum, which must be stored in what I call the 'public benefit reserve fund'. The public benefit reserve fund effectively divides a social enterprise corporation's capital into two different pots, which can connect to two different classes of shares.

Holding share capital that makes up part of the public benefit reserve fund does not result in an entitlement to profit distribution. However, it does provide relevant third sector associated funders with a route to participation in governance in a social enterprise corporation, along with some legal surety that their donations, grants or equity investments will be used exclusively in the pursuit of a particular firm's societal value creation agenda. This maintains the social enterprise corporation's link with the institutional logic of the third sector. We might call these 'impact shares', because the profits generated by a social enterprise corporation and allocated to impact shares would be exclusively designated for the achievement of the chosen

[391] ibid 292.

corporate purpose. They must be reinvested for that goal or otherwise reinvested back into the business for its maintenance and development.

However, as we saw above, the proportion of profits to be stored in the public benefit reserve fund also prescribes the maximum amount of midstream profits that a firm's more economically oriented participants can expect to legally appropriate from a social enterprise corporation. In Denmark, contributors of equity capital eligible to receive a distribution may not expect more than a rate of 15 per cent return on investment, and the firm itself cannot pay out more than 35 per cent of its total post-tax profits. The UK legal regime is slightly different in that it does not prescribe the rate of return on investment, but a social enterprise corporation is nonetheless limited to the distribution of only 35 per cent of its yearly profits. We can call the shares that are eligible for profit distribution 'performance shares'.

Thus, the regulatory frameworks in both jurisdictions are interested in attracting capital providers – from both the private sector and the third sector – that are prepared to get an income like bond-holders or quasi-donors would if they had invested in a conventional third sector organisation with limited profit distribution potential. In this way, the return on capital gained from participation in a social enterprise corporation is best understood as compensation, rather than a reward for risk-taking. In this respect, it is clear that the 'participation of shareholders' characteristic of the traditional corporation has been used as inspiration and adjusted to allow for outside equity investor involvement, which connects the social enterprise corporation to the private sector, but is also, at least on its face, consistent with the preferences of interested third sector actors. This architectural arrangement is also meant to accord with the overarching publicness nature of the social enterprise corporation. This is because the public benefit reserve fund is to be stored and used for societal value creation objectives, and a regulatory oversight body is in place in both jurisdictions to essentially police adherence to the limits on midstream profit distribution. This is primarily achieved through a reporting requirement, and the possibility of an audit, as we shall see in our review of the social enterprise corporation's protective mechanisms.

4.5 Protective Mechanisms

In examining the corporate purpose, the board of directors and shareholders themes, we have already encountered some of the social enterprise corporation's distinctive protective

mechanisms. These protective mechanisms limit pecuniary self-interest and the extent to which private ordering for that purpose is permissible. The state regulators in both jurisdictions are the most conspicuous protective institutional mechanisms. Their powers are broadly framed and arguably interventionist, and they have the mandate to administratively review just about anything a given social enterprise corporation does, either in the boardroom or at the general meeting.[392] The corporate purpose statement, the new directorial duty of loyalty, the limitation on midstream profit distribution to shareholders and the forfeiture of capital at the end of the social enterprise corporation lifecycle are also key protective mechanisms installed to ensure the private commercial pursuit of public benefit. However, there are four other mandatory and irreversible protective mechanisms with which we ought to make ourselves familiar. These protective mechanisms collectively form the fourth major distinction between the social enterprise corporation and the traditional corporation.

(a) Denmark

First, like the limitation on midstream profit distribution for shareholders, directors must also be comfortable with public oversight limitations on their maximum pecuniary incentives. The Danish corporate law and governance system, generally speaking, requires shareholder approval for the remuneration of a traditional corporation's board of directors at the annual meeting every four years. Likewise, from 2021, Danish firms are required to put a remuneration report to an advisory shareholder vote annually. However, in addition to these rules, Danish social enterprise law holds that directors' remuneration cannot exceed what is customary according to the nature of the business and what would be reasonable in relation to a particular social enterprise corporation's social purpose.[393]

Therefore, the remuneration must strike a balance between the need to reward directors for their contributions to a social enterprise corporation's success and the impact that directors' remuneration would have on its activities to be carried on for public benefit. What is 'reasonable' remuneration will depend upon the circumstances of individual firms. However, again, directors and shareholders alike are bound to act in conformity with the superseding idea that social enterprise corporations principally exist to create societal value in the public interest.

[392] Danish Social Enterprise Law, §11; CA 2004, s 41(3).
[393] ibid § 9.

A social enterprise corporation would not satisfy this requirement if the profit from trading activities were diverted from meeting pro-social goals towards increasing the level of directorial remuneration. This would potentially leave a social enterprise corporation making little or no profit for distribution to furthering the chosen corporate purpose.

Given these constraints, it does not seem likely, at least in the majority of instances, that a social enterprise corporation would be able to offer directors variable components in relation to their remuneration. Devices like short-term bonuses, stock options or any other performance-based fees would necessarily derive from incentivising directors to focus mainly on increasing a social enterprise corporation's share price, which is not permitted by Danish social enterprise law because shareholder wealth maximisation is prohibited.

However, it stands to reason that a variable component of directorial remuneration could theoretically be attached to reaching a specified target of increasing societal value. For example, if a social enterprise corporation was established to generate subsidised hydroelectric power and also clear contamination in a specific water system, then it might be legitimate to introduce a variable remuneration component that would incentivise directors to improve the rate of decontamination from year-to-year. The problem, though, is that it would be difficult to calculate whether the actual target was achieved. The measurement formula for determining this would need to be very precise, and, ultimately, it is questionable whether such a variable component could withstand scrutiny from the Danish Business Authority. This is especially so if it did not also feature a claw-back provision that allowed for the reclaiming, either in full or in part, of performance-based remuneration paid on the basis of information that later turned out to be incorrect or misleading.

This puts shareholders in a very delicate position when it comes to voting for an incentive plan for directors that includes a variable remuneration component. They must exercise their governance entitlements in a way that is consistent with, and respects, the chosen corporate purpose. Consequently, in practical terms the likelihood of a social enterprise corporation being able to offer performance-based compensation to directors would be rare.

The obligation that non-shareholder constituencies must be allowed to participate in the enterprise and that evidence of this ought to be included in the annual report is also germane in this context. Granting non-shareholder constituencies an advisory vote on directorial

remuneration would meet the requirement, and it would also serve as a good proxy for whether the arrangements were reasonable. Whilst this is not an explicit legal constraint, failing to seek their approval would be a missed opportunity to meet the requirement, and it would also raise concerns regarding the reasonableness of the directorial remuneration, notably where a social enterprise corporation had an identified class of beneficiaries in the corporate purpose statement that had not been consulted on the matter. At the very least, it is best practice for a social enterprise corporation to engage with its non-shareholder constituencies on directorial remuneration, because securing their approval would create a strong presumption that the arrangements were valid.

The stakeholder monitoring backstop is also relevant in this context. If a non-shareholder constituency group made a complaint about a potential violation of the chosen corporate purpose, the Danish Business Authority has wide powers to investigate and make determinations about the reasonableness of directors' remuneration. If it appeared that the level of remuneration was legally indefensible, enforcement action could be taken.

Second, that a social enterprise corporation is adhering to the regulatory regime is also supported through addition transparency obligations that must be included in the annual report. Namely, directors must provide a detailed explanation on what a social enterprise corporation has done to create public benefit, how non-shareholder constituencies have been consulted and, if a dividend has been declared, how it was calculated. Directors must also disclose detailed information about their remuneration.[394] This information must be lodged with the Danish Business Authority.

It is clear that the annual report should be distributed to shareholders. But the requirement that a social enterprise corporation must evidence that non-shareholder constituencies are being given an opportunity to participate in the enterprise means that the annual report would likely need to be distributed to them as well. This is because the purpose of the heightened transparency obligations is to certify that a social enterprise corporation is still satisfying the legislation's societal value creation rationale, and that it is engaging appropriately with non-shareholder constituencies in carrying out its activities for public benefit. It would be difficult for a social enterprise corporation to argue that it was engaging appropriately with non-

[394] ibid § 8.

shareholder constituencies if the latter were denied access to essential information about the firm. After all, it is only through this information channel that non-shareholder constituencies would able to participate to any significant degree in the first instance. Thus, this is another avenue through which a social enterprise corporation could cultivate stakeholder buy-in. Consistent with other monitoring scenarios, if a social enterprise corporation failed to distribute the annual report, or there was some inconsistency therein, the Danish Business Authority could be notified. The Danish Business Authority is able to appoint auditors to scrutinise and report on the accounts of a social enterprise corporation, and take enforcement action where necessary.

Third, if a social enterprise corporation may only distribute 35 per cent of its total post-tax profits in a given year of trading, what happens to the remainder? The social enterprise corporation introduces another asset partition that this Chapter refers to as the public benefit reserve fund, which was mentioned above in Section 4.4(d). Alongside the traditional 'affirmative' and 'defensive' asset partitions, the public benefit reserve fund requires a social enterprise corporation to devote 65 per cent of its yearly profits to a ring-fenced pool of bonding assets that stimulates public trust that firm-insiders are properly focused on societal value creation in the public interest.[395] The public benefit reserve fund can only be accessed to advance the chosen corporate purpose, maintain the firm as a going concern or invest in, or donate to, other social enterprise corporations or charitable organisations with a social purpose. In other words, a social enterprise corporation's participants cannot appropriate the capital within the public benefit reserve fund for personal gain. To ensure its integrity, where the traditional corporation's corporate constitution is incomplete and malleable, the social enterprise corporation's is more comprehensive and rigid. This is most noticeable with respect to how it places compulsory limits on the contractual freedom of a firm's participants to set and adjust their own pecuniary entitlements. In between disclosure periods, shareholders have information rights concerning the public benefit reserve fund to aid their monitoring of the board of directors, and its overall health can be measured year-to year in the annual report. To reiterate, if there are any irregularities, shareholders (and likely also non-shareholder constituencies) can alert the Danish Business Authority, which may subsequently result in an investigation and enforcement action being taken.

[395] H Hansmann and R Kraakman, 'The Essential Role of Organizational Law' (2000) 110 *Yale Law Journal* 387, 392-393, 398, 423-427.

Fourth, no more than 35 per cent of the remaining assets can be distributed to shareholders at the end of the social enterprise corporation lifecycle. We know the reasoning behind this rule is directly linked to Danish welfare state politics – it is designed to lock in capital within the third sector over the long-term. However, where do these assets travel after a social enterprise corporation's death? That the assets of a social enterprise corporation ought to be used for public benefit, even after de-registration from the scheme, obliges the nomination of another entity (or entities) with legal limits on asset distribution, such as a charity, in the articles of association.[396] In the event that a social enterprise corporation is dissolved when it is not insolvent, any remaining assets must be transferred to the specified nominee entity as a matter of law. Parallel with the avenues through which shareholders and non-shareholder constituencies are able to inform the Danish Business Authority of any concerns, the nominee entity could also make similar representations. For example, if it came to pass that a social enterprise corporation failed to transfer its remaining assets, directors of the nominee entity can make a complaint to the Danish Business Authority. A failure on the part of a social enterprise corporation to observe this asset transfer rule results in a financial penalty. [397]

(b) The UK

These same protective mechanisms can be found in the British social enterprise law ecosystem. First, like the limitation on mid-stream profit distribution for shareholders, directors must be prepared to accept public oversight restraints on their maximum pecuniary incentives. Whilst there is no explicit cap on directorial remuneration, directors are not in a position to set their own pay. The Regulator states that allowing directors to authorise their own remuneration would be 'controversial'.[398] Authorising directors' remuneration through a resolution not backed by a provision in the articles of association would also be unsuitable. Thus, express provisions for directorial remuneration ought to be included in the articles of association.[399]

The provisions authorising directorial remuneration should not be broadly stated or discretionary; they must strike a balance 'between the need to reward directors for their contribution to the company's success…and the impact which directors' salaries may have on'

[396] Danish Social Enterprise Law, § 10.
[397] ibid § 17.
[398] Office of the Regulator of Community Interest Companies (n 38) 8.
[399] Model Articles for Community Interest Companies Limited by Shares, Schedule 3 of CIR 2005, art 25.

a social enterprise corporation's activities carried on for public benefit.[400] What is 'reasonable' remuneration will depend upon the circumstances of each firm. However, like in Denmark, directors and shareholders are required to act in conformity with the overriding idea that social enterprise corporations exist principally to create public benefit. As the Regulator notes a social enterprise corporation 'does not satisfy the…test if it is…established to benefit the community by devoting the profits from its trading activities to charitable or other community causes, but in fact consistently sets its directors' remuneration at a level which means that the company is left making little or no profit for distribution to these…causes'.[401]

A proxy for the reasonableness of directorial remuneration is gaining the approval of relevant non-shareholder constituencies. Whilst this is not a formal legal requirement, according to the Regulator, not seeking approval raises concerns regarding the reasonableness of directorial remuneration, especially where a firm has an identified class of beneficiaries that has not been consulted on the matter. At the very least, it is best practice for a firm to engage with its non-shareholder constituencies on directorial remuneration. Gaining their approval creates a strong presumption that the remuneration arrangements are valid.[402]

Similar to the Danish position, the stakeholder monitoring backstop is also relevant in this context. If a non-shareholder constituency group makes a complaint about a potential violation, the Regulator has wide powers to investigate and make determinations about the reasonableness of directors' remuneration.[403] If it appears that the level of remuneration is legally unjustifiable, enforcement action could be taken to, for example, bring proceedings in the name of a social enterprise corporation against the offending director for breach of duty, or, if the circumstances are particularly grave, petition the courts for a winding up.[404]

Second, that a social enterprise corporation is adhering to the regulatory regime is also supported through an additional transparency obligation to prepare and file a separate report alongside the annual accounts. This must be lodged with the Regulator, and distributed to both shareholders and non-shareholder constituencies. The function of the separate report is to certify that a social enterprise corporation is 'still satisfying the…[requirements], and that it is

[400] Office of the Regulator of Community Interest Companies (n 38) 8.
[401] ibid 9.
[402] ibid 12.
[403] CIR 2005, reg 30.
[404] Office of the Regulator of Community Interest Companies (n 370) 9-10.

engaging appropriately with its stakeholders in carrying out its activities' for public benefit.[405] Directors must provide a detailed explanation on what a social enterprise corporation has done to create societal value in the public interest, how non-shareholder constituencies have been consulted and whether a dividend has been declared.[406] Although it is not strictly necessary, directors are also encouraged to disclose more detailed information about their remuneration. The Regulator considers this best practice in establishing 'stakeholder buy-in'.[407] Consistent with other monitoring scenarios, if a social enterprise corporation fails to distribute the separate report, or there is some inconsistency within it, it is open to shareholders and non-shareholder constituencies to notify the Regulator. The Regulator is able to appoint auditors to scrutinise and report on the accounts of a social enterprise corporation, and take enforcement action where necessary.[408]

Third, British social enterprise law also includes the public benefit reserve fund asset partition. Like in Denmark, the public benefit reserve fund requires a social enterprise corporation to dedicate 65 per cent of its yearly profits to creating societal value in the public interest. Therefore, the public benefit reserve fund can only be accessed to maintain the firm as a going concern or further the creation of public benefit. The Regulator requires that profits are to be 'reinvested back into the company or used for the community it was set up to serve'.[409] In this way, a social enterprise corporation's participants cannot appropriate the capital within the public benefit reserve fund for personal gain. To maintain its integrity, where the traditional corporation's corporate constitution is incomplete and malleable, the social enterprise corporation's is more comprehensive and rigid. This is most noticeable with respect to how the law places compulsory limits on the contractual freedom of a firm's participants to set and adjust their own pecuniary entitlements.

In between disclosure periods, shareholders have information rights concerning the public benefit reserve fund to aid in their monitoring of the board of directors, and its overall health can be measured yearly in the annual accounts. To reiterate, if there are any irregularities,

[405] Office of the Regulator of Community Interest Companies, *Statutory Obligations* (2016) 4 <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/605420/13-711-community-interest-companies-guidance-chapters-8-statutory-obligationstions.pdf>. See also, CIR 2005, regs 26-28.
[406] Office of the Regulator of Community Interest Companies (n 405) 4.
[407] Office of the Regulator of Community Interest Companies (n 38) 13.
[408] Office of the Regulator of Community Interest Companies (n 370) 7.
[409] Office of the Regulator of Community Interest Companies (n 360) 8.

shareholders and non-shareholder constituencies can alert the Regulator, which may subsequently trigger an investigation and enforcement action.

Fourth, recall that shareholders cannot receive more than the paid-up value of their shares at the end of a social enterprise corporation's lifecycle. We know the modern and historical political rationale for this rule, but where do these assets travel after a social enterprise corporation's death? That 'the assets of a…[social enterprise corporation]…ought to be used for the benefit of the community'[410] in perpetuity obliges the nomination of another entity (or entities) with legal constraints on asset distribution, such as a charity or registered society, in the articles of association.[411] As in Denmark, in the event that a social enterprise corporation is wound up when it is not insolvent, any remaining assets must then be legally transferred to the specified nominee entity. Consistent with how shareholders and non-shareholder constituencies are able to inform the Regulator of any concerns, the nominee entity can also make similar representations.

4.6 Concluding Remarks

This Chapter has made one contribution to the legal literature. In particular, it has offered a full and systematic treatment of the social enterprise corporation that showcases how it is distinguishable from the traditional corporation, and, at various points, it has drawn attention to political economy. The political drivers underpinning the social enterprise corporation are important because they had an explicit impact upon its organisational architecture and regulatory infrastructure in both jurisdictions, which are calibrated to lexically prioritise private action for public benefit and lock in capital within the third sector.

Policymakers originally introduced the social enterprise corporation to spin off some level of centralised public responsibility to non-state actors for the implementation and financing of social welfare policy. That the social enterprise corporation emerged in a period of welfare state restructuring in both Denmark and the UK meant that there was a desire for any private capital – once committed to a social enterprise corporation pursuing a social welfare purpose – to remain in the third sector to support its financial stability independent of government

[410] ibid 4.
[411] Model Articles for Community Interest Companies Limited by Shares, Schedule 3 of CIR 2005, art 3(5).

subsidisation. Although overlooked by commentators, this is why we observe a range of mandatory and irreversible legal modifications that are overseen by a state regulator. The collective function of the legal modifications and the state regulator is to limit private ordering within the context of internal firm governance, especially with respect to taking self-interested financial decisions that could undermine the public interest.

In contributing a complete theoretical model to the legal literature, we discovered that, generally, the social enterprise corporation is at odds with the traditional corporation since it is not nearly as contractually customisable or economically efficient in the orthodox sense. More specifically, I contended that there are four major distinctions between the social enterprise corporation and the traditional corporation.

The first major distinction concerns the corporate purpose theme. A traditional corporation can either generate societal value indirectly or depart from the pro-shareholder position, either in whole or in part, and select a corporate purpose that more directly produces specific public benefit. However, this choice is purely contractual. The social enterprise corporation is a very different creature – the Danish and British regulatory regimes both explicitly communicate that creating societal value in the public interest is a mandatory and irreversible legal requirement. A social enterprise corporation cannot be formed without the specification of proposed activities to be carried on for public benefit, and the state regulator has broad discretion to determine whether the stated activities would do so.

The second major distinction concerns the board of directors. Since the activities to be carried on for public benefit is a firm's purpose, the board of directors has a differently constituted duty of loyalty that is not owed to the corporation for shareholders' private benefit, but rather to the firm itself as a separate socio-institutional entity. This connects closely with how a social enterprise corporation's board of directors must act in exercising corporate power, and the standard of loyalty to which it is held accountable. A social enterprise corporation's board of directors must formulate and executive a strategy in which the firm engages in productive processes and generates profit, instrumentally, in the pursuit of the selected public benefit. Whilst this is not the same thing as arguing that social enterprise corporations cannot pursue profit, pursuing profit must nevertheless be consistent with the corporate purpose statement and ultimately tied back to it.

This reality, in effect, blunts the economic and non-economic entitlements that shareholders would otherwise enjoy in a traditional corporation, which is the third major distinction that disconnects the social enterprise corporation from the traditional corporation. Although shareholders still have economic and governance rights, the purpose to create public benefit arguably transcends the private identities and interests of a social enterprise corporation's participants and is, indeed, why there are mandatory and irreversible restraints on corporate capacity and fetters on self-interest.

Whilst shareholders in a social enterprise corporation still perform a risk-bearing function, the law precludes shareholder wealth maximisation. Therefore, the residual economic rights that shareholders do hold ought not be viewed as a reward for risk-taking. At the most, shareholders can expect only a modest form of compensation, which makes them more like bondholders or quasi-donors. This essentially downgrades shareholders' interests within a social enterprise corporation, making it 'wrong' and damaging to a firm's social legitimacy to consider or prioritise their interests in the pursuit of profit if it cannot be shown to serve the chosen corporate purpose.

We can say that a social enterprise corporation's shareholders have non-economic rights to oversee the board of directors. However, this oversight jurisdiction can only be exercised if it is in conformity with the corporate purpose statement and the overall requirement to prioritise the creation of public benefit. If shareholder action does not conform to the corporate purpose statement and the overall requirement to create societal value in the public interest, it is voidable. Thus, shareholders' role in a social enterprise corporation is custodial in nature, in the sense that their main function is to monitor the performance of the firm and the board of directors.

In our discussion of shareholders, we also saw that there is a role for non-shareholder constituencies within the context of monitoring. True, whilst non-shareholder constituencies' approval is clearly important in the social enterprise law context, consulting them and taking account of their views is not 'law' as such, but rather something like 'best practice'. However, there are a couple of significant scenarios in which non-shareholder constituencies can have a quantifiable impact upon internal firm governance, which is, in effect, consonant with democratising the monitoring function. The most pivotal is that, if a social enterprise corporation has an identified class of beneficiaries, the state regulator in both jurisdictions

would likely not consider an application to amend the corporate statement unless they have been consulted. Non-shareholder constituencies also seem to have information rights through reporting, which allows them to monitor the public benefit reserve fund, midstream profit distribution to shareholders and directorial remuneration. Although this is not entirely clear in the Danish case, if information about the firm is not disseminated through reporting, or anything therein appears improper, non-shareholder constituencies can bring this to the attention of the state regulator – in both jurisdictions they can investigate and take enforcement action where necessary.

The same is true if the board of directors or shareholders contravene the corporate purpose statement. Whilst this is not the same thing as equipping non-shareholder constituencies with 'hard' governance rights, the stakeholder monitoring backstop engineered into the regulatory infrastructures can nonetheless bypass firm insiders. Although a social enterprise corporation's shareholders are the first line of defence, this provides non-shareholder constituencies with a route to holding the board of directors accountable if shareholders fail to act, or if shareholders otherwise exercise their suffrage to the detriment of the corporation's separate interests. This goes well past the status of non-shareholder constituencies in the traditional corporation. This is not least because there is supervisory machinery installed that gives them access to a state regulator with broadly framed and arguably interventionist powers to administratively review just about anything a given social enterprise corporation does in Denmark or in the UK.

The fourth major distinction is that, unlike the traditional corporation, the social enterprise corporation features mandatory and irreversible protective mechanisms that are designed to limit pecuniary self-interest and the extent to which private ordering for that purpose is permissible. In Denmark and the UK, these include a state regulator, a corporate purpose statement, a new directorial duty of loyalty, a limitation on midstream profit distribution to shareholders, forfeiture of capital at the end of a social enterprise corporation's lifecycle (the level of which depends upon the jurisdiction), a constraint on directorial remuneration, extra reporting obligations, a public benefit reserve fund and a residual asset transfer rule.

Now that we have a good grasp of how welfare state politics influenced the emergence of the social enterprise corporation and the effect political economy had on its function and structure, we shall now turn to consider the extent to which European social enterprise law is compatible with contemporary investment models and trends.

|5|

MAPPING THE INVESTMENT LANDSCAPE

We now have a solid understanding of how welfare state politics influenced the emergence of European social enterprise law and the effect political economy had on its function and structure. In this Chapter, we are concerned with filling another important gap in the legal literature. Namely, commentators have not considered the extent to which European social enterprise law is compatible with contemporary investment models and trends. Is European social enterprise law amenable and responsive to the norms of the current investment landscape? If not, what sorts of problems could arise? How would the problems potentially disturb the policy intentions of the jurisdictions in introducing the social enterprise corporation? Lastly, how could European social enterprise law be modified to counteract the problems?[412]

To help answer these questions, I present a concept called 'isomorphism'. Isomorphism is a term found throughout the social enterprise literature. It denotes how an organisation may be forced to take on certain features of a dominant or prevailing form in its environment. Social enterprise commentators often postulate that isomorphism could adversely affect hybrid organisational forms like the social enterprise corporation, so that firms become more shareholder-focused over time. The reason is that a key policy intention of the jurisdictions in engineering the social enterprise corporation was to entice outside equity investors to subsidise the provision of goods and services associated with public welfare. Under these circumstances, given that more market-oriented stakeholders would necessarily have power over both the flow of organisational resources and how far social value creation is pursued, it could eventually lead to the situation in which social enterprise corporations come to behave like traditional corporations. Of course, the danger with this happening is that social value creation might be displaced by pecuniary self-interest, thus jeopardising a principal logic of the legislation.

After bringing isomorphism into the discussion, I then try to determine when and where it might manifest within the social enterprise corporation. I suggest that a tension between social value creation and the pursuit of profit for shareholders' private benefit will not, at least generally, occur during the early stages of a social enterprise corporation's lifecycle. This is

[412] Some of the contents of this Chapter appear in J S Liptrap, 'The Social Enterprise Company in Europe: Policy and Theory' (2020) 20 *Journal of Corporate Law Studies* 495.

because of the type of equity capital providers that would likely invest at the early stage. This point was briefly canvased in Chapter 4. Therefore, here I argue that, on its face, there does not seem to be a conflict between European social enterprise law and contemporary investment models and trends.

However, I argue that the position changes at the later stages of a social enterprise corporation's lifecycle. I identify an isomorphic threat called the 'legacy problem', which can become an issue once a social enterprise corporation reaches maturity and requires access to deeper capital pools. Again, this proposition turns on the kind of equity capital providers that would tend to invest at the later stage. The current investment landscape is referenced to show how the legacy problem could impact a social enterprise corporation and the circumstances under which it would arise. Special attention is paid to conversion and winding up scenarios. All else being equal, this seems to be where the legacy problem is apt to be of greatest concern to social value creation. Consequently, European social enterprise law and contemporary investment models and trends do appear to be at odds with each other at the later stage.

We saw in Chapter 4, though, that European social enterprise law does include rules that cover conversion and winding up scenarios. To be discussed, this is in anticipation of the legacy problem. Therefore, whilst there is theoretical scope for conflict, in practical terms more self-interested investors would not be able to side-step the legislative prioritisation of ensuring firms' fidelity to making a positive social impact. In other words, more self-interested investors would not be in a position to extract the capital dedicated to social value creation through a conversion or winding up transaction. Once equity capital is dedicated to social value creation, it is largely dedicated to that end in perpetuity.

This is an encouraging finding in terms of ensuring private action for public benefit. But it does call into question whether the social enterprise corporation is able to meet the jurisdictions' policy intention of redirecting and locking in more private capital towards the subsidisation of public welfare over the long-term. Ultimately, the organisational form must be commercially appealing to interested market actors for the jurisdictions to achieve their objectives. The Chapter concludes with some criticisms in this regard and suggestions for improvement.

5.1 Isomorphism

A by-product of hybridity is that the amalgamation of different legal mechanisms and institutional logics can result in tensions at the organisational level. More specifically, under certain circumstances a hybrid entity could be obliged to conform to the demands of a particular institutional logic to gain legitimacy and sustain competitiveness. This can erase, rather than blur, the boundaries between converging sector logics and compel a firm to prioritise the customs and patterns of behaviour that define only a single sector.[413] This is what commentators are referencing when they talk about isomorphism, which is a 'first principle' when considering hybridity and social enterprise.[414] Isomorphism concerns the degree to which an entity has been forced to internalise external environmental pressures in order to survive.[415]

It will be recalled that the overall policy aim was to encourage civil society actors – and others in the private sector interested in pro-social entrepreneurship – to coordinate with providers of private capital to reduce states' financial liabilities in social policy areas. Thus, the choice was made to provide interested market actors with a resource flexible organisational form capable of pursuing non-financial objectives in the public interest. The policy intention for the social enterprise corporation to operate, at least partially, under the legal form and financing of the private sector means that firms must satisfy the expectations of more market-oriented stakeholders. These stakeholders would necessarily have power over both the flow of organisational resources and how far social value creation is pursued.

The available empirical evidence shows that, although social entrepreneurs are typically committed to creating benefits for society, a conflict can occur between generating social value and maximising financial returns for shareholders.[416] That is to say, even some investors – like banks, development finance institutions, pension funds and venture capital funds – interested in financial returns with a minimum expected social (or environmental) impact still focus on

[413] T Reay and C R Hinings, 'Managing the Rivalry of Competing Institutional Logics' (2009) 30 *Organization Studies* 629, 631-632.
[414] The pioneers of this idea are Paul DiMaggio and Walter Powell, whose joint work has heavily influenced the commentary dealing with hybrid entities and social enterprise. See generally P J DiMaggio and W Powell, 'The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organizational Fields' (1983) 48 *American Sociological Review* 147.
[415] C Mason, 'Isomorphism, Social Enterprise and the Pressure to Maximise Social Benefit' (2012) 3 *Journal of Social Entrepreneurship* 74, 77-79.
[416] See eg E T Kodzi, Jr, 'The Clash of Missions: Juxtaposing Competing Pressures in South Africa's Social Enterprises' (2015) 6 *Journal of Social Entrepreneurship* 278, 285-287.

'financial-first' investments. Finance-first investors would make an investment in a social enterprise corporation when it is probable that implementing such a strategy is economically rational in the normal way.[417] This means that potential investment opportunities are based on financial merit using the same professional due diligence screening practises employed by mainstream investors. Therefore, finance-first investors seek to achieve a market-competitive rate of financial return from their investments that also happens to offer the derivative prospect of some sort of social impact. In this way, finance-first investors are not usually willing to pursue an investment opportunity that involves a trade-off between financial returns and social impact.[418] Another way of formalising this idea is to say that there is an issue with 'hands-tying', in the sense that finance-first investors may change their minds downstream when the chance to 'cash in' financial gains presents itself. In some parts of the economics literature this is called a 'time-consistency' problem.[419]

The possibility of wider access to resources from outside equity investors – and by extension the potential for greater revenues, improvements in economic efficiency and competitive positioning in existing or new markets – also invites increased exposure to external financial forces. Isomorphic threats could hypothetically develop in a number of ways, but they eventually result in a firm's 'goals, priorities and modes of operation…more closely resemble[ing] those' of the traditional corporation.[420] The isomorphic threat to social value creation that this Chapter identifies is the legacy problem, which, as mentioned in the introductory remarks, can become problematic at the later stages of a social enterprise corporation's lifecycle. Thus, this is the fault line on which European social enterprise law and contemporary investment models and trends do seem to clash. This is something that I examine in greater depth below.

But before we launch into that discussion, it is argued that there is not much cause for concern regarding a potential divergence between social value creation and the pursuit of profit for shareholders' private benefit during the early stages of a social enterprise corporation's

[417] Ormiston, Charlton, Donald and Seymour (n 378) 352, 365, 373.
[418] ibid 366. See generally also Alan Hirzel, 'To Grow, Social Enterprises Must Play by the Rules of Business' (2013) *Harvard Business Review* <https://hbr.org/2013/01/to-grow-social-enterprises-mus>.
[419] See generally eg A Lindbeck and J W Weibull, 'Altruism and Time Consistency: The Economics of Fait Accompli' (1988) 96 *Journal of Political Economy* 1165.
[420] M L Di Domenico, P Tracey and H Haugh, 'The Dialectic of Social Exchange: Theorizing Corporate – Social Enterprise Collaboration' (2009) 30 *Organization Studies* 887, 903.

lifecycle. To properly situate our evaluation of the legacy problem, it is essential to appreciate why this is the case.

5.2 Early Stage Investor Involvement

I noted above that it is, broadly speaking, improbable that isomorphic threats would surface in the formative stages of a social enterprise corporation's development. The type of equity capital providers that would likely invest is a central part of this claim, but there are a few other reasons why I argue that there does not seem to be a conflict.

First, as a category, social entrepreneurs – those individuals who establish enterprises primarily to meet social objectives – are not generally opportunistic.[421] Social entrepreneurs are not 'motivated by economic gains' but are 'rewarded directly through non-material benefits (status, honor, fame, respect and recognition) or indirectly through an increase in public welfare'.[422] Second, social entrepreneurs commonly root their operations directly within communities characterised by specific socio-economic and welfare problems. For these firms, an integral aspect of creating social value is fostering community engagement and local development through active participation and dialogue in the business. This could relate to, for example, employing members of the community or inviting them to serve on the board.[423] Therefore, the impetus to expand operations is not always present or viewed as a positive step – 'growth may not be the best approach to achieve the organization's goals or to have the greatest social impact. Growth for the sake of growth has the potential to squander organizational resources and can actually detract from the organization's overall impact'.[424] This may render social entrepreneurs' initiatives remaining small-to-medium-sized, but this is not customarily viewed as a failure because staying localised preserves autonomy and social mission commitment.[425] Third, in the instances in which organisational growth makes sense at the early stage it is likely

[421] See eg A J Germak and J A Robinson, 'Exploring the Motivation of Nascent Social Entrepreneurs' (2014) 5 *Journal of Social Entrepreneurship* 5, 13-17.
[422] D Christopoulos and S Vogl, 'The Motivation of Social Entrepreneurs: The Roles, Agendas and Relations of Altruistic Economic Actors' (2015) 6 *Journal of Social Entrepreneurship* 1, 23. See also F Santos, 'A Positive Theory of Social Entrepreneurship' (2012) 111 *Journal of Business Ethics* 335, 344-347.
[423] See eg M L Di Domenico, H Haugh and P Tracey, 'Social Bricolage: Theorizing Social Value Creation in Social Enterprises' (2010) 34 *Entrepreneurship Theory and Practice* 681, 690, 694-695.
[424] Austin, Stevenson and Wei-Skillern (n 382) 7. See also T Scheuerle and B Schmitz, 'Inhibiting Factors of Scaling Up the Impact of Social Entrepreneurship Organizations – A Competitive Framework and Empirical Results from Germany' (2016) 7 *Journal of Social Entrepreneurship* 127, 152.
[425] Scheuerle and Schmitz (n 424) 151.

that social entrepreneurs will draw from the multiple sources of funding traditionally associated with the third sector. These include membership fees, donations and private or public grants.[426] However, in the event that social entrepreneurs take the decision to look outside the third sector and include interested (private sector) investors, contemporary investment models and trends suggest that they would normally only engage with 'impact-first' investors, such as angel investors, charitable foundations and smaller community-based funds. This was a point I briefly made in Chapter 4. Impact-first investors are the opposite of finance-first investors, in the sense that they seek to maximise a social return whilst also having set a secondary minimum financial return expectation.[427] Impact-first investors traditionally offer two unique advantages over other sources of private funding that reduce the risk of isomorphic threats. The way in which I want to illustrate this idea is to focus on so-called 'angel investors'. I have selected angel investors since impact-first investing as a general strategy depends on investors' varying appetites for risk and their expectations with respect to financial returns and social impact. In the first years of a social enterprise corporation's lifecycle a firm will have little or no operating history or tangible assets with which to predict future performance. Although there would obviously be exceptions to this assumption, the most likely actor interested in a firm with this kind of front-loaded risk profile would be the angel investor.

(a) Angel Investors

Angel investors could be either natural or juristic persons, but they are usually high net-worth ex-entrepreneurs, meaning that they can be expected to understand investing as a default matter, but start-up investments specifically.[428] As the commentary notes, many 'angels made their fortunes after going through the very same funding process on the other side, when running their own start-ups'.[429] As a class, angel investors are interested in engaging with firms

[426] See eg E Shaw and S Carter, 'Social Entrepreneurship: Theoretical Antecedents and Empirical Analysis of Entrepreneurial Processes and Outcomes' (2007) 14 *Journal of Small Business and Enterprise Development* 418, 428.
[427] Ormiston, Charlton, Donald and Seymour (n 378) 355.
[428] See eg M Van Osnabrugge and R J Robinson, *Angel Investing: Matching Start-Up Funds with Start-Up Companies – The Guide for Entrepreneurs, Individual Investors, and Venture Capitalists* (John Wiley & Sons 2000) 108; J Freear, J E Sohl and W E Wetzel, Jr, 'Angels and Non-Angels: Are There Differences?' (1994) 9 *Journal of Business Venturing* 109, 111; J E Fisch, 'Can Interest Offerings Bridge the Small Business Capital Barrier?' (1998) 2 *Journal of Small and Emerging Business Law* 57, 74.
[429] Ibrahim (n 381) 1427.

that have capital needs ranging from relatively small amounts to between £750,000 and £1.5 million in approximately the initial two years of existence.[430]

Angel investors traditionally offer two unique advantages over other sources of private sector funding that reduce the likelihood of isomorphic threats to social value creation. First, angel investors provide social entrepreneurs with 'patient capital'. Patient capital is another way of describing long-term capital.[431] In the context of creating social value, an angel investor would be prepared to make a financial investment in a firm with no expectation of a market rate of return or turning a profit in the short-term. Angel investors 'often share founders' non-financial objectives, and, since they invest their own money rather than that of a fund investor…[they] are more likely to be comfortable investing for the warm glow and community benefits that social enterprises provide',[432] particularly in relation to investing in a firm that will create jobs in an angel investor's community.[433] It has also been observed that angel investors miss the excitement of building a business and enjoy helping other entrepreneurs[434] – this engagement strategy yields its own 'psychic income'.[435]

Second, angel investors are not typically interested in overburdening the 'seed deal with onerous terms and conditions' that would lead to the situation in which social entrepreneurs were faced with pressure from the external environment to maximise a firm's financial potential to the detriment of its social value objectives. This is mainly due to angel investors not usually seeking to acquire control rights or board positions.[436] Angel investors prefer to target firms in industries that they know,[437] and many angel investors are familiar with industries where socially conscious hybrid firms are the most active.[438] Rather than aim for considerable control or oversight protections, angel investors favour local investments so that

[430] See eg J E Sohl, 'The U.S. Angel and Venture Capital Market: Recent Trends and Developments' (2003) 6 *Journal of Private Equity* 7, 14; S Cash, 'The European Seed Landscape: 2018 So Far' *VentureBeat* (22 Aug 2018) <https://venturebeat.com/2018/08/22/the-european-seed-landscape-2018-so-far/>.
[431] Austin, Stevenson and Skillern (n 382) 13-15.
[432] Yockey (n 352) 816. See also Ibrahim (n 381) 1440.
[433] Freear, Sohl and Wetzel, Jr (n 428) 111. See also Wetzel, Jr (n 388) 31.
[434] Ibrahim (n 381) 1408-1409.
[435] Wetzel, Jr (n 388) 31.
[436] J M Fried and M Ganor, 'Agency Costs of Venture Capitalist Control in Startups' (2006) 81 *New York University Law Review* 967, 1009.
[437] Wong, Bhatia and Freeman (n 384) 223; Prowse (n 384) 789.
[438] Yockey (n 352) 817. See also D Floyd, 'Social Investment: Guidance and Guardian Angels' *The Guardian* (13 Sept 2013) <https://www.theguardian.com/social-enterprise-network/2013/sep/13/social-investment-angel-investors>.

they can make regular visits to a firm's facilities.[439] Angel investors use their industry expertise to negotiate for a more 'hands on' role with a firm's management.[440] As ex-entrepreneurs themselves, angel investors bring useful business knowledge to firms in which many social entrepreneurs lack the professional managerial experience to animate their otherwise good ideas to solve particular socio-economic and welfare problems.[441]

Aside from the above, angel investors – as well as other impact-first investors with similar preferences – often self-identify as for-profit philanthropists.[442] This is communicated to potential investee firms through the informal contractual frameworks within which angel investors prefer to transact. An angel investor contract negotiates for participation and a consulting relationship with an investee firm in exchange for risk capital; it will seldom include down-side provisions to limit financial loss or ensure the extraction of a disproportionate share of the financial gains.[443] This sends a signal to an investee firm; it acts as a proxy for angel investors' trustworthiness and altruistic commitment to social value creation that is discernible and can be gauged by social entrepreneurs. Argued by one commentator, 'an individual may refrain from including a particular clause in a contract in order to signal his type'.[444] Similarly, consider the

> signalling effect of a detailed, preference-laden contract in the context of angel investing. If an angel presents an entrepreneur with such a contract that must be signed before receiving funds, the entrepreneur may interpret it as a lack of trust, or that the relationship will be more combative than cooperative. And if entrepreneurs think this, then angels' nonfinancial goals are jeopardized.[445]

For social entrepreneurs, this is important because 'they…worry that an investor might use control to pillage a venture's finances', and will 'need assurances that investors will not literally

[439] MIT Entrepreneurship Center, *Venture Support Systems Project: Angel Investors* (2000) 31-32 <http://nutsandbolts.mit.edu/resources/angelreport.pdf>.
[440] Ibrahim (n 381) 1419.
[441] Yockey (n 352) 816.
[442] See eg J L Sorenson and A Jagelewski, 'Why 2018 is the Year of the Philanthropic Investor' *Forbes* (18 Dec 2017) <https://www.forbes.com/sites/forbesfounders/2017/12/18/why-2018-is-the-year-of-the-philanthropic-investor/>.
[443] Ibrahim (n 381) 1442.
[444] K E Spier, 'Incomplete Contracts and Signalling' (1992) 23 *Rand Journal of Economics* 432, 432.
[445] Ibrahim (n 381) 1441. See also M M Blair and L A Stout, 'Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law' (2001) 149 *University of Pennsylvania Law Review* 1735, 1806.

sell out or simply stop trying to change the world once big profits become attainable. If they cannot solve these high-degree-of-difficulty trust problems, capital will remain elusive'.[446]

Therefore, the additional legal and institutional mechanisms we covered in Chapter 4 that limit pecuniary self-interest are likely appropriate (if not redundant) for protecting the regulatory frameworks' social value creation rationale during early stage investor involvement. A firm's participants will have in the majority of instances organically cultivated 'calculative' or 'internalised' trust independently of the legislation.[447] This is 'true' trust that confirms the 'other-regarding preference[s]' of the parties.[448] When trust is cultivated

> it can substantially reduce the inefficiencies associated with both agency and team production relationships. Trust permits transactions to go forward on the basis of a handshake rather than a complex formal contract [or because of the imposition of a rigid regulatory framework]; it reduces the need to expand resources on constant monitoring of employees and business partners; and it avoids the uncertainty and expense associated with trying to enforce formal and informal agreements in court.[449]

This is possible because of angel investors' preferences and their financial return expectations, which are subsidiary to engendering social impact. Although there are no doubt exceptions to this argument, we can assume that other impact-first investors would also generally have similar preferences and financial return expectations. Therefore, what we can distil from this is that, on its face, there does not seem to be a conflict between European social enterprise law and contemporary investment models and trends at the early stage. This is an important conclusion. The trust cultivated between a firm and its investors does appear to create the conditions necessary for more private capital to flow towards the subsidisation of public welfare in the short-term, at least in the abstract.

However, I argue that the same may not be true at the later stages of a social enterprise corporation's lifecycle. The statutory limitations on asset distribution – in particular within

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[446] D Brakman Reiser and S A Dean, *Social Enterprise Law: Trust, Public Benefit, and Capital Markets* (Oxford University Press 2017) 11 (hereafter *Trust*). See also D Brakman Reiser and S A Dean, 'Hunting Stag with Fly Paper: A Hybrid Financial Instrument for Social Enterprise' (2013) 54 *Boston College Law Review* 1495, 1518-1520.
[447] See generally O E Williamson, 'Calculativeness, Trust, and Economic Organization' (1993) 36 *Journal of Law and Economics* 453.
[448] Blair and Stout (n 445) 1750-1751. See also Wong, Bhatia and Freeman (n 384) 227.
[449] Blair and Stout (n 445) 1757.

conversion and winding up scenarios – are potentially not sufficient to create trust between a firm's participants. This is because the regulatory frameworks' specificities appear to be at cross-purposes with the preferences and financial return expectations of the kind of equity capital providers that would tend to invest at the later stages. Not only could this occasion the attraction of market actors with pecuniary motivations that are inconsistent with the policy goal to create social value, but it might also negatively affect the flow of private capital to social enterprise corporations. This calls into question whether the social enterprise corporation is able to meet the jurisdictions' policy intention of redirecting and locking in more private capital towards the subsidisation of public welfare over the long-term. In the end, the organisational form must be, at least to some extent, commercially appealing to interested market actors for the jurisdictions to achieve their policy objectives.

5.3 Later Stage Investor Involvement

Some firms will not survive. But for those firms that do manage to stabilise their operations, the type of relationship that investors might have with a social enterprise corporation after early stage involvement will unavoidably be context-specific and turn on each investor's circumstances. Investors that have established a deep connection with a firm may elect to remain invested throughout its lifecycle; others may decide that a single round of investment was sufficient and will move on to other opportunities. Angel investors, for example, do not normally focus on ongoing business relationships with the firms in which they invest. Angel investors usually fund one round in a particular firm and then exit to look for other investment opportunities.[450] It is also worth considering that social entrepreneurs' needs could have been met during early stage investor involvement. Due to being conventionally localised within a small geographic area or community, further capitalisation may not be essential, or desirable, for the maintenance of a firm's social value objectives. It follows that, in many situations, isomorphic threats may never arise between a firm and its investors.

Notwithstanding, those social enterprise corporations that do endure roughly the first few years and have ambitions to, for example, expand into other markets or deliver more products and services to consumers (or, more rarely still, aim for a trade sale to a larger corporation) will

[450] However, there is some evidence that, in the right circumstances, angel investors will stay on with a promising investee firm for longer periods. See eg D M Ibrahim, 'Should Angel-Backed Start-Ups Reject Venture Capital?' (2013) 2 *Michigan Journal of Private Equity and Venture Capital Law* 251, 256-259.

require extra capital beyond the relatively small amounts that angel investors, and other early stage impact-first investors, are able, or prepared, to provide. At this juncture, according to what we know about the current investment landscape, a firm would arguably be obliged to transact with finance-first investors. This is because finance-first investors offer access to deeper capital pools.

Finance-first investors were already described above, but it is useful to restate that they would only make an investment in a social enterprise corporation when it appears likely that doing so is economically rational in the normal way.[451] This means that potential investment opportunities are based on financial merit using the same professional due diligence screening practises employed by mainstream investors. Therefore, finance-first investors seek to achieve a market-competitive rate of financial return from their investments that also happens to offer the derivative prospect of some sort of social impact. Finance-first investors – especially institutional investors – are not usually willing to pursue an investment opportunity that involves a trade-off between financial returns and social impact.[452]

It is debateable, though, whether social enterprise corporations will have sufficient capitalisation to attract certain types of finance-first investors, notably larger institutional investors. A fear will necessarily remain that a firm is illiquid, lacks a satisfactory track record or could fail prematurely.[453] It is also the case that larger institutions will owe bright-line fiduciary duties and legal obligations to those that invest in them, and cannot pursue investment opportunities that involve a trade-off between financial returns and social impact.[454] It seems fair to surmise, therefore, that financially successful social enterprise corporations may be appealing to only a category of finance-first investor that specialises in providing larger capital injections to high-growth, high-risk firms at later stages of progression – venture capital funds.

Why is this? Venture capital funds, and similar investment intermediaries, have more relaxed fiduciary duties and legal obligations than their institutional counterparts, and will, therefore, have increased elasticity to consider the placement of social impact within their investment decision-making processes and how it might contribute to portfolio diversification. However,

[451] Ormiston, Charlton, Donald and Seymour (n 378) 365, 373.
[452] ibid 366.
[453] Ibrahim (n 450) 253
[454] Ormiston, Charlton, Donald and Seymour (n 378) 366.

even though venture capital funds have more transacting flexibility when it comes to, for example, deal size, time horizons, liquidity and other important factors, the pursuit of an investment that includes non-financial considerations can only be justified once a case has been sufficiently made out that the expected rate of financial return is commensurate with the risk exposure. Thus, for finance-first investors like venture capital funds, any investment opportunity must have financial merit.[455]

Venture capital funds in particular exhibit contracting tendencies and have pecuniary preferences that can lead to the legacy problem. To be clear, this is not to say that venture capital funds would be the only type of finance-first investor with the requisite behavioural traits essential for the legacy problem to surface. Nor is it the argument here that all venture capital funds and other comparable investment intermediaries that choose to engage would expose social enterprise corporations to isomorphic threats. It is simply that the possibility of the legacy problem affecting a social enterprise corporation and contravening the legislative intention of the regulatory frameworks is easily observable in traditional venture capital funds' general structure and transacting patterns. Later in this Chapter after the nature of venture capital funds and the legacy problem have been analysed, we will examine how the regulatory frameworks anticipate the legacy problem. We will also problematise whether the particular conversion and winding up legal mechanisms are desirable in their current form *vis-à-vis* redirecting and locking in more private capital towards the subsidisation of public welfare over the long-term.

(a) Venture Capital Funds

Although venture capital funds – like angel investors – are specialist investors interested in targeting newer firms with growth potential and more risk, venture capital would not be immediately available to a social enterprise corporation in the first few years.[456] Venture capital funds are generally set up as limited partnerships. Venture capitalists are the 'general partners', and the investors – for example, pension funds, sovereign wealth funds and insurance

[455] ibid 373.
[456] Ibrahim (n 450) 254. See also P A Gompers, 'Optimal Investment, Monitoring, and the Staging of Venture Capital' (1995) 50 *Journal of Finance* 1461, 1473.

companies – are the 'limited partners'.[457] The limited partners of a venture capital fund supply the capital. A venture capital fund attracts larger amounts of capital from investors with an expectation that the specific fund will generate timely and high returns.[458] Venture capital funds invest in multiple rounds, and a typical round of funding is between £1.5 and £10 million, but it can be far higher in later rounds.[459] Therefore, while it is possible that a venture capital fund could choose to apply a social impact investment strategy to a proportion of its investment portfolio (or across certain or all of its asset classes), it would not make sense to invest in a social enterprise corporation until it can be verified that a firm has survived the early stage and is expanding. Risk and uncertainty must be seen to be decreasing, not least because investors' expectation is that their capital ought to be allocated efficiently by making larger investments that may not be suitable for younger firms.[460]

The downstream pressure on venture capitalists from investors to produce high financial returns is intensified since venture capital funds have a maximum lifespan of ten to twelve years before they must liquidate and make final distributions.[461] During a specific venture capital fund's existence, the venture capitalists must begin soliciting for investments in future funds, often from the same investors. A satisfactory financial return acts as an inducement for the limited partners to invest in venture capitalists' next project(s). The final distribution 'allows fund investors to evaluate the quality of their venture capitalists and, if necessary, to reallocate their funds away from venture capital to other investment vehicles or from less successful venture capitalists to more successful venture capitalists'.[462] Additionally, for their efforts, venture capitalists generally receive a management fee of 2 per cent of the invested funds, coupled with 20 per cent of the overall profits on final distribution.[463] This large proportion of the profits can only be justified if venture capitalists offer access and expertise that the limited partners could not match on their own. Venture capital funds' reputations are,

[457] D M Ibrahim, 'The New Exit in Venture Capital' (2012) 65 *Vanderbilt Law Review* 1, 8. See also R J Gilson, 'Engineering a Venture Capital Market: Lessons from the American Experience' (2003) 55 *Stanford Law Review* 1067, 1070-1071.
[458] Ibrahim (n 381) 1431-1433
[459] See eg E McGowan, 'Series A, B, C, D, and E Funding: How it Works' *The Startups.co Platform* (3 May 2018) <https://www.startups.co/articles/series-funding-a-b-c-d-e>. It should also be noted that, for present purposes, the amount of capital allocated to each funding round involving a social enterprise corporation could theoretically be in this range; however, it is more likely that the funding rounds would feature smaller amounts of capital due to the nature of social enterprise corporations' social value objectives.
[460] Ibrahim (n 381) 1417.
[461] ibid 1438. See also P Gompers and J Lerner, 'An Analysis of Compensation in the US Venture Capitalist Partnership' (1999) 51 *Journal of Financial Economics* 3, 19.
[462] D G Smith, 'The Exit Structure of Venture Capital' (2005) 53 *UCLA Law Review* 315, 316.
[463] Ibrahim (n 381) 1437.

therefore, made by identifying firms with attractive risk and financial return profiles, and structuring and managing investments in them to generate satisfactory investor returns.[464] Thus, venture capitalists – even those using a social impact investment strategy – are highly motivated to treat their investments as purely financial endeavours with minimal emotional attachment.[465]

Given the regulatory frameworks' institution of an asset partition that mandates a firm's participants to store a specified amount of capital in the public benefit reserve fund, a high growth social enterprise corporation looking to expand would not necessarily be capital-deficient. However, such a firm would still be seeking further capitalisation to scale its operations, which impact-first investors like angel investors may not be able, or willing, to facilitate. This creates a prime situation for a venture capital fund's general partners to use their bargaining power over a social entrepreneur to secure the most protective investment contract possible. Indeed, even with traditional corporations, it is standard for venture capital funds to use their leverage over entrepreneurs to insist on comprehensive investment contracts.[466]

From venture capitalists' perspective, the nature of a venture capital fund is such that it must make multiple investments concurrently to generate timely and high financial returns for investors. This inevitably requires venture capital funds to operate at arms-length and sacrifice some of the intimacy and familiarity with firms that, for example, angel investors – without downstream pressure – possess. The relational distance between a venture capital fund and a particular investee firm converts to an assumption on the part of venture capitalists that investments are 'rife with uncertainty, information asymmetry, and…agency costs in the form of potential opportunism by entrepreneurs'.[467] To mitigate these apparent problems, venture capitalists opt for certain control and monitoring contractual rights that, at least under the conventional wisdom, social entrepreneurs are obliged to accept.[468] Among others, these include contractual provisions relating to staged financing, board seats and specific exit rights.[469] In the majority of circumstances, it is the combination of these, and similar, protective contractual features that can lead to the legacy problem.

[464] Brakman Reiser and Dean, *Trust* (n 446) 146.
[465] Ibrahim (n 381) 1439. See also M Stathis, *The Startup Company Bible for Entrepreneurs* (AVA 2004) 134.
[466] Ibrahim (n 381) 1407.
[467] ibid.
[468] ibid 1412.
[469] Venture capital funds also commonly negotiate for negative covenants and preferred stock, but these do not concern the analysis.

(b) The Legacy Problem

The moment at which the legacy problem starts to incubate is when the founding social entrepreneurs of a firm retire, sell or otherwise elect to involve finance-first investors in the business. For example, it is not uncommon for social entrepreneurs to be 'serial entrepreneurs', in the sense that they exit one social venture to pursue another.[470] The social value objectives can be thought of as the 'legacy' of the founding social entrepreneurs.[471] The social mission would not, in most circumstances, come under threat during early stage investor involvement because the controllers and shareholders may be the same parties, and any outside equity capital providers would, generally, either come from the third sector or have impact-first investing preferences. The issue arises later when a firm requires larger capital injections that cannot be sourced from the third sector or impact-first investing pools. Whilst the choice to involve outsiders brings with it the possibility of expanding the reach of a firm's social impact, it also invites more heterogeneous aims and interests that could displace or dilute founding social entrepreneurs' original vision for a firm. The legacy problem is challenging since the regulatory frameworks are designed to attract and incorporate private sector investors, and some of them will be outsiders that may prefer greater profitability and less aggressive pursuit of the social value objectives.

In the context of venture capital funds being a likely candidate for investing in a social enterprise corporation during later stage investor involvement, the legacy problem connects initially with the aforementioned contractual provisions that provide for capital disbursements in different stages. Staged funding has been characterised as the 'most potent control mechanism a venture capitalist can employ'.[472] Venture capitalists' thinking is that staged financing limits uncertainty, information asymmetry and agency costs by allowing a venture capital fund to more effectively screen an investment and spend less time monitoring between the various financing stages. Theoretically, if social entrepreneurs agree to the distribution of more funds upon satisfactory economic performance between funding rounds it allows venture capitalists to measure the quality of a firm. This makes it less necessary to constantly monitor

[470] Brakman Reiser and Dean, *Trust* (n 446) 143 and 145. See also Shaw and Carter (n 426) 424.
[471] R A Katz and Antony Page, 'The Role of Social Enterprises' (2010) 35 *Vermont Law Review* 59, 95-97 (hereafter *Role*). R A Katz and A Page, 'Sustainable Business' (2013) 62 *Emory Law Journal* 851, 866.
[472] Gompers and Lerner (n 461) 139. See also M Klausner and K Litvak, 'What Economists Have Taught Us About Venture Capital Contracting' in M J Whincop (ed), *Bridging the Entrepreneurial Financing Gap: Linking Governance with Regulatory Policy* (Routledge 2001) 56.

each investee firm, since 'good' social entrepreneurs will have an aligned incentive to perform well to reach the next capital injection. This reduces the likelihood that social entrepreneurs would seek private benefits or shirk at the expense of a venture capital fund, which, as the argument runs, minimises agency costs. Furthermore, it allows venture capitalists to delay the next funding round until it is shown that a social entrepreneur has achieved benchmarks set by the venture capital fund, and affords venture capitalists the option to exit an investment early if a firm does not reach the pre-agreed benchmarks.[473]

Importantly, whilst the timing and placement will vary from contract to contract, a recurring contractual condition in one of the funding rounds will also stipulate that a venture capital fund will use its network of contacts to source and install professional managerial talent with seasoned expertise in decision-making on the business side.[474] One of the contractual reasons for this is that venture capital funds take on a more formal role with investee firms. Different from angel investors, venture capitalists 'for the most part have little entrepreneurial experience' and are instead usually 'financial MBA-types'.[475] This will be appealing to a social enterprise corporation as a value-added service, since social entrepreneurs will oftentimes lack the requisite practical managerial experience to realise their social goals. However, the involvement of professional management marks the next foothold whereby a firm's participants may disagree and diverge on how to balance the pursuit of the social value objectives against profitability. How this might precisely play out will be analysed below.

Similarly, venture capital funds' investment contracts are structured to allocate disproportionate decision-making control at board level. This lessens the probability of social entrepreneurs behaving opportunistically – who, notionally, would otherwise have such opportunities due to their majority ownership. For instance, a venture capital fund routinely inserts a general partner into an investee firm's board, and this occurs in each investee firm that venture capitalists' fund.[476] Venture capital funds also generally secure more board seats with each round of funding. Resultantly, because 'venture capitalists typically gain additional board seats with each round of investment, over time the board composition provisions of venture-

[473] Ibrahim (n 381) 1413.
[474] ibid 1411.
[475] Van Osnabrugge and Robinson (n 428) 109. See also K Southwick, *The Kingmakers: Venture Capital and the Money Behind the Net* (John Wiley & Sons 2001) 66-67.
[476] Ibrahim (n 381) 1417.

based companies tend to move from "entrepreneur control"…to "investor control"'.[477] A majority on the board entitles a venture capital fund to significant control due to a board's broad power under traditional corporate law to steer a business. The commentary suggests that, in a contested vote scenario, board members chosen by a venture capital fund are likely to side with venture capitalists, giving them effective board control in many cases.[478] In this situation, a majority on the board may reinforce the viewpoint of professional business-oriented managers. They may 'prefer…greater profitability and less aggressive pursuit of…[the social] vision. In this respect, the enterprise's controllers (typically a board of directors) are agents of multiple principals – the founder and outside investors, among others – whose interest may diverge'.[479]

The installation of professional managers and a venture capital fund's normally strong presence on an investee firm's board allows venture capitalists to set in motion their specific contractual exit preferences with limited resistance from social entrepreneurs – that is, if they are still involved. This is the apex of the legacy problem. For venture capitalists, the attraction to a social enterprise corporation would be the assets contained in the public benefit reserve fund. At the time of investment, an outside venture capital fund's expectations of short-term profits are tempered by the awareness that a social enterprise corporation pursues social value objectives and this is protected through the regulatory frameworks' statutory limitations on midstream profit distribution. But the act of investing does not also imply that venture capitalists are expecting or agreeing to modest returns indefinitely. If a social enterprise corporation was forced to later abandon or reduce the prioritisation of its social value objectives, then it is possible that a venture capital fund could receive a greater financial return later in a firm's lifecycle.

Financially successful social enterprise corporations will be relatively asset-buoyant since the public benefit reserve fund is designated primarily for the pursuit and maintenance of the chosen social value objectives. An interested venture capital fund would be in a position to test how much stored-up capital exists as it is common practice in the venture capital industry to heavily screen potential investments – the 'typical venture organization receives many dozens of business plans for each one it funds. Although most proposals are swiftly discarded, serious

[477] Smith (n 462) 326.
[478] Fried and Ganor (n 436) 988-989.
[479] Katz and Page, *Role* (n 471) 97.

candidates are extensively scrutinized through both formal studies…and informal assessment of the management team (It is not unusual for a venture team to complete 100 or more checks before deciding to invest in a firm)'.[480] From this standpoint, the prospect of statutory limitations of dividends would not necessarily act as a deterrent to an opportunistic venture capital fund. This is because venture capital funds' investment contracting patterns suggest that the ultimate goal would be a profitable exit from the investment, rather than profits accruing through midstream distributions. Indeed, limited partners accept that they cannot reclaim their initial capital contributions or investments until after the ten or twelve-year period in which a particular venture capital fund must liquidate.[481]

Venture capital funds' ideal preference would be to remain invested in each investee firm for an average of three to four years.[482] The reason for this is that, as a general rule, venture capitalists require relatively early exits from investments due to the fixed lifespan of a venture capital fund. Venture capitalists do not want to risk an overlap between exiting an investment and needing to make final distributions to the limited partners. Such an overlap could damage relations with the limited partners and affect venture capitalists' ability to fund later projects. During the three to four-year period, the objective would be to bloat a social enterprise corporation's public benefit reserve fund through more aggressive commercial practises to increase the firm's overall value, and then exit the investment. Depending on the circumstances, the exit could involve (i) converting a social enterprise corporation into a traditional corporation and taking it public; (ii) selling it to a larger tradition corporation through a trade sale; or (iii) winding up a firm if its performance did not justify an additional round of funding. These exit options are normally contractually negotiated for by venture capital funds at the time of investment.[483] Added to this, participation in management provides a venture capital fund with the information necessary to evaluate when to take such an exit decision. Assuming that the venture capitalists are successful in securing board representation, a venture capital fund's exit preferences can then be acted upon because exits are initiated at board level. A 'VC-controlled [board] may prematurely push for' an exit event to artificially

[480] Gompers and Lerner (n 461) 5.
[481] U Rodrigues, 'Securities Law's Dirty Little Secret' (2013) 81 *Fordham Law Review* 3389, 3400.
[482] This is an ideal situation. The average seems to be closer to seven years in most situations, if not longer, but the intention would still be to aim for an exit after three to four years. L Cowan, 'Investment in Early-Stage Firms Endures' *The Wall Street Journal* (23 Feb 2009) <https://www.wsj.com/articles/SB123534808550244493>. See also B Peters, *Early Exits: Exit Strategies for Entrepreneurs and Angel Investors (But Maybe Not Venture Capitalists*) (MeteorBytes 2009) 40.
[483] Ibrahim (n 381) 1415-1416, 1428. See also Ibrahim (n 457) 11.

occur that aligns with venture capitalists' pecuniary incentives to furnish high financial returns for the limited partners.[484]

Outcome (i), whilst unlikely in the circumstances, would allow a venture capital fund to sell some or all of its shares in a social enterprise corporation to the public. There are a number of reasons why a larger corporation might be interested in acquiring a social enterprise corporation. Often these are economy-of-scale benefits where the manufacturing or distribution capability of the buyer would be increased through the trade sale. Other motivations might include, for example, the elimination of a competitor, reducing the time of entering into a new market or gaining the custom of socially conscious consumers. Outcome (ii) would also allow a venture capital fund to sell some or all of its position in a social enterprise corporation. Outcome (ii) represents a more realistic result compared with outcome (i). Outcome (iii) would allow a venture capital fund to appropriate the assets contained in the public benefit reserve fund through a winding up transaction. If a venture capital fund successfully achieved any of these exits, with outcomes (ii) and (iii) being the most probable, then the general and limited partners could potentially gain a windfall from the investment – at the expense of societal value creation in the public interest.

(c) Preliminary Conclusions

To return to the main contention, it is these contractual tendencies relating to staged financing, board seats and specific exit preferences that can lead to the legacy problem. The exit preferences in particular are problematic since they are calibrated to extract the highest financial returns possible for the benefit of a given venture capital fund. However, I do not think that the divergence between social value creation and financial returns stops with venture capital funds. Any finance-first investor with comparable preferences for generating some peripheral social value will necessarily see social enterprise corporations in a similar light – with high financial return potential, and high risk that must be hedged accordingly.

This is not only why I draw a distinction between early stage and later stage investor involvement, but it is also why I suggest that there is a conflict between European social enterprise law and contemporary investment models and trends at the later stage. Here the

[484] Fried and Ganor (n 436) 972.

statutory limitations on asset distribution – in particular within conversion and winding up scenarios – seem to be at cross-purposes with the preferences and financial return expectations of the kind of equity capital providers that would tend to invest. This could occasion the attraction of market actors with pecuniary motivations that are inconsistent with the policy goal to create social value. We saw in Chapter 4, though, that European social enterprise law does include rules that cover conversion and winding up scenarios in anticipation of the legacy problem.

There are good reasons for this approach in terms of discouraging the situation in which a firm's participants traded on a pro-social platform for the duration of a social enterprise corporation's lifecycle and then attempted to convert to a traditional corporation or wind up in order to by-pass the legal limitations on profit distribution. I say more about this apprehension below, but it appears to only be a theoretical concern. In practical terms, more self-interested investors would not be able to side-step the legislation and extract the capital dedicated to social value creation through a conversion or winding up transaction. Once equity capital is dedicated to social value creation, it is largely dedicated to that end in perpetuity.

Clearly, the legislation is engineered to prioritise firms' social impact fidelity over meeting the expectations of the market actors that inhabit the current investment landscape. This is obviously an encouraging finding in terms of ensuring private action for public benefit. However, the strict nature of the legislation and its prioritisation of social value creation, and whether it is amenable and responsive to the norms of the current investment landscape, is another matter entirely. Unlike early stage investor involvement, the relationship between a firm and its private sector investors does not appear to cultivate the trust and the conditions necessary for more private capital to flow towards the subsidisation of public welfare in the same way. This calls into question whether the social enterprise corporation is fit-for-purpose with respect to redirecting and locking in more private capital in the long-term. For the social enterprise corporation to be attractive to interested market actors as policymakers envisaged, at least at the later stage, I argue that the legislation must better balance the protection of social value creation and meeting the financial return expectations of the market actors that inhabit the current investment landscape.

5.4 Social Impact Fidelity

In this Section, I want to say a bit more about the thinking behind the policy decision to curb asset distribution within conversion and winding up scenarios. The statutory limitations on asset distribution in this context are present to anticipate the legacy problem. I think there are good reasons for this approach in terms of shunning the situation in which a firm's participants traded on a pro-social platform for the duration of a social enterprise corporation's lifecycle and then attempted to convert to a traditional corporation or wind up in order to by-pass the legal limitations. As Dunn and Riley argue, the absence of such rules would create a litany of regulatory complications for maintaining public trust in social enterprise corporations. It

> is crucial to…[social enterprises] that they are…able to signal clearly to the public their assets are…locked in, for by so doing they should be able to engender greater trust from those whose support they hope to win. Donors will likely be happier to contribute their time, labour or money to organisations that are constrained in this way. And others will probably be happier to purchase the goods or services supplied by…[social enterprises], knowing that they have, compared to for-profits, less incentive to act opportunistically.[485]

The legislation is clearly engineered with the above in mind. Firms must prioritise social impact fidelity over meeting the expectations of the market actors that inhabit the current investment landscape.

But the apprehension regarding market actors favouring profit maximisation over the policy goal to create social value is only a theoretical concern. In practical terms, more self-interested investors would not be able to side-step the legislation and extract the capital dedicated to social value creation through a conversion or winding up transaction. Once equity capital is dedicated to social value creation, it is largely dedicated to that end in perpetuity. As such, whilst the assets in the public benefit reserve fund might occasion the attraction of market actors with pecuniary motivations that are inconsistent with the policy goal to create social value at the later stage, the fear that they might succeed in appropriating these assets is unrealistic. This is obviously an encouraging finding in terms of ensuring private action for public benefit.

[485] Dunn and Riley (n 43) 647-648. See generally also Hansmann (n 45).

The more pressing issue, though, is that the statutory limitations on asset distribution seem to be at cross-purposes with the preferences and financial return expectations of the kind of equity capital providers that would tend to invest at the later stage. Unlike early stage investor involvement, the relationship between a firm and its investors does not appear to cultivate the trust and the conditions necessary for more private capital to flow towards the subsidisation of public welfare in the same way. On the one hand, social entrepreneurs would likely prefer patient capital and a more contractually cooperative, less invasive, relationship with outside equity capital providers that does not jeopardise the chosen social value objectives. On the other hand, however, finance-first investors like venture capital funds are highly motivated to treat their portfolio corporations as purely financial endeavours with minimal emotional attachment. Therefore, venture capitalists and other finance-first investors with similar preferences – even those using a social impact investment strategy – seek contractual protections and exits that are calibrated to extract the highest financial returns possible.

These objectives are not consistent with each other in the majority of circumstances. This matters for present purposes because it does not seem probable that the necessary trust can be cultivated between a social enterprise corporation and its private capital providers. Social entrepreneurs, even those keen to access deeper capital pools, will not want to imperil their social value objectives, and finance-first investors like venture capital funds will not want to compromise their investment goals. This is why I argue that the strict nature of the legislation and its prioritisation of social value creation is not particularly amenable and responsive to the norms of the current investment landscape at the later stage.

Consequently, I suggest below how the legislation could better balance the prioritisation of firms' social impact fidelity with going some way towards meeting the expectations of the later stage market actors that inhabit the current investment landscape. The social enterprise corporation must be attractive to these interested market actors, otherwise the organisational form's role of subsidising public welfare as envisaged by policymakers will fall short of redirecting and locking in more private capital in the long-term.

(a) Theoretical Concerns

We can reflect on how the regulatory frameworks anticipate the legacy problem in the following way. Social entrepreneurs wishing to retire, sell or otherwise invite outside equity

investor participation could be very reluctant to yield control to investors they believe intend to use their position to extract for themselves all the stored-up capital dedicated to social value creation by converting or winding up a social enterprise corporation. Social entrepreneurs could ensure that a firm would pursue its social value objectives – their legacy – by forfeiting the involvement of finance-first investors. Although a firm's social value objectives would be preserved in this scenario, excluding the presence of investors external to the third sector would require social entrepreneurs to make do without the larger capital injections they might supply. Without that capital, a firm's social mission might be protected, but it would not be able to scale its operations. In some situations, deciding to only draw from the multiple sources of capital within the third sector would allow a firm to continue creating social value on a smaller scale, but in others retaining control may not be a viable option for a firm's longevity.

When circumstances make a sale of some or all of a firm's equity necessary, being able to ascertain potential investors' intentions becomes a dominant factor. Parting with a large equity stake in a social enterprise corporation means surrendering an equal measure of control over its future direction. Investors with a majority stake have the ability to contractually negotiate for the instalment of managers and the election of directors who might not always share founders' vision of social value creation. During early stage investor involvement, these considerations are not as important. In this period, investors will usually be like-minded, and social entrepreneurs would be in a position to test their commitment by looking at the contractual provisions that would dictate a potential investor-investee firm relationship. Angel investors, for example, forfeit strong contractual protections against downside risk and financial loss in favour of intimacy. This helps to build trust in the accessing of capital, and assists pro-social ventures' growth. But this would only be successful to a point, as access to larger capital pools is necessary to meet the jurisdictions' wider policy goals. Capital beyond the third sector must be able to find its way into social enterprise corporations if the jurisdictions' policy goals are to be met in the long-term.

Therefore, aside from the statutory limitations placed on midstream profit distribution, the regulatory frameworks include further legal mechanisms that also screen out investors that do not share a strong commitment to a firm's social value objectives at the later stage. The social enterprise corporation's organisational structure sends a signal to would-be opportunistic investors – interested foremost in profit – that they would not be in a position to contractually

bargain for the right to convert or wind up a firm and siphon out its assets or receive a lopsided profit from an analogous transaction.

This is in contradistinction to the law that applies to traditional corporations, which allows a firm's participants to, for example, reorganise the business within a different organisational structure, take it public, sell it on to a larger company or wind it up. Both the decision-making prerogative and the value that accrues through any of these acts are deemed to be a contractual matter that ought to be left to a firm's participants to bargain for between themselves. However, the social enterprise corporation is not as private in nature as the traditional corporation. Even though the social enterprise corporation is a semi for-profit organisational form, the social value creation rationale at the heart of the regulatory frameworks means that taking one of the above decisions to the detriment of a firm's chosen social value objectives would cut across legislative intent. The social enterprise corporation deals with this problem by installing legal mechanisms that limit a firm's participants' ability to privately order with respect to converting or winding up a social enterprise corporation. This makes the organisational form unappealing to those whose commitment to social value creation is (or becomes) a pretence.

Social impact fidelity is achieved, and the legacy problem avoided, by placing statutory constraints on the amount of capital a firm's participants could extract when a social enterprise corporation is converted or wound up. To preserve social value creation in perpetuity, the legal mechanisms that trigger upon conversion or winding up require a firm's participants to leave behind a percentage of its assets. Neither shareholders nor directors have the power to undermine this commitment. Said differently, even finance-first investors that would otherwise have the managerial and board-level backing to shift the use of resources from principally generating social value to a dedication to profit extraction are prohibited from doing this by the legislation.

The percentage of assets left behind must be transferred to another pre-identified social enterprise corporation or similar organisation. Interlocking with the regulatory frameworks' statutory limitations on midstream profit distribution, these additional legal mechanisms provide social entrepreneurs with surety that a firm's social value creation objectives will remain intact. Such legal mechanisms also encourage public trust; donors and other third sector actors interested in investing in social enterprise corporations have some legal assurance that their capital is protected from pecuniary opportunism.

(b) Conversion and Winding Up Legal Mechanisms

In their current form, the regulatory frameworks conversion and winding up legal mechanisms are very responsive to the apprehension over more market oriented actors trying to pervert the public interest nature of a social enterprise corporation.

Once committed, the legal mechanisms effectively lock in investors' capital, protecting it from future withdrawal if a particular social enterprise corporation becomes asset-buoyant. By choosing to engage with a social enterprise corporation, a firm's participants agree to pursue social value creation ahead of pecuniary self-interest – finance-first investors would not be able to avoid this obligation through contractual arbitrage. The legal mechanisms crystallise participants' assurances to each other by, *ex ante*, stipulating what is to be done with a social enterprise corporation's residual capital if an attempt were made to convert it back into a traditional corporation or wind it up. In either event, a firm would be required to transfer a percentage of its remaining assets to another social enterprise corporation or comparable organisation. As described in Chapter 4, however, the conversion and winding up legal mechanisms do not take the same form in every jurisdiction.

In Denmark, a social enterprise corporation that elects to convert to a traditional corporation or wind up would face a partial restriction on the assets that could be distributed to shareholders. This partial restriction corresponds to the statutory limitations that stipulate that a Danish social enterprise corporation may only distribute 35 per cent of its post-tax profits in dividends in any given year of trading. The remaining 65 per cent of profits not distributed to shareholders must be allocated to the public benefit reserve fund. Therefore, upon conversion or winding up, 65 per cent of a firm's assets must also be transferred either to another social enterprise corporation, or to another organisation featuring a legally mandated social value objective with an asset lock. It follows that a conversion or winding up would result in only a 35 per cent distribution of a firm's residual assets going to shareholders.[486]

In the UK, a social enterprise corporation may not convert into a traditional corporation; it must wind up. In the event of a *de facto* winding up through an attempted conversion or an actual winding up, a firm's shareholders would only be permitted to extract their initial capital

[486] Danish Social Enterprise Law, §§ 5(2), 10(1).

contributions. The remaining assets would need to be transferred to another social enterprise corporation or other firm with similar legal characteristics.[487]

(c) Criticisms

From an enforcement perspective, the legal mechanisms discussed above appear to be more than sufficient to repel isomorphic threats like the legacy problem, and ensure a firm's participants pursue social value creation throughout a social enterprise corporation's lifecycle. However, another factor that ought to be accounted for is the conceivable attractiveness of an organisational form that places these types of financial statutory constraints on a firm's participants.

Of course, the amount of capital that a firm's participants are permitted to extract upon conversion or winding up is a political question that ought to be left to the jurisdictions' policymakers. But it is nonetheless worth highlighting that the design of such constraints should attempt to balance a firm's dedication to social value creation against the probability that interested market actors at the later stage will find the social enterprise corporation inhospitable. The amount of capital that must be left behind should assure social entrepreneurs and investors of each other's impact fidelity. However, the constraint design must not be so prohibitive that it would discourage those seeking a level of potential profit realisation that could be reasonably accommodated alongside a commitment to prioritise social good. Even the most devoted social impact investors might recoil at the idea of leaving behind a majority of a firm's assets no matter how long a social enterprise corporation remains faithful to its social value objectives. This criticism must be understood in the context of policymakers' broader goal of attracting interested market actors to utilise the organisational form, and redirecting and locking in more private capital towards the subsidisation of public welfare in the long-term.

One possible option for modifying European social enterprise law to counteract this problem and attract more private capital to social enterprise corporations would be to reorient the statutory limitations through an annual 'drawn-down' scheme. More specifically, the starting point would be to fix the amount of residual capital that may be extracted by a firm's participants at a given figure at the outset. For example, the figure could be set at 65-70 per

[487] CIR 2005, reg 23.

cent initially. Each year the legislation could incrementally draw-down the limit. This could be reduced annually and incrementally until, after perhaps ten years, a firm's participants would only be required to leave a small percentage of the remaining assets behind if it converted to a traditional corporation or wound up – for example, 10 per cent.

The draw-down scheme could potentially appeal to a broader demographic of investors interested in both social value creation and long-term financial returns. Not only might this policy recommendation lessen the conflict between European social enterprise law and contemporary investment models and trends at the later stage, but it could also redirect and lock in more private capital towards the subsidisation of public welfare in the long-term.

However, this suggestion comes with an important caveat. The policy background to the social enterprise corporation is complex, and the objectives themselves are not necessarily complementary bedfellows. A draw-down scheme could aid in attracting more interested market actors to utilise the organisational form at the later stage; it could also help to subsidise public welfare with private finance. But it also means that the regulatory frameworks would become more flexible. A more permissive regulatory framework could inadvertently encourage predatory investors, for example, to engage in contractual arbitrage in order to extract additional capital. Therefore, policymakers ought to exercise due care and be unhurried to make any such adjustments to the regulatory frameworks that would weaken the restrictions on post – conversion and winding up capital appropriation. Ultimately, making a value judgment to modify the regulatory frameworks away from their current form would require a substantial period of policy learning and monitoring the behaviour of social enterprise corporations to collect the necessary data. Opening periodic reform consultations with relevant industry and regulatory stakeholders, as and when it becomes expedient, would also be necessary.

5.5 Concluding Remarks

This Chapter has been concerned with addressing an important gap in the legal literature related to whether European social enterprise law is compatible with contemporary investment models and trends. The analysis centred on the concept of isomorphism, which is an often-referenced term in the social enterprise literature. Isomorphism describes the degree to which an entity has been forced to internalise external environmental pressures in order to survive. In other words, it is about how an organisation may be forced to take on certain features of a dominant or

prevailing form in its environment – in this case the traditional corporation. Isomorphism has special relevance to an organisational form like the social enterprise corporation because of the jurisdictions' policy intentions. The overall policy aim was to encourage civil society actors – and others in the private sector interested in pro-social entrepreneurship – to coordinate with providers of private capital to reduce states' financial liabilities in social policy areas. Thus, the choice was made to introduce a resource flexible organisational form capable of pursuing non-financial objectives in the public interest.

That social enterprise corporations operate, at least partially, under the legal form and financing of the private sector means that firms must satisfy the expectations of more market-oriented stakeholders. These stakeholders would necessarily have power over both the flow of organisational resources and how far social value creation is pursued. Isomorphic threats are potentially problematic because some investors – even those interested in achieving a minimum social impact – still focus on finance-first investments that do not involve a trade-off. This can create a tension between social value creation and the pursuit of profit.

As we saw, however, there is not much cause for concern regarding a divergence between social value creation and the pursuit of profit during the early stages of a social enterprise corporation's lifecycle. Using angel investors as an example, this comes down to the type of equity capital providers that would likely invest at the early stage. Impact-first investors like angel investors prioritise social value creation ahead of profit maximisation for personal benefit, which accords with how the legislation orders social impact fidelity. Therefore, at least theoretically, the regulatory frameworks seem to be amenable and responsive to the norms of the current investment landscape at the early stage.

However, I argued that the position changes when social enterprise corporations mature and require access to deeper capital pools at the later stage. At this juncture, impact-first investors may not be able, or willing, to provide the necessary capital injections to facilitate firms' expansion. In this context, a firm would arguably be obliged to transact with finance-first investors that offer access to additional capital. Because finance-first investors have stronger financial preferences and are not generally willing to accept a trade-off in which financial returns are subordinate to social value creation, it invites an isomorphic threat that I identified called the legacy problem. The current investment landscape was referenced – in particular venture capital funds – to show how the legacy problem could impact a social enterprise

corporation and the circumstances under which it would arise. The legacy problem is apt to be of greatest concern to social value creation in conversion and winding up scenarios.

Whilst European social enterprise law does include rules that cover conversion and winding up scenarios in anticipation of the legacy problem, the strict nature of the legislation and its prioritisation of social value creation is not necessarily consistent with the preferences and financial return expectations of finance-first investors, like venture capital funds, at the later stage. Thus, I submitted that it does not seem likely that the necessary trust can be cultivated between a social enterprise corporation and its private sector capital providers. Social entrepreneurs, even those keen to access deeper capital pools, will not want to imperil their social value objectives, and finance-first investors will not want to compromise their investment goals by subjecting themselves to a rigid regulatory regime. This is why I argued that the legislation's focus on social value creation is not particularly amenable and responsive to the norms of the current investment landscape at the later stage.

There are good reasons for this approach in terms of discouraging the situation in which a firm's participants traded on a pro-social platform for the duration of a social enterprise corporation's lifecycle and then attempted to convert to a traditional corporation or wind up in order to by-pass the legal limitations on asset distribution. However, it was contended that this ought not detract from the practical reality that the legislation could better balance the prioritisation of firms' social impact fidelity with going some way towards meeting the expectations of the later stage market actors that inhabit the current investment landscape. The social enterprise corporation must be attractive to these actors, otherwise the organisational form's role of subsidising public welfare as envisaged by policymakers will fall short of redirecting and locking in more private capital in the long-term.

In this regard, I argued that the regulatory frameworks' conversion and winding up legal mechanisms should be adjusted with a yearly draw-down scheme. The draw-down scheme could potentially appeal to a broader demographic of investors interested in both social value creation and long-term financial returns at the later stage. This might lessen the conflict between European social enterprise law and contemporary investment models and trends at the later stage, and help to redirect and lock in more private capital towards the subsidisation of public welfare in the long-term. We now turn to consider the EU dimension of social enterprise regulation.

|6|

A SOCIAL ENTERPRISE CORPORATION IN EU ORGANISATIONAL LAW?

In the preceding discussion – notably in Chapter 4 – we were able to get a well-rounded sense of the function and structure of social enterprise law from a comparative European perspective. However, something else conspicuously missing from the legal literature is an account exploring whether there is an EU dimension to the regulation of social enterprise corporations. The purpose of this Chapter is to take a step towards filling that knowledge gap.[488] To help do this, the analysis focuses on the most recent policy activity in this area – the European Parliament's July 2018 non-legislative resolution proposing to the European Commission a directive for facilitating social enterprise corporations' cross-border activities ('Proposal').[489]

The Proposal is novel and worth exploring because it links to a much larger narrative about the so-called 'social economy' and its relationship with European integration. We have already encountered the third sector earlier in this thesis, but the social economy term is preferred within the EU context and, therefore, it will be used in this Chapter.[490] At the EU level, the social economy is a strategically important and enormous socio-economic 'engine',[491] which accounts for roughly 7 per cent of all jobs and 8 per cent of the EU's GDP.[492] As the social legitimacy of the EU, and particularly that of the Single Market, has been progressively called into question over time, the Union level interest in the social economy has not only increased but the nature of the policy attraction has evolved in kind.

This has resulted in a paradigmatic shift in which justification for recognising the sector in EU organisational law is now different. Past attempts were essentially framed in terms of the undesirability of Member States' organisational forms remaining heterogeneous, which was

[488] This Chapter serves as the loose basis for J S Liptrap, 'A Social Enterprise Company in EU Organisational Law?' (2021) 23 *Cambridge Yearbook of European Legal Studies* 193.
[489] The Proposal also includes provisions for securing the cross-border activities of social enterprise firms assuming other forms (eg, cooperative), but this does not concern the analysis. European Parliament, *Statute for Social and Solidarity-Based Enterprises* (2018) <https://oeil.secure.europarl.europa.eu/oeil/popups/ficheprocedure.do?lang=en&reference=2016/2237(INL)>.
[490] See n 216.
[491] L M Salamon and W Sokolowski, 'The Size and Composition of the European Third Sector' in B Enjolras, L M Salamon, K H Sivesind and A Zimmer (eds), *The Third Sector as a Renewable Resource for Europe: Concepts, Impacts, Challenges and Opportunities* (Palgrave Macmillan 2018) 54.
[492] This is reiterated in numerous texts. See generally eg Government of Spain, *Madrid Declaration – The Social Economy, A Business Model for the Future of the European Union* (2017) <http://www.lavoro.gov.it/notizie/Documents/2017-05-23-DICHIARAZIONE-MADRID-English-Version.pdf>; Smith and Teasdale (n 220) 157.

merely a prop for Single Market intervention. The Proposal, however, is situated in a changed context in which the EU has committed itself, and faces pressure, to reimagine the Single Market with social dimensions and objectives that go beyond the purely commercial.[493] Since the EU lacks competences to take more direct action in this regard, the thinking seems to be that the sector could be used as a mechanism to embed, or constitute, economic relations within European society. This could be achieved, at least partially, by integrating the social economy in to the Single Market, on this occasion through the Proposal and assigning social enterprises increased socio-economic functions and responsibilities.

Under the Proposal, Member States are required to introduce, or adapt existing, legislation, which makes provision for a social enterprise corporation in domestic organisational law. To be discussed, Member States' regulatory frameworks must include four features. Distinguishable from past attempts to recognise the social economy at Union level through discrete organisational units, firms that duly incorporate would be issued a 'European Social Enterprise' juridical label ('ESE label'). The ESE label is best understood as a kind of European 'passport', rather than a supra-national organisational form, for facilitating such firms' cross-border activities.

The European Commission responded in November 2018, but declined to take action.[494] Citing perceived differences in national legal traditions and contexts, the European Commission was not convinced that Member States would be amenable to the Proposal. However, this Chapter argues that there is good reason to think that the European Commission's response is not the end of the story.

I initially look at the social economy and explain the sector's growing importance within the European integration context. The Proposal is then examined, followed by the European Commission's response. Here, it will be argued that a consensus may already exist that is sufficient to secure Member States' agreement on the Proposal. Even if this prediction is wrong, however, there are discernible political and socio-economic reasons to surmise that

[493] As a general matter, we can say that the adoption of the Social Pillar was a significant turning point. See generally eg S Deakin, 'What Follows Austerity? From Social Pillar to New Deal' in F Vandenbroucke, C Barnard and G de Baere (eds), *A European Social Union after the Crisis* (Cambridge University Press 2017) 192.
[494] SP (2018) 630, *Follow-up to the European Parliament Non-legislative Resolution of 5 July 2018 with Recommendation to the Commission on a Statute for Social and Solidarity-Based Enterprises* (2018) <https://oeil.secure.europarl.europa.eu/oeil/popups/ficheprocedure.do?lang=en&reference=2016/2237(INL)>.

Member States would likely be receptive to reassessing and ultimately endorsing a Union level instrument for social enterprises' cross-border activities at some future point.

In essence, owing to the effects of Member States' political institutionalisation of their domestic social economies, some of which we considered in Chapter 3, the Proposal achieves an outcome, from which many Member States stand to benefit, that could not be realised by national policymakers acting alone. This extends to the idea that there are intersecting policy priorities at Union and Member State levels that make vertical intervention politically palatable. Therefore, plausibly, a proliferation of social enterprise corporate legislation and the increased frequency of such firms' cross-border activities across Europe could soon be a reality. In this way, a central claim of this Chapter is that we can expect some degree of harmonisation of European social enterprise law to occur through Union level coordination in future.

However, neither the European Parliament nor the European Commission attempted to visualise the consequences of the Proposal. As such, I conclude the Chapter by viewing the Proposal through a reflexive harmonisation lens. Through the analysis, two regulatory issues are identified.

The immediate regulatory issue created by the current terms of the Proposal is a market for incorporation that could be abused by opportunistic actors. At this juncture, whereas earlier in this thesis we were only concerned with two jurisdictions, for the purposes of this Chapter, it is necessary to expand that scope and study the full range of Member States that feature social enterprise regulation. As we shall see, the French regulatory framework's optional conversion and winding up legal mechanisms are of particular importance.

The market for incorporation problem is exacerbated because the Proposal 'locks out' Member States from taking remedial action. Over time, the normalisation of a market for incorporation would engender a longer-term regulatory issue, which is the entrenchment of private sector behaviours and commercial practices leading to more permanent distortions of the social economy's institutional logic.[495] If a sufficient level of regulatory arbitrage occurred for any extended period of time, it is argued that the sector would not be able to sustain the production

[495] We dealt with the concept of an institutional logic in Chapter 4.1.

of the macro socio-economic effects of interest to both EU and Member State level policymakers. This is especially troubling if the aim of the EU is to then attempt to assimilate the sector in the Single Market, in an effort to offset some of the social problems it generates.

The suggested solution involves enlarging the number of provisions within the Proposal that constrain asset distributions in Member States' domestic regulatory frameworks. However, for the reasons we established in Chapter 5 with respect to successfully attracting interested market actors to utilise the ESE label, especially at the later stage, the Proposal ought to also include a drawn-down scheme.

At a minimum, uploading this suggested solution into the European Parliament's Proposal would, at least theoretically, result in a 'good' reflexive harmonisation legal instrument that reduces the possibility of suboptimal outcomes, but does not outright strip Member States of the prerogative to set their own domestic rules. A revised Proposal including the suggested solution could build legitimacy and confidence between the EU and Member States, leading to an increased likelihood of timely political agreement when it is eventually resuscitated.

6.1 The Social Economy

At the outset, it is worth locating discussion of the Proposal within the relevant political setting, which centres on the social economy. It must be emphasised that the social economy is an umbrella term that covers a wide-ranging set of organisations with diverse size and structure, which engage in numerous socio-economic activities in local, regional and national contexts. Many things impact how the social economy looks and operates across Member States: 'history, culture…[economic conditions] and relationships among public administrators and private organizations determine, or rather select, the forms of development taken by the social economy'.[496] We got a taste of these dynamics in Chapter 3.

Whilst this Chapter is not the appropriate forum to wade into those jurisdictional complexities any further than we already have, more will be said in Section 6.3(b)(i) about the relationship between Member States' social economies. Consequently, a historically rooted, traditionalist

[496] I Vidal, 'Social Economy' in R Taylor (ed), *Third Sector Research* (Springer 2010) 64.

understanding of the sector is utilised, which allows for the referencing of some helpful generalisations germane to the present analysis.

Deriving from the French 'économie sociale',[497] the social economy is a 'third sector'[498] occupying a space between the state and the market. It is an expression of civil society assuming direct responsibilities for addressing the needs of individuals, groups, communities and regions ignored or not adequately served by policymakers and private sector business organisations.[499] In this way, the social economy stems from citizens' capacity to self-organise with the shared goal of confronting socio-economic problems for themselves.

The social economy is an organisational 'family' including associations, cooperatives, foundations, mutuals and social enterprises.[500] Here, it is beneficial to momentarily reflect on these organisational taxonomies and the institutional logic governing their operation. Conventionally, associations and foundations form a 'non-market sub-sector'.[501] By contrast, cooperatives, mutuals and social enterprises are, typically, engaged in the production of goods and services in a 'market sub-sector'.[502] Thus, with respect to the attributes shared with private sector business organisations, notably the traditional corporation, cooperatives, mutuals and social enterprises likewise occupy market spaces.[503]

Regarding social enterprises in particular, they are distinguishable from the other entities in the social economy in that they are not discrete organisational forms in any real sense. Rather, they are an organisational category, or breed, that, compared with orthodox conceptions of associations, cooperatives, foundations and mutuals, exhibit 'more innovative behaviour'.[504] They also 'rely on a more varied mix of resources, in particular on income generated through trading rather than grant funding from public authorities; and they are more entrepreneurial –

[497] G Smith, 'Green Citizenship and the Social Economy' (2005) 14 *Environmental Politics* 273, 276-278.
[498] V Hodgkinson and A Painter, 'Third Sector Research in International Perspective: The Role of ISTR' (2003) 14 *Voluntas* 1, 4.
[499] Ridley-Duff Bull (n 219) 15-16; G Jenei and E Kuti, 'The Third Sector and Civil Society' in Osborne (n 261) 9.
[500] A Amin, A Cameron and R Hudson, *Placing the Social Economy* (Routledge 2002) 61.
[501] J L Monzón and R Chaves, 'The European Social Economy: Concept and Dimensions of the Third Sector' (2008) 79 *Annals of Public and Cooperative Economics* 549, 561.
[502] F Moulaert and O Ailenei, 'Social Economy, Third Sector and Solidarity Relations: A Conceptual Synthesis from History to Present' (2004) 42 *Urban Studies* 2037, 2042.
[503] L Sepulveda, 'Social Enterprise – A New Phenomenon in the Field of Economic and Social Welfare?' (2015) 49 *Social Policy & Administration* 842, 846.
[504] Smith and Teasdale (n 220) 156.

they have a strong inclination towards [commercial] and financial risk-taking'.[505] Consequently, a 'social enterprise' is merely a type of corporation[506] that pursues a social purpose through the provision of goods and services.[507]

As a default matter, there is not much separating a social enterprise corporation from a traditional corporation when it comes to, for example, outward-facing things like insolvency, tax or tort – the same legal rules, generally, apply to both types of firm. However, it is not uncommon for would-be shareholders in a social enterprise corporation to be given tax incentives for investing in such a firm. For example, this is the case in France (and, as we saw in Chapter 3, the UK).[508]

What does separate a social enterprise corporation from a traditional corporation is the regulation of the former's internal affairs, which are governed by unique rules peculiar to entities operating within the social economy. Analysed in Chapter 4, at the point of registration, a social enterprise corporation's articles of association must normally feature legally mandated provisions dealing with the selection and maintenance of a social purpose, limits on profit distributions and corporate governance mechanisms that foster participatory routes for non-shareholder constituencies affected by a particular firm's activities.[509]

More broadly, no matter the sub-sector, all social economy organisations go beyond classic commercial transacting and operate according to a distinct institutional logic that is separate from the private sector. Noted in Chapter 4, an institutional logic is an overarching set of norms that dictate the values and objectives of an organisational field; it is the standard mode of operation that makes an entity's behaviour predictable.[510]

Highlighted by commentators, job creation, entrepreneurship and consumer demand, for example, are important driving forces – especially in the market sub-sector – but the ultimate goal is not to produce economic surplus that can then be appropriated based upon a residual

[505] ibid.
[506] Although note that social enterprises can also take a cooperative form.
[507] Defourny and Nyssens (n 331) 8.
[508] See generally eg Ministères de l'Économie et des Finance, *ESS: Qu'est-ce que l'agrément "Entreprise Solidaire D'Utilité Sociale"?* (2018) <https://www.economie.gouv.fr/entreprises/agrement-entreprise-solidaire-utilite-sociale-ess>.
[509] See eg Regulation (EU) 1296/2013 on a European Union Programme for Employment and Social Innovation ('EaSI') [2013] OJ L347/238, art 2(1).
[510] Woodside (n 268) 39.

claim connected to the investment of capital. Rather, the sector's institutional logic is such that social economy organisations pursue goals for community, and more broadly public, benefit. A timely example of a social economy organisation pursuing public benefit is Imperial College London's social enterprise – VacEquity Global Health – that was formed to develop and deliver a COVID-19 vaccine to the world at low cost.[511]

Social economy organisations are usually formed and managed by individuals within a wider social fabric that elect to cooperate with each other on the basis of reciprocity and solidarity to improve living conditions for employees, members and stakeholders over capital contributors' interests.[512] Moreover, social economy organisations are legally prohibited from distributing residual earnings to those with a managerial or ownership interest, or profit distribution is proportionate to the work performed or the services rendered. Otherwise, profits are reinvested back into the particular organisation, or used to pursue social development objectives within a community or target demographic – for example, drug users, the elderly, homeless individuals, immigrants or the unemployed.[513]

The social economy is, therefore, often referred to as reflecting a kind of 'caring' capitalism in which organisations engage in a broad assortment of socio-economic activities and deploy economic surplus for essentially public interest purposes.[514] As we shall see, this has come to be politically valued in the European integration context.

6.2 Positioning the Social Economy Within European Integration

The aim of this section is to briefly examine past attempts by Union level policymakers to recognise the social economy in EU organisational law, and highlight the paradigmatic shift from which the Proposal emerged. The change in context that occurred between past attempts and the Proposal is quite important, as the justifications for vertical intervention are now different. Indeed, later in Section 6.4(a) I show that many Member States likewise have evolving policy priorities and incentives that are likely to make vertical intervention politically palatable.

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[511] See A Scheuber, 'Imperial Social Enterprise to Accelerate Low-Cost COVID-19 Vaccine' *Imperial News* (2020), <http://www.imperial.ac.uk/news/198053/imperial-social-enterprise-accelerate-low-cost-covid-19/>.
[512] Borzaga and Tortia in Noya and Clarence (n 216) 35.
[513] Chaves and Monzón (n 270) 9.
[514] Brandsen, van de Donk and Putters (n 267) 751.

(a) Past Attempts to Recognise the Social Economy in EU Organisational Law

Regarding past attempts, the social economy has not historically been well recognised in EU organisational law. With the exception of the Societas Cooperativa Europaea ('SCE'), the crux of the problem seems to be that unanimity has been elusive. Member States have had an 'interest in keeping…[their organisational] law exactly as it is, preventing exogenous (i.e. European) innovations and preserving the status quo', which has made the institutionalisation and the scaling up of the social economy difficult at Union level.[515]

The process of recommending Union level organisational forms began with a proposal for a European Association ('EA'), which was formally submitted to the Council in 1992.[516] However, little progress was made in the 1990s – the general attitude amongst Member States appears to have been that the proposed EA Regulation was an inappropriate encroachment attempt by the EU that clashed with national legal traditions and domestic policy objectives.[517] This apprehension of interference continued into the 2000s, when, in 2003, there was some indication that the Greek Council intended to revive the proposal. Nevertheless, the proposed EA Regulation failed to secure Member States' backing and was finally removed from the European Commission's agenda in 2006. One commentator suggests that the idea of an EA was a 'symbol in need of friends', and argues that 'it is obscure whether anybody, either outside or inside the official bureaucracy of Brussels, much cared about what happens' to the proposal.[518] From a legal perspective, the point was also echoed that – in the midst of wider efforts to modernise EU organisational law – 'support for the [EA] in legal circles has…been scarce'.[519]

The European Commission also tabled its SCE proposal in 1992. Legislative progress was initially hamstringed for some time by disagreements about employee participation. However, the SCE Regulation and the connected employee Directive were eventually enacted in 2003 shortly after the launch of the Societas Europaea. Since the latter 'marked a watershed for the

[515] R Ghetti, 'Unification, Harmonisation and Competition in European Company Forms' (2018) 29 *European Business Law Review* 813, 836.
[516] COM (91) 273 final, *Proposal for a Council Regulation on the Statute for a European Association*.
[517] J Kendall and L Fraisse, 'The European Statute of Association: Why Still an Obscure but Contested Symbol in a Sea of Indifference and Scepticism?' in Kendall (n 220) 211-215.
[518] O Gjems-Onstad, 'The Proposed European Association: A Symbol in Need of Friends?' (1995) 6 *Voluntas* 3, 4.
[519] O B Breen, 'EU Regulation of Charitable Organizations: The Politics of Legally Enabling Civil Society' (2008) 10 *International Journal of Not-for-Profit Law* 50, 59.

further development of European corporate law', it somewhat overshadowed the launch of the SCE.[520] This has led many commentators to view the SCE as a 'socio-political tag-along' to the EU's 'flaggschiff' (flagship) project of creating a pan-European corporate form.[521]

The European Commission proposed a Fundatio Europaea ('FE') in 2012. Before any EU institutional or legislative activity dealing with foundations was overtly discernible, the possibility of an FE statute was mentioned in the European Commission's 2003 action plan on modernising corporate law and enhancing corporate governance.[522] However, the FE proposal was ultimately withdrawn in 2015. Noted by one commentator, the extent to which foundations operating under the proposed FE regulation would be permitted to engage in economic activity and receive tax incentives were contentious issues that could not be reconciled.[523] The European Commission did not see how it could obtain Member States' agreement on these matters – 'there are no prospects that agreement can be reached'.[524]

Lastly, a proposal was also listed for a European Mutual in 1992.[525] The proposal, however, never got beyond the discussion stage and was removed from the European Commission's agenda in 2005 due to lack of substantive progress. In 2013, the European Commission did initiate a follow-up consultation on the possible revival of the statute. It was rumoured that an impact assessment on the efficacy of creating a recast draft regulation was completed, but it was never made public. When the European Parliament questioned the European Commission about the impact assessment in 2015, it declined to produce the impact assessment, presumably owing to a supposed lack of unanimous support for the statute.[526]

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[520] J Armour and W-G Ringe, 'European Company Law 1999-2010: Renaissance and Crisis' (2011) 48 *Common Market Law Review* 125, 158.
[521] H Fleischer, 'Supranational Corporate Forms in the European Union: Prolegomena to a Theory on Supranational Forms of Association' (2010) 47 *Common Market Law Review* 1671, 1677-1678.
[522] See generally COM (2003) 284 final, *Communication from the Commission to the Council and the European Parliament on Modernising Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward*. See generally also eg K J Hopt, T von Hippel, A Anheier, V Then, W Ebke, E Reimer and T Vahlpahl, *Feasibility Study on a European Foundation Statute: Final Report* (2009) <http://archiv.ub.uni-heidelberg.de/volltextserver/18688/1/feasibilitystudy_en.pdf>.
[523] K J Hopt, 'Corporate Governance in Europe: A Critical Review of the European Commission's Initiatives on Corporate Law and Corporate Governance' (2015) 12 *New York University Journal of Law & Business* 139, 189.
[524] COM (2014) 910 final, *Annex to the Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions – Commission Work Programme 2015, A New Start*, 12.
[525] COM (91) 273 final, *Proposal for a Council Regulation on the statute for a European mutual society*.
[526] See generally European Commission, *Synthesis Report on the comments on the open consultation on the measures proposed by a study financed by the Commission for the promotion of mutual societies in the EU and the necessity for a Status for a European Mutual Society* (2013) <http://ec.europa.eu/DocsRoom/documents/12924/attachments/1/translations/en/renditions/native>; European

What is significant about these past attempts to recognise the social economy in EU organisation law is that, despite slightly different circumstances surrounding each proposal, the context was essentially the same. That is to say, the argument for Union level action was couched in terms of the undesirability of Member States' organisational forms remaining heterogeneous, which was merely a prop for Single Market intervention. For example, *vis-à-vis* the EA and the European Mutual proposals, the legal base was Article 100 – for the approximation of Member States' laws – of the Treaty Establishing the European Economic Community. With respect to the FE proposal, the legal base was Article 352 – the flexibility clause – of the Treaty on the Functioning of the European Union ('TFEU'). According to the European Commission, the FE would have a 'positive impact on…the EU economy as a whole'.[527]

However, as the social legitimacy of the EU has been progressively called into question over time, the Union level interest in the social economy has not only increased but the nature of the policy attraction has evolved in kind. This has resulted in a paradigmatic shift in which justification for recognising the sector in EU organisational law is now more cogent.

(b) The Change in Context

Union level policymakers have been interested in the economic dimension of the social economy since roughly the 1980s. Namely, social economy organisations have been viewed as effective tools for economic stimulation and job creation. For example, even around the time when the Single European Act came into force, Jacques Delors saw the social economy as an 'EU policy instrument for strengthening economic development, and also coping with the employment problems associated with the decline of traditional [ie, private sector] industry in the regions'.[528] This sentiment has been reflected in numerous texts, ranging from the European Commission's very early *Business in the 'Economie Sociale' Sector: Europe's Frontier-Free Market* communication,[529] to more recent pronouncements such as the European Council's

Parliament, *Question for Written Answer E-001717-15 to the Commission* (2015) <https://www.europarl.eu.doceo/document/E-8-2015-001717_EN.html>.

[527] See COM (2012) 35 final, *Proposal for a Council Regulation on the Statute for a European Foundation (FE)*.

[528] J Kendall, C Will and T Brandsen, 'The Third Sector and the Brussels Dimension: Trans-EU Governance Work in Progress' in Kendall (n 222) 348. See generally also J Delors, 'The European Union and the Third Sector' in Evers and Laville (n 215) 206.

[529] SEC (89) 2187 final, *Communication from the Commission to the Council on Business in the 'Economie Sociale' Sector – Europe's Frontier-Free Market*, 26-27.

Promotion of the Social Economy as a Key Driver of Economic Development in Europe communication.[530]

Moreover, there is also a Union level interest in fostering social economy organisations' economic development because they seem to fare better in periods of commercial downturn. As the argument runs, social economy organisations' prioritisation of cooperation and solidarity creates group incentives that appear to allow for the stabilisation of productive processes during periods of economic turbulence, thereby buffering against the threat of insolvency and the need to reduce employment levels. The European Commission has acknowledged this on several occasions. For example, the

> social economy…[has] proven to be very resilient during the economic and financial crisis in recent years…[Social economy organisations] have an ability to overcome multiple obstacles and to absorb shocks that affect the stability of employment…The social economy is therefore a crucial part of the European economic landscape and needs to be part of any European entrepreneurship or job creation agenda.[531]

Although there is certainly still a policy concentration on the social economy's economic aspects, it is not difficult to observe a marked policy gravitation towards the sector's social dimension. This directly relates to the idea that the EU has been weathering a social legitimacy crisis for a number of years. Different commentators take different views on how well the EU is weathering this crisis. Some argue that the 'social' aspect of European integration is dead. Others do not go so far.[532]

In attempting to locate Union level interest in the sector's social dimension, a useful starting point is the 1990s. The European Commission's *Action Plan for the Single Market* communication ('*Action Plan*') set a goal to deliver a Single Market for the 'benefit of all citizens'.[533] Endorsed by the Amsterdam Council in a 1997 resolution, the *Action Plan* is significant because it openly portrayed the Single Market in more holistic terms to include not

[530] See generally European Council, *The Promotion of the Social Economy as a Key Driver of Economic Development in Europe* (2015).
[531] European Commission, *Social Enterprises and the Social Economy Going Forward – A Call for Action from the Commission Expert Group on Social Entrepreneurship* (2016), 10.
[532] See eg C Barnard, 'EU Employment Law and the European Social Model: The Past, the Present and the Future' (2014) 67 *Current Legal Problems* 199, 202.
[533] European Commission, *Action Plan for the Single Market* (1997).

only economic integration, but also the aspiration to engineer in social safeguards.[534] In other words, the *Action Plan* stressed that the Single Market was not simply an economic structure.

This turn in European integration also changed the way in which policymakers at Union level treated the social economy. Instead of exclusively concentrating on the sector's economic applications, more emphasis was attached to the social economy's socio-cultural importance to, and interconnection with, the European Project. For example, the European Commission's 1997 *Promoting the Role of Voluntary Organisations and Foundations in Europe* communication suggested that social economy organisations – in particular associations and foundations – 'make important contributions to the fight against social exclusion…They have played a major role in the mobilisation of public opinion in favour of development…and have established privileged connections with the representatives of civil society'.[535] The European Commission further argued that social economy organisations 'are active in every conceivable field of human interest or endeavour and their contribution to the welfare and development of our societies and to our diverse cultures remains as essential as it has ever been, especially in view of the process of European integration'.[536]

The 2000 Lisbon European Council's introduction of its ten-year policy priorities also constitutes another important milestone ('*Lisbon Agenda*'). As a precursor to Article 3(3) of the Treaty on European Union ('TEU'), the *Lisbon Agenda* set a new strategic goal for the EU to become the 'most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion'.[537] Completion of the Single Market was one aspect of this,[538] and modernisation of the European social model – in particular through active employment, updating social protections and promoting social inclusion – was the other dimension.[539] Striking a balance between the two was seen as necessary to ensure that the 'emergence of this new economy does not compound existing social problems of unemployment, social exclusion and poverty'.[540] The European Commission's 2000 *Review of the Internal Market Strategy* communication also underscores

[534] European Council, *Resolution of the European Council on the Stability and Growth Pact Amsterdam* (1997).
[535] COM (97) 241 final, *Communication from the Commission on Promoting the Role of Voluntary Sector Organisations and Foundations in Europe* (1997), 5.
[536] ibid.
[537] European Council, *23 and 24 March 2000 Presidency Conclusions* (Mar 2000), para 5.
[538] ibid paras 5, 16-21.
[539] ibid paras 28-34
[540] ibid para 24.

that the Single Market ought to be economically efficient, as well as conducive to social cohesion.[541] The Feira,[542] Nice[543] and Stockholm Councils later reiterated this commitment – there was 'full agreement that economic reform, employment and social policies were mutually reinforcing'.[544]

The social economy was not initially factored in to achieving the *Lisbon Agenda* in a direct manner. However, overlapping problems accelerated the need for reconsidering the positioning of, and the policy expectations placed on, the sector. First, there is little doubt that the social facet of European integration suffered because of the EU's handling of the 2008 economic and financial crisis, in part because of financial austerity and cutbacks in social spending, but also in part because the greatest concern at the time was keeping the EU – economically – afloat.[545] In the words of Jean-Claude Juncker, 'the measures taken during the crisis can be compared to repairing a burning plane whilst flying', with errors made including a 'lack of social fairness'.[546] Second, in addition to the above and how it impacted upon the EU's social legitimacy, new anxieties emerged in relation to globalisation, low rates of economic growth and mounting demands for new social services. From the European Commission's perspective, as

> life expectancy increased, so did the need to find new ways to care for the elderly; as more and more women entered the workforce, child care has emerged as a major new area of intervention; as Europe has attracted more and more people from other countries and other parts of the world, the economic and social integration of migrants has required attention and new policy tools; and as the economy has become more knowledge-based, the education systems have needed to diversify and improve. In addition, society needs to find responses to climate change and dwindling natural resources.[547]

[541] COM (2000) 257 final, *Communication from the Commission to the European Parliament, the Council, the Economic and Social Committee and the Committee of the Regions – 2000 Review of the Internal Market*, para 2.
[542] European Council, *19 and 20 June 2000 Presidency Conclusions* (June 2000), paras 19-39.
[543] European Council, *7-10 December 2000 Presidency Conclusions* (Dec 2000), paras 13-33.
[544] European Council, *23 and 24 March 2001 Presidency Conclusions* (Mar 2001), para 2.
[545] See generally eg P Tsoukala, 'Euro Zone Crisis Management and the New Social Europe' (2013) 20 *Columbia Journal of European Law* 31.
[546] J-C Juncker, *A New Start for Europe: My Agenda for Jobs, Growth, Fairness and Democratic Change* (2014), 2 <https://www.eesc.europa.eu/resources/docs/jean-claude-juncker---political-guidelines.pdf>.
[547] European Commission, *Social Economy and Social Entrepreneurship – Social Europe Guide Volume 4* (2013), 15.

Taken together, this combination of issues led the European Commission to state that the public and private sectors could 'no longer be seen as the only possible providers of a balance between social justice and economic freedom'.[548]

It can be said that the EU was sensitive to its social deficit, and this is why the Treaty of Lisbon modified the wording of Article 3(3) TEU to introduce a commitment to create a 'social market economy'.[549] However, now widely understood, 'the social promise that Lisbon represented was…hollow'.[550] In part, this is because the 'social' compass that purportedly 'guided the Lisbon process was essentially in the ordoliberal mold. It equated social policy with modernization', which was not 'aimed to protect people from the effects of the market but to help them adjust to the market'.[551] Even if this had not been the case, supposing that the EU wished to fundamentally override the economic constitution of the Single Market and impute it with a socially calibrated conscience, it lacks the competences to do so directly.[552] The EU's inability to realise fully a social market economy through express law making – that is, without a complete re-writing of the Treaties – goes a long way towards rationalising Union level policymakers' interest in the sector's social dimension.[553]

Launched in 2010, the *Europe 2020* strategy was conceived as the ramifications of the 2008 economic and financial crisis unfolded, and, as the (retrospective) successor to the *Lisbon Agenda*, represented the EU's plan for moving forward and attempting to deliver on Article 3(3) TEU.[554] The priority was to construct an economy based on knowledge and innovation, promote a more resource-resilient, greener and competitive economy and foster a high

[548] ibid 13.
[549] Whether the EU is ultimately in a position to create a social market economy seems to be seriously doubted. See generally eg F de Witte, 'The Architecture of the EU's Social Market Economy' in P Koutrakos and J Snell (eds), *Research Handbook on the Law of the EU's Internal Market* (Edward Elgar 2017) 117; F Scharpf, 'The Asymmetry of European Integration, or Why the EU Cannot be a "Social Market Economy"' (2010) 8 *Socio-Economic Review* 211.
[550] G Dale and N El-Enany, 'The Limits of Social Europe: EU Law and the Ordoliberal Agenda' (2013) 14 *German Law Journal* 613, 625.
[551] ibid 626.
[552] de Witte (n 549) 135.
[553] However, in making this claim about limited social policy competences, it should not be forgotten that the horizontal clauses in the Treaties have been cited in some of the case law on clashes between social rights and Single Market law. See generally eg *Hungary v European Parliament and Council of the European Union*, Case C-620/18, EU:C:2020:1001.
[554] For an insightful analysis that compares the *Lisbon Agenda* with the *Europe 2020* strategy see generally eg K Armstrong, 'The Lisbon Strategy and Europe 2020' in P Copeland (ed), *The EU's Lisbon Strategy: Evaluating Success, Understanding Failure* (Palgrave Macmillan 2012) 208.

employment economy delivering social and territorial cohesion.[555] Targets included achieving employment for 75 per cent of people aged 20-64, and at least 20 million fewer people in, or at the risk of, poverty or social exclusion.[556] Regarding achievement of the *Europe 2020* strategy, the European Commission published the 2011 *Single Market Act* communication in which it laid out several structural reforms aimed at ensuring that the Single Market 'benefits all citizens'. A 'high expectation' was placed on the social economy and its supposed capacity to improve the 'social dimension of the internal market and the protection of public services'.[557] One of the key action points concerned facilitating and scaling up social entrepreneurship and the social economy.[558] In the later 2011 *Social Business Initiative* communication, the European Commission again placed the social economy at the 'heart' of the *Europe 2020* strategy and argued that bolstering Union level support for the sector would lead to 'territorial cohesion and…new solutions to societal problems, in particular poverty…and social exclusion'.[559]

The same kinds of considerations are present within the preparatory studies that underpin the Proposal, and it is evident that the case being made for Union level intervention is not merely concerned with the heterogeneity of Member States' social enterprise regulatory frameworks. Rather, the Proposal is situated within a changed context in which the EU has committed itself, and faces pressure, to reimagine the Single Market with social dimensions and objectives that go beyond the purely commercial. The social economy's distinct institutional logic and the sector-wide practice of a more socially responsible version of capitalism feature prominently in the preparatory studies. For example, it is stated that the social economy reconciles 'principles of market freedom and those of social security and social compensation', which allows the sector to combine 'economic liberalism, (re)distributive mechanisms and support to collective welfare through the provision of goods and services of general interest'.[560]

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[555] COM (2010) 2020 final, *Communication from the Commission on Europe 2020: A European Strategy for Smart, Sustainable and Inclusive Growth*, 3.
[556] ibid.
[557] COM (2011) 206 final, *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on the Single Market Act – Twelve Levers to Boost Growth and Strengthen Confidence*, 4.
[558] ibid 14-15.
[559] COM (2011) 682 final, *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on the Social Business Initiative – Creating a Favourable Climate for Social Enterprises, Key Stakeholders in the Social Economy and Innovation*, 2.
[560] Q Liger, M Stefan and J Britton, *Social Economy* (European Parliament 2016), 37 <https://www.europarl.europa.eu/RegData/etudes/STUD/2016/578969/IPOL_STU(2016)578969_EN.pdf>.

Thus, the sector and the Single Market have converged in such a way that the social economy is now tethered to the Article 3(3) TEU commitment to create a social market economy. The thinking appears to be that the sector could be used as a mechanism to embed, or constitute, economic relations within European society by the back door without having to face the prospect of imposing social controls on the Single Market overtly.[561] This could be achieved, at least in part, by integrating the social economy into the Single Market, on this occasion through the Proposal and assigning social enterprises increased socio-economic functions and responsibilities.[562] Therefore, to be clear, the position this Chapter takes is that the Proposal is conceptually distinct from past attempts to recognise the sector at Union level.

If the context has changed, the question then becomes why the focus is on social enterprises and not on reviving the aforementioned, earlier proposals. From the European Parliament's viewpoint, social enterprises make the same variety of contributions that are synonymous with other social economy organisational forms. However, there is a noticeably heightened policy interest in social enterprises that assists with explaining the Proposal's explicit focus on them, to the exclusion of the other organisations found in the sector. This is for two reasons, but it is also because of tax incentives. Tax incentives were a major stumbling block for the FE despite it being proposed in the context of the paradigmatic shift that we examined above. The Proposal under review in this Chapter would not create the conditions for firms to engage in tax arbitrage. However, there are nonetheless incentives for forming a social enterprise corporation and acquiring the ESE label that could spur equally significant regulatory arbitrage issues – see Section 6.5(b) below.[563]

First, social enterprises can currently be found engaging in, for example, agriculture, banking, health and social services, insurance, manufacturing, recycling, renewable energy, social housing, the sustainable regeneration of marginalised urban and rural areas, tourism, transportation and waste management.[564] The commentary suggests that the industries in which social enterprises' operate are steadily expanding further, which has occasioned policymakers

[561] See eg G Davies, 'Internal Market Adjudication and the Quality of Life in Europe' (2015) 21 *Columbia Journal of European Law* 289, 306-308.
[562] See note 572 below.
[563] See eg B Weitemeyer, 'Fundatio Europaea – Risk of Abuse by Tax Shopping?' (2013) 14 *ERA Forum* 277, 285-287.
[564] Liger, Stefan and Britton (n 560) 33. See also eg E Thirion, *European Added Value Assessment on Statute for Social and Solidarity-Based Enterprises* (European Parliament 2017), 11 <https://www.europarl.europa.eu/RegData/etudes/STUD/2017/611030/EPRS_STU%282017%29611030_EN.pdf>.

to view social enterprises as distinctly placed to amplify the wider social economy's contributions to European integration. Thus, the European Commission, for example, puts 'more emphasis on the innovative features of social enterprises, which lies in particular in their capacity to bring an entrepreneurial and commercial dimension' to their socially valuable activities.[565] With an estimated 250,000 social enterprises across Europe,[566] these entities are 'associated with social...innovation, as a result of the expansion of their activity in new fields of production of goods or of delivery of services…designed to meet new societal, territorial or environmental demands and challenges'.[567] Second, unlike, for example, associations and foundations, social enterprises are more prone to being financially independent and commercially viable. This means that, generally, they do not require the same degree of governmental support in the furtherance of their publicly oriented activities – the commentary points out that this ability to be more sustainable without the need for subsidisation 'has proved attractive to policymakers'.[568]

6.3 The Proposal

This brings the analysis to examining the Proposal. The substantive architecture of the Proposal is initially considered, followed by a critique and clarification of the European Parliament's stated rationale. The central argument spanning Section 6.3 is that deeper inspection is required, as the full case for Union level intervention is not completely fleshed out by the preparatory studies supporting the Proposal. It ought to be appreciated that, in addition to the more straightforward aim of equipping social enterprises with the ability to engage in cross-border activities, the Proposal also attempts to tackle the social problems associated with the Single Market. Here it is essential to, among other things, drag the Single Market dimension to the forefront of the discussion, otherwise the conceptual and long-term importance of the Proposal could be obfuscated.

[565] Liger, Stefan and Britton (n 560) 42.
[566] Thirion (n 564) 11.
[567] European Parliament Proposal (n 489) rec W.
[568] Smith and Teasdale (n 220) 156.

(a) The Proposal

The European Parliament's approach is, roughly, similar to that taken with the Societatis Unius Personae ('SUP').[569] The Proposal advocates for a directive, rather than a regulation, with a legal base under Article 50 TFEU. Notably, the Proposal does not argue for a new organisational form to add to EU organisational law. Differently, social enterprises' cross-border activities would be secured through the ESE label.[570] Since the choice of a juridical label represents a new chapter in EU law making, further elaboration is necessary. Like the SUP, the Directive would 'piggyback' on Member States' domestic social enterprise regulatory frameworks. For those that lack such a regulatory framework, Member States would be required to introduce a social enterprise corporation into their national legal system, or adapt pre-existing models and rules to conform with the Proposal. The Proposal leaves wide latitude for national variety and co-evolution, in that it only compels the inclusion of four features that would be present in all Member States. To be further discussed in Section 6.5(a), this is very much in the spirit of reflexive harmonisation. The (inchoate) intention with the Proposal seems to have been not to attempt a unified or invasive regulatory intervention, but to set a 'thin' procedural floor of boundary requirements that leaves ample room for domestic autonomy and variation between Member States.[571]

To comply with the Proposal, Member States' social enterprise regulatory frameworks would need to offer a corporate option with the following features. First, national law must oblige firms to prioritise a social purpose 'essentially focused on the general interest or public utility', the scope of which would be a question for each Member State. The Proposal includes some examples of a suitable 'social purpose'. For instance, a social purpose could 'aim to provide support to vulnerable groups, to combat social exclusion, inequality and violations of fundamental rights…or to help protect the environment, biodiversity, the climate and natural resources'.[572] Second, firms must be subject to at least partial constraints on profit distributions

[569] Ghetti (n 515) 826-831; Fleischer (n 521) 1678-1680.
[570] See A Fici, *A European Statute for Social and Solidarity-Based Enterprise* (European Parliament, 2017), 36-37 <https://www.europarl.europa.eu/RegData/etudes/STUD/2017/583123/IPOL_STU%282017%29583123_EN.pdf>.
[571] See generally S Deakin, 'Legal Diversity and Regulatory Competition: Which Model for Europe?' (2006) 12 *European Law Journal* 440 (hereafter *Legal Diversity*); S Deakin, 'Two Types of Regulatory Competition: Competitive Federalism Versus Reflexive Harmonisation. A Law and Economics Perspective on *Centros*' (1999) 2 *Cambridge Yearbook of European Legal Studies* 231 (hereafter *Two Types*).
[572] European Parliament Proposal (n 489) Annex.

and to specific rules on the allocation of profit, with some profit made reinvested to achieve the selected social purpose.[573] Third, national law ought to prescribe corporate governance mechanisms that foster participatory routes for non-shareholder constituencies affected by a particular firm's activities.[574] Fourth, firms must incur extra disclosure obligations through the issuance of an annual 'social report', detailing to regulatory authorities firms' 'activities, results, involvement of stakeholders, allocation of profits, salaries, subsidies, and other benefits received'.[575] These latter three features are similarly procedural and intended to be open to Member States' interpretation.

For social enterprises that incorporate under a national regulatory framework aligning with the above, the Proposal envisions that acquisition of the ESE label itself would be optional, and administered directly by Member States and representatives of their respective social economies. Monitoring and auditing would likewise be done at the Member State level, with penalties for infringement ranging from a 'mere admonition to the withdrawal of the label'.[576] Once acquired, any social enterprise corporation bearing the ESE label would be mutually recognised in all Member States, thereby allowing relevant firms entry and exit to other social economies under, generally, the same conditions as domestic undertakings. Therefore, the ESE label can be understood as a kind of European passport for social enterprise corporations to facilitate their cross-border activities.

(b) Clarifying the European Parliament's Regulatory Justifications

Looking behind the Proposal at the supporting preparatory studies, the stated justification for regulatory intervention is no great surprise. According to the European Parliament, beyond aggregated domestic impact the consensus seems to be that social enterprises' participation in the Single Market remains low. The prime reason for this is Member States' largely disjointed regulation – or lack thereof – of social enterprises.[577] This regulatory incongruity makes cross-border re-incorporation or the opening of a branch office in another Member State essentially not possible, rendering the freedom of establishment hollow in practical terms. Further, until

[573] ibid.
[574] ibid.
[575] ibid.
[576] ibid.
[577] Other 'problem drivers' mentioned, for example, are a lack of public visibility and awareness and the absence of common mechanisms for impact measurements across the EU. See Thirion (n 564) 21.

Member States' regulatory frameworks allow social enterprises to add a cross-border dimension to their activities, it will act as a barrier to the EU providing supplementary developmental support – for example, through increased access to debt or equity financing.[578]

However, as already noted, this account does not provide a complete picture. This is so for two reasons. First, whilst quietly present in the Proposal, the preparatory studies fail to explicitly develop the relational link between it and the Single Market and why this is significant. Second, overlaying the missed opportunity to explain how the Proposal could address some of the negative externalities associated with the Single Market, the preparatory studies also claim that there are corporate mobility barriers, but do not plainly articulate the substantive problems confronting social enterprises seeking to engage in cross-border activities. Each is discussed in turn.

(i) The Relationship Between the Proposal and the Single Market

The initial consideration is that Member States' social economies have historically developed according to their own path dependencies in essentially closed sub-systems. In other words, Member States' social economies do not come together to form an internal market in the same way that Member States' private sectors come together to create the Single Market. Nor do Member States' social economies connect to the Single Market, such that the former can be viewed as a subdivision within the latter. Differently, social economy organisations' activities, generally, coincide with domestic governments' social and welfare policy infrastructure. This has, over time, resulted in cross-border insulation.

Most Member States – due to perceived economic and budgetary constraints – have sought to control the sector as a *de facto* annex of the welfare state. For example, to create more employment opportunities or outsource some combination of administrative, fiscal or implementation responsibilities to social economy organisations with respect to the domestic provision of general interest and welfare goods and services. For a useful primer on this in the context of jurisdictions that have introduced a social enterprise corporation refer back to Chapter 3. To ensure public trust, Member States impose high regulatory burdens on entities seeking entry, as well as those attempting to exit and, for example, transition to operating in

[578] ibid 19-20.

the private sector, which extends to robust governmental oversight throughout social economy organisations' lifecycles.[579]

It is, therefore, not the position that any social economy organisation has a natural and unqualified right of access to the protections afforded by Articles 49 and 54 TFEU and the Court of Justice of the European Union's freedom of establishment jurisprudence ('CJEU'). Member States' social economies are freestanding and safeguarded ecosystems beyond the reach of Union competence. [580] Thus, any Union level intervention in this area that is designed to facilitate social economy organisations' ability to engage in cross-border activities is, tacitly, also calculated to liberalise, open up or otherwise interlock Member States' sequestered social economies together. It is beneficial to treat this as knitting together a new kind of internal market – a 'European Social Economy' – that has yet to be completed.

With the Proposal, however, a further outcome would be achievable, since social enterprises are effectively limited companies that operate in markets, albeit of a special sort. It will be recalled that social enterprises operate in the market sub-sector of the social economy, which is governed according to the sector's distinct institutional logic and results in the practice of a more socially responsible version of capitalism. As new opportunities for expansion arise, social enterprises can be expected to continue penetrating into more areas where social intervention is required.[581] Were social enterprises permitted to freely engage in cross-border activities and fully participate in the Single Market, the effect of this expansionary tendency could be that the boundary lines between the sector and the Single Market could start to blur. Thus, although the Proposal, in the immediate sense, attempts to facilitate social enterprises' cross-border activities, it also triggers the construction of a (market sub-sector) European Social Economy, and potentially its assimilation into the Single Market.

This is only one piece of legislation and it cannot be expected to instantly, or by itself, embed or constitute the Single Market within European society. However, it does create the conditions necessary for social enterprises *qua* ambassadors of the social economy to commit what

[579] In the case of France, for example, see eg D Chabanet, 'The Social Economy Sector and the Welfare State in France: Towards a Takeover of the Market?' (2017) 28 *Voluntas* 2360, 2375.
[580] For a broader analysis of the issues relating to non-market sub-sector social economy organisations' lack of freedom of establishment see generally eg S Lombardo, 'Some Reflections on Freedom of Establishment of Non-Profit Entities in the European Union' (2014) 14 *European Business Organization Law Review* 225.
[581] See eg J L Monzón and R Chaves, *The Social Economy in the European Union* (European Economic and Social Committee 2012), 85-86 <https://www.eesc.europa.eu/resources/docs/qe-30-12-790-en-c.pdf> .

commentators refer to as 'norm violations' in which the market constituting logic of the Single Market could be challenged and unsettled.[582] Through repeat interactions with private sector corporations, and perhaps even occupying shared industry spaces across the EU, each norm violation by social enterprises could encourage additional violators to emerge, and, if deviations reach a critical mass, the preceding *status quo* could alter.[583] This outcome would be politically welcome because it positions the EU to appear to be taking substantive action to address its social deficit without having to face the prospect of imposing social controls on the Single Market overtly – this approach lets the market 'decide' for itself.

(ii) The Obstacles Social Enterprises Face in Moving Across Borders

Anticipating potential challenges to the argument that social enterprises face obstacles in moving across borders, a sceptic might argue that, since there is little difference between a social enterprise and a private sector corporation – at least in terms of outward-facing activities and relations with third parties – it is doubtful whether Union level intervention achieves anything aside from harmonisation. There is currently nothing standing in the way of such firms engaging in cross-border activities that would allow either the jurisdiction of incorporation to refuse an exit or the host Member State to justify a refusal of registration. Ultimately, social enterprises are essentially limited companies and the Treaty and the CJEU's freedom of establishment jurisprudence necessarily guarantee their movement across borders in the normal way.

However, this reasoning likely has serious limits, which, whilst not emphasised by the preparatory studies, would justify the Proposal. This is because social enterprises, being entities of an isolated environment that is both jurisdictionally ring-fenced and separated from the larger Single Market, do not have a natural and unqualified right of access to the protections afforded by the Treaty and the CJEU's freedom of establishment jurisprudence. For example, in the context of branching, the commentary provides that 'Member States are probably allowed to refuse registration in the central register…if they do not allow domestic companies

[582] R H McAdams, 'The Origin, Development, and Regulation of Norms' (1997) 96 *Michigan Law Review* 338, 393 (see also footnote 186). For a further analysis of the differences between the institutional logics of the social economy and the private sector see the discussion in Chapter 4.
[583] C R Sunstein, 'Social Norms and Social Roles' (1996) 96 *Columbia Law Review* 903, 909.

of that type to be registered there'.[584] When applying the idea that Member States can constrain firms' cross-border activities based upon what types of organisational forms they recognise domestically, there are three reasons that could be used to negate an inbound social enterprise's right of establishment in justifying a refusal of registration.

First, a number of Member States do not legally recognise, or otherwise make provision for, social enterprise in any (ie, cooperative or corporate) form, which means that a denial of such a firm's registration request would not likely contravene Union level obligations. For example, Belgian and German organisational laws do not include a bespoke social enterprise organisational form or legal status for the regulation of such entities. Belgian organisational law did include such a form – the *société à finalité socialé* – among its available options, but it was abolished with the February 2019 *le Code des Sociétés et des Associations* modernisation. Second, some Member States only allow social enterprises to take a cooperative form, which translates to the idea that a host Member State can, plausibly, legally deny a social enterprise corporation access to its social economy on the ground that domestic firms of that sort are not permitted to exist. This is the case in, for example, Greece and Hungary. Third, even where a host Member State does legally recognise social enterprise corporations, there are two types. 'Type A' social enterprises are permitted to carry out an extensive range of social entrepreneurship activities, the limits to which are at the discretion of the particular Member States' regulator. 'Type B' social enterprises, by contrast, must explicitly engage only in work integration services for the hard to employ.[585] Thus, for example, Type A social enterprises can be denied access by a host Member State that only legally recognises Type B social enterprises. There is evidence of registration refusal on similar grounds in the private sector context, as Member States may in some instances not afford mutual recognition because of an inbound firm's activities. This is important for the present analysis, as work integration is a rather narrow activity when compared with the large volume of social entrepreneurship activities that Member States could theoretically consider as normatively legitimate.[586]

[584] K E Sørensen, 'Branches of Companies in the EU: Balancing the Eleventh Company Law Directive, National Company Law and the Right of Establishment' (2014) 11 *European Company and Financial Law Review* 53, 63.
[585] For an in-country discussion on Type A and Type B social enterprises see eg N Tomaževič and A Aristonvnik, *Social Entrepreneurship: Case of Slovenia* (2018), 45 <https://zavod14.si/wp-content/uploads/2018/10/Social-Entrepreneurship_Case-of-Slovenia.pdf>. See also eg Thirion (n 564) 23.
[586] See M Becht, L Enriques and V Korom, '*Centros* and the Cost of Branching' (2009) 9 *Journal of Corporate Law Studies* 171, 180-182.

That being so, whilst the contention is not that social enterprises are completely restricted from moving across borders, it is argued that their right of establishment is uncertain and tightly controlled. The scope of the right would not be the same in every circumstance, and would, therefore, require testing on a case-by-case basis, probably with the need to challenge Member States' decisions to restrain social enterprises' cross-border movement through judicial review in many instances. The foreseeable chilling effect manifested due to the time and expenses required before even determining whether the right exists and is exercisable means that, practically, it is non-existent for the majority of social enterprises in the EU. Properly construed, these are the sorts of underlying corporate mobility problems that the preparatory studies attempted, but failed, to make clear.

(c) Preliminary Conclusions

As might be expected, the extent to which a social enterprise would enjoy the right of establishment – to the degree that private sector corporations do – is a function of how the terms of the Proposal are framed, coupled with how Member States decide to specifically structure their individual regulatory regimes. The complications that could spring from this arrangement will be examined in Section 6.5(b). Presently, it is enough to say that, provided a particular firm carries the ESE label, Member States would no longer be able to legitimately deny an exit from, or access to, their respective social economies on the ground that the sector is on a separate footing that precludes corporate mobility. However, the ESE label goes further than simply creating the conditions necessary for harmonisation. Beyond being a kind of European passport that requires Member States to liberalise and open up their historically closed social economies to inbound firms, which may result in a European Social Economy, the legislation is also designed to aid the EU in addressing its social deficit.

6.4 The European Commission's Response

The European Commission responded in November 2018, but did not 'share the Parliament's analysis' concerning the feasibility of facilitating social enterprises' cross-border activities at Union level at this stage.[587] According to the European Commission, strong weight was attached to the idea that 'setting up criteria for a [statute]…at European level would run against

[587] European Commission (n 494).

the need to take into account sometimes significantly different national traditions and contexts'.[588] However, this assertion does not seem to be borne out empirically. It is (cautiously) submitted that a consensus may already exist that is sufficient to garner Member States' agreement under Article 50 TFEU. This is for two reasons.

First, whilst a number of Member States do not include a social enterprise corporation in their organisational menus, many jurisdictions – Croatia, the Czech Republic, Denmark, France, Luxembourg, Malta, Portugal, Romania and Spain – do so, or are in the process of enacting such legislation. We considered Denmark's regulatory framework in Chapter 4. It should also be noted that the UK includes a social enterprise corporation in its organisational menu, but, due to the implications of Brexit, it is not directly considered in this analysis.

Not only is a generally common approach to facilitating social enterprise through a corporate organisational unit reflected in these Member States' regulatory frameworks, but also their national accounts likely comply with the particulars of the Proposal. This can be seen in Table 6.1.

Table 6.1 Legislation that complies with the Proposal

Jurisdiction	**Prioritisation of a social purpose**	**Constraints on profit distributions**	**Rules on the allocation of profit towards the maintenance of the social purpose**	**Participatory Governance Mechanisms**	**Social reporting obligations**
Croatia[589]	X	X	X	X	X
Czech Republic[590]	X	X	X	X	X
Denmark[591]	X	X	X	X	X
France[592]	X	X	X	X	X

[588] Ibid.

[589] Strategija razvoja društvenog poduzetništva u Republici Hrvatskoj za razdoblje od 2015. do 2020 <http://www.esf.hr/wordpress/wp-content/uploads/2015/02/Strategija-razvoja-društvenog-poduzetništva-u-RH-za-razdoblje-2015-2020.pdf>.

[590] 13/19 Návrh zákona o sociálním podniku <www.komora.cz/legislation/13-19-navrh-zakona-o-socialnim-podniku-18-2-2019/>.

[591] Lov No. 711 om registrerede socialøkonomiske virksomheder <www.retsinformation.dk/pdfPrint.aspx?id=163865>.

[592] Loi No. 2014-856 du 31 juillet 2014 relative à l'économie sociale et solidairé <www.legifrance.gouv.fr/affichTexte.do?cidTexte=JORFTEXT000029313296&categorieLien=i>.

Luxembourg[593]	X	X	X	X	X
Malta[594]	X	X	X	X	X
Portugal[595]	X	X	X	X	X
Romania[596]	X	X	X	X	X
Spain[597]	X	X	X	X	X

Second, in addition to the Member States that have already contemplated social enterprise regulatory frameworks that likely accord with the Proposal, there is also a number of other Member States – Finland, Italy, Latvia, Lithuania, Poland and Slovenia – that include legal recognition of social enterprise corporations. Whilst at present these do not fully meet the Proposal's specifications, they could be amended to satisfy the conditions with only minor modifications. Within this latter cohort of Member States, there seems to be asymmetry with respect to the structure of rules that place constraints on both profit distributions and on the allocation of profit. More specifically, Italy, Latvia, Poland and Slovenia strictly prohibit the involvement of outside equity investors along with any form of asset distributions to a firm's participants. This means that all profits must be allocated to the maintenance of the selected social purpose. Conversely, Finland and Lithuania allow outside equity investors' participation and place no limits on asset distributions, and also do not require a firm's participants to allocate any surplus profit to the furtherance of the chosen social purpose. In all other respects, though, these Member States' legislation appears to conform to the Proposal. This is reflected in Table 6.2.

[593] Loi du 12 Décembre 2016 portant creation des sociétés d'impact sociétal et modifiant <http://data.legilux.public.lu/eli/etat/leg/loi/2016/12/12/n1/jo>.
[594] Social Enterprise Bill (2015) <https://economy.gov.mt/en/public_consultation/Social%20Enterprise%20Act/Documents/White%20Paper%20-%20Social%20Enterprise%20Act.pdf>.
[595] Decreto do Presidente da República No. 58/2013, Lei de Bases da Economia <http://app.parlamento.pt/webutils/docs/doc.pdf?path=6148523063446f764c324679595842774f6a63334e7a637664326c7564475634644739 7a58324677636d39325957527663793879 4d44457a4c3078664d7a42664d6a41784d7935775a47593d&fich=L_30_2013.pdf&Inline=true>.
[596] Lege No. 219 din 23 iulie 2015 privind economia sociala <www.monitoruljuridic.ro/act/lege-nr-219-din-23-iulie-2015-privind-economia-social-emitent-parlamentul-publicat-n-monitorul-170086.html>.
[597] Ley 5/2011, de 29 de marzo, de Economía Social <https://www.boe.es/boe/dias/2011/03/30/pdfs/BOE-A-2011-5708.pdf>.

Table 6.2 Legislation that does not comply with the Proposal

Jurisdiction	**No profit distributions permitted; all profit must be allocated towards the maintenance of the social purpose**	**No constraints on profit distributions**	**No rules on the allocation of profit towards maintenance of the social purpose**
Finland[598]		X	X
Italy[599]	X		
Latvia[600]	X		
Lithuania[601]		X	X
Poland[602]	X		
Slovenia[603]	X		

However, that the requisite number of Member States have social enterprise regulatory frameworks either in, or very near, alignment with the Proposal does not on its own mean that it would automatically achieve agreement under Article 50 TFEU. Indeed, it must be conceded that Member States without a social enterprise regulatory framework may balk at the prospect of the ESE label. This could be for several reasons – for example, subsidiary arguments have often been invoked in relation to past attempts to recognise the social economy in EU organisational law.[604]

Germany, which has historically characterised its social economy domain as more a sphere of non-economic activity, was a staunch opponent of the EA proposal. The commentary notes that the envisaged degree to which an EA would be able to engage in economic activity had come to be seen as an unbridgeable rift: 'associations…inherently cannot be "economic" firms or entities at all. The very coupling of matters economic with matters social under the banner

[598] Laki sosiaalisista yrityksistä _1351/2003 <https://www.finlex.fi/en/laki/kaannokset/2003/en20031351>.
[599] Decreto Legislativo 24 Marzo 2006, No. 155, Disciplina dell'impresa sociale <https://www.gazzettaufficiale.it/eli/id/2006/04/27/006G0176/sg>.
[600] Sociālā uzņēmuma likums <https://likumi.lv/ta/id/294484-sociala-uznemuma-likums>.
[601] Lietuvos Respublikos socialinių įmonių įstatymo Nr. IX-225 pakeitimo įstatymas <https://e-seimas.lrs.lt/portal/legalAct/lt/TAD/289d7e52e35b11e99f05bdf72918ad4e?jfwid=-gs2045x92%5C>.
[602] Projekt ustawyo przedsiębiorczości społecznej <https://www.rpo.gov.pl/sites/default/files/13220556010.pdf>.
[603] Zakono socialnem podjetništvu <http://www.pisrs.si/Pis.web/pregledPredpisa?id=ZAKO6175#>.
[604] See Kendall and Fraisse in Kendall (n 222) 212.

of *economie sociale*…[has] come to be perceived as threatening to…the German third sector'.[605]

Analogically, similar concerns could act as barriers, even amongst those Member States with already existing and (quasi-) compliant regulatory frameworks. Regulatory protectionism more generally has led some commentators to surmise that perhaps 'the most appropriate response…would be for the EU to simply refrain from legislative activity in this field for awhile'[606] and 'limit itself to the core [corporate law] areas essential for European integration'.[607]

Nevertheless, assuming for the sake of argument that such a consensus is currently absent, Member States, too, have experienced changing circumstances. These changing circumstances suggest that, unlike past attempts to recognise the social economy in EU organisational law, they would likely be receptive to reassessing and ultimately endorsing a Union level instrument for facilitating social enterprises' cross-border activities at some future point.

(a) Reflecting on the Political Institutionalisation of Member States' Social Economies

I just claimed above that Member States have experienced changing circumstances that suggest that they would likely be receptive to reassessing and ultimately endorsing a Union level instrument for facilitating social enterprises' cross-border activities at some future point. To appreciate why this is the case, it is necessary to more deeply reflect on the implications of the already underlined idea that most Member States have, to some extent, politically institutionalised their respective social economies over time.[608] We already got a sense of this in Chapter 3, regarding the political economy circumstances that led Denmark and the UK to introduce their respective versions of the social enterprise corporation. Similar political economy circumstances exist in many Member States.

[605] J Kendall and H A Anheier, 'The Third Sector and the European Union Policy Process: An Initial Evaluation' (1999) 6 *Journal of European Public Policy* 283, 291. See generally also Lombardo (n 580).
[606] Ghetti (n 515) 837-839 and 842.
[607] Hopt (n 523) 201.
[608] For an introduction to the political institutionalisation of the social economy in, for example, Italy see generally eg C Borzaga and L Fazzi, 'Processes of Institutionalization and Differentiation in the Italian Third Sector' (2011) 22 *Voluntas* 409.

Initially resulting from a collective decline in economic growth that was exacerbated by upsurges in unemployment and public expenditure,[609] domestic authorities across Europe have been engaging with social economy organisations to, for example, provide employment to marginalised groups and implement social and welfare policy since the late twentieth century.[610] The exact shape the relationship has taken varies across jurisdictions. To illustrate, in Denmark policies for the temporary subsidisation of vocational training and employment recruitment through grants to facilitate (re)entry into working life have been implemented.[611] Importantly, in many respects policymakers' preferences have incentivised and steered social economy organisations into becoming favoured mechanisms in the delivery of social and welfare policy. A result of this policy integration is that social economy organisations – particularly those in the non-market sub-sector – have increasingly come to rely on public funding.

This is perceived as politically problematic because of a wider change occurring in which liberal capitalism and market forces have prompted governments to engage in 'institutional searching' to find a palliative to offset the administrative and fiscal pressures that policymakers think they are facing.

As we know, this is the case even in jurisdictions like Denmark, where, from 2008 onwards in particular, and indeed before that, Danish politicians argued in favour of a

> welfare society supporting initiative, independence and energy. A welfare society helping everybody to become active citizens instead of passive recipients of welfare benefits...We have to demand that everyone contributes and assumes responsibility for himself and the community. We have to remind ourselves that care for other people is not to be provided by tax payments alone. The civil society and the voluntary sector also have their roles to play.[612]

This sentiment is also noted by Danish commentators, referring to 'society in transition, marked by globalization, financial crises and social differentiation...The "competition state" was the

[609] Amin, Cameron and Hudson (n 500) 3-5; J Kerlin, 'Social Enterprises in the United States and Europe: Understanding and Learning from the Differences' (2006) 17 *Voluntas* 247, 252-253; Defourny and Nyssens (n 211) 34-37.
[610] For a broad European perspective see eg C Borzaga and G Galera, *Social Enterprises and their Eco-systems: Developments in Europe* (European Commission 2016), 25-26 <https://ec.europa.eu/social/main.jsp?catId=738&langId=en&pubId=7934&type=2&furtherPubs=yes>.
[611] See generally eg Hulgård and Brisballe (n 59).
[612] Hækkerup (n 197).

modern "welfare state". It was more important to support the individual in becoming self-reliant and to live according to their own choices than to compensate for the absence of abilities'.[613]

Thus, whilst this has unfolded and led to variations across jurisdictions, virtually every domestic government is being pushed away from 'welfare state guarantor to regulator, grant-giver and…market maker'.[614] Additionally, new types of socio-economic vulnerabilities were also generated by the 2008 economic and financial crisis and its aftermath. This aggravated the effectiveness of the policy bundles implemented from the late twentieth century.[615] It has also enlarged the demand for general interest and welfare goods and services, and widened the gamut of target populations customarily served by social economy organisations.[616]

Consequently, the issue in the last years has been how a political consensus can be reached that allows for supplementary restructuring to reflect policymakers' commitment to lower public spending and reduce overall responsibility for social and welfare policy. Moreover, a question has also been raised about how public budget cuts can be positively coloured so that they, at least on their face, signal the appearance of defensible and fair economic stabilisation strategies. The policy dialogue has remained positioned on the assumed efficacy of non-state solutions to unemployment, gaps in welfare coverage and other socio-economic problems, with policymakers continuing to look to social economy organisations as a central component to economic and welfare reform.[617] Namely, they are seen as vehicles that could be further institutionalised to open up employment creation and the provision of general interest and welfare goods and services to supplementary privatisation to meet regional and national needs. However, the solution has not been to reinforce partnership with the social economy through direct financial subsidisation. Rather, the solution appears to turn on how civil society could be made to be more autonomous and financially sustainable as an instrument to offset eventual attempts at reducing levels of state support. Similar to our discussion of the political economy circumstances in Denmark and the UK, this has meant that many jurisdictions are now resorting to the systematic involvement of social enterprises, and attempting to cultivate social

[613] See J H Petersen and K Petersen (n 68) 162.
[614] P Lloyd, 'The Social Economy in the New Political Economic Context' in Noya and Clarence (n 216) 66.
[615] See eg K Cooney, M Nyssens, M O'Shaughnessy and J Defourny, 'Public Policies and Work Integration Social Enterprises: The Challenge of Institutionalization in a Neoliberal Era' (2016) 7 *Nonprofit Policy Forum* 415, 424.
[616] See eg Borzaga and Galera in Costa, Parker and Andreas (n 314) 103-106
[617] For an analysis of the situations in, for example, France and Spain see eg A Zimmer and B Pahl, 'Barriers to Third Sector Development' in Salamon, Sivesind and Zimmer (n 491) 150-153.

investment markets to reduce the social economy's dependence on public funding in an effort to make it more self-sustaining.

Whilst it is clear that not every Member State has gone in this direction, there are indicators to suggest that more countries will look to social enterprises. This is because economic conditions have 'worsened the public sector's ability to finance the traditional infrastructure-based services of general interest. Public budget cuts have therefore strengthened further the policy interest in social enterprises as vehicles for achieving balanced and fair economic growth'.[618]

For those Member States with a social enterprise regulatory framework there is a visible policy evolution that began with the political institutionalisation of associations and foundations. Policymakers' interest then rotated to the possible application of cooperatives to perform job creation, general interest and welfare functions for the benefit of specific target groups or communities. Most recently, there has been a widespread trend to weld the meaning of 'social enterprise' on to a corporate form capable of attracting the participation of interested outside equity investors.[619] As the commentary notes, 'rediscovery of non-profit organizations…as social service providers and work-integration organizations coupled with the strengthening of cooperatives' concern for the community paved the way for an increasing convergence, which ultimately contributed to the conceptualization of the social enterprise company'.[620]

This progression is consistent with the broader (neo)liberal global paradigm, in which the overriding assumption amongst policymakers is that private organisations, nested within environments subject to commercial and financial imperatives, are better placed to effectively allocate resources, respond locally and improve programme outcomes.[621] Social enterprises naturally fit this model as they are 'thought to be something new and something distinct from [other social economy organisational forms], combining…elements…of social purpose' with a market orientation and financial performance standards not unlike the private sector corporation.[622] Therefore, whilst not all Member States are moving at the same speed and in precisely the same way, it would not be unreasonable to suggest that interest in a social

[618] Borzaga and Galera in Costa, Parker and Andreas (n 314) 100-101.
[619] See eg C Borzaga, L Fazzi and G Galera, 'Social Enterprise as a Bottom-up Dynamic: The Reaction of Civil Society to Unmet Social Needs in Italy, Sweden and Japan' (2016) 26 *International Review of Sociology* 1, 5-6.
[620] Galera and Borzaga (n 231) 213.
[621] See eg Defourny in Borzaga and Defourny (n 104) 1ff.
[622] Galera and Borzaga (n 231) 212.

enterprise regulatory framework will continue to proliferate across the EU as most, if not all, 'countries are proceeding down this [economically liberal, market oriented] track'.[623]

(b) Intersecting Policy Priorities at Union and Member State Levels

Theoretically, if the position is that Member States will continue to look to their social economies, and social enterprises in particular, as a partial surrogate for direct state coordination of domestic social and welfare policy, then there would potentially be no need, or justification, for Union level intervention. That is, through processes of horizontal competition, Member States could institute regulatory frameworks that clearly authorise and empower social enterprises to engage in cross-border activities across the EU. However, the organic convergence of national laws in this area is 'highly unlikely'.[624] Some Member States will necessarily wish for their social economies, and by extension their social and welfare policy architecture, to remain insulated. Member States 'have…traditionally viewed social policies as a vital element of their self-understanding, and consequently social policies have continued to be one of the few policy areas where national governments have tried to resist integration'.[625] Moreover, even for those Member States that would be interested in liberalising their social economies and equipping social enterprises with a formally clarified right of establishment, there are still those Member States that recognise a 'sharp distinction between [the social economy's 'social' and 'economic' dimensions]', and domestically locate the sector 'firmly in the "social" pigeon hole'.[626] Indeed, with past attempts to bore through Member States' 'armour of sovereignty'[627] in recognising the social economy in EU organisational law, when subsidiarity objections were lodged the argument against Union level intervention was often framed on the 'social' and 'economy' fault line.[628]

Nevertheless, supposing that a consensus for the Proposal does not yet exist, it is submitted that there are discernible political and socio-economic reasons to surmise that Member States would be receptive to reassessing and ultimately endorsing a Union legal instrument at some future point.

[623] Lloyd in Noya and Clarence (n 216) 66.
[624] Thirion (n 564) 31.
[625] U Neergaard, 'Europe and the Welfare State – Friends, Foes, or…?' (2016) 35 *Yearbook of European Law* 341, 350.
[626] Kendall and Anheier (n 605) 301.
[627] Fleischer (n 521) 1671.
[628] See generally Kendal and Anheier (n 605).

This is because the ESE label's market liberalisation aspect positions interested Member States to potentially address some of the perceived problems flowing from political institutionalisation of their respective social economies. Said differently, whilst not detracting from the contributions made in overlapping social and welfare policy areas, social economy organisations' growing reliance on public funding over the last decades has marked an ideological pivot in many Member States' domestic policy dialogues. The bottom-up mobilisation and continued expansion of social economy initiatives is seen as a public good, but the sector's present and future scaling with further public funding is not viewed as politically sustainable.

The social enterprise corporation offers the possibility of developing a vehicle to 'spin off' some centralised public responsibility for things like job creation and local development, and the Proposal's market-making effect positions policymakers to create the necessary infrastructure to compete to attract relevant foreign firms interested in engaging across borders.

Likewise, as we have discussed at various points in the thesis, another consideration worth referencing is that introducing a social enterprise corporation and engaging in the fashioning of an internal market to facilitate such firms' cross-border activities also positions domestic policymakers to attract and encourage the flow of social impact investors' capital. Social impact investors are a relatively recent private sector investor class that has emerged, interested in targeting firms that produce both social value and financial returns. Enticing social impact investors would necessarily form part of the equation to offset financial reductions in social and welfare policy areas. Data from 2017 suggest that there are approximately £89.55 billion of assets under management devoted to this investment strategy across Europe.[629] Creating hospitable conditions for attracting and encouraging the flow of social impact investors' capital is also a point that the EU ought to consider regarding proposed modifications to the current terms of the ESE label. We will speak more about this in Section 6.5(c).

The above would be of interest in particular to Member States in the Eurozone, and especially those on the Eastern and Southern peripheries. They are subject to a form of constitutionalised austerity in which 'severe constraints have been put on the autonomy of certain Member States

[629] See Eurosif, *European SRI Study* (2018), 36–37 <www.eurosif.org/wp-content/uploads/2018/11/European-SRI-2018-Study-LR.pdf>. See generally also eg Ormiston, Charlton, Donald and Seymour (n 378) .

in the exercise of some of their core social functions'.[630] This has had 'deep and direct implications for national welfare states, and has established a kind of permanent constitutional pressure' towards de-regulation and a downgrading of the role granted to public social security.[631] Thus, it can be expected that these Member States – as well as many others – would be sufficiently incentivised to support the Proposal, and would be politically neutral with respect to the usual negative tensions over Union level intervention.

This is because of the socio-economic benefits that privately funded, financially independent social enterprises bearing the ESE label may be able to produce through cross-border expansion and replication.[632] Therefore, although it cannot be denied that some Member States would inevitably remain apprehensive, the Proposal achieves a market outcome from which many Member States stand to benefit that could not be realised through national policymakers acting alone. This is of principle relevance to this Chapter since the legal base is Article 50 TFEU and 'can be decided upon with a qualified majority and thus cannot be easily blocked by individual Member States'.[633]

Although outwith the scope of this Chapter, the COVID-19 global pandemic and its implications for domestic governments' capacity to maintain current levels of public spending, with far less tax revenue, are also important factors. Even before the outbreak of the virus, many jurisdictions had shifted to an 'all-hands-on-deck' mentality in which fiscal pressures influenced national policymakers to experiment with a range of market solutions in the social and welfare policy sphere. Virtually any potential workable strategy for lessening direct public sector responsibility for social and welfare policy was seen as welcome and at least open for debate. Consequently, the prior conditions that may have catalysed certain Member States to challenge something like the Proposal are necessarily evaporating with the prospect of another economic crisis and recession, including currently unforeseen time-delayed effects. This will arguably accelerate the further softening of Member States' political reservations over

[630] Neergaard (n 625) 349.
[631] Ibid. See also eg Dale and El-Enany (n 550) 623.
[632] For useful primers on the scaling up of social enterprises see generally eg K Deiglmeier and A Greco, 'Why Proven Solutions Struggle to Scale Up' *Stanford Social Innovation Review* (2018) <https://ssir.org/articles/entry/why_proven_solutions_struggle_to_scale_up>; S Galitopoulou and A Noya, *Policy Brief on Scaling the Impact of Social Enterprises: Policies for Social Entrepreneurship* (European Commission 2016) <https://op.europa.eu/en/publication-detail/-/publication/53e3ccbd-9a83-11e6-9bca-01aa75ed71a1/language-en>.
[633] S Jung, 'Societas Unius Personae (SUP) – The New Corporate Element in Company Groups' (2015) 26 *European Business Law Review* 645, 646.

harmonisation in this area.[634] We are now in a proper place to visualise the consequences of the Proposal.

6.5 Visualising the Consequences of the Proposal

Whilst the European Commission was not moved to act on the Proposal, this Chapter has argued that Member States' changing circumstances are such that many would be receptive to a Union level instrument for facilitating social enterprise corporations' cross-border activities at some future point, if they are not already. True, it is difficult to postulate the exact timing of when the Proposal would be reconsidered, but it seems plausible that the ESE label could soon be a reality.[635] This is why I claim that we can expect some degree of harmonisation of European social enterprise law to occur through Union level coordination in future. However, neither the European Parliament nor the European Commission attempted to visualise the consequences of the Proposal. Therefore, the purpose of this section is to view the Proposal with a reflexive harmonisation lens. Through the analysis, regulatory issues are identified and a solution is then suggested.

(a) Viewing the Proposal with a Reflexive Harmonisation Lens

Section 6.3(a) mentioned that the Proposal is calibrated according to reflexive harmonisation. Reflexive harmonisation is a particularly useful lens through which to view the Proposal because an evaluation guided by the theory's tenets ultimately places the present analysis in a position to clearly visualise its consequences and potentially pre-empt any regulatory issues. In the abstract, 'reflexive harmonisation' is a species of regulatory competition based upon the assumption that the purpose of competition is to spur a process whereby sub-units within a system are able to select and de-select individual rules through discovery, the sharing of information and mutual learning. This can be contrasted with 'competitive federalism', which is the regulatory competition model prevalent in the US.[636] The 'wider the "pool" of solutions from which lawmakers can choose, the more likely that the system as a whole will achieve

[634] See generally eg OECD, *Tackling Coronavirus (COVID-19): Contributing to a Global Effort* (2020) <http://www.oecd.org/coronavirus/policy-responses/the-territorial-impact-of-covid-19-managing-the-crisis-across-levels-of-government-d3e314e1/>.
[635] See eg K J Hopt and P C Leyens, 'The Structure of the Board of Directors: Boards and Governance Strategies in the US, the UK and Germany' in A Afsharipour and M Gelter (eds), *Comparative Corporate Governance* (Edward Elgar 2021) 136.
[636] See Deakin, *Legal Diversity* (n 571) 445-447.

dynamic efficiency, in the sense of its capacity to adapt and survive under rapidly changing environmental conditions'.[637] As such, reflexive harmonisation is not designed to nudge lower level units towards 'convergence around [an] "evolutionary peak" or end-state envisaged by [a] general equilibrium model';[638] rather 'diversity of national systems is a good in its own right'.[639] Reflexive harmonisation presupposes that there will be a 'floor' of rules, below which states cannot go, but allows them diversity above that floor. Thus, it envisages some role for positive harmonisation through Union level regulation. The classic case is the type of social policy directive that contains both a non-regression clause and a minimum standards clause.[640]

In the context of the EU this is now, broadly speaking, a familiar technique in which the act of law making is spread between different levels.[641] At the Union level, the function of policymakers is to encourage dynamic efficiency and mediate competition through legal instruments that devolve rulemaking power to local actors. The legal instruments are procedural in nature – they contain general principles or standards outlining the 'rules of the game'.[642] Using the general principles or standards as a guidepost, Member States then draft more detailed and explicit rules. This division of labour enables decentralisation and allows Member States to match how rules are formulated with their local circumstances and preferences. A 'second order effect' of this is that, through the basic standards set, at least some parity in the law across jurisdictions can be, typically, observed. But this does not amount to the EU operating to 'occupy the field' as a monopoly regulator and forcing rigidly prescriptive rules upon Member States.[643] Rather, intervention is limited to the harmonisation of essential requirements, with the end goal being the promotion of diverse approaches to shared regulatory questions. As one commentator suggests, 'by providing mechanisms for the preferences of different users of laws to be expressed and for alternatives to common problems to be compared, it enhances the flow of information on what works in practice'.[644]

[637] Deakin, *Two Types* (n 571) 242.
[638] Deakin, *Legal Diversity* (n 571) 445.
[639] Deakin, *Two Types* (n 571) 242.
[640] For further reading on the typology of directives and reflexive law more broadly, see generally, respectively, K Armstrong and S Bulmer, *The Governance of the Single Market* (Manchester University Press 1998) and G Tuebner, *Law as an Autopoietic System* (Blackwell 1993).
[641] Deakin, *Two Types* (n 571) 250.
[642] ibid 260.
[643] Deakin, *Legal Diversity* (n 571) 442.
[644] ibid 441-442.

Equipped with this sketch of reflexive harmonisation, it is now possible to more fully consider the anatomy of the Proposal. The Proposal mentions nothing about the form that a particular Member States' regulatory framework ought to take, save that each must include the four procedural aspects that would create a common regulatory floor across the EU. Apart from this the Proposal is silent on, for example, what the social enterprises in a particular Member State ought to pursue as a 'social purpose'. The amount of yearly profit to be reinvested towards achievement of the social purpose is similarly not set. The other features are likewise open-ended. From this it can be inferred that the European Parliament was intent on leaving wide latitude for national variety. Therefore, if the Proposal's regulatory approach were to be judged against the above criteria, it would be rational to suggest that it accords reasonably well with what the EU is charged to do within the reflexive harmonisation context.

However, for a specific proposal to be characterised as a 'good' reflexive harmonisation instrument, it would also need to '"steer" or channel the process of adaptation of rules at state level away from…sub-optimal outcomes'.[645] It is argued that, in this respect, the Proposal is lacking. This is for two reasons. The immediate regulatory issue created by the current terms of the Proposal is a market for incorporation that could be abused by opportunistic actors. The market for incorporation problem is exacerbated because the Proposal locks out Member States from taking remedial action. Over time, the normalisation of a market for incorporation would engender a longer-term regulatory issue, which is the entrenchment of private sector behaviours and commercial practices leading to more permanent distortions of the social economy's institutional logic. If a sufficient level of regulatory arbitrage occurred for any extended period of time, it is argued that the sector would not be able to sustain the production of the macro socio-economic effects of interest to both EU and Member State level policymakers. This is especially troubling if the aim of the EU is to then attempt to assimilate the sector into the Single Market, in an effort to offset some of the social problems it generates. Each is discussed in turn.

(b) Regulatory Issues

First, the Proposal would generate a market for incorporation that could be abused by opportunistic actors. In terms of the incentives for incorporating as a social enterprise, a number

[645] ibid 444-445.

of attractive commercial and financial advantages exist. For example, social enterprises with viable business models and plans for creating social value have access to working capital at, potentially, a lower cost from sources not available to private sector companies. For example, there are a number of Union level funds that social enterprises can access, like the *European Social Fund* and the *European Regional Development Fund*. The cost of labour may also be lower for social enterprises, especially those engaging in work integration services for the hard to employ. Additionally, whilst forming a social enterprise under any of the aforesaid jurisdictions does not result in direct tax advantages, would-be shareholders are eligible to receive personal tax incentives on their investments in some jurisdictions – for example, France (and also the UK).[646] Social enterprises' goods and services can also expect to attract the custom and loyalty of socially conscious consumers, which, in some circumstances, can become a competitive advantage over other, less socially conscious, firms.[647] Likewise, the EU has introduced improved rules allowing public authorities to take social and environmental aspects into account in their specifications and when assessing tenders. Competitions for certain contracts listed in the *Common Procurement Vocabulary*, mainly in the social and health sectors, are now 'reserved' to organisations such as social enterprises that meet specific criteria.[648]

Similarly, there is the idea that social economy markets are structured for essentially public interest purposes, and the institutional logic of the sector supports a version of capitalism that prizes cooperation, reciprocity and solidarity over rawer forms of competition and the prioritisation of profit maximisation.[649] If opportunistic actors were able to identify underdeveloped and undervalued markets within Member States' social economies, it would be theoretically possible to infiltrate these economically and financially less competitive spaces and design firms to externally seem like social enterprises but covertly engage in aggressive trading practices for personal benefit.[650]

[646] See n 508.
[647] See eg C Alemany, 'Marketing in the Age of Resistance' *Harvard Business Review* (3 Sept 2020) <https://hbr.org/2020/09/marketing-in-the-age-of-resistance>.
[648] Directive 2014/24/EU on public procurement ([2014] OJ L94/95). See generally also eg L Ankersmit, 'The Contribution of EU Public Procurement Law to Corporate Social Responsibility' (2020) 26 *European Law Journal* 9.
[649] Pache and Santos (n 269) 980.
[650] See eg Chaves and Monzón (n 270) 19-20.

Normally, opportunistic actors would not think to form a social enterprise since the vast majority of the capital flowing from the above advantages cannot be extracted. Regulatory controls are typically present that limit the extent to which a firm's participants can be motivated by pecuniary incentives. However, with the ESE label in operation, Member States' ability to discipline and prevent opportunistic behaviour would be markedly reduced. This is principally because the Proposal allows for broad variation with respect to constraints on asset distributions across Member States, which invites regulatory arbitrage. More specifically, opportunistic actors that have identified a market opportunity could engage in 'incorporation shopping' and attempt to find a less restrictive option that would produce a mismatch in regulation.

For example, assume that the market opportunity were in Romania. Romania has a regulatory framework featuring 'lifelong' constraints on managerial remuneration, mid-stream profit distributions to shareholders and completely prohibits capital extraction in the event of a conversion to a private sector corporation or a voluntary winding up. Under the Romanian regulatory framework, an asset partition is required, and at least 90 per cent of a firm's yearly profits must be allocated to achieving and maintaining the selected social purpose. Because 90 per cent of a firm's yearly profits must be allocated to creating value for society, only 10 per cent of the profits generated may be distributed to shareholders in a given year of trading. The statutory language also provides that a firm must apply the principle of 'social equity' to employees and ensure fair levels of pay, which means that the employee-manager remuneration ratio cannot exceed 1:8. Finally, in the event of a conversion to a private sector corporation or a winding up, all the assets would, by operation of law, pass to another social economy organisation.[651]

It would only be necessary to locate a more relaxed jurisdiction, incorporate a 'letterbox' corporation, gain the ESE label and make arrangements to branch to Romania. As I foreshadowed in the introductory remarks of this Chapter, the French regulatory framework is an apt example. True, the French legislation also includes constraints on both managerial remuneration and mid-stream profit distributions to shareholders that are, broadly, similar to its Romanian counterpart. The yearly profits figure that must be set aside in support of the chosen social purpose is 50 per cent. The remaining 50 per cent of the yearly profits is

[651] Lege No. 219 din 23 iulie 2015 privind economia socială, art 8(4)(b)-(d).

distributable to shareholders. The average salary for the 5 highest paid managers cannot exceed 7 times the minimum wage, and the salary for the highest paid manager cannot exceed 10 times the minimum wage.[652] However, these constraints are only 'annual' in nature. That is, the legislation also features a loophole that affords the possibility of exploiting the identified market opportunity in Romania's social economy. Namely, if the decision were taken to convert an *entreprise solidaire d'utilité sociale* to a private sector corporation or voluntarily wind up, the French legislation affords a firm's participants the option to extract all the capital, free of any regulatory oversight.[653]

Of course, the Romanian register could decline the application of the French social enterprise regulatory framework and attempt to apply its own local provisions requiring all the remaining assets to be left behind. However, branches are mainly 'subject to the law of the Member State where the parent company is incorporated', in this situation France.[654] More importantly, this action would not conform to the terms of the Proposal. Whilst Member States are free to impose stricter rules with respect to constraining profit distributions and the allocation of profit on firms that incorporate under their domestic regulatory frameworks, they must also respect inbound social enterprises bearing the ESE label that choose to be governed by less strict rules. This is mandatory under the Proposal, irrespective of any justification the Member State in question may think it has. To be sure, the CJEU has 'very explicitly encouraged private parties to profit from the divergences between Member States' laws',[655] and there is no indicator to suggest that the Proposal would be treated differently.

For example, in *Inspire Art*, where the issue was whether a Member States' imposition of stricter disclosure obligations on the branch of a corporation not provided for by the 'eleventh company law directive' was contrary to its requirements, the court easily brushed away arguments defending the national legislation. The CJEU simply held that it 'is contrary to…[the directive]…to impose on the branch of a company formed in accordance with the laws of another Member State disclosure obligations not provided for by that directive'.[656] It is argued

[652] Loi No. 2014-856 du 31 juillet 2014 relative à l'économie sociale et solidaire, arts 1(II)(2)(c) and 11(1)(3)(A)-(B).
[653] ibid art 1(3)(b).
[654] Sørensen (n 584) 60.
[655] J Meeusen, 'Freedom of Establishment, Conflict of Laws and the Transfer of a Company's Registered Office: Towards a Full Cross-Border Corporate Mobility in the Internal Market' (2017) 13 *Journal of Private International Law* 294, 311.
[656] *Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art Ltd*, Case C-167/01, EU:C:2003:512, para 144(1).

that the example situation is no different, as the Romanian register's deviation from the registered office as the connecting factor and the imposition of the host Member State's law would undermine the integrity and reach of the Proposal.

The French ESE branch in Romania is but one instance in which a firm's participants could engage in regulatory arbitrage. Indeed, it is possible to interchange the featured jurisdictions with other regulatory frameworks. For example, the Romanian regulatory framework could be substituted with the Luxembourgish regulatory framework, which not only requires a firm's participants to transfer the majority of the remaining assets – aside from original capital contributions – to another social economy organisation, but it also does not permit a conversion to a private sector corporation. An attempted conversion is treated as a *de facto* winding up under Luxembourg's regulatory regime.[657]

On its own, though, isolated or infrequent incidents of regulatory arbitrage and the exploitation of unfair competitive advantages across a European Social Economy would perhaps not amount to a cause for serious alarm. In the context of the private sector and deterring traditional corporations from engaging in regulatory arbitrage, Member States have largely eliminated the competitive and financial advantages that could be gained from the avoidance of rules that govern outward-facing relationships with, for example, creditors and employees. This has been achieved by exploiting gaps between Union legal instruments and the right of establishment through the appropriate design of domestic law. This allows Member States to remove particular subject matters 'from the [foreign] *lex societatis*, or, in spite of belonging to the [foreign] *lex societatis*' govern the subject matters 'cumulatively by the *lex causae* and…[rules] of the *lex fori*'.[658] It is for this reason, amongst others,[659] that a market for incorporation has, thus far, not emerged in the private sector context within the EU – 'today's corporate landscape differs little from that of the late 1990s'.[660] Therefore, a cursory investigation would suggest that Member States could likewise thwart potential challenges to

[657] Loi du 12 décembre 2016 portant creation des sociétés d'impact sociétal et modifiant, art 11(2).
[658] C Gerner-Beuerle, F Mucciarelli, E Schuster, and M Siems, 'The Illusion of Motion: Corporate (Im)Mobility and the Failed Promise of *Centros*' (2019) 20 *European Business Organization Law Review* 425, 429 (the authors also note that Member States try to ensure that the 'connecting factor that applies in lieu of or in addition to the registered office is "grounded in reality", that is, it cannot be manipulated as easily as a fictitious connecting factor such as the registered office').
[659] For example, Member States have also chosen to remove the incentives for engaging in regulatory arbitrage through defensive harmonisation. See generally eg M Gelter, '*Centros* and Defensive Regulatory Competition: Some Thoughts and a Glimpse at the Data' (2019) 20 *European Business Organization Law Review* 467.
[660] Gerner-Beuerle, Mucciarelli, Schuster, and Siems (n 658) 426.

their domestic social economies and limit the exploitation of unfair competitive advantages in a way similar to their supervisory handling of private sector corporations' attempts to outflank inconvenient laws through incorporation outside particularly restrictive jurisdictions.

However, this would not be possible with the Proposal. As discussed in Section 6.3(b)(ii), social enterprises do not have a natural and unqualified right of access to the protections afforded by the Treaty and the CJEU's freedom of establishment jurisprudence – it is the Proposal itself that generates a clarified right of establishment. Therefore, unlike private sector corporate law directives that are merely harmonising conflict rules and explicating procedural boundaries for the exercising of the right of establishment, which exists independently, the Proposal actually both cements that there is a right of establishment for social enterprises and lays down the terms upon which they are permitted to move across borders.

This means that the scope of the application of the relevant Union legal instrument – in this situation the Proposal – and the scope of the right of establishment are synchronised. This effectively closes the gaps that Member States might otherwise occupy to deter regulatory arbitrage and the gaining of unfair competitive advantages. Thus, the ESE label locks out Member States from implementing corrective measures, and safeguard's a firm's participants' prerogative to choose the body of rules under which they wish be governed. This is the case even if that choice affords opportunistic actors the flexibility to select a regulatory framework with weak constraint standards, making it possible to secure and leverage unfair competitive advantages.

Second, over time, the normalisation of a market for incorporation is likely to result in a longer-term regulatory issue – the entrenchment of private sector behaviours and commercial practices leading to more permanent distortions of the social economy's institutional logic. This is a danger that commentators writing about the social economy often emphasise. As we saw in Chapter 5, the formal term to denote the erosion of the social economy's institutional logic is isomorphism, which is a process whereby social economy organisations mutate away from their original nature and come to resemble and behave like private sector corporations.[661]

[661] See generally eg DiMaggio and Powell (n 414); Mason (n 415).

If it is possible for opportunistic actors to identify underdeveloped and undervalued markets within Member States' social economies and infiltrate these economically and financially less competitive spaces across the EU at scale, it obliges traditional social economy organisations to operate in an unfamiliar context. Here, they must interact with transient entities that more intensely focus on competition, resource efficiency and profit maximisation. In these circumstances, this could pressure traditional social economy organisations to forsake their cooperative, reciprocal and solidarity-based characteristics,[662] and 'adopt the practices of capitalist private companies, even though they do not convert into this type of company, in order to carry on'.[663] When social economy organisations' focus shifts in this way, they are, necessarily, no longer in a position to preserve the socio-economic qualities discussed earlier in this Chapter that make them distinctive – see Section 6.1.

For social enterprises, increased attention to competitiveness, resource efficiency and profit maximisation might result in, for example, utilising purely economic cost-benefit analyses to determine the types of socio-economic activities 'worth' engaging in, discontinuing the supply of socially desirable goods and services at low cost or refusing to train and employ low-skilled individuals facing labour market exclusion. Moreover, internal governance mechanisms could become more centralised and hierarchical, thereby crowding out important social stakeholders' interests.[664] If a sufficient level of regulatory arbitrage occurred for any extended period of time, it is argued that the sector would not be able to sustain the production of the macro socio-economic effects of interest to both EU and Member State level policymakers. This is especially troubling if the aim of the EU is to then attempt to assimilate the sector into the Single Market, in an effort to offset some of the social problems it generates.

(c) Suggested Solution

The identified regulatory issues that would flow from the Proposal are a side effect of the way in which the European Parliament has employed reflexive harmonisation. It must be remembered that the ESE label is itself the bridge connecting Member States' social economies together. Therefore, the extent to which social enterprise corporations would enjoy a clarified

[662] Borzaga and Fazzi (n 608) 419-420.
[663] Chaves and Monzón (n 270) 20. See also eg R Chaves and D Demoustier, *The Emergence of the Social Economy in Public Policy: An International Analysis* (Peter Lang 2013) 65-70.
[664] Borzaga, Fazzi and Galera (n 619) 12-13.

right of establishment at all is a function of how the terms of the Proposal are framed. Presently, the organisation of the procedural floor within the directive is very thin, in the sense that it only addresses four features that would be common across the EU. As an examination of the disparities between the French and Romanian social enterprise regulatory frameworks has demonstrated, the way in which the general principles or standards are arranged leaves wide latitude for national variety and allows Member States to shape their rules to local circumstances and preferences.

However, when the correct balance is not achieved between the different levels of law making within the EU, it can lead to suboptimal outcomes. The thin procedural floor of the Proposal would leave Member States with wide discretion to set their own regulatory limits, and it is the mismatches in regulation deriving from the allowance for broad variations in Member States' regulatory frameworks that would be of prime interest to opportunistic actors. Taken to its logical conclusion, widespread and long-term abuse of embedded regulatory differences would not only pervert the essence of social enterprises as predominantly 'public good' organisational units, but it might well distort, or even erase, the distinctions between the social economy and the private sector constructs.[665]

This is not to say, though, that the Proposal ought to be abandoned. It is still the case that the EU and many Member States have mutually reinforcing policy priorities that could be achieved through the ESE label. More generally, it is accepted by commentators that regulatory competition and corporate mobility are 'a type of discovery mechanism that helps to reveal the particular mix of…corporate rules that aligns best with the preferences of potential users. Findings from this discovery mechanism should improve the evidence base for policy and be a safeguard against policy error'.[666] Therefore, it is argued that reflexive harmonisation is not the issue. Rather, it is the way in which the European Parliament has, on this occasion, used reflexive harmonisation that must be modified.

Importantly, the modification suggested below would not undermine the local-level diversity of Member States' rules – after all, without diversity the stock of knowledge and experience in

[665] This is sometimes referred to in the commentary as a shift from creating value for society to 'value capture' for personal benefit. See eg Santos (n 422) 337-341.
[666] E Ferran, 'Corporate Mobility and Company Law' (2016) 79 *Modern Law Review* 813, 831.

which the learning process depends upon is necessarily restricted – but it would likely check some of the unwanted spill-over effects.

Instead of a thin procedural floor, the Proposal ought to feature a 'thick(er)' procedural floor requiring a larger number of provisions in Member States' domestic regulatory frameworks. Specifically, the commentary provides that rules constraining asset distributions can be operationalised in three ways through a series of alternative combinations: 'it can be applied to the profits generated, the assets accumulated, or the remuneration gained by the workers and managers employed'.[667] France only has annual constraint mechanisms that can be avoided through converting to a private sector corporation or voluntarily winding up. If the Proposal required lifelong constraint mechanisms, like Romania, that only allowed for the partial appropriation of a firm's capital after a conversion or a voluntary winding up, the basic assumption would be that opportunistic actors could not use the ESE label to disarm Member States from preventing distortions to their domestic social economies. There would be at least some legal parity across the EU.[668]

However, in addition to the Proposal requiring lifelong constraint mechanisms that only allowed for the partial appropriation of a firm's capital after a conversion or a voluntary winding up, the EU must be mindful about creating hospitable conditions for attracting and encouraging the flow of social impact investors' capital. Enticing social impact investors would necessarily form part of the equation for Member States to offset financial reductions in social and welfare policy areas. Therefore, to gain Member States' political cooperation, the EU should not implement a legal instrument that is overly rigid.

As I demonstrated in Chapter 5, more regulatory flexibility is particularly important at the later stage of a social enterprise corporation's lifecycle. Here, impact-first investors may not be able, or willing, to provide the necessary capital injections to facilitate firms' expansion. In this context, a firm would arguably be obliged to transact with finance-first investors that offer access to deeper capital pools. Because finance-first investors have stronger financial

[667] Borzaga and Galera in Costa, Parker and Andreas (n 314) 98. See generally also eg V Valentinov, 'The Economics of the Non-Distribution Constraint: A Critical Appraisal' (2008) 79 *Annals of Public and Cooperative Economics* 35.

[668] Of course, we have considered other jurisdictions with lifelong constraint mechanisms earlier in the thesis. For example, another jurisdiction with lifelong constraint mechanisms is Denmark. See generally Danish Social Enterprise Law.

preferences and are not generally willing to accept a trade-off in which financial returns are subordinate to social value creation, the strict nature of European social enterprise law and its prioritisation of social value creation does not seem consistent with finance-first investors' preferences. Thus, it is unlikely that the necessary trust can be cultivated between a social enterprise corporation and its private sector capital providers. Social entrepreneurs, even those keen to access deeper capital pools, will not want to imperil their social value objectives, and finance-first investors will not want to compromise their investment goals by subjecting themselves to an overly rigid regulatory regime. This is why I argued in Chapter 5 that the legislation's focus on social value creation is not particularly amenable and responsive to the norms of the current investment landscape at the later stage.

Again, there are good reasons for this approach in terms of discouraging the situation in which a firm's participants traded on a pro-social platform for the duration of a social enterprise corporation's lifecycle and then attempted to convert to a traditional corporation or wind up in order to by-pass the legal limitations on profit distribution. We saw this with the French and Romanian example. However, this ought not detract from the practical reality that the legislation could better balance the prioritisation of firms' social impact fidelity with going some way towards meeting the expectations of the later stage interested market actors that inhabit the current investment landscape. The social enterprise corporation must be attractive to these actors, otherwise the organisational form's role of subsidising public welfare as envisaged by policymakers will fall short of redirecting and locking in more private capital in the long-term.

These same considerations apply in the EU harmonisation context. Union level intervention should not obstruct domestic jurisdictions' ability to adapt their regulatory frameworks to potentially appeal to a broader demographic of investors interested in both social value creation and long-term financial returns. Doing so would severely reduce the ESE label's market liberalisation effect and the value it would add in terms of positioning domestic policymakers to potentially offset some of the negative implications of political institutionalisation of their respective social economies. In other words, the introduction of an overly rigid EU legal instrument runs the risk of restraining domestic policymakers' ability to attract and encourage the flow of social impact investors' capital. Ultimately, this is because such an overly rigid EU legal instrument would entrench the already-identified conflict between European social enterprise law and contemporary investment models and trends at the later stage that we

discussed in Chapter 5. It would deter the redirection and locking in of more private capital towards the subsidisation of public welfare in the long-term.

Furthermore, the EU also has its own incentives to take a more flexible route. An overly rigid EU legal instrument is not likely to be utilised by otherwise interested market actors, which jeopardises the core logic of the Proposal. If the ESE label is unpopular, there would be fewer social enterprises engaging in cross-border activities and undertaking the socio-economic functions and responsibilities that have been envisioned by Union level policymakers. This limits the scale at which the EU would be able to use the social economy to embed, or constitute, the Single Market within European society and make it more socially-responsive.

In this regard, the Proposal should also feature a draw-down scheme. The draw-down scheme could potentially appeal to a broader demographic of investors interested in both social value creation and long-term financial returns across borders. Obviously, this would be a matter for each Member State, but the Proposal could call for domestic legislation to arrange for an initial draw down limit to be reduced annually and incrementally until, after perhaps 10 years, a social enterprise corporation bearing the ESE label would only be required to leave a small percentage of the remaining assets behind if it converted to a traditional corporation or wound up – for example, 10 per cent.

At a minimum, uploading this suggested solution into the Proposal would, theoretically, result in a good reflexive harmonisation instrument that reduces the possibility of suboptimal outcomes, but does not outright strip Member States of the choice to set their own domestic rules. Thus, a revised Union legal instrument including the suggested solution could build legitimacy and confidence between the EU and Member States, leading to an increased likelihood of timely political agreement when the Proposal is eventually resuscitated.

Whether the suggested solution would allow the EU and Member States to realise their mutually reinforcing policy goals remains to be seen. Indeed, a market for incorporation could still emerge, even with the suggested solution having been implemented. However, it is submitted that the likelihood of this happening cannot be either gauged or guaranteed. The commentary suggests that, in addition to dis-applying or ignoring firms' foreign *lex societatis* in conflict of laws scenarios, Member States also engage in 'defensive harmonisation' to remove or curtail the incentives that would otherwise derive from regulatory arbitrage in the

private sector context. It is possible that Member States would defensively harmonise in a similar way to protect the integrity of their domestic social economies and close regulatory gaps to deter opportunistic actors.

This defensive harmonisation would reduce the extent to which opportunistic actors could shield themselves with the ESE label. Ultimately, the ESE label is itself the gateway through which social enterprise corporations would be able to engage in cross-border activities. If the Proposal called for the imposition of more rules on asset distributions, and all Member States opted for similar regulatory regimes, then it would follow that the clarified right of establishment provided by the Proposal would be more uniform and narrower. What any eventual defensive harmonisation might look like is difficult to guess, but it is sensible to suggest that it would involve Member States homogenously fixing the economic incentives and the amounts of capital that firms' participants could appropriate through the recommended drawn-down scheme. This would have the effect of Member States' social enterprise regulatory frameworks co-evolving, mutually learning from each other and arriving at 'what works in practice', in the sense that they would respond to the possibility of regulatory arbitrage by limiting self-interested private ordering in a similar way.[669]

6.6 Concluding Remarks

To conclude, this Chapter has contributed to the legal literature by exploring the EU dimension of social enterprise regulation, which links to a much larger narrative about the social economy's relationship with European integration. That the EU lacks the competences to create a social market economy has resulted in the social economy and the Single Market gradually converging. The sector is now tethered to the Article 3(3) TEU commitment to create a social market economy.[670] This makes it possible to distinguish between the Proposal and past attempts to recognise social economy organisations in EU organisational law. In other words, although the Proposal is the most recent iteration in a line of policies, this Chapter has sought to relocate the argument from one that is merely about the heterogeneity of Member States' organisational forms over the last decades, to an argument that the Proposal is situated within a paradigmatic shift.

[669] See generally Gelter (n 659).
[670] Liger, Stefan and Britton (n 560) 37-38.

In this context, the EU has bound itself, and faces pressure, to reimagine the Single Market with social dimensions and objectives that go beyond the purely commercial. This could be achieved, at least in part, by integrating the social economy into the Single Market, on this occasion through the Proposal and assigning social enterprises increased socio-economic functions and responsibilities. Importantly, this focus on social enterprises allows the EU to appear to take steps towards addressing its social deficit without explicitly subordinating the goal of competition, and, simultaneously, in some measure elides the fact that it lacks the competences to take more direct action.

Because the ESE label has a market liberalisation effect, it adds value by positioning domestic policymakers to potentially offset some of the negative implications of political institutionalisation of their respective social economies. Therefore, the Proposal is likely to succeed where past efforts to include the social economy in EU organisational law have failed. Thus, it is plausible that a proliferation of social enterprise legislation and the increased frequency of such firms' engagement in cross-border activities could soon be a reality. In this way, we can expect some degree of harmonisation of European social enterprise law to occur through Union level coordination in future.

However, this Chapter has shown that the current terms of the Proposal would generate regulatory issues. The most immediate is the creation of a market for incorporation that could be abused by opportunistic actors. This problem is exacerbated because the Proposal locks out Member States from taking remedial action. Over time, the normalisation of a market for incorporation would engender a longer-term regulatory issue, which is the entrenchment of private sector behaviours and commercial practices leading to more permanent distortions of the social economy's institutional logic. If a sustained level of regulatory arbitrage occurred across the EU, the sector would not be able to sustain production of the macro socio-economic effects of interest to both Union and Member State level policymakers. This is especially troubling if the aim of the EU is to attempt to harness the sector, in an effort to offset some of the social problems generated by the Single Market.

However, the Proposal ought not be abandoned. It is still the position that the EU and Member States have mutually reinforcing policy priorities that could be achieved through the Proposal. Thus, instead of a thin procedural floor, this Chapter has argued that the Proposal ought to feature a thick(er) procedural floor requiring a larger number of provisions in Member States'

domestic regulatory frameworks that deal with asset distributions. For the reasons we established in Chapter 5 with respect to successfully attracting interested market actors to utilise the ESE label, particularly at the later stage, the Proposal ought to also include a drawn-down scheme.

At a minimum, uploading this suggested solution into the Proposal would result in a Union legal instrument that reduces the possibility of suboptimal outcomes, but does not forsake the benefits that reflexive harmonisation can yield. A revised Proposal including the suggested solution could build legitimacy and confidence between the EU and Member States, leading to an increased likelihood of timely political agreement when the Proposal is eventually resuscitated.

Therefore, as a practical matter, it is probable that social enterprises could play an upcoming role as an EU policy tool in areas such as providing support to vulnerable groups, combatting social exclusion, inequality and violations of fundamental human rights or in helping to protect the environment, biodiversity, the climate and natural resources. Indeed, absent further treaty modifications, it can be expected that the EU will attempt to address its social deficit through additional regulatory interventions that envision a greater focus on the social economy. In this regard, the European Social Economy Summit 2021 may serve as an incubation hub for the tabling of future proposals and recommendations for social economy policies at the Union level.[671] However, it is an open question whether they are likely to be effective, or enough on their own, without far more ambitious Treaty reforms.

[671] See <https://www.euses2020.eu>.

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CONCLUDING REMARKS

This thesis considered a relatively recent phenomenon in the area of corporate law and governance – the social enterprise corporation. In so doing it made four original contributions to the legal literature. In making these contributions, I have tried to present a 'system' of social enterprise law from a European perspective, in the sense that the analysis was centred on asking where it comes from, why it takes the shape that it does, how it can be modelled across jurisdictions and whether there is an interplay at Union level. Allied to this, I have also attempted to determine the extent to which this particular type of corporate law has a positive interaction with the capital markets. This latter contribution was a critical one because it has potential regulatory implications not only across jurisdictions, but also for the EU.

As we saw, European social enterprise law and traditional corporate law are markedly distinct landscapes. More specifically, whilst the social enterprise corporation does feature the five basic legal characteristics that are often associated with the traditional corporation, it also includes additional legal and institutional mechanisms that alter its nature and how it operates. Collectively, it is these additional legal and institutional mechanisms that make the social enterprise corporation unique. To date, no commentator has attempted to provide an account of the reasons for this divergence. Therefore, the first contribution I made in this thesis was to put forward a theory that explains why European social enterprise law is different from traditional corporate law. I undertook this task in Chapters 2 and 3, focusing in particular on Denmark and the UK, as representative of European social enterprise law more broadly.

The second contribution I made in this thesis was concerned with providing a complete analytical model that adequately reflects the relational link between welfare state politics and the influence it had on the social enterprise corporation's structure and function. Thus, continuing with the focus on Denmark and the UK, our departure point in Chapter 4 was that the social enterprise corporation is a relatively new and unfamiliar type of corporate innovation with its own rules. Among other things, I contended that there are four major distinctions between the social enterprise corporation and the traditional corporation.

In Chapter 5, the analysis moved on to consider another important gap in legal knowledge. More specifically, commentators have not considered the extent to which European social enterprise law is compatible with contemporary investment models and trends. Thus, the third contribution I made was to answer whether European social enterprise law is amendable and responsive to the norms of the current investment landscape. I argued that the Danish and UK regulatory frameworks seem to be amenable and responsive to the norms of the current investment landscape at the early stage of investor involvement. However, I argued that the position alters when social enterprise corporations mature and require access to deeper capital pools later on. At this juncture, the financial preferences of investors change, which invites a tension between societal value creation and the pursuit of financial profit. I suggested that this tension is of greatest concern in conversion and winding up scenarios. In this regard, I argued that the regulatory frameworks' conversion and winding up legal mechanisms should be adjusted with a yearly drawn-down scheme.

Another conspicuous gap in legal knowledge is that no study has explored whether there is an EU dimension to social enterprise regulation. As such, the fourth, and final, contribution I made in Chapter 6 was to consider where this area of the law may be headed in future. To help do this, the analysis focused on the most recent policy activity in this area – the European Parliament's July 2018 non-legislative resolution. Here, I expanded the jurisdictional focus beyond Denmark and the UK, and considered the full range of Member States that feature social enterprise regulation.

Although the European Commission declined to legislate on the European Parliament's non-legislative resolution, I argued that there is good reason to think that this is not the end of the story. Even if this prediction is wrong, however, I showed that there are discernible political and socio-economic reasons to surmise that Member States would likely be receptive to reassessing and ultimately endorsing a Union level legal instrument for social enterprises' cross-border activities at some future point. Thus, a central claim in Chapter 6 was that we can likely expect some degree of harmonisation of European social enterprise law to occur through Union level coordination.

However, neither the European Parliament nor the European Commission attempted to visualise the consequences of harmonisation. I concluded Chapter 6 by analysing some regulatory issues that would be problematic if the European Commission were to legislate

based upon the contents of the European Parliament's non-legislative resolution. I then suggested a possible solution involving enlarging the number of provisions within the non-legislative resolution that constrain asset distribution in Member States' domestic regulatory frameworks. However, for the reasons we established in Chapter 5 regarding successfully attracting market actors (in this case to form social enterprises and engage in cross-border activities), I argued that any forthcoming regulatory proposal ought to also include a draw-down scheme. At a minimum, uploading this suggested solution into a forthcoming regulatory proposal would, at least theoretically, result in a 'good' legal instrument that reduces the possibility of suboptimal outcomes.

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