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ENTERPRISE FOR COMMUNITIES

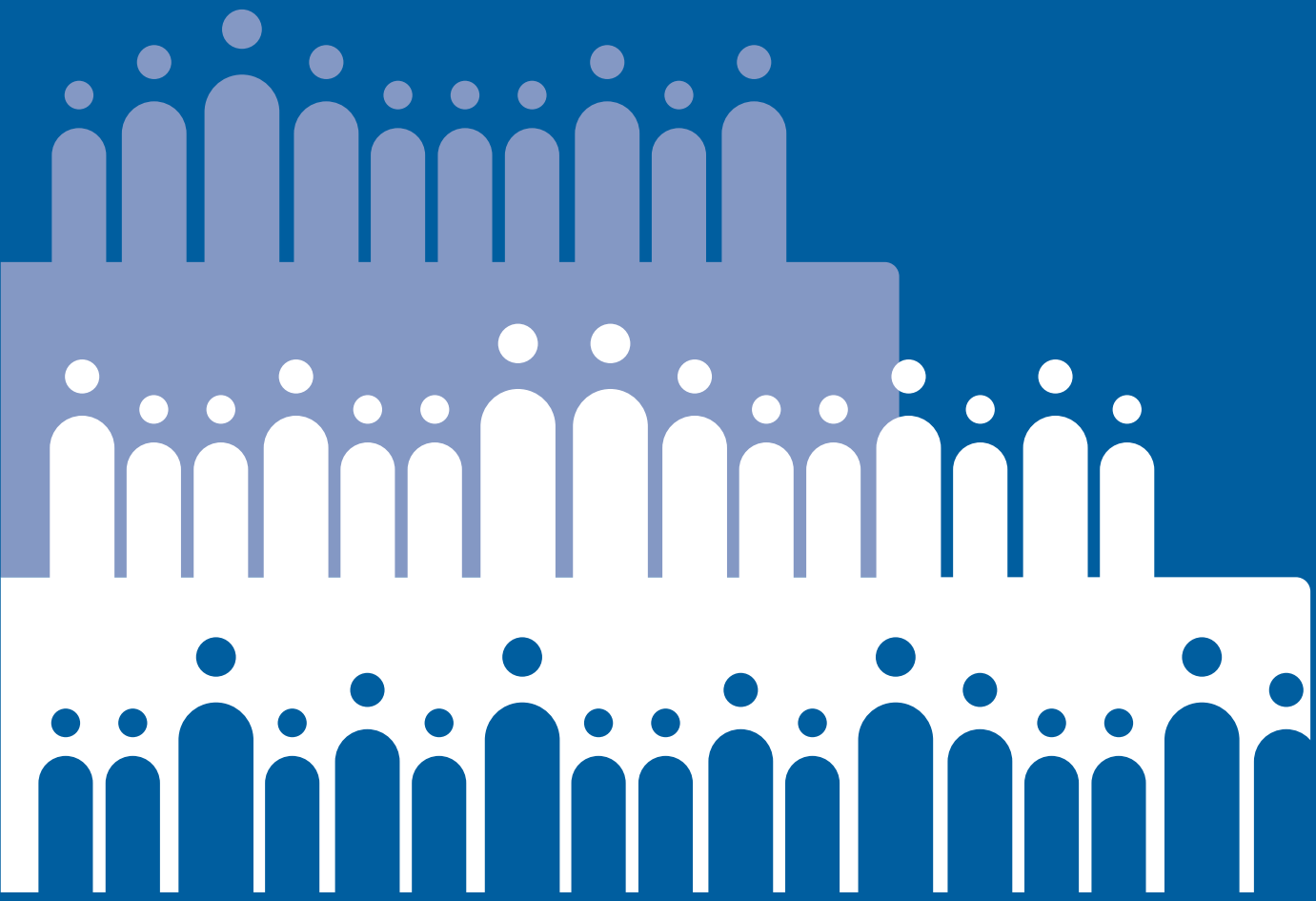
Proposals for a Community
Interest Company

March 2003



HM TREASURY

Home Office
BUILDING A SAFER, JUST
AND TOLERANT SOCIETY





The DTI drives our ambition of 'prosperity for all' by working to create the best environment for business success in the UK. We help people and companies become more productive by promoting enterprise, innovation and creativity.

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HM TREASURY



Enterprise for Communities

Proposals for a Community
Interest Company



Foreword

by Patricia Hewitt, Secretary of State for Trade and Industry
Gordon Brown, Chancellor of the Exchequer
and David Blunkett, Home Secretary

For many years, groups of people have worked and campaigned to improve local services, regenerate their environment, and create better living conditions. This community action and enterprise is essential for a healthy society. The promotion of enterprise, in every part of society and every corner of our country, is at the heart of Government's agenda. Entrepreneurial talent is essential to deliver social justice, locally and nationally. We need to ensure there are the right structures for this to happen.

This Government is committed to building a more enterprising society, to creating opportunities for all, and to tackling specific barriers that inhibit successful enterprise – whether it is social, community-based or private business. Several initiatives have been introduced to boost enterprise in our most disadvantaged areas, particularly through the Phoenix Fund. Other measures are focused on Enterprise Areas, such as the forthcoming exemption from stamp duty for all

commercial property transactions, the Community Investment Tax Relief and Bridges Community Ventures.

To build on these measures, we are therefore proposing to establish, for the first time, a custom-made legal vehicle for community and social enterprises. The Community Interest Company (CIC) is an entirely new form designed to meet the needs of people seeking to pursue enterprise in the public interest, dedicating their profits to the public good. The introduction of the CIC will enable the growth of the social enterprise sector and will create real opportunities for people in areas where they are needed most.

Such an approach is essential in the 21st century. Socially responsible enterprises are already starting to play an increasingly vital role; in regenerating disadvantaged areas, empowering local communities, and delivering new, innovative services at local level. These social enterprises, large and small, show how much can be achieved by using





new solutions to tackle traditional problems – wherever they occur. We need to harness expertise in the community, and facilitate those who act as enablers in their neighbourhoods. We recognise, however, that they often face obstacles that make the pursuit of these objectives difficult. Charitable structures are not always appropriate. Equally, there is no simple way to guarantee that a not-for-profit-distribution company will always work for the public good. And that can in turn make it difficult for people to raise money to finance their enterprise. We must not let their energy and vibrancy be stifled by inflexible and inappropriate legal structures.

The Community Interest Company will be a transparent model; clearly defined, easily recognisable and understandable by users, staff, and the wider community they serve. It will be a flexible structure, allowing organisations that use the CIC model to thrive and grow, while being accountable to local communities.

The Government does not intend that CICs should deliver essential public services in core sectors such as hospitals and schools. Rather, CICs should develop to meet the needs of local communities, complementing core Government services in areas such as childcare provision, social housing, leisure and community transport.

With the introduction of Community Interest Companies, we are one step closer to achieving the vision that is central to the mission of this Government – enterprise and opportunity for all within strong, cohesive communities.

Gordon Brown



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About this Document

What is this document for?

This public consultation paper invites views on proposals for a new type of company, the Community Interest Company (CIC). We welcome views on all aspects of the proposals outlined in the paper. A summary of the most important proposals is set out at page 24.

Which parts of the United Kingdom are affected by these proposals?

The Government intends to bring forward legislation to make these proposals part of company law. Company law matters relating to Scotland are reserved to the UK Parliament under the Scotland Act 1998, and those relating to Wales have not been transferred to the National Assembly for Wales under the Government of Wales Act 1998. These proposals would therefore affect the law in England, Wales and Scotland. Northern Ireland has its own companies legislation, and will not be affected by these proposals.

Who should be interested?

All those who have an interest in the proposals are very welcome to respond. We expect that people and organisations who will find the paper particularly relevant will include:

- those who have an interest in social enterprise (see the definition on page 9 – including those who run social enterprises, those who use their services, and people who are considering or have considered setting up such an enterprise
- those who may be involved in providing finance to social enterprises – including grant-givers, and philanthropic and commercial lenders and investors
- those who are interested in the development of the wider voluntary and community-based sector
- those who have an interest in the legal issues relating to this sector.



How can I respond?

We invite comments by 18 June 2003 at the latest. Responses can be sent to us:

- by email to CICS@dti.gsi.gov.uk
- by post to:
Patrick Barry
Consultation responses
Community Interest Company team
DTI
1 Victoria Street
London SW1H 0ET

All responses will be acknowledged. In accordance with the code of practice on open government, all comments received will be made publicly available unless respondents specifically request otherwise.

There will be a number of public events and meetings taking place to discuss these proposals during the consultation period. Details of these can be found on our website, <http://www.dti.gov.uk/cics>

This consultation paper, and associated material including working papers on various aspects of the proposals, can also be found on the website.



Introduction: Enterprise for Communities

1 The Government is proposing a new type of company – the Community Interest Company (CIC) – whose profits and assets will be used for the public good. The CIC will present new opportunities for social enterprises to benefit the people they serve: it will be easy to set up, with all the flexibility and certainty of the company form, and some special features, to guarantee that it is working for the benefit of the community or the wider public. Easy for investors to understand, with an assured lock on profits and assets to attract social investors, it will help create a strong new brand for social enterprise and a new marketplace for social investment. By doing so, it will cut the costs of setting up and financing social enterprises. It will recognise the strong links between social enterprise and the wider community, encouraging stakeholders to engage in enterprising communities. This in turn will improve the delivery of local services.

CICs will be registered as companies in the usual way, but with an additional requirement to show that they are dedicated to the community interest.

They will use their assets and profits for the benefit of the community or the wider public.

They will report to an independent regulator on how they are delivering on that commitment, and on how they are involving their stakeholders in their activities.



2 The concept of the CIC was outlined in the report *Private Action, Public Benefit*, published by the Strategy Unit in September 2002¹. This paper fulfils the report's commitment to carry out a technical consultation on the concept before legislation. Responses to the Strategy Unit's consultation have been taken into account in developing the fuller proposals in this paper. A summary of the responses relating to CICs is on the DTI website at <http://www.dti.gov.uk/cics>.

3 The Government's aim is to widen and deepen the enterprise culture in our country, so that everyone, regardless of their background or circumstances, has the chance to go as far as their talents will take them. Our strategy is to support small and medium sized businesses and social enterprises to modernise and reform the delivery of services at local level, regenerate disadvantaged communities and spread the enterprise culture. Several initiatives have been introduced to boost enterprise and community development in our most disadvantaged areas, particularly through the Phoenix Fund. Other measures are focused on Enterprise Areas, such as the forthcoming exemption from stamp duty for all commercial property transactions, the Community Investment Tax Relief and Bridges Community Ventures. The introduction of CICs builds on these measures, enabling the growth of the social enterprise sector, and creating real opportunities for people in areas where they are needed most.

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

Social enterprises tackle a wide range of social and environmental issues and operate in all parts of the economy. By using business solutions to achieve public good, the Government believes that social enterprises have a distinct and valuable role to play in helping create a strong, sustainable and socially inclusive economy.

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

from *Social Enterprise – a strategy for success*



¹ Available at www.cabinet-office.gov.uk/innovation/charity/report

Case study

Bulwell Hall Community Gardens Ltd

Bulwell Hall was established in 1999 to provide training opportunities for the long-term unemployed, create community space and sell healthy produce. The main activities undertaken include tending the garden and allotments and providing work placements. Membership of the company is restricted to residents of the estate, who tend to be long-term unemployed. Any surplus produce is sold to non-residents.

Bulwell Hall is a Company Limited by Guarantee, without charitable status and established for the benefit of the community. It has a management committee of about 12 members who are elected at the AGM, designed to protect the organisation from external organisations and to ensure it stays under the control of local residents. However, the current system, which allows trainees to put themselves forward for the management committee, has led to problems over accountability, discipline and grievance procedures.

Bulwell Hall believes that inventing its form itself has led to a "hotch potch" structure. It also believes that there is a lack of understanding amongst funders about this type of organisation, which combines services and social inclusion aims.

4 As social enterprises grow and flourish, they create more and better choices for local people, helping to empower local communities and encourage active citizenship. The Government's strategy for the sector, *Social Enterprise: a strategy for success*², and *Private Action, Public Benefit* highlight the growing impact of social entrepreneurship at all levels. Social enterprises, large and small, bring together the expertise and dedication of the voluntary sector with the flair and flexibility of the commercial world, and can be particularly relevant in the many activities where commerce and public service meet. They are currently active in sectors ranging from waste recycling, and village post offices, to community transport and the provision of care services to children and the elderly.

THE NEED FOR A NEW TYPE OF COMPANY

5 Social enterprises use a wide variety of legal forms, reflecting the diversity of the sector. Many set themselves up as companies or Industrial and Provident Societies, directing any surplus back into the pursuit of their social objectives. Some also have charitable status. All these approaches have a vital part to play in developing social enterprise, contributing both to the UK economy and to society.

6 Nonetheless, the report *Private Action, Public Benefit* points to a gap in the range of options available to social enterprises that wish to incorporate as companies. The CIC will fill that gap³.

² Available at <http://www.dti.gov.uk/socialenterprise/pdfs/strategy.pdf>

³ For more details see technical note 1, on types of company



Case study

Hackney Community Transport

Hackney Community Transport (HCT) was formed in 1982 and began as a collection of some 25 voluntary sector organisations who joined together to provide local minibuss transport. The organisation is intimately tied to its inner city location, both in terms of its mission and workforce. It runs a number of different services including group transport, training and employment for newly trained drivers and taxi services for local authorities. It has recently begun to provide mainstream fixed route bus services. Initially the organisation had four vehicles and one paid member of staff. It now has 175 staff (a number that is expected to rise to 200 by the end of 2003) and expects turnover to reach £8.5m by 2004.

Hackney Community Transport is a company limited by guarantee and has approximately 400 members which are all local voluntary and community organisations. HCT believes that this large membership operates well, offering local participation and accountability. HCT is also a registered charity, although it feels that the benefits of charitable status to its organisation are marginal. HCT believes that the transparency of the CIC could make this form attractive to social enterprises seeking to entrench their assets and profits.



7 Social entrepreneurs often set up companies because they enjoy the flexibility that this approach offers. The company model is well-established in the UK, and is well understood by its users, consumers, financiers and lawyers. It is relatively quick and easy to set up a new company with commercial objectives. However, social entrepreneurs who want their companies to operate on a not-for-profit basis run into difficulties because company law provides no simple and transparent way to lock profits into a company.⁴

8 These difficulties cause problems for social enterprises, both on incorporation and when they seek to raise finance to deliver for their communities. For instance,

- the legal process of creating a not-for-profit company can currently be lengthy and expensive, so the transaction costs of setting up are high;
- social and philanthropic investors can be deterred by the lack of an obvious profit and asset lock, and so prefer to support other organisations such as charities (see below); and
- conversely, commercial investors can be puzzled by the complexity and diversity of not-for-profit structures, and so can see social enterprises as riskier than they really are – which raises the cost of funds.



⁴ For more details see technical note 2, on entrenchment

Alternatives to CICs : Industrial and Provident Societies

Other not-for-profit enterprises choose to establish themselves not as companies but as Industrial and Provident Societies (IPSs). These can take the form of co-operatives set up for the benefit of their members, or of organisations operating for the benefit of the wider community ('BenComs'). The Government strongly values the IPS form and the guarantee of democratic accountability that it provides. Co-operatives have a long history of achievement and a key role to play in providing local services, and IPSs are at the forefront of stakeholder involvement in the development of community services. It is important that the choice between IPS and CIC form should be available to social entrepreneurs. Some will opt for the CIC brand, the new regulator and the familiar corporate and legal envelope that being a company will entail. Others will be more comfortable with the traditional brand and strong stakeholder involvement of the IPS. The IPS legal framework has already been improved in some respects by the Industrial and Provident Societies Act 2002, which was taken through Parliament by Gareth Thomas MP with Government support. In the current Parliamentary session the Government is supporting Mark Todd MP's private member's bill to further reform IPS legal structures. One of the changes proposed by this bill is an asset lock for BenCom IPSs. The report *Private Action, Public Benefit* recommends further changes to the framework, and the Government is now considering the consultation responses to those recommendations.

Alternatives to CICs : charitable status

Whatever their legal form - company, IPS or unincorporated - social enterprises with exclusively charitable objects and which cannot distribute assets to their members will have charitable status. Charity law in Scotland is different in some important respects; see technical note 3. Charitable status confers benefits, most notably tax advantages and, in England and Wales, the assurance of Charity Commission supervision of purposes and assets. Enterprises operating as a charity must also accept the obligations which come with charitable status, including:

- the need to justify any payment to charity trustees; this includes company directors
- rules on trading and investment that can place significant limits on permissible activity, depending on the charity's objects; and
- tougher regulation than that applying to normal companies - since it is aimed at protecting the rights of beneficiaries, donors and other stakeholders who do not have enforceable rights and may have limited information.

These obligations are unattractive to some social entrepreneurs.

The report *Private Action, Public Benefit* makes proposals for the reform of charities, including a new form of incorporation specifically for charities, the Charitable Incorporated Organisation. This would allow charities to incorporate without having to register as a company or an IPS. Again, the Government is considering the consultation responses to these proposals.



Case study

Hesket Newmarket Brewery

This community brewery was established in December 1999 after the previous owner manager retired. Local villagers and well-wishers formed a buyout group with the aim of maintaining the village business, safeguarding jobs and retaining a real ale brewery in the village. Benefits to the community also included income generated by tourists and the future of related businesses, such as the local pub, which served the brewery's beer.

The brewery is an Industrial and Provident Society community co-operative with every shareholder having £1500 in shares. There are currently 66 members, who elect a Committee of five members to direct the operation of the brewery. The co-operative form was chosen so that the group could set up and operate more or less in line with their vision of pursuing social objectives. There is a high degree of local support for the business. So far the IPS model seems ideally suited to the needs of the community brewery.



9 The CIC will help people who want to use the company form to deliver for their communities. The form will be flexible, so that its users can meet changing market conditions and grow their businesses. They will be able to deliver new services for enterprising communities, without all the necessary checks and balances of mutuality or charitable status, but with the confidence that the CIC's controls on objects and assets will provide.

10 The Government does not intend that CICs should deliver essential public services in core sectors such as hospitals and schools. Rather, CICs should develop to meet the needs of local communities, complementing core Government services in areas such as childcare provision, social housing, leisure and community transport.

11 The CIC is an alternative to charitable status. If an enterprise has charitable objects but wishes to become a CIC, it will forego the benefits and obligations of charitable status⁵. Both options will provide a lock on purposes, assets and profits, with regulatory supervision, but CICs will not be eligible for the tax relief available to charities. In choosing between charitable status and becoming a CIC, enterprises will weigh the relative benefits of charitable tax status and regulation on the one hand, and the flexibility of the CIC on the other.



⁵ As CICs cannot be charities, an existing charitable company that wishes to convert to a CIC will be subject to the same sort of controls as apply at present when a charitable company seeks to use the powers in the Companies Act 1985 to convert to a non-charitable company. A CIC that wishes to convert to a charitable company will of course have to have exclusively charitable purposes.

Case study

Ibstock Community Enterprises Ltd

Ibstock Community Enterprises Ltd was formed in 1995 and provides a number of services for residents and workers in Ibstock. Their main aims include restoring financial services, providing access to services and supporting local businesses, and activities to date have included acquiring the local bank and reinstating the ATM, organising community events, publishing the village newsletter and providing support to organisations applying for grant funding. They have just acquired a former school building which they hope to develop to produce small workplace units. The beneficiary of ICE's work is the community, with some services specifically targeted towards particular groups, such as the elderly or the young.

ICE is a company limited by guarantee defined as a community co-operative without charitable status. There are 13 voluntary board members who have a say in project management and day-to-day recommendations but this can cause conflict between the board and the chief executive. Becoming a registered charity was considered but rejected, but may be revisited in future to allow a permanent lock on assets. The current form is seen as being tax-efficient and relatively painless to administer, but does prohibit some sources of funding that might otherwise be accessible with charitable status. In view of this, they may revise their current form at some point in the future.

12 The CIC will be more suited to activity for public and community benefit than existing types of company:

- a test committing the CIC to pursue the community interest, together with a statutory profit and asset lock, will give assurance to social and philanthropic investors;
- annual 'community interest reports', setting out the action each CIC has taken to pursue public or community benefit, will reinforce this assurance; and
- CIC legislation will reflect the role and importance of stakeholders, and CICs will report on how they involve them.

13 The CIC is a new idea for the UK. Its uses will develop and change in the light of experience. The aim, over time, is to establish a new brand for social enterprise, well understood and valued, sitting alongside and as an alternative to charities and IPSs, delivering local services as part of enterprising communities.



CREATING THE MARKET IN SOCIAL ENTERPRISE

14 Of course, a change in the law will not in itself create all the conditions to enable social enterprises to grow and to become significant players in the economy. However, we believe it is an important step in removing barriers to growth, and in the process of culture change. The attitude of investors will be crucial in growing the sector. The Government is considering the wider financing issues for the sector as part of the Social Enterprise Strategy, and the Bank of England is currently reviewing how the sector is financed. The introduction of the Community Investment Tax Relief will enhance the flow of capital to enterprises in disadvantaged communities, including social enterprises, through Community Development Finance Institutions (CDFIs)⁶. The CIC will contribute to the wider development and financing of the sector. As part of its consultation on this paper, the Government will explore the ways in which the CIC may be used to stimulate the development of a stronger market in social enterprise, through seminars and other events. Further details will be made available on the DTI and Home Office websites, <http://www.dti.gov.uk/cics> and <http://www.homeoffice.gov.uk> respectively.

Bank of England review of finance and funding

At the request of DTI, the Bank of England is reviewing the provision of debt and equity finance to social enterprises. The Bank is currently surveying the sector and consulting with social enterprises and their representative groups, banks, Community Development Finance Institutions, venture capitalists and others. Questions being addressed in the review include:

- To what extent does the number and success of existing social enterprises depend on their access to appropriate finance?
- What is the current take up of external finance? Is it appropriate, and is there unmet demand?
- What are social enterprises' attitudes to and demand for mainstream finance?
- Do social enterprises experience difficulties in accessing finance that differentiate them from other start-ups and small businesses?
- Are there aspects of bank lending policies that might directly or indirectly disadvantage social enterprises?
- Is there need/scope for new products or new packages of finance for social enterprises?

The Bank will report on its review this spring. Where the report identifies gaps or barriers on either the demand or supply side, the DTI will develop recommendations to address these. This work will complement the development of the CIC model in helping to build the market in social investment.



⁶ The Community Investment Tax Relief, introduced in the 2002 Budget, will be worth 25% of the amount invested via CDFIs in start-up businesses and social enterprises in deprived areas over a five year period. More information is available from the finance section of the Small Business Service website <http://www.sbs.gov.uk/>

THE KEY FEATURES OF THE COMMUNITY INTEREST COMPANY

15 CICs will be established as companies under the Companies Act 1985. They will follow the same incorporation and reporting procedures as other companies, and their directors and members will have the same rights and duties. Their special status will arise from some additional statutory requirements.

The Community Interest Test

16 Public and community interest is the defining factor at the heart of the CIC. To ensure that CICs are focused on this, the regulator will need to apply a robust test at the time of registration. At the same time, it will be important to ensure the greatest possible flexibility for organisations with a social purpose to use the CIC form.

17 **The Government proposes that the regulator should apply a 'reasonable person' test of community interest.** To become a CIC, an organisation will have to satisfy the regulator that its purposes could be regarded by a reasonable person as being beneficial to the community or wider public interest. It will also be asked to confirm that access to the benefits it provides will be widely available, and not confined to an unduly restricted group. The regulator will publish guidance on the test.⁷

18 To ensure that the regulator does not become involved in debate about whether particular political purposes are beneficial, **it is proposed that political parties should not be able to become CICs, or to set up CIC subsidiaries. It is also proposed that organisations whose purposes are support for a political party, or political campaigning, should be unable to become CICs.** This could include, for instance, groups established to campaign on issues involving changes to the law (such as vivisection, the freedom to smoke tobacco, or opposition to abortion), or groups formed to campaign for changes in Government policy, for instance on the environment. However, such organisations will be able to establish CIC subsidiaries if they wish, as long as the purposes of the subsidiary are not themselves political, and if a reasonable person could consider them to be beneficial, even though other people might regard their activities as controversial or even detrimental.

19 Since this test will give the regulator substantial discretion, **it is proposed that the regulator should issue guidance as to how the discretion will be exercised.** For illustrative purposes, the guidance will draw on the sort of tests currently used in legislation in the UK and abroad.



⁷ A detailed working paper on the community interest test will be published on DTI's website as part of this consultation.

Test of charitable status

The current test for charitable status is that the organisation must be established for exclusively charitable purposes. Currently the purposes recognised in law as being charitable fall under four heads:

- the relief of poverty,
- the advancement of education,
- the advancement of religion,
- or other purposes beneficial to the community: these are defined by case law and interpreted by the Charity Commission - see technical note 4

The rules are that all charities should benefit the public. They must focus on carrying out charitable objectives within these categories, with private benefits to individuals being incidental, and must provide benefits to the community at large or to a sufficient sector within it. They must not entirely exclude those of limited means.



Japanese test

A **Japanese** law of 1988 to promote non profit activities specified the following categories:

- promotion of health, medical care or welfare
- promotion of social education
- promotion of community development
- promotion of culture, the arts or sport
- activities to protect the environment
- disaster relief
- ensuring community safety
- protecting human rights and promoting peace
- international co-operation
- promotion of the creation of a gender equal society
- advice and support relating to any of the activities listed



Companies Act definition

The Companies Act 1985 provides for some special treatment for not-for-profit companies (technical note 5). The company's objects must be the promotion of commerce, art, science, education, religion, charity, or any profession and anything incidental or conducive to those objects.



20 The Government considers that a test based on a list defined in law, while appropriate for charities which enjoy substantial tax reliefs, would not be appropriate for CICs. A list may reduce the freedom of the sector to innovate and to find new ways to work in the public and community interest. This would run contrary to the Government's vision, which is not to prescribe what social enterprises can do, but to support variety and diversity.

21 Once a CIC is registered, **the regulator would also need to approve any proposals for changes in its purposes.**

Ongoing obligation to pursue community interest

22 CICs will have an obligation to operate in pursuit of their public or community interest purposes. Stakeholders will be in a position to alert the regulator if they believe a CIC is failing to meet this obligation (see paragraph 32 below), and the regulator will have powers to investigate and to take action (paragraph 43 below).

Finance: an asset lock

23 Together with the community interest test, the idea of reinvesting profits for the benefit of the community or the wider public is central to the CIC concept. It will be critical to acceptance by charitable and ethical investors that those who set up CICs should commit to lock profits and assets into the company irrevocably, and that they should be seen to do so. The accounts of CICs will be open to stakeholders and the public, in the same way as those of all companies, and this will help stakeholders to satisfy themselves that CICs are complying with the statutory lock.

24 A lock on profits and assets will not affect the ability of CICs to use their assets in the normal course of their business. For instance, they will be able to use their assets as collateral for finance, and if they do so the assets will be available to creditors in the event of default⁸. However, the lock will affect CICs' ability to raise finance and make a return to investors. In some ways it will make finance easier to obtain. As set out above, a clear lock, guaranteed by a regulator, will provide assurance to philanthropic investors; grants and loans from charities are an important source of finance for many social enterprises, particularly when they first start out.

Finance: debt

25 CICs will need to be able to raise debt (e.g. loans and bonds) in the commercial markets on the same terms as other companies. Lenders will assess the risk to their investment, and will set interest rates, in the usual way. The transparency of the CIC form should help lenders to understand the risks and result in fair prices for debt finance. There is a risk that CICs might use artificially inflated debt repayment as a way of distributing assets, but this risk will be managed through existing company law provisions on directors' duties and (in cases of outright fraud) by criminal proceedings. The CIC regulator would be able to deal with very clearly excessive debt repayment which, while not fraudulent, would amount to a breach of the statutory requirements on CICs to maintain the asset lock and pursue the public or community benefit.

⁸ See technical note 6, on disposal of assets

Finance: equity

26 As they grow, most companies raise finance by issuing shares to raise equity. Equity shareholders provide risk capital and expect a corresponding return on their investment, enjoying a share of profits in the form of dividends on shares and capital growth. CICs will not be able to adopt the same approach to equity as other companies, since unrestricted distribution of CICs' profits to investor shareholders, and the ability of investors to profit from capital growth, is clearly incompatible with a lock on profits and assets. Indeed, on a purist view any distribution of profits to investors is incompatible with such a lock. However, if CICs are to have the scope to grow they will need access to a range of sources of finance, and the model needs to be appropriate for growing and large companies, as well as small.

27 The Government therefore proposes that Community Interest Companies should be able to issue tradable fixed or capped rate (preference⁹ or 'investor') shares, and to pay dividends to the holders of these shares up to a fixed percentage above base rate, LIBOR or another appropriate benchmark. The holders of such shares would not be able to control the CIC (see paragraph 37 below).

28 CICs will be free to decide the rate of return for such shares, which may be fixed or floating, provided that it is within an overall cap. It is intended that the cap will be set at a level that will optimise CICs' access to a wide range of sources of finance while maintaining the lock on profits and assets in a way that will give comfort to philanthropic and charitable lenders. The legislation establishing CICs will need to provide for the level of the cap to be changed over time, in the light of experience of its operation and as market conditions and expectations change. **As part of this consultation, the Government will work with social enterprises and potential investors to develop the mechanism for setting the cap.**

29 If a CIC goes into liquidation (see paragraph 45 below) then investor shareholders will have a claim on any residual assets remaining after the claims of creditors are met, but only in respect of the capital initially invested and any unpaid dividend.

30 CICs will not be in the public sector and hence, like other companies outside the public sector, some CICs will fail and some will succeed. As with the not-for-profit and private sector in general, it would not be the role of Government to guarantee that CICs did not fail.



⁹ See technical note 7, on preference shares. A CIC will be unable to issue such shares if it takes the form of a company limited by guarantee – see technical note 1.

31 The Government has considered whether it would be appropriate for CICs to access a measure of real equity – risk capital – by issuing shares with an uncapped dividend and the ability to benefit from capital growth. This would open up a wider range of sources of finance to those CICs able to attract equity investors, and so could contribute to the development of social enterprise. Without the ability to access risk capital, CICs will be limited to organic growth. However, such equity investors will expect to make profits from their shares if a CIC does well. One way of reconciling this with the principle of the primacy of public and community benefit could be to have an overall limit on the dividends payable on such shares, leaving the large majority of assets locked into the CIC. However, even with such a solution the use of real equity is contrary to the concept of the CIC profit and asset lock.

Therefore it is proposed that CICs should not be able to issue shares that pay an uncapped dividend.

Transparency in Operation

32 The reports and accounts of CICs will be in the public domain, in the same way as those of other companies. **The Government proposes that, in addition to the reports and accounts required from other companies, CICs should submit short, straightforward annual reports to the regulator on how they have pursued their public or community benefit objectives. These reports should also explain what the CIC has done to involve stakeholders.**

The regulator will monitor these reports and will make them public. This will allow stakeholders and the public to monitor whether CICs are operating in the community interest.

Governance: Involvement of Stakeholders

33 It is Government policy to encourage all organisations to engage with their stakeholders for the long term health of their business. Many social enterprises are at the forefront of good practice, using a wide range of approaches, including stakeholders on the board. All these options will be available to CICs. However, there can be a tension between the active involvement of stakeholders in the governance of a company, and the freedom of its directors to act. This needs to be taken into account in setting out the statutory requirements for all CICs.

34 The Government expects CICs to display a strong focus on stakeholder needs. The regulator will produce guidance setting out best practice in involving stakeholders and in balancing the interests of different stakeholder groups. One option, which would go further than the general requirement for CICs to report annually on stakeholder involvement, would be a statutory requirement to seek the views of stakeholders. This would help to enshrine good practice on stakeholder engagement in all CICs.



35 However, a statutory requirement could cause some difficulties for those CICs whose stakeholders are not easy to define or are remote from the business (for instance in the case of overseas development activity). It could also be perceived by some social entrepreneurs as bureaucratic and unnecessary, and therefore as a disincentive to using the CIC form. In any case, a statutory requirement is most likely to be relevant for larger enterprises, in which the decision-making process is further removed from stakeholders, and which have the capacity to organise stakeholder consultation. It therefore seems reasonable to exempt small CICs from any statutory requirement, although they would still be encouraged to follow best practice.¹⁰

The Government invites views on a minimum statutory requirement for CICs to seek the views of their stakeholders, with an exemption for small CICs.

36 Where CICs are involved in the delivery of services, there will be a need to ensure stakeholder involvement in their governance, to meet requirements for democratic accountability. The required arrangements for stakeholder involvement would not be appropriate for generic legislation; they could be set out in contracts, or possibly in sectoral legislation.

Governance: Rights of Investors

37 Investors will often expect to have an influence over the direction of the company, if only through participation in general meetings. Substantial commercial investors may expect to appoint directors to protect their interests. Commercial investors often bring very valuable skills to the direction and management of a social enterprise. Nevertheless, there is clearly a tension between the desire to secure a good return on investment and the drive to operate in the public or community interest. **The Government therefore proposes that CIC legislation should place limits on the power that investors may have to control the activities of CICs.** There are a number of technical means of achieving this¹¹, but the principle will be that while investors may have influence over a CIC, they cannot control it. The Government will seek views on the appropriate restrictions on control as part of this consultation.

38 It is not proposed that legislation should place restrictions on the transferability of membership in a CIC, although a CIC will be free to embed such restrictions in its constitution if it wishes. In principle, charities and other organisations will be able both to own and invest in CICs. The restrictions on investor control described above, taken together with the lock on public or community benefit objectives, should be sufficient to protect CICs from adverse changes of ownership.

¹⁰ The Companies Act 1985 defines a small company as satisfying at least two of the following – not more than £2.8m turnover, not more than £1.4m 'balance sheet total' (total assets), not more than 50 employees. The Government is currently proposing to increase the turnover and balance sheet total thresholds to the European maxima (presently £4.8m and £2.4m respectively).

¹¹ See technical note 8, on limits on the powers of investor shareholders

Governance: Subsidiaries of CICs

39 CICs will be free to set up subsidiaries if they wish. These subsidiaries may themselves be CICs, with public or community benefit objectives similar to or different from those of the parent. Alternatively, a CIC might wish to set up a non-CIC subsidiary, e.g. to raise uncapped equity finance for a new venture which is riskier than the CIC's core business, with a view to using any resulting profit for public or community benefit purposes. A CIC will be able to do this provided it has a purely commercial relationship with its non-CIC subsidiary; the parent could give a loan to the subsidiary on commercial terms, but could not simply transfer assets to it, since to do so would breach the asset lock.

Governance: Gifting assets to other organisations

40 Where a successful CIC has accumulated more assets than it needs to fulfil its own objects, it may wish to transfer the surplus to another organisation with public or community benefit purposes, whether a CIC or a charity. **The Government proposes that CICs should be able to transfer such surpluses to other suitable organisations** provided that:

- the beneficiary organisation is listed in the donor CIC's constitution, or
- the CIC notifies its stakeholders of the proposed transfer, and the regulator agrees to it.

This will protect the interests of those who have invested in the donor CIC in order to support its particular purposes.

Regulation

41 The regulator is an essential element: the guarantor that public or community benefit is being pursued, and that profits and assets are working to that end. **The Government proposes that to provide the necessary assurance, the regulator will need to:**

- **Check that applicants for CIC status are not-for-profit companies working in the community interest;**
- **Review community interest reports, which set out the actions the company is taking to pursue public or community benefit, and to involve stakeholders;**
- **Publish these reports, allowing stakeholders to check them and Companies House records to ensure the company is complying with the obligations of its status; and**
- **Ensure that the residual assets of wound-up CICs continue to serve the public or community benefit.**

42 While monitoring is required to provide assurance, the regulator will need to strike the right balance. Entrepreneurs need freedom to develop their companies and to take risks. The Government intends that the core functions of the regulator should be closely aligned with those of Companies House, and that for most CICs, regulation will be similarly light touch, with a one stop shop for the social entrepreneur.



What are a company's ongoing regulatory responsibilities?

- To file its annual return and accounts
- To give notice of certain changes, the main ones being:
 - new directors or secretary
 - change of registered office
 - new shares being allotted
 - certain resolutions.
- To adhere to its responsibilities as set out in law and regulation

What will a CIC's ongoing regulatory responsibilities be?

- All the above, plus
- to submit a community interest report
- to seek the CIC regulator's permission for any change to its community interest purposes
- to adhere to its legal responsibilities as a CIC



43 However, **the regulator will need powers to investigate complaints that the statutory requirements of CIC status (pursuit of the public or community benefit and not-for-profit operation) are not being observed, and powers to take action if such complaints are justified.** Action to put a CIC back on track could include replacing directors, facilitating takeovers or mergers, or, if all else fails, applying to the court to have the CIC wound up.

44 These powers will be used to remedy breaches of statutory requirements in an appropriate and proportionate way, and thus to protect public faith in the CIC brand. The regulator's powers will not be used to keep a CIC running when there are good reasons for it to fail. If a CIC were to be delivering a service that the local community values, then alternative providers should be found, if the CIC delivering them were to fail. Detailed arrangements for continuing service delivery would not be appropriate for generic legislation.

45 CICs will be subject to insolvency law like any other company.¹² However, any residual assets remaining after creditors and any investor shareholders have been paid will not be available to the CIC's members. Instead, the regulator would transfer them to another CIC or a charity, which will use the assets, and any proceeds from their sale, for the same purpose as the original CIC, or for another public or community benefit purpose approved by the regulator.

46 In accordance with the principle of the one stop shop, the regulator will work with other companies' regulators, and with any sectoral regulators with relevant competences, to ensure that there is a single interface between CICs and their stakeholders on one hand, and regulators on the other.¹³



¹² For more details see technical note 7, on disposal of assets

¹³ A detailed working paper on CIC regulation will be published on DTI's website as part of this consultation

Summary of Proposals and Invitation to Comment

Comments are invited on all the proposals in this paper, by 18 June 2003. See "How can I respond?" on page 7 for details of how to comment.

Comments are particularly invited on the following points:

1. There should be a new type of company, the Community Interest Company (CIC) (para 15).
2. A regulator should apply a 'reasonable person' test of community interest (para 17), and should issue guidance on the test (para 19).
3. Political parties should not be able to become CICs or to set up CIC subsidiaries, and organisations whose purposes are support for a political party, or political campaigning, should be unable to become CICs (para 18).
4. Once a CIC is registered, the regulator would need to approve any proposal for a change to its purposes (para 21).
5. CICs should be able to issue tradable fixed or capped rate shares, and to pay dividends to the holders of these shares up to a fixed percentage above base rate, LIBOR or another appropriate benchmark (para 27).
6. The cap on returns on such shares should be set at a level that optimises CICs' access to finance while maintaining a sufficient lock on profits and assets to give comfort to philanthropic lenders. The Government will work with investors and social enterprises on arrangements for the cap (para 28).
7. CICs should not be able to issue shares that pay an uncapped dividend (para 31).



8. CICs should submit short annual reports on the action they have taken to pursue their public or community benefit objectives, and to involve stakeholders (para 32).
9. CICs will be encouraged to involve stakeholders in their enterprises. The Government invites views on whether a statutory requirement for CICs to seek the views of their stakeholders, with an exemption for small CICs, would be appropriate (para 35).
10. There should be limits on the powers that investors may have to control the activities of CICs. The Government seeks views on the appropriate restrictions (para 37).
11. CICs should be able to transfer surplus assets to another CIC or charity, subject to certain conditions (para 40)
12. The regulator should exercise the following functions (para 41):
 - check that applicants for CIC status will be not-for-profit companies working in the community interest;
 - review community interest reports, which will be published; and
 - ensure that the residual assets of wound-up CICs continue to serve the public or community benefit.
13. The regulator should have powers to investigate complaints that CICs are not complying with the obligations of CIC status, and to take action where necessary (para 43).



Technical Notes

1 Types of company

The CIC will take one of the existing forms of limited company incorporated under the Companies Act 1985, namely the 'company limited by shares' (CLS) or the 'company limited by guarantee' (CLG). Since 1980 it has not been possible to form a company limited by guarantee with a share capital, but where such companies exist they will not be excluded from becoming CICs.

While taking one of these underlying forms, CICs will also be subject to the provisions set out in this consultation paper, including a statutory lock on assets, and regulation to ensure that they pursue the community interest. CICs will be required to identify themselves as such, by including the term 'community interest company' in their company name.

CLS and CLG

In the case of the CLS, the liability of a member is limited to the 'nominal' or 'par' value of the shares held by that member (to the extent that they have not already been paid up). In addition, the shareholder may be obliged as a matter of contract to pay an additional amount or 'premium' over and above the nominal value of the share. The company's articles will typically give the company powers to call on the shareholder to pay up any unpaid amounts during the lifetime of the company, and on winding up any amounts still not paid up are required by statute to be contributed to the company's assets. In the case of a p.l.c., the nominal value of any shareholding must be at least one quarter paid-up on initial allotment, together with the whole of any premium.



In the case of the CLG, the only liability of the members arises on winding up, when they will be obliged to make a contribution to the assets of the company up to the amount guaranteed; no obligation to contribute arises before then. The guarantee is normally set at a low amount, e.g. £1 for each member.

In the case of a private company which is a CLS, there are no statutory requirements regarding the payment up of shares, so that it is possible in principle for no amounts to be paid on the shares prior to the company's winding up; in that case there will be little practical difference between choosing to incorporate as a CLS or as a CLG. In most cases, however, shares will eventually be paid up and the amounts so contributed used by the company.

2 Entrenchment of not-for-profit provisions

'Not-for-profit' clauses preventing the distribution of profits may be inserted, and entrenched, in a company's constitution. However, the mechanisms for doing this are complex, technical, and not always well-understood.

Under section 9 and section 17(1) of the Companies Act 1985, any provision of a company's articles, and any provision of the company's memorandum which could have been included in the articles, may be amended by a special resolution of the members, which requires the assent of 75% of the votes at a general meeting. By amending or deleting a not-for-profit clause, the members would be able to convert a not-for-profit company into a profit-making enterprise for their own benefit.

However, the Act also provides a mechanism whereby certain provisions may be entrenched in the memorandum so as to be unalterable by any resolution of the members: see section 17(2). This may be used to entrench a not-for-profit clause, although it cannot be used to entrench the company's objects.

At first sight, the common-law 'unanimous consent' principle might appear to provide a means of evading such entrenchment. According to that principle, the members of a company may, by their unanimous agreement, bind or empower the company to do anything within its capacity. There is some doubt as to the extent of the principle, and in particular whether it would enable members to take action beyond the powers allocated to them by the company's constitution. But in any event, there is no basis for thinking that the courts would extend the principle so far as to recognise an agreement purporting to remove a provision which had been entrenched in the memorandum, and which was clearly designed to prevent the members of the company from appropriating its assets. Similarly, the court is unlikely to agree to override such a provision under its powers to sanction an arrangement under section 425.

An alternative method of entrenching provisions is to issue a 'golden share' which benefits from enhanced voting rights in respect of certain matters; the holder of the share can then effectively block the passing of the relevant special resolution (e.g. a resolution to remove the non-for-profit clause). In the case of a company limited by guarantee, such special rights would be given to a particular member rather than to the holder of a particular share.



The effectiveness of such a technique obviously depends upon identifying a sufficiently trustworthy shareholder or member.

Both the golden share technique, and the technique of entrenchment of provisions in the memorandum, suffer from a lack of transparency: in order to know that the company concerned cannot distribute any assets to its members, it will be necessary to examine in some detail the provisions of the company's constitution. And drafting such clauses itself requires specialist legal expertise.

3 Charitable status in Scotland

In Scotland, only an organisation which has been given intimation by the Inland Revenue that tax relief will be due under Section 505 of the Income and Corporation Taxes Act 1988 is entitled to describe itself as a Scottish charity. The Law Reform (Miscellaneous Provisions) (Scotland) Act 1990 makes provision for the supervision of charities by Scottish Ministers. The Scottish Executive have recently announced that they will be setting up a new Charity Regulator.

4 Purposes beneficial to the community in charity case law

Over time, the purposes recognised by the courts and the Charity Commission as being charitable have developed extensively. This is particularly so for the fourth head of charity ('other purposes beneficial to the community'), under which the following are recognised as charitable:

- promotion of human rights
- conservation of the natural environment
- promotion of urban and rural regeneration

- relief of unemployment
- promotion of community capacity building
- promotion of community participation in healthy recreation via providing facilities for playing particular sports
- promotion of health

5 The 'section 30' company

The not-for-profit sector is already given limited recognition in the Companies Act 1985, in the form of the dispensation granted by section 30 of the Act. This exempts certain limited companies from the requirement to use the term 'limited' as part of the company name, and from certain other requirements relating in particular to the publication of the name, although the limited status must still be mentioned in business letters. The only companies formed after 25 February 1982 which can benefit from the exemption are companies limited by guarantee which satisfy the conditions laid down by section 30(3). Those conditions are of two kinds, relating respectively to the objects of the company and its ability to distribute assets:

- The first is that the objects stated in the company's memorandum are the promotion of commerce, art, science, education, religion, charity or any profession, and anything incidental or conducive to any of those objects.
- The second is that the company's memorandum or articles require any profits or other income to be applied in promoting its objects (and not distributed by way of dividend to its members), and require all assets which would otherwise be available to its members to be transferred on winding up to another body with similar objects or charitable objects.



It can be seen that the assets of such a company must be dedicated to its objects, rather than to the private benefit of its members. There is, however, nothing to prevent the company from amending or removing those provisions of its memorandum or articles, provided that it changes its name to include the term 'limited'. If the company is a charity, the limitations in section 64 of the Charities Act 1993 will also apply.

6 Disposal of assets

The CIC asset lock is intended to preserve the value of the assets held by CICs in the public or community interest. It will not lock in the physical assets themselves; to do so would reduce the freedom of CICs to use their assets in the way they deem best suited to their community interest objectives. For instance, a CIC may wish to use its assets as collateral to raise finance for its activities.

Where a CIC enters into an insolvency procedure, insolvency practitioners will therefore be able to dispose of the CIC's assets in the usual way; there will be no restriction requiring them e.g. to dispose of assets only to parties who will use them to serve the community interest. A lack of restrictions on the disposal of assets in the event of insolvency is entirely consistent with the asset lock; an insolvent CIC will have obligations to creditors because the latter have already provided finance or assets to assist the CIC's pursuit of its community interest objectives. Any residual assets remaining in the CIC after the claims of creditors and investor shareholders have been satisfied will be transferred, under the regulator's supervision, to another suitable body, either a CIC or a charity, so that they will continue to be used for the public or community benefit.

Where an organisation wishes to make a physical asset available to a CIC, but requires an assurance that the asset itself will remain available for use in the community interest in the event of the CIC failing, this could be done through contractual means. For instance, the donor could attach conditions to the donation in order to:

- prevent the asset being mortgaged or otherwise disposed of to a party that would not use the asset in the community interest, or
- retain title to the asset, enabling it to be returned to the donor in the event of the CIC's insolvency.

CICs will have the option of designating another CIC or a charity to receive any residual assets in the event of insolvency. If they do not do so, or if the designated CIC is itself wound up, the regulator will transfer the residual assets to a suitable recipient in the usual way (see paragraph 45 of the consultation paper).

7 Fixed or capped rate 'preference' or 'investor' shares

Shares offering a fixed rate of return to shareholders are commonly called 'preference' shares. This consultation paper proposes that those CICs that are limited by shares (see also technical note 2, 'Types of company') should be able to issue tradable fixed rate 'preference' or 'investor' shares if they wish to do so.



Each CIC would set the fixed return payable on the shares, subject to a statutory cap on the maximum permissible return, which will be imposed in order to prevent excessive distribution of profits to investor shareholders. This cap will be expressed as a fixed percentage above base rate (e.g. base rate plus 5%), LIBOR, or another appropriate benchmark.

If it wishes to do so, a CIC will have the option of setting the return at a floating rate, subject to a rate cap set by the CIC, which must also fall within the overall statutory cap on CIC returns.

Dividends would be payable to the holders of these shares in accordance with the terms of the shares. The shares may be 'cumulative', in that if a dividend is not declared in one year it will become payable when a dividend is declared in another year.

It is not proposed to place restrictions on the trading of these shares. It is possible that where a market exists, shares may be traded at a premium to their face value, for instance if the CIC involved has established a good track record of paying dividends within the cap. However, it is proposed that it should not be possible for the shares to be redeemed at a premium to their face value. This is because ownership of these shares would confer no right to participate in the assets of the CIC on winding-up, beyond the return of the capital originally invested and any unpaid dividend.

These shares will have restricted voting rights, in order to ensure that investors cannot control the CIC. See technical note 8, 'Limits on the powers of investor shareholders'.

8 Limits on the powers of investor shareholders

A CIC which wishes to distribute a part of its profits as dividends to its members will have two basic kinds of shareholder: (1) holders of 'ordinary' or 'full voting' shares which carry no right to a dividend, or to any part of the assets of the company on winding up; and (2) holders of a class of shares ('investors') who will be entitled to dividends (and may have certain rights to a return of capital on winding up).

It is proposed that the second kind of shares would be limited to those carrying a fixed or floating dividend subject to a statutory cap (see technical note 7). Fixed dividend shares are often called 'preference' shares, although the term is perhaps less appropriate in the context of the CIC. where the ordinary shareholders do not enjoy any possibility of a dividend.

It is quite normal to give the holders of preference shares very limited voting rights, e.g. the right to vote only when their dividends are in arrears, or when the rights attached to their shares are being affected. Other kinds of shares will normally carry more extensive voting rights.

In order to maintain the primacy of the community interest objects of the CIC, it will be important to ensure that the investor shareholders cannot control the management of the company. For instance, they should not be able to dismiss directors (this can be done by a majority of votes cast, under section 303 of the Companies Act 1985), or to pass special resolutions altering the constitution of the company (for which 75% of the votes is required). It might also be thought that they should not

have the power to block special resolutions agreed by the ordinary members. That would suggest limiting the total votes which may be exercised by the investor shareholders to some figure below 25%. The Government is seeking views on the appropriate limitations as part of this consultation.

Such a limitation would not apply where the resolution voted upon specifically concerned the rights of the investor shareholders. If the resolution concerned the alteration of their rights, they could be protected by express provisions in the company's constitution, or by the existing rule that such alterations require the approval (by 75% majority) of a separate meeting of the class of shareholders concerned: see section 125 of the Act.

Investors might also demand greater voting rights on matters which could specifically affect the value of their shares, without actually varying the rights attached to them. Thus the articles of a CIC could be permitted to contain provisions requiring separate class approval before the rights of another class of investor were varied, or before certain categories of debt capital were issued.



Annex A: Glossary of Terms

CDFI	Community Development Finance Institution – see footnote 6
CIC	Community Interest Company – the new type of company proposed in this consultation paper
CLG	Company limited by guarantee – see technical note 1
CLS	Company limited by shares – see technical note 1
IPS	Industrial & Provident Society – see text box on page 12
LIBOR	London interbank offered rate
Social enterprise	See definition in text box on page 9
Strategy Unit	The Strategy Unit in the Cabinet Office, whose report <i>Private Action, Public Benefit</i> , published in September 2002, proposed the establishment of the CIC



Annex B: Draft Initial Regulatory Impact Assessment

Introduction

1. This draft initial Regulatory Impact Assessment (RIA) deals with the proposals set out in the Government consultation paper of March 2003 on the creation of a new type of company, the Community Interest Company (CIC). Comments on this draft RIA, and particularly on its analysis of the benefits and costs of the proposals, are invited as part of the consultation process. The deadline for responses to the consultation is 18 June 2003. The consultation paper can be obtained from the DTI website at <http://www.dti.gov.uk/cics>.

Purpose and intended effect of proposals

2. The purpose of the proposals is to consider whether and how to introduce the CIC concept into company law in England, Wales and Scotland. The key features of the CIC are set out in the consultation paper.

Who is affected by the proposals?

3. The parties affected by the introduction of the CIC will be those people wishing to take advantage of it in order to deliver social enterprise, and the stakeholders of such enterprises. People will only wish to use the CIC, and therefore be affected by its introduction, if they believe it to be more suited to their enterprise than existing forms of incorporation, such as an ordinary company or an Industrial and Provident Society.

Risks and Benefits

4. CICs will simply be an additional option for incorporation. The expected benefits of this new option are detailed in the consultation paper. The introduction of the CIC will address the risk that the absence of a tailored company form for not-for-profit social enterprises may inhibit the social enterprise sector from reaching its full potential. It is expected that the CIC will initially be used mainly



by new enterprises, rather than by existing enterprises which have already customised an appropriate legal form. Take-up is hard to estimate given the lack of data on start-ups in the sector, but our working assumption is that initially there may be between 100 and 300 CICs registering each year. In summary, we expect that the CIC will:

- reduce the costs of establishing organisations to act on a not-for-profit basis in pursuit of the community interest;
- help raise the profile of the social enterprise sector; and
- help social enterprises to access finance.

5. There is a risk that if the CIC concept is established without adequate regulation, the concept could lose some credibility. The regulatory structure proposed in the consultation paper will manage this risk, and will also address the risks that:

- a CIC might in practice fail to act so as to further the community interest, and
- the assets of a CIC might be distributed or otherwise misused.

Costs

6. The regulatory arrangements for CICs, detailed in the consultation paper, would impose costs on central Government, including:

- the costs of the regulator's staff and accommodation,
- the costs of developing and publishing guidance to CICs on their obligations, and
- the operational costs associated with making community interest reports available to the public, and of investigating and taking action on complaints.

7. It is estimated that initially the regulator will require around 6-8 staff, at an estimated annual cost of approximately £250,000. The regulator will need its own distinct identity, in order to differentiate the CIC brand, but it is anticipated that the regulator will be co-located with Companies House in Cardiff, to provide a 'one stop shop' for CICs and their stakeholders, and where possible the regulator will draw on existing expertise and resources in Companies House and in other bodies such as the Charity Commission and DTI Companies Investigation Branch. These arrangements should help to reduce the regulator's ongoing operational and overhead costs. Fees for CIC registration (see paragraph 8.1 below) will be used to offset the costs of the regulator, although it is not expected that fees will fully cover the costs of the regulator, at least in the early years of operation.

8. Regulation will be streamlined as far as possible, to keep the new administrative burden on those wishing to take advantage of CIC status to the minimum. A detailed working paper on the regulation of CICs will be placed on the DTI website as part of the consultation process. In summary, the main regulatory requirements on CICs will be:

8.1 Application for registration as a CIC. This will resemble the process of registering as an ordinary company as far as possible, with some additional elements, and will be designed as a 'one stop shop' so that applicants do not need to contact both the CIC regulator and Companies House. The regulator will apply a community interest test to applicants, but given the self-selected constraints of CIC status (lock on profits, regulatory requirements etc) we



expect that a large majority of applicants will pass this test easily. An additional fee will be payable for registration as a CIC. In order to avoid deterring potential applicants, it is intended that this will be comparable with the Companies House fee for company registration, currently £20.

8.2 Filing an annual 'community interest report' with the regulator, in which each CIC will record the action it has taken in pursuit of its community interest objectives, including the action it has taken (if any) to involve stakeholders in its activities. The report is intended to be short and straightforward. The reporting requirement will impose some administrative costs on CICs, but the information required should be readily available from their own internal governance procedures where these have been formalised.

9. The CIC regulator will have powers to investigate complaints that CICs are not observing the statutory requirements of CIC status, such as pursuit of community interest, and to take action if such complaints are justified. Such action could include freezing bank accounts, replacing directors or applying to have a CIC wound up.

10. These powers will not have any cost impact on CICs provided they observe the statutory requirements. The regulator will develop guidance to help CICs in meeting these requirements. There will be an appeals mechanism to consider complaints about regulatory decisions. The costs of exercising these powers, producing guidance and considering appeals are included in the overall costs of the regulator outlined at paragraph 7 above.

Impact on small businesses

11. Small and medium size businesses will be eligible and encouraged to take advantage of CIC status where appropriate. The impact on them will be as outlined above, and should not be disproportionate to the burden involved in setting up an ordinary company.

Competition assessment

12. The introduction of the CIC will affect the social enterprise sector, which is active in a range of wide range of markets, often those that can involve a mixture of commercial and public service activity. Examples include waste recycling, local transport, social housing, and the provision of care services to children and the elderly. Within each of these markets, social enterprises are characterised by a high level of diversity, in terms of both economic scale and legal structure. Analysis against the competition filter test suggests that the CIC proposal does not raise competition concerns. There are no market share issues. The CIC will make it quicker and cheaper for aspiring new entrants to the social enterprise sector to incorporate as companies on a not-for-profit basis, thus facilitating entry into a range of markets and, it is hoped, ultimately growing the overall size of the sector. The costs associated with CIC status (e.g. to register and fulfil reporting requirements) will only apply to those that choose to use this new type of company, so will not impose a barrier to those wishing to enter the markets in which social enterprises operate. Those who will do not wish to use the CIC form will have other options available to them, including conventional company forms.



Annex C: Cabinet Office Code of Practice on Consultation

General Principles of Consultation

The criteria in the Code of Practice on Written Consultation issued by the Cabinet Office are as follows:

A: Timing of consultation should be built into the planning process for a policy or service from the start, so that it has the best prospect of improving the proposals concerned, and so that sufficient time is left for it at each stage.

B: It should be clear who is being consulted, about what questions, in what timescale and for what purpose.

C: A consultation document should be as simple and concise as possible. It should include a summary, in two pages at most, of the main questions it seeks views on. It should make it as easy as possible for readers to respond, make contact, or complain.

D: Documents should be made widely available, with the fullest use of electronic means (though not to the exclusion of others), and effectively drawn to the attention of all interested groups and individuals.

E: Sufficient time should be allowed for considered responses from all groups with an interest. Twelve weeks should be the standard minimum period for consultation.

F: Responses should be carefully and open-mindedly analysed, and the results made widely available, with an account of the views expressed, and the reasons for the decisions finally taken.

G: Departments should monitor and evaluate consultations, designating a consultation co-ordinator who will ensure the lessons are disseminated. DTI's co-ordinator is Mr Philip Martin, who can be contacted by email at philip.martin@dti.gsi.gov.uk and by post at 1 Victoria Street, London SW1H 0ET.



