The Social Enterprise LLP – What Is It; And What Is It For?

1. The Social Enterprise LLP (SELLP) is the brainchild of three people. Michael Webber, a former Charity Commissioner, Arthur Wood some time banker and now a committed social entrepreneur interested in applying the tools of capitalism to achieve a social impact and myself, a solicitor who in particular was co-author of the idea that became the community interest company. We developed the idea of SELLP inspired by the work that Arthur Wood, Bob Lang and Marcus Owen have done in the United States to develop the Low Profit Limited Liability Company – the L3C.

2. The L3C is based on American partnership law because in America a company is the equivalent of a UK partnership. Companies under American law are called corporations. This is a classic example of two people being divided by a common language. The L3C has been developed in the United States in order to facilitate the co-mingling of monies from charitable foundations and private sector finance in special purpose vehicles established as L3Cs designed to deliver exclusively charitable purposes as defined in the US Revenue Code but in a way that is acceptable to the Internal Revenue Service (IRS).

3. The L3C builds upon a particular American concept, that of programme related investment (PRI). PRI is sanctioned under a Federal Act of 1969. US foundations are under an obligation to spend 5% of their endowment each year. Any programme related investments go towards their 5% mandatory pay out. However, very few US foundations engage in PRI because of the legal complexities surrounding getting clearance from the IRS. It is hoped that by establishing the L3C as a recognised model to undertake PRI activities, it will facilitate US foundations investing in PRIs as opposed to merely giving their money away. PRIs offer the chance that foundations will be able to recycle what would otherwise be grant monies. PRIs will normally constitute investments by way of loans; equity or quasi equity but which also always deliver a charitable outcome consistent with the investing foundation's charitable purpose. Foundations' investments in L3Cs have already attracted private/public sector finance, hence creating scope for much greater social impact. There are already examples of this happening both in the USA and to enable international collaborative ventures to get underway.

4. The reforms of company law which introduced the Community Interest Company in the UK meant that for the first time there was a dedicated legal form for social enterprises, using company legislation. Companies, however, are not transparent for tax purposes. This means that they are not ideal vehicles for comingling charitable and non-charitable funds to achieve a charitable outcome. On the other hand limited partnerships or limited liability partnership (LLP) are transparent for tax purposes which means that the individual partners pay tax on any profits attributable to them in accordance with their own tax status. If they are charities, they can receive the profits from the LLP tax free. This is dependent upon the LLP carrying out activities which are consistent with the participating charity's own charitable purpose. Limited partnership and limited liability partnerships are used extensively for establishing financing vehicles because of their transparency for tax purposes.

5. The financial recession of 2008/09 left Western governments' finances in a parlous state. Moreover their finances were already not in a good position given the gradual build up of trade and spending deficits over many years. Long term problems include changing demography; climate change; pension liabilities and increasing health demands etc all mean that state finances will be under further constraints in the years to come. On the other hand we are witnessing a build up of resources in the private and business sector albeit that much of this is held off-shore and outside the tax net. In the UK charities alone are incapable of taking over the burden from the state – despite the express desires of the Coalition Government that this might happen. Equally there is great suspicion of privatisation of public services eg in health. Hence, it is clearly highly desirable, if it were possible, to achieve a marriage of private and business wealth, with charitable purposes to achieve positive social impact for the benefit of society, hence addressing the fear of commercialisation of the public realm..

6. To achieve this, it is necessary to create a simple to use, cheap legal structure so as to combine charitable, government and private sector funding under one umbrella so as to achieve social goals as well as paying financial returns in a tax efficient structure. The SELLP is expressly designed to address this challenge.

7. How would this be achieved?

8. Just as the community interest company was created by injecting some relatively minor reforms into company law, the SELLP legislation could also be quite simple. It will

require a number of changes to LLP law in order to create a separate type of LLP, the SELLP. This would have the following features:

8.1 It would be established to achieve a charitable purpose as defined in Section 2 of the Charities Act 2006. The SELLP would not be a charity but it could only be a SELLP if it is established to achieve exclusively charitable purposes.

8.2 Just like any other LLP, it would be obliged to be transparent in terms of filing information with the Registrar of Companies in terms of its Members and its Accounts.

8.3 Just as the Community Interest Company is regulated by the CIC Regulator to ensure that it complies with the CIC legislation, it is proposed that the SELLP should also be regulated by the CIC Regulator to ensure it abides by its social enterprise obligations.

8.4 Just like a CIC on formation, an SELLP would have to declare what charitable purpose it will achieve.

8.5 Just like a CIC, an SELLP would have to file an Annual Return to the CIC Regulator specifying how it has achieved its charitable purposes and social impact.

8.6 It is proposed that there must be at least one Charity Member of the SELLP and a minimum of 30% of the LLP's equity must be owned by a charity or charities. The Charity Member could not be connected in any way with any of the other investors in the LLP.

8.7 The Charity Member would have a golden share which would mean that there could be no change to the purposes of the SELLP or change to its Partnership Agreement without its consent.

8.8 At least one member of the Management Committee must be appointed by the Charity.

9. The legislation will also need to make clear that it is legitimate for a charity established under English law to invest in an SELLP both under charity law and under tax law. The legislation should also provide that any financial returns that the investing charity receives will be treated as being exempt from tax under Section 505 of the Taxes Act 1988.

10. The legislation should also clarify the fact that an SELLP would not be seen as, and need to be regulated as, a collective investment scheme.

11. There are already funds in existence which are quite similar to the proposed SELLP. The European Fund for South East Europe was established by the German State Bank kfw Bankengruppe in 2005. It is a tiered structure which brings together different investors. There are public investors including the European Investment Fund, the German Federation Ministry for Economic Cooperation and Development; the Swiss Agency for Development and Cooperation, the Austrian Development Agency, the Danish International Development Agency and the Government of the Republic of Albania. A second tier of investors include international financial institutions such as the European Bank for Reconstruction and Development, Netherland Development Finance Company, the European Investment Bank and kfw. Initially all the investors were from the public sector but now 65% of the Fund comes from private investors, including Deutsche Bank and an English charity, the Waterloo Foundation. The Fund is now worth some €750m. It is established under Luxembourg law as a wholesale investor. It invests in intermediaries who in turn have supported micro and small companies and low income families through the provision of micro finance. Over 250,000 micro loans have been made in the last six years as a result of the Fund's activities. The shift from being predominately publically financed to privately financed indicates that there are appropriate financial returns to be made in the social sector but that the public sector needs to take a lead.

12. Britain lacks an innovative public banking system. Whilst in Germany one third of the banking sector is controlled by the state, the normal position in Britain is that the state owns no part of the banking sector. The RBS and Lloyds Bank investments were forced upon the state reluctantly. This means that the British state has not played a role in helping to develop social finance, although the Big Society Bank will hopefully help to do so. However, charities could do this and the SELLP structure could be the ideal mechanism in helping them do this.

13. Much coverage has been given to the Social Impact Bond recently developed to finance work to combat recidivism in Peterborough Jail. In a nutshell this involves a charity, St. Giles, with a proud record of combating prisoner reoffending, being awarded a contract by the Ministry of Justice which means that if St. Giles achieves certain targets to improve reoffending rates, it will be rewarded by the Ministry of Justice. However, it

needed short term cash in order to carry out the work in order to win the reward. To do this, it has raised money from a number of charities and private investors. Doing this has been legally very complicated because of the inter-relationship between charity, tax and company law. The SELLP would make it much simpler to set up an arrangement similar to the Social Impact Bond. The SELLP could be the hybrid investment vehicle which raised funds, from both charities and the private sector, to finance the equivalent of St. Giles to undertake the work and then participate in the financial returns (if any).

14. Conclusion

14.1 To combat the many social problems that the UK now faces, allied with the severe restrictions in government and local authority spending, we need creative new thinking. The innovative SELLP hybrid structure could contribute to drive down the costs of combining charitable, public and private sector finance in one vehicle.

14.2 The availability of the SELLP could help London become a centre for the nascent social finance investment market – enabling US, UK and other charitable moneys to be blended with public and private sector funds to deliver major social projects eg building sanitation facilities in developing countries.

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