



**Submission to
Ontario Ministry of Government and Consumer Services
RE: Legislation for Social Enterprise Corporations**

**Dual Purpose Corporations or Hybrid Corporations intended
to provide for social good and private profit
March 23, 2015**

The Ontario Nonprofit Network (ONN) has prepared this submission based on research, knowledge of the field and feedback from those working in social enterprises. There are two parts to this submission. This is an issue that significantly impacts the non-profit sector. Hybrid legislation has far reaching implications for government provision of services and the work of the nonprofit sector in providing social good and building community wealth.

In this document, ONN addresses the proposed hybrid legislation. ONN has addressed the hybrid corporation structure in more detail in the context of setting policy priorities to support social enterprise in Ontario. That report can be found [here](#).

In our response, we address the two questions asked:

1. Should we have a hybrid corporate structure in Ontario?
2. If so, how should the hybrid corporation be structured?

To begin, here are a few definitions and some baseline facts upon which we have built our response:

Definitions

- **Social enterprises** are those enterprises that provide a social good while generating income to undertake their work. (Note: includes nonprofit, cooperative or for-profit corporate forms)
- **Non-share capital corporation** - legal term for nonprofits who have members, not shares and shareholders (nonprofit organizations)
- **Share-capital corporation** - legal term for for-profit corporations that have shares and different classes of shares

Key Facts

- **Ontario's public benefit organizations are entrepreneurial** – from arts and culture, sports and recreation to newcomer settlement, housing, faith groups and many more – Many public benefit organizations are social enterprises.
- **Almost 2/3 of the revenue of these organizations comes from earned income** (fees and sales of goods and services). 45.6% of the core nonprofit sector's¹ revenue comes from sales of goods and services and an additional 15.9% comes from membership fees.

¹ The core nonprofit sector does not include hospitals, universities or colleges.

Government transfers from the three levels of government comprise only 19.7%, with charitable donations at 14% and 4% from other sources.²

- **Currently, 95% of social enterprises operate for the public good as non-share capital corporations.** In Ontario, 88% of socially responsible businesses are operated by charities and nonprofits. Another 3% are cooperatives and 4% are for-profit corporations wholly owned by charities. **Just 5% are independent for-profit companies.**³
- **Core nonprofit organizations** generate \$35.6 billion or **2.5% of Ontario's GDP**. The core nonprofit sector is one of the fastest growing sectors of the economy with a Canada wide annual growth rate of 7.1%; nearly doubling from 1997-2008.
- **The B-Corp is a certification process for for-profit corporations seeking recognition for their social benefit work.** The B-Corp was developed in the United States, but is now international; including Canada. B-Corp certification helps for-profit organizations undertaking public benefit work assure their investors and government of their involvement in and commitment to the social good.

Primary Question for Social Enterprise

1. Will hybrid legislation assist social enterprise in communities and grow community wealth and resiliency?

Based on our research, ONN does not believe that hybrid legislation will significantly address the challenges faced by social enterprise⁴, promote social innovation or attract significant capital investment for social good.

ONN is supportive of any legislative framework that encourages and ensures enduring public benefit work. We understand that one size does not fit all and different enterprises have different needs that require different corporate forms. However, the hybrid models, as currently constituted, do not seem to meet the needs of any of the key stakeholders: social entrepreneurs, communities, investors or governments.

ONN recommends that:

1. **Modifications to the Ontario Business Corporations Act to provide for dual purpose “a mandated social purpose and the pursuit of private profit” not be undertaken at this time.**

Emerging evidence indicates that hybrid legislation models do not work for the purposes intended. More experience and close study of existing arrangements in this area would be beneficial before moving to legislation. Social entrepreneurs, investors and governments

² Statistics Canada, “[The Satellite Account of Non-profit Institutions and Volunteering](#)”, 2009.

³ The Canadian Community Economic Development Network, “[Inspiring Innovation: The Size, Scope and Socioeconomic Impact of Nonprofit Social Enterprise in Ontario](#).” 2013.

⁴ While ONN is a network of nonprofit organizations, in considering this hybrid legislation we included the full spectrum of social enterprises, including for-profit businesses, in our analysis.

looking for blended returns (profit and social good) can currently undertake agreements and contracts under existing share capital corporate legislation. ONN recommends they be left free to experiment and evolve, documenting lessons learned in key cases. At the same time, the experiences of British Columbia and Nova Scotia, who are implementing different variations of the [UK Community Interest Companies](#), can be watched.⁵

2. The Government of Ontario should move forward with enabling amendments to legislation and regulation for social enterprises operating as non-share capital organizations.

Ontario should finish modernizing its nonprofit corporate legislation. It should be a priority to amend and implement the Ontario Not-for-Profit Corporations Act (ONCA), 2010. It is also critical that Ontario work with the federal government to amend or reinterpret nonprofit legislation and regulation in the Income Tax Act. The section of the Income Tax Act related to corporations “not for purpose of profit” is currently interpreted as preventing nonprofit organizations from making any surplus, hindering them in raising essential revenues to support their operations and their mission-based work. Charitable regulation on social enterprise activities also needs modernizing, as it places too many restrictions on the capacity of charities to raise their own revenues ([detail in Appendix B](#)).

Achieving these legislative and regulatory changes will make the nonprofit corporate form more attractive as a corporate structure for new social enterprise and remove a significant barrier for existing social enterprises. Modernization of existing legislation and regulation is urgently needed.

3. The Government of Ontario should focus on improving access to appropriate capital investment across the different corporate forms to support social enterprises.

Social enterprises have challenges and needs that require different types and structures of investment capital. While modifications to existing legislation will bring much needed clarity to social enterprise work, access to capital is more appropriately addressed through non-legislative mechanisms. Increasing access to capital funds and investments that are designed for, and in collaboration with, social enterprises will do much to grow socially responsible enterprises across diverse corporate forms. Enterprises need access to a wide variety of capital and supports through the different stages of their development. Shareholder equity is just one, and possibly the most complicated, of many financing methods for social enterprise.

⁵ A description of the range of British and American hybrid legislation is provided in Ontario Nonprofit Network’s, “[A Policy Blueprint for Strengthening Social Enterprise in the Province of Ontario](#)”, 2014.

Secondary Question for Social Enterprise

2. If there is legislation, then what must it contain?

There are significant, fundamental questions about the ability for hybrid legislation to succeed in its statement mission. Some key ones are described here. They need to be addressed for hybrid legislation to succeed.

- **A pivotal issue for hybrid legislation is “balancing” the social purpose mission with the private profit interests:** The concern for many existing social enterprises is that hybrid companies might claim social purpose, but not really commit to it or might abandon it in favour of investor returns, thereby leaving communities disillusioned and damaging their trust in other organizations providing public benefit in communities. On the other hand, investors are concerned that too much focus on the pursuit of the social objective might impact the ability of the organization to make a return on investment.
- **The Profit/Loss Split:** The UK model of dual purpose legislation (a variation of which is proposed for Ontario in this consultation) establishes a clear structure in legislation to “balance” public good and private returns. It defines what good work is done and who shares the revenue. In the UK structure, legislation currently provides for a 65%/35% split of profits, with 65% vesting for the social benefit and 35% available for profit. British Columbia legislation has 60% vesting and 40% profit distribution to shareholders. Locking in a social benefit component is important and the split between public benefit and private profit is still a work in progress.⁶
- **Governance:** A key component of “balancing” social good and private profit is who makes decisions. Who governs the company? Who determines the balance between social mission and private profit? This is where it gets complicated. The hybrid legislation is fundamentally share-capital legislation (a modification of the Business Corporations Act); therefore, shareholders vote for the Directors who make these decisions. In British Columbia for example, shareholders are the people who put up the capital and lay claim to 40% of the profit. As currently constituted in the UK and British Columbia legislation, these hybrid corporations are controlled by shareholders who elect directors. In an attempt to balance the equation, these directors are *obligated* to consider the social mission when making decisions and they must also report annually on their social mission work. However, this creates a distinctly unequal balance of power, as community members do not have decision-making authority to work with investors. Instead, investors retain control of what are essentially community assets.

To illustrate some of the complications in the legislation, we have prepared examples of potential situations:

Situation

An investor puts up the capital to build and operate a seniors’ centre. Government has stepped away from the business of providing capital, leaving it to the private sector and, in return, the

⁶ Ontario Nonprofit Network, “[A Policy Blueprint for Strengthening Social Enterprise in the Province of Ontario](#)”, 2014 describes the US and UK models and the efforts to find the right “split” to attract investors.

investor takes share capital in the hybrid company and, as a shareholder, acquires the right to elect the directors.

The seniors' centre is very popular and grows significantly. After a few years, it makes a significant profit each year.

Q. Balancing decision-making: The legislation allows for a profit split of 60% reinvested in the social good with 40% profit able to be paid out in dividends to investors. In the early years, a 60/40 split might be appropriate for the investor, but as the centre grows more successful and profitable, should the investor always get 40% of the profit? How will the Board of Directors elected by the shareholders make this determination about sharing the profits? Do they not have a conflict of interest? Moreover, how will the Directors make the decision about reinvestment in the social good? Will they build more residences because that gives the biggest return on investment or expand the homecare program which is in high demand but which barely breaks even? The Board of Directors elected by the shareholders makes the decision about size of dividend and about the nature of the community reinvestment. Shouldn't community stakeholders have input in the governance decisions about the social enterprise? How might that happen?

Q. Realizing Investment: Let's say the investors invested \$1 million in the senior's centre. Over the 15 years, the centre has averaged a 20% profit. The investors have received, over that time, \$1.2 million (\$80,000/year on average). During this time, \$1.8 million has been reinvested (\$120,000 per year) in the centre. It has been 15 years and the investor wants to sell their shares to get their investment back. How will this happen? How do you value the seniors' centre when the community portion has been reinvested and the investor's portion paid out in dividend? In the UK, the investor gets the original investment back. In this case, it would be the \$1 million. Where does the seniors' centre get the million to buy back shares? Does it find another investor or owe more money?

Q. Losing Money: The seniors' centre made some poor program choices and returns were not as planned. The investor put \$1 million into the business originally, but the centre is losing money every year. If the profits are split 60/40, how are the losses shared? Does the investor cover 40% of the losses and the seniors' centre 60% of the losses? Or does the seniors' centre cover 100% of the losses? The investor decides they can't tolerate the losses and wants out. Does the seniors' centre have to buy out the shares for a million dollars? How do you value the company? Whether it is \$1 million or even \$500,000, where does the seniors' centre get the money?

The deeper one delves into it, the more complex the hybrid structure becomes. This is why we believe it is not suitable for either increasing social outcomes or private investment in social good. For the public benefit sector, this corporate structure limits community involvement in key decisions weighing public good against private profit and leaves the social enterprise vulnerable. For the investor, this company has fixed limits on investment returns and presents significant hurdles in exiting from the investment. For the social entrepreneur, looking for a structure that is nimble and flexible, they will be faced with corporate constraints requiring the balancing of social mission with investor returns while trying to get a new enterprise off the ground.

Seeking the best of all worlds

Governments, faced with escalating costs and shrinking revenues, have been interested in the promise of “profit with purpose” organizations. The idea of for-profit enterprises doing good for communities, funded by private sector investors, has strong attraction. The appeal of being able to do good and do well financially has caught the imaginations of many. However, while the idea is appealing – achieving the balance needed for realistic, effective implementation is a significant challenge - it may well be too good to be true.

Thus far, there is no clear picture of what these hybrid businesses look like⁷ - what role they play in the spectrum of social enterprises or how the profit and purpose motives can be balanced or integrated. Nor is it clear what kinds of social missions lend themselves to this corporate form and which do not.

It is early days in these shifts. There is much to learn and there are many changes needed. A number of governments have rushed to legislate a new dual purpose corporate structure hoping to attract private sector investors. And while these legislative initiatives are still in the experimental stage, to date, investors have not participated as hoped. Moreover, uptake of the new dual purpose corporations by enterprises has been poor. Even in the UK, where uptake of the new legislation has been greater, the vast majority of enterprises are operating as member based non-share capital corporations (using it in a way similar to the Canadian nonprofit form which does not exist in the UK). Few British CIC Companies (12%) are using the share and dividend options that make the form ‘hybrid’.⁸

ONN recommends a wait-and-see approach to hybrid legislation. In the meantime, there are significant gains to be made by improving existing nonprofit legislation and regulation to enable social enterprise and focus on developing social finance products that meet the different types and stages of social enterprise across the corporate spectrum.

Post Script

Following below is a detailed response to the questions asked in the consultation regarding the shape and structure of the legislation should a decision be made to proceed with legislation at this time. [Appendix A](#)

⁷ Nonprofit Quarterly, “[Hybrids, Hybridity, and Hype](#)”, 2014,

⁸ The Regulator of Community Interest Companies, “[Changes to the Dividend and Interest Caps for Community Interest Companies: Response to the CIC consultation on the dividend and interest caps](#)”, 2013.

Appendix A

<p>Your contact information. Please provide your name, title and the full name and address of your organization if you are submitting comments on behalf of an organization. <i>(insert contact information)</i></p>	<p>Cathy Taylor Executive Director Ontario Nonprofit Network 720 Bathurst Street, Suite 405 Toronto, ON (416) 642-5786</p>
<p>About You or Your Organization <i>(please check the appropriate box)</i></p> <p> <input checked="" type="checkbox"/> Social Enterprise <input checked="" type="checkbox"/> Not for Profit Corporation <input type="checkbox"/> Impact Investor <input type="checkbox"/> B-Corp <input checked="" type="checkbox"/> Other: nonprofit sector network </p>	
<p>Consultation Proposals</p>	
<p>1. Corporations should be created with a dual purpose that includes a mandated social purpose and allows the organization to pursue profit making activity.</p>	
<p><i>(insert comments – if necessary, the box will expand as you type)</i> No, hybrid legislation should not be developed or introduced at this time. <i>See ONN response</i></p>	
<p>2. Dual purpose corporations should be able to attract share capital and allow founders, employees and stakeholders to have equity in the organization.</p>	
<p><i>(insert comments)</i> Legislation that provides for equity – share capital- must consider how the social good and social purpose assets are to be provided for within the corporate structure. Current hybrid corporate models are inadequate in assuring sound management of community wealth over the long term. Providing a social good is insufficient. Wealth must be shared with community and the community must have a say in how that wealth is managed over the long term.</p>	
<p>3. New legislation should complement existing legislation used for social enterprises.</p>	
<p><i>(insert comments)</i> Absolutely. Any new legislation should complement existing legislation, but current hybrid legislative models lean much further toward the for-profit corporate model. Work needs to be undertaken to determine which corporate structure suits what kind of enterprises. This has not been done and until we know what kinds of enterprises will benefit from hybrid legislation, it is difficult to legislate and for governments to develop sound policy. (See example in remarks above. It illustrates the kinds of dilemmas that present when human services are involved).</p>	
<p>4. Dual Purpose corporations would need a statement of the social purpose in the Articles of Incorporation.</p>	
<p><i>(insert comments)</i></p>	

Yes, the social purpose should be in the articles, but that is not sufficient. The bigger question is: Is the social purpose THE purpose or just one objective of many? To be protected, it should be THE primary purpose.

5. New legislation should use either a “reasonable person test” or define social purpose (e.g. “a purpose that is beneficial to society or a segment of society beyond just shareholders, directors or other persons related to the company.”)

(insert comments)

This question illustrates the difficulties of using a definition of social purpose to qualify for legislation that is, at its heart, profit-sharing legislation. Both would likely be needed. A definition of social purpose is necessary, but also a regulator that can judge the worth through a reasonable person’s understanding of the definition. How can one define social purpose? Where to draw the line?

For example: Is a shop a social purpose? But is it a social purpose if it is in a northern community without other shops or if it sells wholesome foods? Does it need to sell wholesome foods in disadvantaged communities or in any community to have a social purpose?

6. Proposed legislation should establish distribution constraints on assets/profits to protect the organization’s social purpose and help develop a brand to attract impact investors and consumers.

(insert comments)

Yes. Distribution constraints would be essential to assure public benefit, build community assets and maintain public trust. It may be required to attract impact investors, but also the public will require them, as will government.

7. Proposed legislation should set out director responsibilities including requiring directors to consider the organization’s social purpose, requiring a minimum number of directors and indicating that directors not be restricted from receiving compensation.

(insert comments)

Yes to all of these features. The legislation must also grapple with how the social wealth and equity building up in the corporation can be accountable to the community or other stakeholders over time. Otherwise, it is just a fancy way of retaining earnings in the company. Directors cannot be solely responsible to shareholders unless community members are shareholders along with investors proportionate with the asset mix.

8. Proposed legislation should provide shareholder rights similar to those found in the Ontario Business Corporations Act.

(insert comments)

This is the central problem. This makes it a business corporation first. There is a community reinvestment requirement, but it does nothing to build community assets and wealth if they remain exclusively controlled by shareholder investors. With rights similar to those found in the

<p>OBCA, the proposed structure is not a dual purpose structure. It's a for profit structure which will use the community profit that vests in the company as a source of capital for the company and investors. Operating under the OBCA as proposed, the dual purpose company will actually privatize community wealth and assets. See example in introductory remarks of the seniors centre.</p>
<p>9. Proposed legislation should require organization to report annually on the organization's activities and outcomes aimed at its social purpose and include financial information to demonstrate that the financial obligations associated with the distributions constraints are being met.</p>
<p><i>(insert comments)</i> An annual report should be required. However, as proposed, it will have limited to no impact without external accountabilities to stakeholders and communities. It does not address how the retained earnings are deployed and does not provide for interested stakeholders – e.g. community members - to be able to undertake meaningful analysis or undertake redress if felt necessary. Without an ombudsman/regulator to address complaints, this requirement is inadequate to its intended purpose of protecting the social purpose.</p>
<p>10. Proposed legislation should include only those reporting requirements necessary to achieve transparency objectives.</p>
<p><i>(insert comments)</i> This depends on the tax breaks that might be attached to this legislation. Transparency objectives need to be met and should complement accountability objectives to ensure public good.</p>
<p>11. Proposed legislation should require that directors approve the social benefit report and that it be provided to shareholders and be publicly accessible.</p>
<p><i>(insert comments)</i> Yes, but without review against some accountability standard, it will not be meaningful. Accountability and feedback opportunities must be provided.</p>
<p>12. Proposed legislation should require that financial statements be approved by the directors and provided to the shareholders.</p>
<p><i>(insert comments)</i> This is standard. What about having access more broadly by other stakeholders? What about the regulator? Is there not a need for a high transparency? Building on the OBCA brings with it all the for-profit objectives of competition and secrecy. Maybe the hybrid corporation would be better built on the ONCA that operates on other principles.</p>
<p>13. Proposed legislation should establish a framework for a basic regulator that provides flexibility and does not impede momentum for this new corporate structure to flourish.</p>
<p><i>(insert comments)</i> Yes, this legislation requires a regulator. Given the inherent tensions and potential for conflicting interests of social purpose and private profit as dual goals of the same corporation, the regulator will need some powers to rule.</p>
<p>14. Proposed legislation should establish a regulator to approve and review eligibility and manage the filing of annual social benefit reports. Proposed legislation should enable cost recovery.</p>

(insert comments)

Cost recovery might be difficult to achieve if the regulator undertakes responsibility to ensure the social purpose is met.

We are interested in any other comments or suggestions you wish to make.

(insert comments)

In Britain, 88% of Community Interest Companies operate as not-for-profit companies with members – similar to Ontario’s not-for-profit corporate form. These corporations clearly prefer to utilize debt for their capital needs, where the return to investors is known and does not involve putting what should be community assets into private hands. The risk of privatization of public assets is not on the edges of social enterprise and innovation. Investors often stay clear of these ventures. The risks are with the everyday community infrastructure that, today, is primarily in nonprofit ownership. This is where the real financial returns can be achieved; particularly in fields where government purchases services. The seniors home, the homes and facilities for people with disabilities, the sports facilities, daycares and other community supports and services are at risk. Currently, these services operate largely as not-for-profit organizations with all excess revenues going to enhance services. The hybrid corporation, while it may provide a social good, does not protect social good and does provide for community input into the nature of the goods provided. Moreover, it does not support the development of community wealth over time. Indeed, it risks giving private financial interests control over assets that purport to be social goods.

Government should explore the creative use of debt financing for a nonprofit sector that is freed up to earn revenues before it embarks on a venture of this kind that may ultimately decrease service quality and increase costs to government as community infrastructure is managed for private profit.

Send Feedback to consumerpolicy@ontario.ca by May 4, 2015

Privacy Statement

Please note that unless agreed otherwise by the Ministry of Government and Consumer Services, all submissions received from organizations in response to this consultation will be considered public information and may be used and disclosed by the ministry to help the ministry in evaluating and revising its proposal. This may involve disclosing any response received to other interested parties.

An individual who provides a response and indicates an affiliation with an organization will be considered to have submitted the response on behalf of that organization.

Responses received from individuals who do not indicate an affiliation with an organization will not be considered to be public. Responses from individuals may be used and disclosed by the ministry to help evaluate and revise the proposal. Any personal information such as an individual's name and contact details will not be disclosed by the ministry without the individual's prior consent unless required by law.

If you have any questions about the collection of this information, please contact consumerpolicy@ontario.ca.

Appendix B

Legislative Updating for Social Enterprise and Innovation

Modern Corporate Legislation: Adapted to the needs of the nonprofit sector

Fifty years after the last update, corporate legislation for the nonprofit sector in Ontario is in the process of being revamped. The Ontario Not-for-Profit Corporations Act (ONCA) is moving towards proclamation. While a vast improvement on the current Corporations Act, a few important amendments remain outstanding to provide a clear framework for social enterprise. Modern and up-to-date corporate legislation for not-for-profit organizations is a priority.

Income Tax Act: Enabling public benefit nonprofits to earn revenue to support mission

In Canada, there is clear evidence that nonprofits operating social enterprises need a more enabling environment for their enterprising activities. Recent audits by the Canadian Revenue Agency (CRA) generated uncertainty and concern for social enterprises with their statement that “a significant portion of incorporated organizations would fail to meet at least one of the requirements set out in 149(1) (l) of the (Income Tax) act.” Further, the auditors were surprised to find that many of the nonprofit organizations they audited believe that nonprofits must produce a profit to thrive and their capital assets to be maintained. In particular, there is a common view in the sector that as long as profits are used to further their organizations purpose, the source of the funding shouldn’t matter. CRA’s position, however, is different.⁹ The profit of nonprofits must be only incidental and earning a profit to reinvest in mission is not permitted.¹⁰

Charitable Regulation: Charities need to be able to diversify revenue sources

Charities are only slightly more enabled to diversify revenue than nonprofits without charitable status. Charities, with the exception of private foundations, are allowed to operate a “related business.” However, this is defined by the CRA as run substantially (90%) by volunteers or “linked” and “subordinate” to a charity’s purpose. “Linked” is interpreted very narrowly and “subordinate” requires the business activity be a minor portion of the charity’s activities and resources.¹¹ For charities to be able to diversify their revenues to include social enterprises, the regulations that govern their ability to earn revenues need modernization.

⁹ Even though Paragraph 149(1)(l) of the Income Tax Act exempts organizations from income tax that are, “organized and operated exclusively for social welfare, civic improvement, pleasure or recreation or for any other purpose except profit, no part of the income of which was payable to, or was otherwise available for the personal benefit of, any proprietor, member or shareholder thereof ...”

¹⁰ Canada Revenue Agency, “[Non-profit Organization Risk Identification Project](#)”.

¹¹ Canada Revenue Agency, “[Policy Statement CPS-019: What is a Related Business?](#)”, 2003.