

**AMENDMENTS TO THE COMMUNITY INTEREST COMPANY
REGULATIONS 2005 – SUMMARY OF RESPONSES AND GOVERNMENT
RESPONSE TO CONSULTATION**

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1. INTRODUCTION

The Department for Business, Enterprise and Regulatory Reform (BERR) published a consultation document in February 2009 seeking views on proposed amendments to the Community Interest Company Regulations 2005¹.

The Community Interest Company (CIC) came into force in July 2005² as a new legal form for social enterprises. Since the CIC form became available, there have been a number of legislative developments and stakeholders have raised a number of points arising from the legislation. The Government therefore consulted on making some limited amendments to update the Regulations and to reflect the experience of CICs and the CIC Regulator to date.

Consultation process

The consultation document was published on the BERR website for 6 weeks. The shorter consultation period reflected the fact that the proposals should not result in burdensome effects for CICs and did not seek to alter the general policy approach to CICs. Full consultations were conducted at the time of the original legislation establishing CICs in 2003 & 2004. BERR contacted stakeholders with an interest in CICs, Social Enterprise and the wider third sector.

Who responded

12 responses were received of which:

- 6 were representative bodies from the social enterprise or wider third sector;
- 3 were law firms;
- 2 were consultants working in the sector; and
- 1 was a social finance intermediary.

Overall the responses were positive in respect of many of the proposed amendments and respondents also brought to BERR's attention a number of issues concerning impacts of some of the proposals. The Government is very grateful to those who took the time and trouble to comment. The responses were very helpful in considering the proposed amendments and a number of changes in our approach have been made as a result. A list of respondents is at Annex A.

¹ Consultative Document: Proposed Amendments to the Community Interest Company Regulations 2005
<http://www.berr.gov.uk/files/file50202.pdf>

² Under the Companies (Audit, Investigations & Community Enterprise Act) 2004 & the Community Interest Company Regulations 2005 (SI 2005 No 1788)

3. SUMMARY OF RESPONSES TO CONSULTATION QUESTIONS: CONSULTEES' VIEWS AND THE GOVERNMENT'S RESPONSE

This section sets out consultees' views and the Government response to each question following the order of the consultation document.

Conversion to Community Benefit Society³ with an Asset Lock

Q1. Do you agree with the draft amendments to recognise the asset lock form of community benefit society?

Consultees' views

Respondent's views were positive with all supporting the proposal to permit conversion to the asset locked form of community benefit society on the basis that enterprises should, where appropriate, have the ability to move from one legal form to another and to transfer assets for community benefit.

One respondent queried why this amendment modifying the Industrial and Provident Societies Act 1965 was necessary now when there was an intention to overhaul that Act. At the same time, they questioned whether permitting conversion to the community benefit society form of Industrial and Provident Society would deliver the modern type of flexible governance of the CIC form. Another questioned the extent to which the Industrial and Provident Society form would remain attractive.

Government Response

It was the Government's intention at the time of the original legislation to allow conversion to the community benefit form of Industrial and Provident Society as part of our policy to ensure freedom of movement, where appropriate, between the various legal forms which social enterprises may adopt. The choice of legal form is one for the organisations to take based on their individual requirements; the Government did not intend to promote the use of one form rather than another. It was not possible to include this provision at the time as legislation providing a statutory asset lock form for the community benefit society was not yet in place. That has now been addressed⁴ and the draft amendments therefore reflect established policy by updating the CIC legislation in line with these changes. As we are making amendments to the Regulations, it seems sensible to make this change now in advance of any more substantive review of the Industrial and Provident Society Act 1965.

³ Under the Industrial and Provident Societies Act 1965, an Industrial and Provident Society may be set up as either a cooperative or as a society for the benefit of the community (community benefit society)

⁴ By The Community Benefit Societies (Restriction on the Use of Assets) Regulations 2006, SI No 264 and the Community Benefit Societies Restriction on the Use of Assets) Regulations (Northern Ireland) 2006 No 258 as amended.

We have made some revisions to the draft amendment Regulations included with the consultation document to make the procedure for conversion clearer but, subject to those drafting changes, we intend to proceed as proposed.

Conversion to a Scottish Charity

Q2. Do you agree with the proposed amendments to allow a Scottish charitable company to convert to a CIC?

Consultees' views

Nine respondents agreed with the proposed amendment with one stating that it will allow greater consistency in the CIC form wherever it is used and applied. Of the others, two had no view and one was not in favour.

The respondent who disagreed with this proposal was concerned that assets achieved by a charity might be used, on conversion, to pay the directors of the CIC, thus undermining the integrity of the charity brand. Given the sizeable number of Scottish charities compared with the number of Scottish CICs, it was also not considered there was a significant demand or need for the proposed change.

Government response

As with conversion to community benefit societies, it was the intention at the time of the passage of the original legislation to permit conversion from charity to a CIC in line with the Government's policy to provide freedom of movement between the available legal forms. Accordingly, an English charity may already convert to a CIC and the legislation was drafted to allow for conversion from Scottish charities once the Office of the Scottish Charity Regulator (OSCR) was established. As that Office is now in place, the Government intends to permit conversion from a Scottish charity in line with existing Government policy.

With regard to the concern about safeguards on the use of a charity's assets, at the point of conversion to a CIC, the assets of the former charity would become impressed with a trust for charitable purposes; income arising from the activity of the charity would therefore remain in the charitable trust. This arrangement applies already for English or Welsh charities converting to CICs and would be overseen and managed by the CIC Regulator and the OSCR.

Community Interest Test

Q3 Do you agree that adding a reasonable persons test to Regulation 5 will help to clarify the purpose of the community interest test? If so, will it help ensure it excludes those for whom the form was not designed?

Consultees' views

Ten respondents agreed that the introduction of a reasonable persons test would help to clarify the purpose of the community interest test and to exclude groups for whom the form was not intended.

Of the two respondents who did not support the amendment, one did not consider that such a change was necessary on the basis that it was not likely that applications would be made on behalf of arbitrary groups for whom the form was not intended. Additionally, they did not consider the drafting would offer significant help in achieving our purpose without making an explicit link to the 2004 Act. The other respondent was concerned that the test should be aligned with the public interest test applying to charities and considered the approach proposed may be unduly prescriptive.

Of those in favour, one respondent suggested that the proposal may more easily enable CICs to identify their community of benefit as serving a particular community of interest rather than a geographical area.

Some noted that the amendment provided more scope for the Regulator to exercise discretion in considering applications and excluding those for whom it was not intended which, one noted, could give rise to challenge. It was suggested that the test must be applied consistently and that guidance should be published to help potential CICs to understand how this test would be applied.

Government response

On the basis that the amendment does not make the test more prescriptive but gives more certainty to the Regulator in her decision making, we intend to retain the amendment as drafted, with guidance provided by the Regulator on how the test will be applied. With regard to the comment about alignment with the charity public interest test, the community interest test was expressly drawn more widely and the Government was not proposing to review that policy with this amendment. With regard to the drafting, the Government considers that the amendment is already linked to the s35 of the 2004 Act which sets out the context ie that the activities must be considered to be carried on for the benefit of the community.

Detrimental Effects

Q4. Do you agree that the Regulator should take account of the impact of a prospective CIC's activities on the wider community and public policy considerations? Will the proposed amendment help the Regulator to interpret more clearly the meaning of community interest?

Consultees' views

There were mixed responses to this question. Although a small majority recognised and supported the aim of this amendment, many nonetheless expressed reservations about the implications in practice.

The main concerns focused on the risk of involving the Regulator in more subjective and qualitative decisions which were more appropriate for the courts to determine and which may fundamentally alter the Regulator's role. Some noted that such potential conflicts of interest were not uncommon and not particular to CICs; as such they should be resolved through dialogue or existing routes of arbitration. A couple of respondents cited the example of wind farms which, while supported by many as beneficial and consistent with public policy, are regarded by other sections of the community as detrimental eg to wildlife habitats or to the natural landscape.

One respondent suggested that guidance would be needed to explain how this power would be used while another considered that the amendment may be helpful subject to a right of appeal.

A couple of respondents made the point that social enterprises were often ahead of public policy and this amendment could inadvertently stifle their ability to innovate.

Government response

The Government notes the arguments that this amendment could significantly alter the role of the Regulator by involving her in judging subjective and potentially contentious issues which are more appropriate for the courts to determine. The statutory provisions governing the role of the Regulator make clear that she must adopt an approach which has regard to the likely impact on those affected by the discharge of her functions as well as to the outcome of consultation with relevant parties. In light of this and the reservations expressed, the Government proposes to omit this amendment and retain the status quo.

Political Activities

Q5. Do you agree with the widening of the definition of governmental authority?

Consultees' views

All but two respondents were in favour of widening the definition as proposed. Of those in favour, one noted that it should be clear that the definition does not include non-governmental authorities. It is considered that the drafting is sufficiently explicit to exclude such bodies.

One respondent who did not support this amendment disagreed with the established Government policy which excludes CICs from engaging in political or campaigning activities; they considered CICs should be free to lobby policy makers in the interests of its community. Against that, another respondent stated that it is essential that the CIC is not used for political activity for the benefit of governments, political parties or political campaigning groups, noting that this does not restrict CICs from commenting on the public policy environment in terms of how it impacts upon CICs. Another noted that the current policy on CICs was consistent with the approach applying to charities.

The other respondent who disagreed considered the amendment in practice would have the effect of making the definition too restrictive.

Government response

The proposed amendment is consistent with the existing policy with regard to the restriction on a CIC's ability to engage in political activities (except where incidental to the CIC's main activities). It effectively clarifies the definition of the relevant authorities and, on that basis, the Government intends to proceed as proposed.

Asset Lock and Distributions

Q6. Do you agree with the aim of permitting relevant public authority or regulatory bodies to seek distribution of residual asset of a CIC subsidiary on winding up?

Consultees' views

Respondents were divided on this subject. While six respondents supported the aims here, most of their comments were subject to caveats on how this provision was exercised. Five respondents did not support the amendment and one was undecided, on the basis that more detail was needed on the implications.

Points raised included:

- the need to ring-fence the assets to ensure continuing community benefit and in keeping with the objects of the CIC though one respondent noted that ring-fencing in the manner suggested would constrain the independence of the CIC and/or public authority or regulatory body in how it used the assets;
- The potential to alter the relationship between the CIC and the relevant body and to constrain the independence of the CIC;
- That investors may not appreciate that their investment in a CIC may be transferred to a public body.

One respondent suggested that if a public body is financing a CIC, it might use a contractual clawback provision in the event that its money or assets are no longer being used for the purpose intended.

There were no responses from bodies who would be potential beneficiaries of this amendment.

Government response

In light of the relatively small number of responses and the level of concern about how this might work in practice, the Government does not intend to proceed with this amendment now. Instead we plan to consider further in liaison with interested parties how such a provision might work, having regard to these concerns.

Transfer of Assets for less than full consideration

Q7. Do you consider the current provisions create inconsistency? If so, how would you propose we should deal with this?

Background

Schedules 1, 2 & 3 of the Regulations provide that a CIC may not transfer any of its assets for less than full consideration except:

- where the transfer is to an asset locked body specified in their memorandum and articles or, with the Regulator’s consent, to another asset locked body; or
- where the transfer of assets is made for the benefit of the community other than by way of a transfer of assets to an asset locked body.

Any such transfers should be included in the CIC annual report and the Regulator would have the opportunity to explore where a transfer made under this provision seemed inconsistent with community benefit. The consultation asked for views on the apparent inconsistency of approach which requires that the Regulator must give consent for such a transfer to an asset locked body but does not need to consent to a transfer where it is for the benefit of the community. Two options were suggested as follows:

- a) the Government could remove the requirement for the Regulator’s consent to a transfer to an asset locked body leaving this as a matter for the judgement of the CIC on the basis that any such transfers will come to the notice of the Regulator in due course; or
- b) the Government could require that the Regulator’s consent should also be required where a transfer is made for the benefit of the community.

Consultees’ views

11 respondents expressed a view on this question and, while all agreed the current provisions appeared inconsistent, they were divided on how best to resolve this.

Of the two options outlined, a marginal majority, favoured (b) above. The main arguments were:

- Such transfers offered most scope for abuse
- Seeking recovery of funds after the event was too late and uncertain
- The CIC form was designed to offer more protections for assets held for community benefit and assurance to those dealing with CICs.

However, another respondent argued that this more interventionist approach could hinder growth and impose a burden on CICs as well as being inconsistent with a light regulatory approach. Another considered that option (a) was more consistent with charity law where the Commission was not required to consent to transfer of assets at less than full value where the trustees considered the transfer fulfilled the charity’s objects.

Government response

There is no clear consensus on the best approach and the option outlined at (b) supported by several respondents would have implications for the Regulator’s role and resources. In practice, only a limited number of cases have arisen testing these provisions to date. With regard to transfers at less than full value for the benefit of the community, only 15 had been reported in CIC reports of which 11 were to charities which were not specified in the CIC’s memorandum and articles. The amounts were also largely less than £500.

In light of the responses, we propose to maintain the status quo now but to explore further how best to deal with the inconsistency for a later review of the Regulations.

Appointment and Removal of Directors

<p><i>Q8. Do you agree with the proposal to remove the provisions on appointment and removal of directors?</i></p>
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Consultees’ views

While a majority of respondents were in favour of this proposal, a number of respondents were concerned that removal as a mandatory requirement in a CIC’s articles risked

undermining the role of the members and stakeholders in the governance of the CIC. Some respondents suggested that while the provision might be removed as a mandatory requirement, a CIC might be encouraged to include a similar provision in its articles of association if it wishes to do so.

Government response

While we recognise the concerns expressed with regard to the role of members and stakeholders, under company law, the CIC members have the right to remove a Director. Equally, Directors, regardless of how appointed, are also bound by the same fiduciary duties to act to promote the success of the company for the benefit of its members. We therefore propose that instead of retaining the existing mandatory requirement, the guidance should encourage CICs to consider whether they wish to adopt similar provisions tailored to their requirements, for example, to require a certain proportion of member appointments.

Alternate Directors

Q9. Do you agree with our intention to leave the provision on alternate directors on the basis it does not impose any requirement on CICs?

Consultees' views

Respondents were split on this proposal. A couple of respondents considered that as the provisions do not require CICs to have alternate Directors, it was helpful to retain them against possibility that their circumstances may change in the future.

Other respondents recommended removing the provisions as unhelpful and causing unnecessary confusion for example, to those CICs who had no intention of appointing alternate Directors. One respondent considered that it was inconsistent to leave this provision as mandatory when the Government was, in other instances, proposing to make requirements for the articles a matter for the individual CIC to decide.

Government Response

Taking account of the views expressed and for reasons of consistency of approach with the other proposals relating to provisions in the articles, the Government intends to remove these provisions on the basis that it should be a decision for the CIC. The guidance will encourage CICs to consider the relevance of such provisions in their articles.

Casting Vote

Q10. Do you agree with the proposal to remove the provision on a casting vote?

Consultees' views

All but one of the respondents who commented on this point agreed to the removal of the provision on a casting vote. The respondent who disagreed considered that the casting vote provided a useful means to avoid uncertainty and delay in decision-making.

Of those who were supportive, many expressed the view that it should be for the CIC to decide how they wished to resolve voting deadlocks and to include provisions in their articles accordingly.

Government response

The Companies Act 2006 does not include any similar provision on casting vote at meetings of Directors of non CIC companies but leaves this as a matter for the individual company to decide and include in its articles as it chooses. There seems no reason to impose this requirement on CICs, many of whom may prefer a consensus based decision making process. On that basis, the Government intends to remove these provisions leaving CICs to choose how they wish to deal with this governance issue.

4. TRANSITIONAL ARRANGEMENTS

Companies Act 2006: Consequential amendments

The draft amendments also implement consequential amendments to the CIC Regulations arising from the Companies Act 2006. In particular the Act introduces changes to the information contained within a company's memorandum and articles. Under section 28 of the Companies Act 2006, any provisions in a company's memorandum immediately before commencement (1 October 2009) will be treated as provisions in the company's articles, if they are of a type that will not be in memoranda of companies formed under the Act. As CICs are companies, they are covered by this provision and do not need to take any action to transfer provisions currently in the memorandum to their articles unless they so wish.

Changes to mandatory provisions for a CIC's articles

The consultation proposed a number of changes to the Schedules to the Regulations which CICs are required currently to include in their memorandum and articles. In light of consultation, we now propose to remove some mandatory provisions which will in future be matters for CICs to decide individually. We do not intend to require existing CICs to amend their articles to reflect these changes. Any CICs being formed after the amended Regulations come into force ie 1 October 2009 will need to apply the revised

requirements while existing CICs may wish to amend their articles to reflect these changes as and when they are amending their articles in the normal course of business.

5. NEXT STEPS

The Government intends to lay these draft amendment Regulations as revised with the intention that they will come into effect from 1 October 2009. The issues on which we have decided not to proceed at present will, as outlined, be taken forward in the future with stakeholders. Any further changes would be subject to consultation.

LIST OF RESPONDENTS

Adrian Ashton
Wales Council for Voluntary Action
TPP Law
Co-operatives UK
CIC Association
Charlie Cattell
Resonance Limited
Scottish Council for Voluntary Organisations
Association of Charitable Foundations
Bates Wells & Braithwaite
Social Enterprise Coalition
Wrigleys Solicitors