*Cambridge Yearbook of European Legal Studies*, 23 (2021), pp. 193–227
doi:10.1017/cel.2021.1

First published online 30 June 2021

# *A Social Enterprise Company in EU Organisational Law?*

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**Abstract**
This article explores the European Parliament's July 2018 non-legislative resolution proposing to the European Commission a directive for facilitating social enterprise companies' cross-border activities. The proposal is first situated within the context of the social economy and how the sector has grown in importance to European integration. The proposal and the European Commission's response are then examined. Although the European Commission was not convinced that Member States would be amenable to the proposal, a consensus may already exist that is sufficient to garner their support. Even if this prediction is wrong, however, it is argued that there are reasons to surmise that the proposal will likely be reassessed and ultimately successful at some future point. Finally, the proposal is viewed with a reflexive harmonisation lens. Through the analysis, regulatory issues are identified, and a solution is then suggested.

**Keywords:** comparative law, corporate mobility, organisational law, reflexive harmonisation, social enterprise

## I. INTRODUCTION

A few commentators have considered social enterprise law from a comparative European perspective, but something noticeably missing from the literature is a study exploring whether there is a EU dimension to the regulation of social enterprises.[1] The purpose of this article is to take a step towards filling that research gap. To do so, the analysis focuses on the most recent policy activity in this area—the European Parliament's July 2018 non-legislative resolution proposing to the

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[1] See generally K E Sørensen and M Neville, 'Social Enterprises: How Should Company Law Balance Flexibility and Credibility?' (2014) 15(2) *European Business Organization Law Review* 267; J S Liptrap, 'The Social Enterprise Company in Europe: Policy and Theory' (2020) 20(2) *Journal of Corporate Law Studies* 495.

European Commission a directive for facilitating social enterprise companies' cross-border activities ('Proposal').[2]

The Proposal is novel and worth exploring because it links to a much larger narrative about the so-called 'social economy' and its relationship with European integration. Briefly, the social economy is a strategically important and enormous socio-economic 'engine',[3] which accounts for roughly seven per cent of all jobs and eight per cent of the EU's GDP.[4] As the social legitimacy of the EU, and particularly that of the Single Market, has been progressively called into question over time, the Union-level interest in the social economy has not only increased but the nature of the policy attraction has evolved in kind. This has resulted in a paradigmatic shift in which justification for recognising the sector in EU organisational law is different. Past attempts were essentially framed in terms of the undesirability of Member States' organisational forms remaining heterogeneous, which was merely a prop for Single Market intervention. The Proposal is situated in a changed context in which the EU has committed itself, and faces pressure, to reimagine the Single Market with social dimensions and objectives that go beyond the purely commercial.[5] Since the EU lacks competences to take direct action in this regard, the thinking seems to be that the sector could be used as a mechanism to embed, or constitute, economic relations within European society. This could be achieved, at least partially, by integrating the social economy into the Single Market, on this occasion through the Proposal and assigning social enterprises increased socio-economic functions and responsibilities.

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

[2] The European Parliament's Proposal also includes provisions for securing the cross-border activities of social enterprise firms assuming other forms (eg cooperative), but this does not concern the analysis. European Parliament, Statute for Social and Solidarity-Based Enterprises, 2016/2237(INL) (2018), https://oeil.secure.europarl.europa.eu/oeil/popups/ficheprocedure.do?lang=en&reference=2016/2237(INL).

[3] L M Salamon and W Sokolowski, 'The Size and Composition of the European Third Sector' in B Enjolras, L M Salamon, K H Sivesind, and A Zimmer (eds), *The Third Sector As a Renewable Resource for Europe: Concepts, Impacts, Challenges and Opportunities* (Palgrave Macmillan, 2018), p 54.

[4] This is reiterated in numerous texts. Eg Government of Spain, *Madrid Declaration – The Social Economy, A Business Model for the Future of the European Union* (2017), http://www.lavoro.gov.it/notizie/Documents/2017-05-23-DICHIARAZIONE-MADRID-English-Version.pdf; G Smith and S Teasdale, 'Associative Democracy and the Social Economy: Exploring the Regulatory Challenge' (2012) 41(2) *Economy and Society* 151, p 157.

[5] The author thanks, in particular, Kenneth Armstrong for a useful exchange about the change in context.

https://doi.org/10.1017/cel.2021.1 Published online by Cambridge University Press

supra-national organisational form, for facilitating such firms' cross-border activities.

The European Commission responded in November 2018, but declined to take action.[6] Citing perceived differences in national legal traditions and contexts, the European Commission was not convinced that Member States would be amenable to the Proposal. However, this article argues that there is good reason to think that the European Commission's response is not the end of the story.

Part II initially explains the social economy, and the sector's growing importance within European integration is explored in Part III. The Proposal is examined in Part IV, and the European Commission's response is addressed in Part V. Here, it will be shown that a consensus may already exist that is sufficient to secure Member States' agreement on the Proposal. Even if this prediction is wrong, however, there are discernible political and socio-economic reasons to surmise that Member States would likely be receptive to reassessing and ultimately endorsing a Union-level instrument for social enterprises' cross-border activities at some future point. In essence, owing to the effects of Member States' political institutionalisation of their domestic social economies, the Proposal achieves an outcome, from which many Member States stand to benefit, that could not be realised by national policy-makers acting alone. This extends to the idea that there are intersecting policy priorities at Union and Member State levels that make vertical intervention politically palatable. Therefore, plausibly, a proliferation of social enterprise corporate legislation and the increased frequency of such firms' cross-border activities across Europe could soon be a reality.

However, neither the European Parliament nor the European Commission attempted to visualise the consequences of the Proposal. As such, Part VI views the Proposal with a reflexive harmonisation lens. Through the analysis, two regulatory issues are identified. The immediate regulatory issue created by the current terms of the Proposal is a market for incorporation that could be abused by opportunistic actors. This problem is exacerbated because the Proposal 'locks out' Member States from taking remedial action. Over time, the normalisation of a market for incorporation would engender a longer-term regulatory issue, which is the entrenchment of private sector behaviours and commercial practices leading to more permanent distortions of the social economy's institutional logic. The suggested solution involves enlarging the number of provisions within the Proposal that constrain profit distributions and the allocation of profit in Member States' domestic regulatory frameworks. Part VII concludes.

## II. THE SOCIAL ECONOMY

At the outset, it is worth locating discussion of the Proposal within the relevant political setting, which centres on the social economy. It must be emphasised that

[6] SP (2018) 630, Follow-up to the European Parliament Non-legislative Resolution of 5 July 2018 with Recommendation to the Commission on a Statute for Social and Solidarity-Based Enterprises (2018), https://oeil.secure.europarl.europa.eu/oeil/popups/ficheprocedure.do?lang=en&reference=2016/2237(INL).

https://doi.org/10.1017/cel.2021.1 Published online by Cambridge University Press

the social economy is an umbrella term that covers a wide-ranging set of organisations with diverse size and structure, which engage in numerous socio-economic activities in local, regional, and national contexts. Many things impact how the social economy looks and operates across Member States: 'history, culture, [economic conditions] and relationships among public administrators and private organizations determine, or rather select, the forms of development taken by the social economy'.[7] This article is not the appropriate forum to wade in to those complexities, but more will be said about the relationship between Member States' social economies in due course.[8] Consequently, a historically rooted, traditionalist understanding of the sector is utilised, which allows for the referencing of some helpful generalisations germane to the present analysis. Deriving from the French 'économie sociale',[9] the social economy is a 'third sector'[10] occupying a space between the state and the market. It is an expression of civil society assuming direct responsibilities for addressing the needs of individuals, groups, communities, and regions ignored or not adequately served by policymakers and private sector business organisations.[11] In this way, the social economy stems from citizens' capacity to self-organise with the shared goal of confronting socio-economic problems for themselves.

The social economy is an organisational 'family' including associations, cooperatives, foundations, mutuals, and social enterprises.[12] At this juncture, it is beneficial to momentarily reflect on these organisational taxonomies and the institutional logic governing their operation. Conventionally, associations and foundations form a 'non-market sub-sector'.[13] By contrast, cooperatives, mutuals, and social enterprises are, typically, engaged in the production of goods and services in a 'market sub-sector'.[14] Thus, with respect to the attributes shared with private sector business organisations, they likewise occupy market spaces.[15] Regarding social enterprises in particular, they are distinguishable from the other entities in the social economy in that they are not discrete organisational forms in any real sense. Rather, they are an organisational category, or breed, which, compared with orthodox

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

[8] See Section IV.B.1 below.

[9] G Smith, 'Green Citizenship and the Social Economy' (2005) 14(2) *Environmental Politics* 273, pp 276–278.

[10] Eg V Hodgkinson and A Painter, 'Third Sector Research in International Perspective: The Role of ISTR' (2003) 14(1) *Voluntas* 1, p 4.

[11] R Ridley-Duff and M Bull, *Understanding Social Enterprise: Theory and Practice*, 2nd ed (Sage, 2016), pp 15–16; G Jenei and E Kuti, 'The Third Sector and Civil Society' in S Osborne (ed), *The Third Sector in Europe: Prospects and Challenges* (Routledge, 2008), p 9.

[12] Eg A Amin, A Cameron, and R Hudson, *Placing the Social Economy* (Routledge, 2002), p 61.

[13] J L Monzón and R Chaves, 'The European Social Economy: Concept and Dimensions of the Third Sector' (2008) 79(3–4) *Annals of Public and Cooperative Economics* 549, p 561.

[14] F Moulaert and O Ailenei, 'Social Economy, Third Sector and Solidarity Relations: A Conceptual Synthesis from History to Present' (2005) 42(11) *Urban Studies* 2037, p 2042.

[15] L Sepulveda, 'Social Enterprise – A New Phenomenon in the Field of Economic and Social Welfare?' (2015) 49(7) *Social Policy & Administration* 842, p 846.

conceptions of associations, cooperatives, foundations, and mutuals, exhibit 'more innovative behaviour'.[16] They also 'rely on a more varied mix of resources, in particular on income generated through trading rather than grant funding from public authorities; and they are more entrepreneurial—they have a strong inclination towards [commercial] and financial risk-taking'.[17] Consequently, a 'social enterprise' is merely a type of company[18] that pursues a social purpose objective through the provision of goods and services.[19]

As a default matter, there is not much separating a social enterprise from a private sector company when it comes to, for example, outward-facing things like insolvency, tax, or tort—the same legal rules apply to both types of firm.[20] What does separate a social enterprise from a private sector company is the regulation of the former's internal affairs, which are governed by unique rules peculiar to entities operating within the social economy. At the point of registration, a social enterprise's articles of association must normally feature legally mandated provisions dealing with the selection and maintenance of a social purpose, limits on profit distributions and the allocation of profit, and corporate governance mechanisms that foster participatory routes for non-shareholder constituencies affected by a particular firm's activities.[21]

More broadly, no matter the sub-sector, all social economy organisations go beyond classic commercial transacting and operate according to a distinct institutional logic that is separate from the private sector.[22] Highlighted by commentators, job creation, entrepreneurship, and consumer demand, for example, are important driving forces (especially in the market sub-sector), but the ultimate goal is not to produce economic surplus that can then be appropriated based upon a residual claim connected to the investment of capital. Rather, the sector's institutional logic is such that social economy organisations pursue goals for community, and more broadly public, benefit.[23] They are usually formed and managed by individuals

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[16] Smith and Teasdale, note 4 above, p 156.

[17] Ibid.

[18] Although note that social enterprises can also take a cooperative form.

[19] J Defourny and M Nyssens, *The EMES Approach of Social Enterprise in a Comparative Perspective* (EMES, 2012), Research Network Working Paper No. 12/03, p 8, https://emes.net/content/uploads/publications/EMES-WP-12-03_Defourny-Nyssens.pdf.

[20] However, it is not uncommon for would-be shareholders to be given tax incentives for investing in such a firm. For example, this is the case in France. See generally eg Ministères de l'Économie et des Finance, *Economie Sociale et Solidaire: Qu'est-ce que l'agrément "Entreprise Solidaire D'Utilité Sociale"?* (2018), https://www.economie.gouv.fr/entreprises/agrement-entreprise-solidaire-utilite-sociale-ess.

[21] See eg Regulation (EU) 1296/2013 on a European Union Programme for Employment and Social Innovation ('EaSI') [2013] OJ L347/238, Art 2(1).

[22] An 'institutional logic' is an overarching set of norms that dictate the values and objectives of an organisational field; it is the standard mode of operation that makes an entity's behaviour predictable. See eg S J Woodside, 'Dominant Logics: US WISEs and the Tendency to Favor a Market-Dominant or Social-Mission Approach?' (2018) 14(1) *Social Enterprise Journal* 39, p 39.

[23] A timely example of a social economy organisation pursuing public benefit is Imperial College London's social enterprise—VacEquity Global Health—that was formed to bring its COVID-19

within a wider social fabric that elect to cooperate with each other on the basis of reciprocity and solidarity to improve living conditions for employees, members, and stakeholders over capital contributors' interests.[24] Moreover, social economy organisations are legally prohibited from distributing residual earnings to those with a managerial or ownership interest, or profit distribution is proportionate to the work performed or the services rendered. Otherwise, profits are reinvested back into the particular organisation, or used to pursue social development objectives within a community or target demographic (eg drug users, the elderly, homeless individuals, immigrants, or the unemployed).[25] The social economy is, therefore, often referred to as reflecting a kind of 'caring' capitalism in which organisations engage in a broad assortment of socio-economic activities and deploy economic surplus for essentially public interest purposes.[26] This has come to be politically valued in the European integration context.

## III. POSITIONING THE SOCIAL ECONOMY WITHIN EUROPEAN INTEGRATION

The aim of Part III is to briefly examine past attempts by Union-level policymakers to recognise the social economy in EU organisational law and highlight the paradigmatic shift from which the Proposal emerged. The change in context that occurred between past attempts and the Proposal is quite important, as the justifications for vertical intervention are now different. Indeed, Part V shows that Member States similarly have evolving policy priorities and incentives that are likely to make vertical intervention politically palatable.

### *A. Past attempts to recognise the social economy in EU organisational law*

Regarding past attempts, the social economy has not historically been well recognised in EU organisational law. With the exception of the *Societas Cooperativa Europaea* ('SCE'), the crux of the problem seems to be that unanimity has been elusive. Member States have had an 'interest in keeping [their] … [organisational] law exactly as it is, preventing exogenous (ie European) innovations and preserving the

*(F'note continued)*
vaccine to the world at low cost. See A Scheuber, 'Imperial Social Enterprise to Accelerate Low-Cost COVID-19 Vaccine', *Imperial News* (7 June 2020), http://www.imperial.ac.uk/news/198053/imperial-social-enterprise-accelerate-low-cost-covid-19.

[24] C Borzaga and E Tortia, 'Social Economy Organisations in the Theory of the Firm' in A Noya and E Clarence (eds), *The Social Economy: Building Inclusive Economies* (OECD, 2007), p 35.

[25] R Chaves and J L Monzón, 'Beyond the Crisis: The Social Economy, Prop of a New Model of Sustainable Economic Development' (2012) 6(1) *Service Business* 5, p 9.

[26] T Brandsen, W van de Donk, and K Putters, 'Griffins or Chameleons? Hybridity as a Permanent and Inevitable Characteristic of the Third Sector' (2005) 28(9–10) *International Journal of Public Administration* 749, p 751.

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status quo', which has made the institutionalisation and the scaling up of the social economy difficult at Union-level.[27]

The process of recommending Union-level organisational forms began with a proposal for a European Association ('EA'), which was formally submitted to the Council in 1992.[28] However, little progress was made in the 1990s—the general attitude amongst Member States appears to have been that the proposed EA Regulation was an inappropriate encroachment attempt by the EU that clashed with national legal traditions and domestic policy objectives.[29] This apprehension of interference continued into the 2000s, when, in 2003, there was some indication that the Greek Council intended to revive the proposal. Nevertheless, the proposed EA Regulation failed to secure Member States' backing and was finally removed from the European Commission's agenda in 2006.[30] The European Commission also tabled its SCE proposal in 1992. Legislative progress was initially hamstrung for some time by disagreements about employee participation. However, the SCE Regulation and the connected employee Directive were eventually enacted in 2003 shortly after the launch of the *Societas Europaea*.[31] The European Commission proposed a *Fundatio Europaea* ('FE') in 2012, but this was ultimately withdrawn in 2015. Noted by one commentator, the extent to which foundations operating across borders would be permitted to engage in economic activity and receive tax incentives were contentious issues that could not be reconciled.[32] Lastly, a proposal was also listed for a European Mutual in 1992.[33] The proposal, however, never got beyond the discussion stage and was removed from the European Commission's agenda in 2005 due to lack of substantive progress.

What is significant about past attempts to recognise the social economy in EU organisation law is that, despite slightly different circumstances surrounding each proposal, the context was essentially the same. That is to say, the argument for Union-level action was couched in terms of the undesirability of Member States' organisational forms remaining heterogeneous, which was merely a prop for Single Market intervention.[34] However, as the social legitimacy of the EU has

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[27] R Ghetti, 'Unification, Harmonisation and Competition in European Company Forms' (2018) 29(5) *European Business Law Review* 813, p 836.

[28] COM (91) 273 final, *Proposal for a Council Regulation on the Statute for a European Mutual Society.*

[29] J Kendall and L Fraisse, 'The European Statute of Association: Why Still an Obscure but Contested Symbol in a Sea of Indifference and Scepticism?' in J Kendall (ed), *Handbook on Third Sector Policy in Europe: Multi-level Processes and Organized Civil Society* (Edward Elgar, 2011), pp 211–15.

[30] Eg O Gjems-Onstad, 'The Proposed European Association: A Symbol in Need of Friends?' (1995) 6(1) *Voluntas* 3, p 4.

[31] Eg H Fleischer, 'Supranational Corporate Forms in the European Union: Prolegomena to a Theory on Supranational Forms of Association' (2010) 47(6) *Common Market Law Review* 1671, pp 1677–78.

[32] Eg K Hopt, 'Corporate Governance in Europe: A Critical Review of the European Commission's Initiatives on Corporate Law and Corporate Governance' (2015) 12(1) *New York University Journal of Law & Business* 139, p 189.

[33] COM (91) 273 final, note 28 above.

[34] Vis-à-vis the EA and the European Mutual, the legal base was Article 100 (for the approximation of Member States' law) of the Treaty Establishing the European Economic Community. With respect to

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

### *B. The change in context*

Whilst it cannot be ignored that Union-level policymakers have been interested in the economic dimension of the social economy since roughly the 1980s (and there is still a policy concentration on its economic aspects), it is not difficult to observe a marked policy gravitation towards the sector's social dimension.[35] This directly relates to the idea that the EU has been weathering a social legitimacy crisis for a number of years.[36] In attempting to locate the Union-level interest in the social dimension of the social economy, a useful starting point is the 2000 Lisbon Council's introduction of its ten-year policy priorities ('Lisbon Agenda').[37] A precursor to Article 3(3) of the Treaty on European Union ('TEU'), the Lisbon Agenda set a new strategic goal for the EU to become the 'most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion'.[38] Completion of the Single Market was one aspect of this,[39] and modernisation of the European social model—in particular through active employment, updating social protections, and promoting social inclusion—was the other dimension.[40] Striking a balance between the two was seen as necessary to ensure that the 'emergence of this new economy does not compound existing social problems of unemployment, social exclusion and poverty'.[41] The European Commission's 2000 Review of the Internal Market Strategy communication also underscored that the Single Market ought to be economically efficient, as well as

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*(F'note continued)*
the FE, the legal base was Article 352 (the flexibility clause) of the Treaty on the Functioning of the European Union. According to the European Commission, the FE would have a 'positive impact on … the EU economy as a whole'. See COM (2012) 35 final, *Proposal for a Council Regulation on the Statute for a European Foundation (FE)*.

[35] The idea that social economy organisations are effective tools for economic stimulation and job creation has deep roots in Union-level policy thinking. Eg J Kendall, C Will, and T Brandsen, 'The Third Sector and Brussels Dimension: Trans-EU Governance Work in Progress' in Kendall, note 29 above, p 348.

[36] Different commentators take different views on how well the EU is weathering this crisis. Some argue that the 'social' aspect of European integration is dead. Others do not go so far. Eg C Barnard, 'EU Employment Law and the European Social Model: The Past, the Present and the Future' (2014) 67(1) *Current Legal Problems* 199, p 202.

[37] There are, of course, earlier instances in which Union-level interest in the social dimension of the social economy is observable. Eg COM (97) 241 final, *Communication from the Commission on Promoting the Role of Voluntary Organisations and Foundations in Europe*, p 5.

[38] European Council, 23 and 24 March 2000 Presidency Conclusions (March 2000), para 5.

[39] Ibid, paras 5, 16–21.

[40] Ibid, paras 28–34.

[41] Ibid, para 24.

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conducive to social cohesion.[42] The Feira,[43] Nice,[44] and Stockholm Councils later reiterated this commitment—there was 'full agreement that economic reform, employment and social policies were mutually reinforcing'.[45]

The social economy was not initially factored in to achieving the Lisbon Agenda in a direct manner. However, overlapping problems accelerated the need for reconsidering the positioning of, and the policy expectations placed upon, the sector. First, there is little doubt that the social facet of European integration suffered through the EU's handling of the 2008 economic and financial crisis, in part because of financial austerity and cutbacks in social spending, but also in part because the greatest concern at the time was keeping the EU (economically) afloat.[46] In the words of Jean-Claude Juncker, 'the measures taken during the crisis can be compared to repairing a burning plane whilst flying', with errors made including a 'lack of social fairness'.[47] Second, in addition to the above and how it impacted upon the EU's social legitimacy, new anxieties emerged in relation to globalisation, low rates of economic growth and mounting demands for new social services. From the European Commission's perspective

> As life expectancy increased, so did the need to find new ways to care for the elderly; as more and more women entered the workforce, child care has emerged as a major new area of intervention; as Europe has attracted more and more people from other countries and other parts of the world, the economic and social integration of migrants has required attention and new policy tools; and as the economy has become more knowledge-based, the education systems have needed to diversify and improve. In addition, society needs to find responses to climate change and dwindling natural resources.[48]

Taken together, this combination of issues led the European Commission to state that the public and private sectors could 'no longer be seen as the only possible providers of a balance between social justice and economic freedom'.[49]

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[42] COM (2000) 257 final, *Communication from the Commission to the European Parliament, the Council, the Economic and Social Committee and the Committee of the Regions – 2000 Review of the Internal Market*, para 2.

[43] European Council, 19 and 20 June 2000 Presidency Conclusions (June 2000), paras 19–39.

[44] European Council, 7–10 December 2000 Presidency Conclusions (December 2000), paras 13–33.

[45] European Council, 23 and 24 March 2001 Presidency Conclusions (March 2001), para 2.

[46] See generally eg P Tsoukala, 'Euro Zone Crisis Management and the New Social Europe' (2013) 20(1) *Columbia Journal of European Law* 31.

[47] J-C Juncker, *A New Start for Europe: My Agenda for Jobs, Growth, Fairness and Democratic Change* (2014), p 2, https://www.eesc.europa.eu/resources/docs/jean-claude-juncker—political-guidelines.pdf.

[48] European Commission, *Social Economy and Social Entrepreneurship – Social Europe Guide, Volume 4* (2013), p 15, https://www.ess-europe.eu/sites/default/files/publications/files/dgempl_social_europe_guide_vol.4_en_accessible_new.pdf.

[49] Ibid, p 13.

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It can be said that the EU was sensitive to its social deficit, and this is why the Treaty of Lisbon modified the wording of Article 3(3) TEU to introduce a commitment to create a 'social market economy'.[50] However, now widely understood, 'the social promise that Lisbon represented was … hollow'.[51] In part, this is because the 'social' compass that purportedly 'guided the Lisbon process was essentially in the ordoliberal mould. It equated social policy with modernization', which was not 'aimed to protect people from the effects of the market but to help them adjust to the market'.[52] Even if this had not been the case, supposing that the EU wished to fundamentally override the economic constitution of the Single Market and impute it with a socially calibrated conscience, it lacks the competences to do so directly.[53]

The EU's inability to realise fully a social market economy through express law making (that is, without a complete re-writing of the Treaties) goes a long way towards rationalising Union-level policymakers' interest in the social economy.

Launched in 2010, the Europe 2020 strategy was conceived as the ramifications of the 2008 economic and financial crisis unfolded, and, as the (retrospective) successor to the Lisbon Agenda, represented the EU's plan for moving forward and attempting to deliver on Article 3(3) TEU.[54] The priority was to construct an economy based on knowledge and innovation, promote a more resource-resilient, greener, and competitive economy, and foster a high employment economy delivering social and territorial cohesion.[55] Targets included achieving employment for 75 per cent of people aged 20–64, and at least 20 million fewer people in, or at the risk of, poverty or social exclusion.[56] Regarding achievement of the Europe 2020 strategy, the European Commission published the 2011 Single Market Act communication in which it laid out several structural reforms aimed at ensuring that the Single Market 'benefits all citizens'. A 'high expectation' was placed on the social economy and its supposed capacity to improve the 'social dimension of the internal market and the protection of public services'.[57] One of the key action points concerned facilitating and scaling up

[50] Whether the EU is ultimately in a position to create a social market economy seems to be seriously doubted. See generally eg F de Witte, 'The Architecture of the EU's Social Market Economy' in P Koutrakos and J Snell (eds), *Research Handbook on the Law of the EU's Internal Market* (Edward Elgar, 2017), p 117; F Scharpf, 'The Asymmetry of European Integration, or Why the EU Cannot be a "Social Market Economy"' (2010) 8(2) *Socio-Economic Review* 211.

[51] G Dale and N El-Enany, 'The Limits of Social Europe: EU Law and the Ordoliberal Agenda' (2013) 14(5) *German Law Journal* 613, p 625.

[52] Ibid, p 626.

[53] de Witte, note 50 above, p 135.

[54] For an insightful analysis that considers the Lisbon Agenda alongside the Europe 2020 strategy, see generally eg K Armstrong, 'The Lisbon Strategy and Europe 2020' in P Copeland (ed), *The EU's Lisbon Strategy: Evaluating Success, Understanding Failure* (Palgrave Macmillan, 2012), p 208.

[55] COM (2010) 2020 final, *Communication from the Commission on Europe 2020: A European Strategy for Smart, Sustainable and Inclusive Growth*, p 3.

[56] Ibid.

[57] COM (2011) 206 final, *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on the Single Market Act – Twelve Levers to Boost Growth and Strengthen Confidence*, p 4.

social entrepreneurship and the social economy.[58] In the later 2011 Social Business Initiative communication, the European Commission again placed the social economy at the 'heart' of the Europe 2020 strategy and argued that bolstering Union-level support for the sector would lead to 'territorial cohesion and … new solutions to societal problems, in particular poverty … and social exclusion'.[59]

The same kinds of considerations are present within the preparatory studies that underpin the Proposal, and it is evident that the case being made for Union-level intervention is not merely concerned with the heterogeneity of Member States' social enterprise regulatory frameworks. Rather, the Proposal is situated within a changed context in which the EU has committed itself, and faces pressure, to reimagine the Single Market with social dimensions and objectives that go beyond the purely commercial.

The social economy's distinct institutional logic and the sector-wide practice of a more socially responsible version of capitalism feature prominently in the preparatory studies. For example, it is stated that the social economy reconciles 'principles of market freedom and those of social security and social compensation', which allows the sector to combine 'economic liberalism, (re)distributive mechanisms and support to collective welfare through the provision of goods and services of general interest'.[60] Thus, the sector and the Single Market have converged in such a way that the social economy is now tethered to the Article 3(3) TEU commitment to create a social market economy. The thinking appears to be that the sector could be used as a mechanism to embed, or constitute, economic relations within European society by the back door without having to face the prospect of imposing social controls on the Single Market overtly.[61] This could be achieved, at least in part, by integrating the social economy in to the Single Market, on this occasion through the Proposal and assigning social enterprises increased socio-economic functions and responsibilities.[62] Therefore, to be clear, the position this article takes is that the Proposal is conceptually distinct from past attempts to recognise the sector in EU law.

If the context has changed, the question then becomes why the focus is on social enterprises and not on reviving the aforementioned, earlier proposals. From the European Parliament's viewpoint, social enterprises make the same variety of contributions that are synonymous with other social economy organisational forms.

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[58] Ibid, pp 14–15.

[59] COM (2011) 682 final, *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on the Social Business Initiative – Creating a Favourable Climate for Social Enterprises, Key Stakeholders in the Social Economy and Innovation*, p 2.

[60] Q Liger, M Stefan, and J Britton, *Social Economy* (European Parliament, 2016), p 37, https://www.europarl.europa.eu/RegData/etudes/STUD/2016/578969/IPOL_STU(2016)578969_EN.pdf.

[61] Eg G Davies, 'Internal Market Adjudication and the Quality of Life in Europe' (2015) 21(2) *Columbia Journal of European Law* 289, pp 306–08. See generally also K Polanyi, *The Great Transformation* (Farrar & Rinehart, 1994); G Hodgson, *Conceptualizing Capitalism: Institutions, Evolution, Future* (University of Chicago Press, 2015).

[62] See note 73 below.

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However, there is a noticeably heightened policy interest in social enterprises that assists with explaining the Proposal's explicit focus on them, to the exclusion of the other organisations found in the sector. This is for two reasons.[63] First, social enterprises can currently be found engaging in, for example, agriculture, banking, health and social services, insurance, manufacturing, recycling, renewable energy, social housing, the sustainable regeneration of marginalised urban and rural areas, tourism, transportation, and waste management.[64] The commentary suggests that the industries in which social enterprises' operate are steadily expanding further, which has occasioned policymakers to view social enterprises as distinctly placed to amplify the wider social economy's contributions to European integration.[65] With an estimated 250,000 social enterprises across Europe,[66] these entities are 'associated with social … innovation, as a result of the expansion of their activity in new fields of production of goods or of delivery of services … designed to meet new societal, territorial or environmental demands and challenges'.[67] Second, unlike, for example, associations and foundations, social enterprises are more prone to being financially independent and commercially viable. This means that, generally, they do not require governmental support in the furtherance of their socially oriented activities—the commentary points out that this ability to be sustainable without the need for public subsidisation 'has proved attractive to policymakers'.[68]

## IV. THE PROPOSAL

This brings the analysis to examining the Proposal. The substantive architecture of the Proposal is initially considered, followed by a critique and clarification of the European Parliament's stated rationale. The central argument spanning Part IV is that deeper inspection is required, as the full case for Union-level intervention is not completely fleshed out by the preparatory studies supporting the Proposal. It ought to be appreciated that, in addition to the more straightforward aim of equipping social enterprises with the ability to engage in cross-border activities, the Proposal also attempts to tackle the social problems associated with the Single Market.

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[63] Another reason relates to tax incentives, which was a major stumbling block for the FE despite it being proposed in the context of the paradigmatic shift. Eg B Weitemeyer, 'Fundatio Europaea – Risk of Abuse by Tax Shopping?' (2013) 14(2) *ERA Forum* 277, pp 285–87. The Proposal under review in this article would not create the conditions for firms to engage in tax arbitrage. However, there are nonetheless incentives for forming a social enterprise company and acquiring the ESE label that could spur other regulatory arbitrage issues. See Section VI.B below.

[64] Liger, Stefan, and Britton, note 60 above, p 33. See also eg E Thirion, *European Added Value Assessment on Statute for Social and Solidarity-Based Enterprises* (European Parliament, 2017), p 11, at https://www.europarl.europa.eu/RegData/etudes/STUD/2017/611030/EPRS_STU%282017%29611030_EN.pdf.

[65] Liger, Stefan and Britton, note 60 above, p 42.

[66] Thirion, note 64 above, p 11.

[67] European Parliament Proposal, note 2 above, Rec W.

[68] Smith and Teasdale, note 4 above, p 156.

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Here it is essential to, among other things, drag the Single Market dimension to the forefront of the discussion, otherwise the conceptual and long-term importance of the Proposal could be obfuscated.

### *A. The Proposal*

The European Parliament's approach is, roughly, similar to that taken with the *Societatis Unius Personae* ('SUP').[69] The Proposal advocates for a directive, rather than a regulation, with a legal base under Article 50 of the Treaty on the Functioning of the European Union ('TFEU').[70] Notably, the Proposal does not argue for a new organisational form to add to EU organisational law. Differently, social enterprises' cross-border activities would be secured through the ESE label.[71] Since the choice of a juridical label represents a new chapter in EU law making, further elaboration is necessary.

Like the SUP, the Proposal would 'piggyback' on Member States' domestic social enterprise regulatory frameworks. For those that lack such a regulatory framework, Member States would be required to introduce a social enterprise company into their national legal system (or adapt pre-existing models and rules to conform with the Proposal). The Proposal leaves wide latitude for national variety and co-evolution, in that it only compels the inclusion of four features that would be present in all Member States. To be further discussed, this is very much in the spirit of reflexive harmonisation. The (inchoate) intention with the Proposal seems to have been not to attempt a unified or invasive regulatory intervention, but to set a 'thin' procedural floor of boundary requirements that leaves ample room for autonomy and variation between Member States.[72]

To comply with the Proposal, Member States' social enterprise regulatory frameworks would need to offer a corporate option with the following features. First, national law must oblige firms to prioritise a social purpose 'essentially focused on the general interest or public utility', the scope of which would be a question for each Member State. The Proposal includes some examples of a suitable 'social purpose'. For instance, a social purpose could 'aim to provide support to vulnerable groups, to combat social exclusion, inequality and violations of fundamental rights … or to help protect the environment, biodiversity, the climate and natural resources'.[73] Second, firms must be subject to at least partial constraints on profit distributions and

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[69] Eg Ghetti, note 27 above, pp 826–31; Fleischer, note 31 above, pp 1678–80.

[70] European Parliament Proposal, note 2 above.

[71] Eg A Fici, *A European Statute for Social and Solidarity-Based Enterprise* (European Parliament, 2017), pp 36–37, https://www.europarl.europa.eu/RegData/etudes/STUD/2017/583123/IPOL_STU%282017%29583123_EN.pdf.

[72] See generally S Deakin, 'Legal Diversity and Regulatory Competition: Which Model for Europe?' (2006) 12(4) *European Law Journal* 440; S Deakin, 'Two Types of Regulatory Competition: Competitive Federalism Versus Reflexive Harmonisation. A Law and Economics Perspective on *Centros*' (1999) 2 *Cambridge Yearbook of European Legal Studies* 231.

[73] European Parliament Proposal, note 2 above, Annex.

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to specific rules on the allocation of profit, with some profit made reinvested to achieve the selected social purpose.[74] Third, national law ought to prescribe corporate governance mechanisms that foster participatory routes for non-shareholder constituencies affected by a particular firm's activities.[75] Fourth, firms must incur extra disclosure obligations through the issuance of an annual 'social report', detailing to regulatory authorities firms' 'activities, results, involvement of stakeholders, allocation of profits, salaries, subsidies, and other benefits received'.[76] These latter three features are similarly procedural and intended to be open to Member States' interpretation.

For social enterprises that incorporate under a national regulatory framework aligning with the above, the Proposal envisions that acquisition of the ESE label itself would be optional and administered directly by Member States and representatives of their respective social economies. Monitoring and auditing would likewise be done at the Member State level, with penalties for infringement ranging from a 'mere admonition to the withdrawal of the label'.[77]

### *B. Clarifying the European Parliament's regulatory justifications*

Looking behind the Proposal at the supporting preparatory studies, the stated justification for regulatory intervention is no great surprise. According to the European Parliament, the consensus seems to be that social enterprises' participation in the Single Market remains low. The prime reason for this is Member States' largely disjointed regulation (or lack thereof) of social enterprises.[78] This regulatory incongruity makes cross-border re-incorporation or the opening of a branch office in another Member State essentially not possible, rendering the freedom of establishment hollow in practical terms. Further, until Member States' regulatory frameworks allow social enterprises to add a cross-border dimension to their activities, it will act as a barrier to the EU providing supplementary developmental support (eg through increased access to debt or equity financing).[79]

However, as already noted, this account does not provide a complete picture. This is so for two reasons. First, whilst quietly present in the Proposal, the preparatory studies fail to explicitly develop the relational link between it and the Single Market and why this is significant. Second, overlaying the missed opportunity to explain how the Proposal could address some of the negative externalities associated with the Single Market, the preparatory studies also claim that there are corporate mobility barriers, but do not plainly articulate the substantive problems confronting

[74] Ibid.

[75] Ibid.

[76] Ibid.

[77] Ibid.

[78] Other 'problem drivers' mentioned, for example, are a lack of public visibility and awareness, and the absence of common mechanisms for impact measurements across the EU. See Thirion, note 64 above, p 21.

[79] Ibid, pp 19–20.

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social enterprises seeking to engage in cross-border activities. Each will be discussed in turn.

### *1. The relationship between the Proposal and the Single Market*

The initial consideration is that Member States' social economies have historically developed according to their own path dependencies in essentially closed subsystems. In other words, Member States' social economies do not come together to form an internal market in the same way that Member States' private sectors come together to create the Single Market. Nor do Member States' social economies connect to the Single Market, such that the former can be viewed as a subdivision within the latter. Differently, social economy organisations' activities, generally, coincide with domestic governments' social and welfare policy infrastructure. This has, over time, resulted in cross-border insulation.

Most Member States—due to perceived economic and budgetary constraints—have sought to control the sector as a *de facto* annex of the welfare state. For example, to create more employment opportunities or outsource some combination of administrative, fiscal, or implementation responsibilities to social economy organisations with respect to the domestic provision of general interest and welfare goods and services.[80]

To ensure public trust, Member States impose high regulatory burdens on entities seeking entry, as well as those attempting to exit and, for example, transition to operating in the private sector, which extends to robust governmental oversight throughout social economy organisations' lifecycles.[81]

It is, therefore, not the position that any social economy organisation has a natural and unqualified right of access to the protections afforded by Articles 49 and 54 TFEU and the Court of Justice of the European Union's ('CJEU') freedom of establishment jurisprudence. Member States' social economies are freestanding and safeguarded ecosystems beyond the reach of Union competence.[82] Thus, any Union-level intervention in this area that is designed to facilitate social economy organisations' ability to engage in cross-border activities is, tacitly, also calculated to liberalise, open up, or otherwise interlock Member States' sequestered social economies together. It is beneficial to treat this as knitting together a kind of internal market—a 'European Social Economy'—that has yet to be completed.

With the Proposal, however, a further outcome would be achievable, since social enterprises are effectively limited companies that operate in markets (albeit of a special sort). It will be recalled that social enterprises operate in the market sub-sector of

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[80] For a useful primer on this in the context of jurisdictions that have introduced a social enterprise company, see eg Liptrap, note 1 above, pp 498–508.

[81] In the case of France, for example, see eg D Chabanet, 'The Social Economy Sector and the Welfare State in France: Towards a Takeover of the Market?' (2017) 28(6) *Voluntas* 2360, p 2375.

[82] For a broader analysis of the issues relating to non-market sub-sector social economy organisations' lack of freedom of establishment, see generally eg S Lombardo, 'Some Reflections on Freedom of Establishment of Non-Profit Entities in the European Union' (2014) 14(2) *European Business Organization Law Review* 225.

the social economy, which is governed according to the sector's distinct institutional logic and results in the practice of a more socially responsible version of capitalism. As new opportunities for expansion arise, social enterprises can be expected to continue penetrating into more areas where social intervention is required.[83] Were social enterprises permitted to freely engage in cross-border activities and fully participate in the Single Market, the effect of this expansionary tendency could be that the boundary lines between the sector and the Single Market could start to blur. Thus, although the Proposal, in the immediate sense, attempts to facilitate social enterprises' cross-border activities, it also triggers the construction of a (market subsector) European Social Economy, and potentially its assimilation into the Single Market.

This is only one piece of legislation and it cannot be expected to instantly, or by itself, embed or constitute the Single Market within European society. However, it does create the conditions necessary for social enterprises *qua* ambassadors of the social economy to commit what commentators refer to as 'norm violations' in which the profit maximisation logic of the Single Market could be challenged and unsettled.[84] Through repeat interactions with private sector companies, and perhaps even occupying shared industry spaces across the EU, each norm violation by social enterprises could encourage additional violators to emerge, and, if deviations reach a critical mass, the preceding status quo could alter.[85]

This outcome would be politically welcome because it positions the EU to appear to be taking substantive action to address its social deficit without having to face the prospect of imposing social controls on the Single Market overtly—this approach lets the market 'decide' for itself.

### 2. *The obstacles social enterprises face in moving across borders*

Anticipating potential challenges to the argument that social enterprises face obstacles in moving across borders, a sceptic might argue that, since there is little difference between a social enterprise and a private sector company (at least in terms of outward-facing activities and relations with third parties), it is doubtful whether Union-level intervention achieves anything aside from harmonisation. There is currently nothing standing in the way of such firms engaging in cross-border activities that would allow either the jurisdiction of incorporation to refuse an exit or the host Member State to justify a refusal of registration. Ultimately, social enterprises are essentially limited companies and the Treaty and the CJEU's freedom of

[83] Eg J L Monzón and R Chaves, *The Social Economy in the European Union* (European Economic and Social Committee, 2012), pp 85–86, https://www.eesc.europa.eu/resources/docs/qe-30-12-790-en-c.pdf.

[84] R H McAdams, 'The Origin, Development, and Regulation of Norms' (1997) 96(4) *Michigan Law Review* 338, p 393 (see also footnote 186). For a further analysis of the differences between the institutional logics of the social economy and the private sector, see eg Liptrap, note 1 above, pp 501–02, 509–10.

[85] C R Sunstein, 'Social Norms and Social Roles' (1996) 96(4) *Columbia Law Review* 903, p 909.

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establishment jurisprudence necessarily guarantee their movement across borders in the normal way.

However, this reasoning likely has serious limits, which, whilst not emphasised by the preparatory studies, would justify the Proposal. This is because social enterprises, being entities of an isolated environment that is both jurisdictionally ring-fenced and separated from the larger Single Market, do not have a natural and unqualified right of access to the protections afforded by the Treaty and the CJEU's freedom of establishment jurisprudence.

For example, in the context of branching, the commentary provides that 'Member States are probably allowed to refuse registration in the central register … if they do not allow domestic companies of that type to be registered there'.[86] When applying the idea that Member States can constrain firms' cross-border activities based upon what types of organisational forms they recognise domestically, there are three reasons that could be used to negate an inbound social enterprise's right of establishment in justifying a refusal of registration.

First, a number of Member States do not legally recognise, or otherwise make provision for, social enterprise in any (ie cooperative or company) form, which means that a denial of such a firm's registration request would not likely contravene Union-level obligations.[87] Second, some Member States only allow social enterprises to take a cooperative form, which translates to the idea that a host Member State can, plausibly, legally deny a social enterprise *company* access to its social economy on the ground that domestic firms of that sort are not permitted to exist.[88] Third, even where a host Member State does legally recognise social enterprise companies, there are two types. 'Type A' social enterprises are permitted to carry out an extensive range of social entrepreneurship activities, the limits to which are at the discretion of the particular domestic regulator. 'Type B' social enterprises, by contrast, must explicitly engage only in work integration services for the hard to employ.[89] Thus, for example, Type A social enterprises can be denied access by a host Member State that only legally recognises Type B social enterprises. There is evidence of registration refusal on similar grounds in the private sector context, as Member States may in some instances not afford mutual recognition because of an inbound firm's activities. This is important for the present analysis, as work integration is a rather narrow activity when compared with the large volume of social

[86] K E Sørensen, 'Branches of Companies in the EU: Balancing the Eleventh Company Law Directive, National Company Law and the Right of Establishment' (2014) 11(1) *European Company and Financial Law Review* 53, p 63.

[87] For example, Belgian and German organisational laws do not include a bespoke social enterprise corporate form or legal status for the regulation of such entities.

[88] This is the case in, for example, Greece and Hungary.

[89] For an in-country discussion on Type A and Type B social enterprises, see eg N Tomaževič and A Aristonvnik, *Social Entrepreneurship: Case of Slovenia* (2018), p 45, https://zavod14.si/wp-content/uploads/2018/10/Social-Entrepreneurship_Case-of-Slovenia.pdf. See also eg Thirion, note 64 above, p 23.

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entrepreneurship activities that Member States could consider as normatively legitimate.[90]

That being so, whilst the contention is not that social enterprises are completely restricted from moving across borders, it is argued that their right of establishment is uncertain and tightly controlled. The scope of the right would not be the same in every circumstance, and would, therefore, require testing on a case-by-case basis, probably with the need to challenge Member States' decisions to restrain social enterprises' cross-border movement through judicial review in many instances. The foreseeable chilling effect manifested due to the time and expenses required before even determining whether the right exists and is exercisable means that, practically, it is non-existent for the majority of social enterprises in the EU. Properly construed, these are the sorts of underlying corporate mobility problems that the preparatory studies attempted, but failed, to make clear.

### *C. Preliminary conclusions*

As might be expected, the extent to which a social enterprise would enjoy the right of establishment (to the degree that private sector companies do) is a function of how the terms of the Proposal are framed, coupled with how Member States decide to specifically structure their individual regulatory regimes. The complications that could spring from this arrangement will be examined in Part VI. Presently, it is enough to say that, provided a particular firm carries the ESE label, Member States would no longer be able to legitimately deny an exit from, or access to, their respective social economies on the ground that the sector is on a separate footing that precludes corporate mobility. However, the ESE label goes further than simply creating the conditions for harmonisation. Beyond being a kind of European passport that requires Member States to liberalise and open up their historically closed social economies to inbound firms, which may result in a European Social Economy, the legislation is also designed to aid the EU in addressing its social deficit.

## V. THE EUROPEAN COMMISSION'S RESPONSE

### *A. The European Commission's response*

The European Commission responded in November 2018, but did not 'share the Parliament's analysis' concerning the feasibility of facilitating social enterprises' cross-border activities at this stage.[91] According to the European Commission, strong weight was attached to the idea that 'setting up criteria for a [statute] … at European level would run against the need to take into account sometimes significantly different national traditions and contexts'.[92]

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[90] Eg M Becht, L Enriques and V Korom, '*Centros* and the Cost of Branching' (2009) 9(1) *Journal of Corporate Law Studies* 171, pp 180–82.

[91] European Commission, note 6 above.

[92] Ibid.

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However, this assertion does not seem to be borne out empirically. It is (cautiously) submitted that a consensus may already exist that is sufficient to garner agreement under Article 50 TFEU. This is for two reasons.

First, whilst a number of Member States do not include a social enterprise company in their organisational menus, many jurisdictions—Croatia, the Czech Republic, Denmark, France, Luxembourg, Malta, Portugal, Romania, and Spain—do so, or are in the process of enacting such legislation.[93] Not only is a generally common approach to facilitating social enterprise through a corporate organisational unit reflected in these Member States' regulatory frameworks, but also their national accounts likely comply with the particulars of the Proposal. Second, in addition to the Member States that have already contemplated social enterprise regulatory frameworks that accord with the Proposal, there is also a number of other Member States—Finland, Italy, Latvia, Lithuania, Poland, and Slovenia—that include legal recognition of social enterprise companies. Whilst at present these do not fully meet the Proposal's specifications, they could be amended to satisfy the conditions with only minor modifications.

Within this latter cohort of Member States, there seems to be asymmetry with respect to the structure of rules that place constraints on both profit distributions and the allocation of profit. More specifically, Italy, Latvia, Poland, and Slovenia strictly prohibit the involvement of outside equity investors along with any form of profit distributions to a firm's participants. This means that all profit must be allocated to the maintenance of the selected social purpose. Conversely, Finland and Lithuania allow outside equity investors' participation and place no limits on profit distributions, and also do not require a firm's participants to allocate any surplus profit to the furtherance of the chosen social purpose. In all other respects, though, these Member States' legislation conform to the Proposal.

However, that the requisite number of Member States have social enterprise regulatory frameworks either in, or very near, alignment with the Proposal does not on its own mean that it would automatically achieve agreement under Article 50 TFEU. Indeed, it must be conceded that Member States without a social enterprise regulatory framework may balk at the prospect of the ESE label. This could be for several reasons.[94]

For example, Germany, which has historically characterised its social economy domain as more a sphere of non-economic activity, was a staunch opponent of the EA proposal. The commentary notes that the envisaged degree to which an EA would be able to engage in economic activity had come to be seen as an unbridgeable rift: 'associations … inherently cannot be "economic" firms or entities at all. The very coupling of matters economic with matters social under the banner of

[93] It should be noted that the UK also includes a social enterprise company in its organisational menu—the 'community interest company'—but, due to the implications of Brexit, it is not directly considered in the analysis. See eg J S Liptrap, 'British Social Enterprise Law' University of Cambridge Faculty of Law Research Paper No. 11/2021 (2021), https://ssrn.com/abstract=3793558.

[94] Subsidiarity arguments have often been invoked in relation to past attempts to recognise the social economy in EU organisational law. See eg Kendall and Fraisse, note 29 above, p 212.

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*économie sociale* … [has] come to be perceived as threatening to … the German third sector'.[95] Analogically, similar concerns could act as barriers, even amongst those Member States with already existing and (quasi-) compliant regulatory frameworks.

Regulatory protectionism more generally has led some commentators to surmise that perhaps 'the most appropriate response … would be for the EU to simply refrain from legislative activity in this field for a while'[96] and 'limit itself to the core [corporate law] areas essential for European integration'.[97]

Nevertheless, assuming for the sake of argument that such a consensus is currently absent, Member States, too, have experienced changing circumstances. These changing circumstances suggest that, unlike past attempts to recognise the social economy in EU organisational law, they would likely be receptive to reassessing and ultimately endorsing a Union-level instrument for facilitating social enterprises' cross-border activities at some future point.

### *B. Reflecting on the political institutionalisation of Member States' social economies*

To appreciate why this is the case, it is necessary to more deeply reflect on the implications of the already underlined idea that most Member States have, to some extent, politically institutionalised their respective social economies over time.[98]

Initially resulting from a collective decline in economic growth that was exacerbated by upsurges in unemployment and public expenditure,[99] domestic authorities across Europe have been engaging with social economy organisations to, for example, provide employment to marginalised groups[100] and implement social and welfare policy since the late twentieth century.[101] Importantly, in many respects policymakers' preferences have incentivised and steered social economy

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[95] J Kendall and H A Anheier, 'The Third Sector and the European Union Policy Process: An Initial Evaluation' (1999) 6(2) *Journal of European Public Policy* 283, p 291. See generally also Lombardo, note 82 above.

[96] Ghetti, note 27 above, pp 837–39, 842.

[97] Hopt, note 32 above, p 201.

[98] For an introduction to the political institutionalisation of the social economy in, for example, Italy, see generally eg C Borzaga and L Fazzi, 'Processes of Institutionalization and Differentiation in the Italian Third Sector' (2011) 22(3) *Voluntas* 409.

[99] Amin, Cameron, and Hudson, note 12 above, pp 3–5; J Kerlin, 'Social Enterprises in the United States and Europe: Understanding and Learning from the Differences' (2006) 17(3) *Voluntas* 247, pp 252–53; J Defourny and M Nyssens, 'Conceptions of Social Enterprise and Social Entrepreneurship in Europe and the United States: Convergences and Divergences' (2010) 1(1) *Journal of Social Entrepreneurship* 32, pp 34–37.

[100] The exact shape the relationship has taken varies across jurisdictions. For example, in Denmark policies for the temporary subsidisation of vocational training and employment recruitment through grants to facilitate (re)entry into working life have been implemented. See generally eg L Hulgård and Bisballe, *Work Integration Social Enterprises in Denmark* (EMES, 2004), Research Network Working Paper No. 04/08, https://www.ess-europe.eu/sites/default/files/publications/files/perse_wp_04-08_dk.pdf.

[101] For a broad European perspective, see eg C Borzaga and G Galera, *Social Enterprises and their Eco-systems: Developments in Europe* (European Commission, 2016), pp 25–26, https://ec.europa.eu/social/main.jsp?catId=738&langId=en&pubId=7934&type=2&furtherPubs=yes.

organisations into becoming favoured mechanisms in the delivery of social and welfare policy.

A result of this policy integration is that social economy organisations (particularly those in the non-market sub-sector) have increasingly come to rely on public funding. This is perceived as politically problematic because of a wider change occurring in which liberal capitalism and market forces have prompted governments to engage in 'institutional searching' to find a palliative to offset the administrative and fiscal pressures that policymakers think they are facing.[102] Whilst this has unfolded and led to variations across jurisdictions, virtually every domestic government is being pushed away from 'welfare state guarantor to regulator, grant-giver and … market maker'.[103]

Additionally, new types of socio-economic vulnerabilities were also generated by the 2008 economic and financial crisis and its aftermath. This aggravated the effectiveness of the policy bundles implemented from the late twentieth century.[104] It has also enlarged the demand for general interest and welfare goods and services, and widened the gamut of target populations customarily served by social economy organisations.[105]

Consequently, the issue in the last years has been how political consensus can be reached that allows for supplementary restructuring to reflect policymakers' commitment to lower public spending and reduce overall responsibility for social and welfare policy. Moreover, a question has also been raised about how public budget cuts can be positively coloured so that they, at least on their face, signal the appearance of defensible and fair economic stabilisation strategies.

The policy dialogue has remained positioned on the assumed efficacy of non-state solutions to unemployment, gaps in welfare coverage and other socio-economic problems, with policymakers continuing to look to social economy organisations as a central component to economic reform.[106] Namely, they are seen as vehicles that could be further institutionalised to open up employment creation and the provision of general interest and welfare goods and services to supplementary privatisation to meet regional and national needs.

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[102] This is perceived as politically problematic even in countries with relatively strong social protections like Denmark. See eg J H Petersen and K Petersen, 'The Concept of "Welfare State" in Danish Public and Political Debates' in N Edling (ed), *The Changing Meanings of the Welfare State: Histories of a Key Concept in Nordic Countries* (Berghahn, 2019), p 162.

[103] P Lloyd, 'The Social Economy in the New Political Economic Context' in Noya and Clarence, note 24 above, p 66.

[104] Eg K Cooney, M Nyssens, M O'Shaughnessy, and J Defourny, 'Public Policies and Work Integration Social Enterprises: The Challenge of Institutionalization in a Neoliberal Era' (2016) 7(4) *Nonprofit Policy Forum* 415, p 424.

[105] Eg C Borzaga and G Galera, 'New Trends in the Nonprofit Sector in Europe: The Emergence of Social Enterprises' in E Costa, L D Parker, and M Andreaus (eds), *Accountability and Social Accounting for Social and Non-Profit Organizations, Vol 17* (Emerald Group Publishing, 2014), pp 103–06.

[106] For an analysis of the situations in, for example, France, and Spain, see eg A Zimmer and B Pahl, 'Barriers to Third Sector Development' in Salamon, Sivesind, and Zimmer, note 3 above, pp 150–53.

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However, the solution has not been to reinforce partnership with the social economy through direct financial subsidisation. Rather, the solution appears to turn on how civil society could be made to be more autonomous and sustainable as an instrument to offset eventual attempts at reducing levels of state support. This has meant that many countries are now resorting to the systematic involvement of social enterprises and attempting to cultivate social investment markets to reduce the social economy's dependence on public funding in an effort to make it more self-sustaining.

It is clear that not every Member State has gone in this direction. However, there are indicators to suggest that more countries will look to social enterprises. This is because economic conditions have 'worsened the public sector's ability to finance the traditional infrastructure-based services of general interest. Public budget cuts have therefore strengthened further the policy interest in social enterprises as vehicles for achieving balanced and fair economic growth'.[107]

For those Member States with a social enterprise regulatory framework there is a visible policy evolution that began with the political institutionalisation of associations and foundations. Policymakers' interest then rotated to the possible application of cooperatives to perform job creation, general interest, and welfare functions for the benefit of specific target groups or communities. Most recently, there has been a widespread trend to weld the meaning of 'social enterprise' on to a corporate form capable of attracting the participation of interested outside equity investors.[108] As the commentary notes, 'rediscovery of non-profit organizations … as social service providers and work-integration organizations coupled with the strengthening of cooperatives' concern for the community paved the way for an increasing convergence, which ultimately contributed to the conceptualization of the social enterprise company'.[109]

This progression is consistent with the broader (neo-)liberal global paradigm, in which the overriding assumption amongst policymakers is that private organisations, nested within environments subject to commercial and financial imperatives, are better placed to effectively allocate resources, respond locally and improve programme outcomes.[110] Social enterprises naturally fit this model as they are 'thought to be something new and something distinct from [other social economy organisational forms], combining … elements … of social purpose' with a market orientation and financial performance standards not unlike the private sector company.[111]

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[107] Borzaga and Galera in Costa, Parker, and Andreaus, note 105 above, pp 100–01.

[108] Eg C Borzaga, L Fazzi, and G Galera, 'Social Enterprise as a Bottom-up Dynamic: The Reaction of Civil Society to Unmet Social Needs in Italy, Sweden and Japan' (2016) 26(1) *International Review of Sociology* 1, pp 5–6.

[109] G Galera and C Borzaga, 'Social Enterprise: An International Overview of its Conceptual Evolution and Legal Implementation' (2009) 5(3) *Social Enterprise Journal* 201, p 213.

[110] Eg J Defourny, 'From Third Sector to Social Enterprise' in C Borzaga and J Defourny (eds), *The Emergence of Social Enterprise* (Routledge, 2001), p 1.

[111] Galera and Borzaga, note 109 above, p 212.

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Therefore, whilst not all Member States are moving at the same speed and in precisely the same way, it would not be unreasonable to suggest that interest in a social enterprise regulatory framework will continue to proliferate across the EU as most (if not all) 'countries are proceeding down this [economically liberal, market oriented] track'.[112]

### *C. Intersecting policy priorities at Union and Member State levels*

Theoretically, if the position is that Member States will continue to look to their social economies, and social enterprises in particular, as a partial surrogate for direct state coordination of domestic social and welfare policy, then there would potentially be no need, or justification, for Union-level intervention. That is, through processes of horizontal competition, Member States could institute regulatory frameworks that clearly authorise and empower social enterprises to engage in cross-border activities across the EU.

However, the organic convergence of national laws in this area is 'highly unlikely'.[113] Some Member States will necessarily wish for their social economies, and by extension their social and welfare policy architecture, to remain insulated.[114] Moreover, even for those Member States that would be interested in liberalising their social economies and equipping social enterprises with a formally clarified right of establishment, there are still those Member States that recognise a 'sharp distinction between [the social economy's 'social' and 'economic' dimensions]', and domestically locate the sector 'firmly in the "social" pigeon hole'.[115] Indeed, with past attempts to bore through Member States' 'armour of sovereignty'[116] in recognising the social economy in EU organisational law, when subsidiarity objections were lodged the argument against Union-level intervention was often framed on the 'social' and 'economy' fault line.[117]

Nevertheless, supposing that a consensus for the Proposal does not yet exist, it is submitted that there are discernible political and socio-economic reasons to surmise that Member States would be receptive to reassessing and ultimately endorsing a Union legal instrument at some future point.

This is because the ESE label's market liberalisation aspect positions interested Member States to potentially address some of the perceived problems flowing from political institutionalisation of their respective social economies. Said differently, whilst not detracting from the contributions made in overlapping social and

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[112] Lloyd in Noya and Clarence, note 103 above, p 66.

[113] Thirion, note 64 above, p 31.

[114] U Neergaard, 'Europe and the Welfare State – Friends, Foes, or …?' (2016) 35(1) *Yearbook of European Law* 341, p 350 (noting that 'Member States … have … traditionally viewed social policies as a vital element of their self-understanding, and consequently social policies have continued to be one of the few policy areas where national governments have tried to resist integration').

[115] Kendall and Anheier, note 95 above, p 301.

[116] Fleischer, note 31 above, p 1671.

[117] Kendal and Anheier, note 95 above.

https://doi.org/10.1017/cel.2021.1 Published online by Cambridge University Press

welfare policy areas, social economy organisations' growing reliance on public funding over the last decades has marked an ideological pivot in many Member States' domestic policy dialogues. The bottom-up mobilisation and continued expansion of social economy initiatives is seen as a public good, but the sector's present and future scaling with further public funding is not viewed as politically sustainable.

The social enterprise company offers the possibility of developing a vehicle to 'spin off' some centralised public responsibility for things like job creation and local development, and the Proposal's market-making effect positions policymakers to create the necessary infrastructure to compete to attract relevant foreign firms interested in engaging across borders. Likewise, another consideration worth referencing is that introducing a social enterprise company and engaging in the fashioning of an internal market to facilitate such firms' cross-border activities also positions domestic policymakers to attract the capital of so-called 'impact investors'. Impact investors are a relatively recent private sector investor class that has emerged, interested in targeting firms that produce both social value and financial returns. Attracting impact investors' capital would necessarily form part of the equation to offset financial reductions in social and welfare policy. Data from 2017 suggest that there are approximately £89.55 billion of assets under management devoted to this investment strategy across Europe.[118]

The above would be of interest in particular to Member States in the Eurozone, and especially those on the Eastern and Southern peripheries. They are subject to a form of constitutionalised austerity in which 'severe constraints have been put on the autonomy of certain Member States in the exercise of some of their core social functions'.[119] This has had 'deep and direct implications for national welfare states, and has established a kind of permanent constitutional pressure' towards de-regulation and a downgrading of the role granted to public social security.[120] Thus, it can be expected that these Member States (as well as many others) would be sufficiently incentivised to support the Proposal, and would be politically neutral with respect to the usual negative tensions over Union-level intervention.

This is because of the socio-economic benefits that privately funded, financially independent social enterprises bearing the ESE label may be able to produce through cross-border expansion and replication.[121] Therefore, although it cannot be denied that some Member States would inevitably remain apprehensive, the Proposal

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[118] See Eurosif, *European SRI Study* (2018), pp 36–37, www.eurosif.org/wp-content/uploads/2018/11/European-SRI-2018-Study-LR.pdf. See generally also eg J Ormiston, K Charlton, M S Donald, and R G Seymour 'Overcoming the Challenges of Impact Investing: Insights from Leading Investors' (2015) 6(3) *Journal of Social Entrepreneurship* 352.

[119] Neergaard, note 114 above, p 349.

[120] Ibid. See also eg Dale and El-Enany, note 51 above, p 623.

[121] For useful primers on the scaling up of social enterprises see generally eg K Deiglmeier and A Greco, 'Why Proven Solutions Struggle to Scale Up', *Stanford Social Innovation Review* (10 August 2018), https://ssir.org/articles/entry/why_proven_solutions_struggle_to_scale_up; S Galitopoulou and A Noya, *Policy Brief on Scaling the Impact of Social Enterprises: Policies for Social Entrepreneurship* (European Commission, 2016), https://op.europa.eu/en/publication-detail/-/publication/53e3ccbd-9a83-11e6-9bca-01aa75ed71a1/language-en.

achieves a market outcome from which many Member States stand to benefit that could not be realised through national policymakers acting alone.[122] This is of principle relevance to this article since the legal base is Article 50 TFEU and 'can be decided upon with a qualified majority and thus cannot be easily blocked by individual Member States'.[123]

## VI. VISUALISING THE CONSEQUENCES OF THE PROPOSAL

Although the European Commission was not moved to act on the Proposal, this article has argued that Member States' changing circumstances are such that many would be receptive to a Union-level instrument facilitating social enterprise companies' cross-border activities at some future point (if they are not already). Whilst it is difficult to postulate the exact timing of when the Proposal would be reconsidered, it seems plausible that the ESE label could soon be a reality. However, neither the European Parliament nor the European Commission attempted to visualise the consequences of the Proposal. Therefore, the purpose of Part VI is to view the Proposal with a reflexive harmonisation lens. Through the analysis, regulatory issues are identified and a solution is then suggested.

### *A. Viewing the Proposal with a reflexive harmonisation lens*

Part IV mentioned that the Proposal is calibrated according to reflexive harmonisation. Reflexive harmonisation is a particularly useful lens through which to view the Proposal, because an evaluation guided by the theory's tenets ultimately places the present analysis in a position to clearly visualise the consequences and potentially pre-empt any regulatory issues.

In the abstract, 'reflexive harmonisation' is a species of regulatory competition based upon the assumption that the purpose of competition is to spur a process whereby sub-units within a system are able to select and de-select individual rules through discovery, the sharing of information, and mutual

[122] Although outside the scope of this article, the COVID-19 global pandemic and its implications for domestic governments' capacity to maintain current levels of public spending, with far less tax revenue, are also important factors. Even before the outbreak of the virus, many jurisdictions had shifted to an 'all hands on deck' mentality in which fiscal pressures influenced national policymakers to experiment with a range of market solutions in the social and welfare policy sphere. Virtually any potential workable strategy for lessening direct public sector responsibility for social and welfare policy was seen as welcome and at least open for debate. Consequently, the prior conditions that may have catalysed certain Member States to challenge something like the Proposal are necessarily evaporating with the prospect of another economic crisis and recession, including currently unforeseen time-delayed effects. This will arguably accelerate the further softening of Member States' political reservations over harmonisation in this area. Eg OECD, *Tackling Coronavirus (COVID-19): Contributing to a Global Effort* (2020), http://www.oecd.org/coronavirus/policy-responses/the-territorial-impact-of-covid-19-managing-the-crisis-across-levels-of-government-d3e314e1.

[123] S Jung, 'Societas Unius Personae (SUP) – The New Corporate Element in Company Groups' (2015) 26(5) *European Business Law Review* 645, p 646.

https://doi.org/10.1017/cel.2021.1 Published online by Cambridge University Press

learning.[124] The 'wider the "pool" of solutions from which lawmakers can choose, the more likely that the system as a whole will achieve dynamic efficiency, in the sense of its capacity to adapt and survive under rapidly changing environmental conditions'.[125] As such, reflexive harmonisation is not designed to nudge lower-level units towards 'convergence around [an] "evolutionary peak" or end-state envisaged by [a] general equilibrium model';[126] rather 'diversity of national systems is a good in its own right'.[127]

In the context of the EU this is now, broadly speaking, a familiar technique in which the act of law making is spread between different levels.[128] At the Union level, the function of policymakers is to encourage dynamic efficiency and mediate competition through legal instruments that devolve rulemaking power to local actors. The legal instruments are procedural in nature—they contain general principles or standards outlining the 'rules of the game'.[129] Using the general principles or standards as a guidepost, Member States then draft more detailed and explicit rules. This division of labour enables decentralisation and allows Member States to match how rules are formulated with their local circumstances and preferences. A 'second order effect' of this is that, through the basic standards set, at least some parity in the law across jurisdictions can be, typically, observed.

But this does not amount to the EU operating to 'occupy the field' as a monopoly regulator and forcing rigidly prescriptive rules upon Member States.[130] Rather, intervention is limited to the harmonisation of essential requirements, with the end goal being the promotion of diverse approaches to shared regulatory questions. As one commentator suggests, 'by providing mechanisms for the preferences of different users of laws to be expressed and for alternatives to common problems to be compared, it enhances the flow of information on what works in practice'.[131]

Equipped with this sketch of reflexive harmonisation, it is now possible to more fully consider the anatomy of the Proposal. The Proposal mentions nothing about the form that a particular Member States' regulatory framework ought to take, save that each must include the four procedural aspects that would be common across the EU. Apart from this, the Proposal is silent on, for example, what the social

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[124] This can be contrasted with 'competitive federalism', which is the regulatory competition model prevalent in the US. Eg Deakin, 'Legal Diversity and Regulatory Competition: Which Model for Europe?', note 72 above, pp 445–47.

[125] Deakin, 'Two Types of Regulatory Competition: Competitive Federalism Versus Reflexive Harmonisation', note 72 above, p 242.

[126] Deakin, 'Legal Diversity and Regulatory Competition: Which Model for Europe?', note 72 above, p 445.

[127] Deakin, 'Two Types of Regulatory Competition: Competitive Federalism Versus Reflexive Harmonisation', note 72 above, p 242.

[128] Ibid, p 250.

[129] Ibid, p 260.

[130] Deakin, 'Legal Diversity and Regulatory Competition: Which Model for Europe?', note 72 above, p 442.

[131] Ibid, pp 441–42.

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enterprises in a particular Member State ought to pursue as a 'social purpose'. The amount of yearly profit to be reinvested towards achievement of the social purpose is similarly not set. The other features are likewise open-ended. From this it can be inferred that the European Parliament was intent on leaving wide latitude for national variety. Therefore, if the Proposal's regulatory approach were to be judged against the above criteria, it would be rational to suggest that it accords reasonably well with what the EU is charged to do within the reflexive harmonisation context.

However, for a specific proposal to be characterised as a 'good' reflexive harmonisation instrument, it would also need to '"steer" or channel the process of adaptation of rules at state level away from … sub-optimal outcomes'.[132] It is argued that, in this respect, the Proposal is lacking. This is for two reasons.

### *B. Regulatory issues*

First, the Proposal would generate a market for incorporation that could be abused by opportunistic actors. In terms of the incentives for incorporating as a social enterprise, a number of attractive commercial and financial advantages exist. For example, social enterprises with viable business models and plans for creating social value have access to working capital at, potentially, a lower cost from sources not available to private sector companies.[133] The cost of labour may also be lower for social enterprises, especially those engaging in work integration services for the hard to employ. Additionally, whilst forming a social enterprise under any of the aforesaid jurisdictions does not result in direct tax advantages, would-be shareholders are eligible to receive personal tax incentives on their investments in some jurisdictions (eg France).[134] Social enterprises' goods and services can also expect to attract the custom and loyalty of socially conscious consumers, which, in some circumstances, can become a competitive advantage over other, less socially conscious firms.[135] Likewise, the EU has introduced improved rules allowing public authorities to take social and environmental aspects into account in their specifications and when assessing tenders. Competitions for certain contracts listed in the Common Procurement Vocabulary, mainly in the social and health sectors, are now 'reserved' to organisations such as social enterprises that meet specific criteria.[136] Similarly, there is the idea that social economy markets are structured for essentially public interest purposes, and the institutional logic of the sector supports a version of

[132] Ibid, pp 444–45.

[133] See note 118 above. See also eg Liptrap, note 1 above, pp 521–25. In addition to these sources of equity capital, there are also a number of Union-level funds that social enterprises can access, for example the European Social Fund and the European Regional Development Fund.

[134] See note 20 above.

[135] Eg C Alemany, 'Marketing in the Age of Resistance', *Harvard Business Review* (3 September 2020), https://hbr.org/2020/09/marketing-in-the-age-of-resistance.

[136] Directive 2014/24/EU on Public Procurement [2014] OJ L94/95. See also eg L Ankersmit, 'The Contribution of EU Public Procurement Law to Corporate Social Responsibility' (2020) 26(1–2) *European Law Journal* 9.

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capitalism that prizes cooperation, reciprocity, and solidarity over raw forms of competition and the prioritisation of profit maximisation.[137] If opportunistic actors were able to identify underdeveloped and undervalued markets within Member States' social economies, it would be theoretically possible to infiltrate these economically and financially less competitive spaces and design firms to externally seem like social enterprises but covertly engage in aggressive trading practices for personal benefit.[138]

Normally, opportunistic actors would not think to form a social enterprise since the vast majority of the capital flowing from the above advantages cannot be extracted. Regulatory controls are typically present that limit the extent to which a firm's participants can be motivated by pecuniary incentives.

However, with the ESE label in operation, Member States' ability to discipline and prevent opportunistic behaviour would be markedly reduced. This is principally because the Proposal allows for broad variation with respect to constraints on profit distributions and on the allocation of profit across Member States, which invites regulatory arbitrage. More specifically, opportunistic actors that have identified a market opportunity could engage in 'incorporation shopping' and attempt to find a less restrictive option that would produce a mismatch in regulation.

For example, assume that the market opportunity was in Romania. Romania has a regulatory framework featuring 'lifelong' constraints on managerial remuneration, mid-stream profit distributions to shareholders and completely prohibits capital extraction in the event of a conversion to a private sector company or a voluntary winding up.[139] It would only be necessary to locate a more relaxed jurisdiction, incorporate a 'letterbox' company, gain the ESE label, and make arrangements to branch to Romania.

France aptly illustrates a more relaxed jurisdiction. Although the French regulatory framework includes constraints on both managerial remuneration and mid-stream profit distributions to shareholders that are generally similar to its Romanian counterpart,[140] these are only 'annual' in nature. That is, the legislation also features a

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[137] Eg A-C Pache and F Santos, 'Inside the Hybrid Organization: Selective Coupling as a Response to Competing Institutional Logics' (2013) 56(4) *Academy of Management Journal* 972, p 980.

[138] Eg Chaves and Monzón, note 25 above, pp 19–20.

[139] Under the Romanian regulatory framework, an asset partition is required, and at least 90 per cent of a firm's yearly profit must be allocated to achieving and maintaining the selected social purpose. Because 90 per cent of a firm's yearly profit must be allocated to creating value for society, only 10 per cent of the profit generated may be distributed to shareholders in a given year of trading. The statutory language also provides that a firm must apply the principles of 'social equity' to employees and ensure fair levels of pay, which means that the employee-manager remuneration ratio cannot exceed 1:8. Finally, in the event of a conversion to a private sector company or a winding up, all the assets would, by operation of law, pass to another social economy organisation. See Lege No. 219 din 23 iulie 2015 privind economia socială, Art 8(4)(b)–(d), http://www.mmuncii.ro/j33/images/Documente/Legislatie/L219-2015.pdf.

[140] The yearly profit figure that must be set aside in support of the selected social purpose is 50 per cent. The remaining 50 per cent of the yearly profit is distributable to shareholders. The average salary for the five highest paid managers cannot exceed seven times the minimum wage, and the salary for the highest paid manager cannot exceed ten times the minimum wage. See Loi No. 2014-856 du 31 juillet 2014

loophole that affords the possibility of exploiting the identified market opportunity in Romania's social economy. Namely, if the decision were taken to convert an *entreprise solidaire d'utilité sociale* to a private sector company or voluntarily wind up, the French legislation allows a firm's participants to extract all the capital, free of any regulatory oversight.[141]

Of course, the Romanian register could decline the application of the French social enterprise regulatory framework and attempt to apply its own local provisions, requiring all the remaining assets to be left behind. However, branches are mainly 'subject to the law of the Member State where the parent company is incorporated', in this situation France.[142]

More importantly, this action would not conform to the terms of the Proposal. Whilst Member States are free to impose stricter rules with respect to constraining profit distributions and the allocation of profit on firms that incorporate under their domestic regulatory frameworks, they must also respect inbound social enterprises bearing the ESE label that choose to be governed by less strict rules. This is mandatory under the Proposal, irrespective of any justification the Member State in question may think it has.

To be sure, the CJEU has 'very explicitly encouraged private parties to profit from the divergences between Member States' laws',[143] and there is no indicator to suggest that the Proposal would be treated differently. For example, in *Inspire Art*, where the issue was whether a Member States' imposition of stricter disclosure obligations on the branch of a company not provided for by the 'eleventh company law directive' was contrary to its requirements, the court easily brushed away arguments defending the national legislation. The CJEU simply held that 'It is contrary to … [the directive] … to impose on the branch of a company formed in accordance with the laws of another Member State disclosure obligations not provided for by that directive'.[144]

It is argued that the example situation is no different, as the Romanian register's deviation from the registered office as the connecting factor and the imposition of the host Member State's law would undermine the integrity and reach of the Proposal.

The French ESE branch in Romania is but one instance in which a firm's participants could engage in regulatory arbitrage. Indeed, it is possible to interchange the featured jurisdictions with other regulatory frameworks. For example, the

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*(F'note continued)*
relative à l'économie sociale et solidaire', Arts 1(II)(2)(c), 11(1)(3)(A)–(B), https://www.legifrance.gouv.fr/affichTexte.do?cidTexte=JORFTEXT000029313296&categorieLien=id.

[141] Ibid, Art 1(3)(b).

[142] Sørensen, note 86 above, p 60.

[143] J Meeusen, 'Freedom of Establishment, Conflict of Laws and the Transfer of a Company's Registered Office: Towards a Full Cross-Border Corporate Mobility in the Internal Market' (2017) 13(2) *Journal of Private International Law* 294, p 311.

[144] *Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art Ltd*, Case C-167/01, EU:C:2003:512, para 144(1).

Romanian regulatory framework could be substituted with the Luxembourg-ish regulatory framework, which not only requires a firm's participants to transfer the majority of the remaining assets (aside from original capital contributions) to another social economy organisation, but it also does not permit a conversion to a private sector company. An attempted conversion is treated as a *de facto* winding up under Luxembourg's regulatory regime.[145]

On its own, though, isolated or infrequent incidents of regulatory arbitrage and the exploitation of unfair competitive advantages across a European Social Economy would perhaps not amount to a cause for serious alarm. In the context of the private sector and deterring traditional companies from engaging in regulatory arbitrage, Member States have largely eliminated the competitive and financial advantages that could be gained (from the avoidance of rules that govern outward-facing relationships with, for example, employees and creditors). This has been achieved by exploiting gaps between Union legal instruments and the right of establishment through the appropriate design of domestic law. This allows Member States to remove particular subject matters 'from the [foreign] *lex societatis*, or, in spite of belonging to the [foreign] *lex societatis*' govern the subject matters 'cumulatively by the *lex causae* and … [rules] of the *lex fori*'.[146] It is for this reason, amongst others,[147] that a market for incorporation has, thus far, not emerged in the private sector context within the EU: 'today's corporate landscape differs little from that of the late 1990s'.[148] Therefore, a cursory investigation would suggest that Member States could likewise thwart potential challenges to their domestic social economies and limit the exploitation of unfair competitive advantages in a way similar to their supervisory handling of private sector companies' attempts to outflank inconvenient laws through incorporation outside particular jurisdictions.

However, this would not be possible with the Proposal. As discussed in Section IV.B, social enterprises do not have a natural and unqualified right of access to the protections afforded by the Treaty and the CJEU's freedom of establishment jurisprudence—it is the Proposal itself that generates a clarified right of establishment. Therefore, unlike private sector company law directives that are merely harmonising conflict rules and explicating procedural boundaries for the exercising of the right of establishment (that exists independently), the Proposal actually both cements

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[145] Loi du 12 Décembre 2016 portant creation des sociétés d'impact sociétal et modifiant, Art 11(2), http://data.legilux.public.lu/eli/etat/leg/loi/2016/12/12/n1/jo.

[146] C Gerner-Beuerle, F Mucciarelli, E Schuster, and M Siems, 'The Illusion of Motion: Corporate (Im)Mobility and the Failed Promise of *Centros*' (2019) 20(3) *European Business Organization Law Review* 425, p 429 (the authors also note that Member States will ensure that the 'connecting factor that applies in lieu of or in addition to the registered office is "grounded in reality", that is, it cannot be manipulated as easily as a fictitious connecting factor such as the registered office').

[147] For example, Member States have also chosen to remove the incentives for engaging in regulatory arbitrage through defensive harmonisation. See generally eg M Gelter, '*Centros* and Defensive Regulatory Competition: Some Thoughts and a Glimpse at the Data' (2019) 20(3) *European Business Organization Law Review* 467.

[148] Gerner-Beuerle, Mucciarelli, Schuster, and Siems, note 146 above, p 426.

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that there is a right of establishment for social enterprises and lays down the terms upon which they are permitted to move across borders.

The scope of the application of the relevant Union legal instrument—in this situation the Proposal—and the scope of the right of establishment are synchronised. This effectively closes the gaps that Member States might otherwise occupy to deter regulatory arbitrage and the gaining of unfair competitive advantages. This means that the ESE label 'locks out' Member States from implementing corrective measures, and safeguards a firm's participants' prerogative to choose the body of rules under which they wish to be governed. This is the case even if that choice affords opportunistic actors the flexibility to select a regulatory framework with weak constraint standards, making it possible to secure and leverage unfair competitive advantages.

Second, over time, the normalisation of a market for incorporation is likely to result in a longer-term regulatory issue—the entrenchment of private sector behaviours and commercial practices leading to more permanent distortions of the social economy's institutional logic.

This is a danger that commentators writing about the social economy often emphasise. The formal term to denote the erosion of the social economy's institutional logic is 'organisational isomorphism', which is a mimetic process whereby social economy organisations mutate away from their original nature and come to resemble and behave like private sector companies.[149]

If it is possible for opportunistic actors to identify underdeveloped and undervalued markets within Member States' social economies and infiltrate these economically and financially less competitive spaces across the EU at scale, it obliges traditional social economy organisations to operate in an unfamiliar context. Here, they must interact with transient entities that more intensely focus on competition, resource efficiency, and profit maximisation. In the circumstances, this could pressure traditional social economy organisations to forsake their cooperative, reciprocal, and solidarity-based characteristics,[150] and 'adopt the practices of capitalist private companies, even though they do not convert into this type of company, in order to carry on'.[151] When social economy organisations' focus shifts in this way, they are, necessarily, no longer in a position to preserve the socio-economic qualities discussed earlier in this article that make them distinctive.[152]

For social enterprises, increased attention to competitiveness, resource efficiency, and profit maximisation might result in, for example, utilising purely economic cost-benefit analyses to determine the types of socio-economic activities 'worth'

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[149] See generally eg P J DiMaggio and W W Powell, 'The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organizational Fields' (1983) 48(2) *American Sociological Review* 147; C Mason, 'Isomorphism, Social Enterprise and the Pressure to Maximise Social Benefit' (2012) 3(1) *Journal of Social Entrepreneurship* 74.

[150] Borzaga and Fazzi, note 98 above, pp 419–20; Liptrap, note 1 above, pp 519–20.

[151] Chaves and Monzón, note 25 above, p 20. See also eg R Chaves and D Demoustier, *The Emergence of the Social Economy in Public Policy: An International Analysis* (Peter Lang, 2013), pp 65–70.

[152] See Part II above.

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engaging in, discontinuing the supply of socially desirable goods and services at low cost or refusing to train and employ low-skilled individuals facing labour market exclusion. Moreover, internal governance mechanisms could become more centralised and hierarchical, thereby crowding out important social stakeholders' interests.[153]

If a sufficient level of regulatory arbitrage occurred for any extended period of time, it is argued that the sector would not be able to sustain the production of the macro socio-economic effects of interest to both EU and Member-State-level policymakers. This is especially troubling if the aim of the former is to then assimilate the sector into the Single Market in an attempt to offset some of the social problems it generates.

### *C. Suggested solution*

The identified regulatory issues that would flow from the Proposal are a side effect of the way in which the European Parliament has employed reflexive harmonisation. It must be remembered that the ESE label is itself the bridge connecting Member States' social economies together. Therefore, the extent to which social enterprise companies would enjoy a clarified right of establishment at all is a function of how the terms of the Proposal are framed. Presently, the organisation of the procedural floor within the directive is very thin, in the sense that it only addresses four features that would be common across the EU. As an examination of the disparities between the French and Romanian social enterprise regulatory frameworks has demonstrated, the way in which the general principles or standards are arranged leaves wide latitude for national variety and allows Member States to shape their rules to local circumstances and preferences.

However, when the correct balance is not achieved between the different levels of law making within the EU, it can lead to suboptimal outcomes. The thin procedural floor of the Proposal would leave Member States with discretion to set their own regulatory limits, and it is the mismatches in regulation deriving from the allowance for broad variations in Member States' regulatory frameworks that would be of prime interest to opportunistic actors.

Taken to its logical conclusion, widespread and long-term abuse of embedded regulatory differences would not only pervert the essence of social enterprises as predominantly 'public good' organisational units, but it might well distort, or even erase, the distinctions between the social economy and the private sector constructs.[154]

This is not to say, though, that the Proposal ought to be abandoned. It is still the case that the EU and many Member States have mutually reinforcing policy priorities that could be achieved through the ESE label. More generally, it is accepted by

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[153] Borzaga, Fazzi, and Galera, note 108 above, pp 12–13.

[154] This is sometimes referred to in the commentary as a shift from creating value for society to 'value capture' for personal benefit. Eg F M Santos, 'A Positive Theory of Social Entrepreneurship' (2012) 111(3) *Journal of Business Ethics* 335, pp 337–41.

https://doi.org/10.1017/cel.2021.1 Published online by Cambridge University Press

commentators that regulatory competition and corporate mobility are 'a type of discovery mechanism that helps to reveal the particular mix of … corporate rules that aligns best with the preferences of potential users. Findings from this discovery mechanism should improve the evidence base for policy and be a safeguard against policy error'.[155] Therefore, it is argued that reflexive harmonisation is not the issue. Rather, it is the way in which the European Parliament has, on this occasion, used reflexive harmonisation that must be modified.

Importantly, the modification suggested below would not undermine the local-level diversity of Member States' rules—after all, without diversity the stock of knowledge and experience on which the learning process depends is necessarily restricted—but it would check some of the unwanted spill-over effects.

Instead of a thin procedural floor, the Proposal ought to feature a 'thick(er)' procedural floor requiring a larger number of provisions in Member States' domestic regulatory frameworks. Specifically, the commentary provides that rules constraining profit distributions and the allocation of profit could be operationalised in three ways through a series of alternative combinations: 'it can be applied to the profits generated, the assets accumulated, or the remuneration gained by the workers and managers employed'.[156]

France only has annual constraint mechanisms that can be avoided through converting to a private sector company or voluntarily winding up. If the Proposal required lifelong constraint mechanisms, like Romania, that only allowed for the partial appropriation of a firm's capital after a conversion or a voluntary winding up, the basic assumption would be that opportunistic actors could not use the ESE label to disarm Member States from preventing distortions to their domestic social economies. There would be at least some legal parity across the EU.[157]

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

Whether the suggested solution would allow the EU and Member States to realise their mutually reinforcing policy goals remains to be seen. Indeed, a market for incorporation could still emerge, even with the suggested solution having been implemented. However, it is submitted that the likelihood of this happening cannot be either gauged or guaranteed.

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[155] E Ferran, 'Corporate Mobility and Company Law' (2016) 79(5) *Modern Law Review* 813, p 831.

[156] Borzaga and Galera in Costa, Parker and Andreaus, note 105 above, p 98. See generally also eg V Valentinov, 'The Economics of the Non-Distribution Constraint: A Critical Appraisal' (2008) 79(1) *Annals of Public and Cooperative Economics* 35.

[157] Another jurisdiction with lifelong constraint mechanisms is, for example, Denmark. See generally Lov Nr. 711 om registrerede socialøkonomiske virksomheder, https://www.retsinformation.dk/eli/lta/2014/711.

The commentary suggests that, in addition to dis-applying or ignoring firms' foreign *lex societatis* in conflict of laws scenarios, Member States also engage in 'defensive harmonisation' to remove or curtail the incentives that would otherwise derive from regulatory arbitrage in the private sector context. It is possible that Member States would defensively harmonise in a similar way to protect the integrity of their domestic social economies and close regulatory gaps to deter opportunistic actors. This defensive harmonisation would reduce the extent to which opportunistic actors could shield themselves with the ESE label. Ultimately, the ESE label is itself the gateway through which social enterprise companies would be able to engage in cross-border activities.

If the Proposal calls for the imposition of more rules on profit distributions and the allocation of profit, and all Member States opt for similarly strict regulatory regimes, then it would follow that the clarified right of establishment provided by the Proposal would be a narrow one. What any eventual defensive harmonisation might look like is difficult to guess, but it is sensible to suggest that it would involve Member States homogenously fixing the economic incentives and the amounts of capital that firms' participants could appropriate. This would have the effect of Member States' social enterprise regulatory frameworks co-evolving, mutually learning from each other and arriving at 'what works in practice'.[158]

## VII. CONCLUDING REMARKS

To conclude, this article has contributed to the literature by exploring the EU dimension of social enterprise regulation, which links to a much larger narrative about the social economy's relationship with European integration. That the EU lacks the competences to create a social market economy has resulted in the social economy and the Single Market gradually converging. The sector is now tethered to the Article 3(3) TEU commitment to create a social market economy.[159] This makes it possible to distinguish between the Proposal and past attempts to recognise social economy organisations in EU organisational law.

In other words, although the Proposal is the most recent iteration in a line of policies, this article has sought to relocate the argument from one that is merely about the heterogeneity of Member States' organisational forms over the last decades, to an argument that the Proposal is situated within a paradigmatic shift. In this context, the EU has bound itself, and faces pressure, to reimagine the Single Market with social dimensions and objectives that go beyond the purely commercial.

This could be achieved, at least in part, by integrating the social economy into the Single Market, on this occasion through the Proposal and assigning social enterprises increased socio-economic functions and responsibilities. Importantly, this focus on social enterprises allows the EU to appear to take steps towards addressing its social deficit without explicitly subordinating the goal of competition, and, simultaneously, in some measure elides the fact that it lacks the competences to take more direct action.

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[158] See generally Gelter, note 147 above.

[159] Liger, Stefan, and Britton, note 60 above, pp 37–38.

https://doi.org/10.1017/cel.2021.1 Published online by Cambridge University Press

Because the ESE label has a market liberalisation effect, it adds value by positioning domestic policymakers to potentially offset some of the negative implications of political institutionalisation of their respective social economies. Therefore, the Proposal is likely to succeed where past efforts to include the social economy in EU organisational law have failed.

However, despite the plausibility that a proliferation of social enterprise legislation and the increased frequency of such firms' engagement in cross-border activities could soon be a reality, this article has shown that the current terms of the Proposal would generate regulatory issues. The most immediate is the creation of a market for incorporation that could be abused by opportunistic actors. This problem is exacerbated because the Proposal 'locks out' Member States from taking remedial action. Over time, the normalisation of a market for incorporation would engender a longer-term regulatory issue, which is the entrenchment of private sector behaviours and commercial practices leading to more permanent distortions of the social economy's institutional logic. If a sustained level of regulatory arbitrage occurred across the EU, the sector would not be able to sustain production of the macro socio-economic effects of interest to both Union and Member-State-level policymakers. This is especially problematic if the aim of the former is to harness the sector in an attempt to offset some of the social problems generated by the Single Market.

However, the Proposal ought not be abandoned. It is still the position that the EU and Member States have mutually reinforcing policy priorities that could be achieved through the Proposal. Thus, instead of a thin procedural floor, this article has argued that the Proposal ought to feature a thick(er) procedural floor requiring a larger number of provisions in Member States' domestic regulatory frameworks. At a minimum, uploading this suggested solution into the Proposal would result in a Union legal instrument that reduces the possibility of suboptimal outcomes, but does not forsake the benefits that reflexive harmonisation can yield. A revised Proposal including the suggested solution could build legitimacy and confidence between the EU and Member States, leading to an increased likelihood of timely political agreement when the Proposal is eventually resuscitated.

Therefore, as a practical matter, it is probable that social enterprises could play an upcoming role as an EU policy tool in areas such as providing support to vulnerable groups, combatting social exclusion, inequality, and violations of fundamental human rights or in helping to protect the environment, biodiversity, the climate, and natural resources. Indeed, absent further treaty modifications, it can be expected that the EU will attempt to address its social deficit through additional regulatory interventions that envision a greater focus on the social economy. In this regard, the European Social Economy Summit 2021 may serve as an incubation hub for the tabling of future proposals and recommendations for social economy policies at the Union level.[160] However, it is an open question whether they are likely to be effective, or enough on their own, without far more ambitious reforms.

[160] See https://www.euses2020.eu.

https://doi.org/10.1017/cel.2021.1 Published online by Cambridge University Press