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## THE ASSET LOCK UNDER THE REGULAR OPERATION OF SOCIAL IMPACT COMPANIES IN LUXEMBOURG

*ABSTRACT. The social impact companies in Luxembourg are subject to the principle of social and solidarity economy, and such companies may employ business means to pursue social objectives. To ensure the realization of this goal, 2016 legislation of creating such companies responds to this, the most essential and important instrument of which is the asset lock. To this end, based on the finance tools of the SIS (issuance of bonds and shares) and the movement of the assets of the company, the paper will elaborate and analyze, in relation to the principal stakeholders (directors, shareholders, and third parties), the legal regimes subordinating to this mechanism which these actors comply with. Besides, the regulation of public bodies may also play a positive role in this regard.*

*CONTENT. 1. Introduction – 2. Directors – 2.1. Directors’ remuneration – 2.2. Impact of the composition of the assembly of shareholders on Directors’ duties – 3. Members/Shareholders – 3.1. Constraints of profit distribution to shareholders/members – 3.2. A ban against shareholders/members (negative obligation of SIS) – 3.3. The repurchase of shares from shareholders/members – 4. Third parties – 4.1. The transactions with third parties – 4.2. The transfer of shares to third parties – 5. Conclusion*

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## 1. *Introduction*

While the legal status of social enterprises has not yet been established in Luxembourg, Social Impact Companies (SIS) are considered to be the appropriate legal form of social enterprises and respond to European expectations (EU operational definition of social enterprise in SBI Initiative 2011).<sup>1</sup> The 2016 law<sup>2</sup> establishes SIS as a legal scheme therein,<sup>3</sup> and according to the Ministry of Labor, Employment, Social and Solidarity Economy, these companies are only one type of social and solidarity economy enterprises. The social and solidarity economy sector has employed more than 15,000 people in the country by 2020, representing 4% of national employment.<sup>4</sup> Likewise, social impact companies have evolved in recent years.

Under the 2016 law, a social impact company must comply with the principle of social and solidarity economy (SSE) and in a legal form consistent with one of a public limited company (S.A.), a private limited liability company (SARL) or a cooperative society (SCOP), set up with the approval of the Minister.<sup>5</sup> The aim of creating SIS is, in general, consistent with the objective of the promotion of the social and solidarity economy, that is, both are intended to foster cultural and innovative activities, as well as to increase the visibility and transparency of the socio-economic sector.<sup>6</sup> Yet, there are nuances to both, an SIS being entirely a company, and the social

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<sup>1</sup> David Hiez and Francesco Sarracino, 'European Commission Social enterprises and their ecosystems in Europe. Updated country report: Luxembourg' (Publications Office of the European Union 2020), <<http://ec.europa.eu/social/publications>> accessed on 15th December 2023.

<sup>2</sup> Expressions of both '2016 legislation' and '2016 law' in this paper refer to 'Loi du 12 décembre 2016 portant création des sociétés d'impact sociétal'.

<sup>3</sup> Loi du 12 décembre 2016 portant création des sociétés d'impact sociétal, s 2.

<sup>4</sup> Impact Luxembourg, 'L'économie sociale et solidaire et les sociétés d'impact sociétal' <<https://luxembourg.public.lu/fr/investir/votre-entreprise-au-luxembourg/economie-sociale-solidaire-societe-impact-societal.html#:~:text=En%20moyenne%2C%20la%20production%20liée,soit%2011%25%20de%20la%20population>> accessed 14th December 2023.

<sup>5</sup> Loi du 12 décembre 2016 portant création des sociétés d'impact sociétal, s 3 (1).

<sup>6</sup> Liptrap, J.S., 'The Social Enterprise Company in Europe: Policy and Theory' (2020) 20 *Journal of Corporate Law Studies* 495, 539; Ministry of Labor, Employment, Social and Solidarity Economy & ULESS, 'Les Sociétés d'impact Sociétal (SIS)', <<https://mteess.gouvernement.lu/dam-assets/publications/brochure-livre/minist-travail-emploi/br>

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mission of the company and performance indicators must be clearly defined in its articles of associations.<sup>7</sup>

The protection of the benefits of vulnerable communities and the pursuit of the public interest are of paramount significance for social enterprises. Consequently, the issue of how to ensure the realization of the social objectives of SIS is central to this, and the 2016 law provides the corresponding response to this, including the regulation of the management and duties of directors (and the restriction of salaries thereof), the limitations on the allocation of profits to shareholders/members, the negative obligations concerning the issuance of debt instruments, the constraints on dealings with the outsiders, as well as the regulation and control of the properties of the SIS; all of which, in effect, are revolving around the asset lock.

The asset lock is a mandatory and irreversible legal or constitutional mechanism that ensures that surplus income, capital, profits, and other property are not distributed to members, shareholders, or individuals of any organization. It prevents an organization's assets from being used for private gain rather than for its social mission throughout its existence and in the event of a sale, dissolution,<sup>8</sup> or even loss of social enterprise qualification.<sup>9</sup> The mechanism applies across the entire life cycle of social enterprises and manifests unique traits while running. It is the regular operation of companies that is normality, and the reflection and the solution of settlement at this stage of the problems that arise may, more or less, be instrumental in resolving the

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sis/societes-impact-societal-sis.pdf> accessed 4th November 2023.

<sup>7</sup> Loi du 12 décembre 2016 portant création des sociétés d'impact sociétal, s 3 (1).

<sup>8</sup> Susan McLaughlin, *Unlocking Company Law* (4th edn. Routledge 2019); Giulia Galera, and others 'Social Enterprises and Their Ecosystems in Europe. Comparative Synthesis Report' (Office of the European Union 2020), < <https://europa.eu/!Qq64ny> > accessed on 4<sup>th</sup> November 2023, Richard C Bishop, *Law and regulation of community interest companies* (Bloomsbury Professional 2022); Giulia Neri-Castracane, 'The Governance Patterns of Social Enterprises' in Henry Peter and others (eds), *The International Handbook of Social Enterprise Law: Benefit Corporations and Other Purpose-Driven Companies* (Springer Nature 2023).

<sup>9</sup> Antonio Fici, 'A European statute for social and solidarity-based enterprise' (2017), European Union <[www.europarl.europa.eu/RegData/etudes/STUD/2017/583123/IPOL\\_STU%282017%29583123\\_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/STUD/2017/583123/IPOL_STU%282017%29583123_EN.pdf)> accessed on 15<sup>th</sup> December 2023; Antonio Fici, 'Social Enterprise Laws in Europe after the 2011 "Social Business Initiative" A Comparative Analysis from the Perspective of Worker and Social Cooperatives' (2020), CECOP <[www.un.org/development/desa/dspd/wp-content/uploads/sites/22/2021/06/Fici\\_Resource1-1.pdf](http://www.un.org/development/desa/dspd/wp-content/uploads/sites/22/2021/06/Fici_Resource1-1.pdf)> accessed on 15<sup>th</sup> December 2023.

difficulties that may occur in exceptional circumstances and be of considerable weight in the social activities and disposition of the assets of the SIS in this phase of their existence. For this reason, this paper will only address the asset lock in the regular operation of social impact companies.<sup>10</sup>

This paper aims to dissect how the asset lock can be employed to achieve the protection of social objectives in Luxembourg during the period. The principal challenge for the operation of the asset lock is how to secure all the very detailed technical regimes under this rule that are well-positioned to guard the social goals. This paper, as such, is structured like this. Section II will deal with the payment of directors' (employees') remuneration, and analyze the impact of the composition of the assembly of shareholders/members on the resolution of the board of directors (section II). This will be followed by dissecting the constraints of the distribution of dividends to shareholders and the negative obligation of prohibition of bond issuance to them (section III). Also, the implications of transactions between companies and third parties on the asset lock (section IV) ought not to be ignored. The last section contains a review of the findings and some conclusions.

## **2. *Directors***

This section will explore the issue of handling assets relating to (board) directors. Precisely speaking, it will try to answer this question, namely, in the course of the normal functioning of the social impact companies (SIS), how directors can pursue the benefits of communities and ensure that they do not deviate from the social ends of the companies in carrying out their duties? The response against it involves two aspects of the legal regime subordinated to the mechanism of asset lock, the restrictions imposed on the remuneration of directors, and the decisive parameter that influences the board's resolution on the disposal of assets. To this end, what follows in the two subsections therein will be elaborated and analyzed respectively surrounding them.

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<sup>10</sup> This paper will not deal with the asset lock in the special circumstances of social enterprises, which comprise, for example, the acquisition, conversion, separation or winding up (and bankruptcy), or even dissolution.

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### ***2.1. Directors' remuneration***

The law on commercial companies in Luxembourg provides that directors' remuneration is determined by the general meeting of shareholders/members and allocated by the board of directors: the general meeting may determine the total amount, and the board of directors then allocates the remuneration.<sup>11</sup> In practice, the situation is somewhat more flexible, and the board of directors may set up a remuneration management committee to establish more precisely the remuneration of each director.<sup>12</sup> The same applies to directors in SIS. There are, however, two special cases to keep in mind hereto.

The first is when the company's directors are also employees. This may seem odd at first blush. After all, directors are agents of the company's shareholders who do not have a subordinate relationship with the company; whereas employees, who are the party to an employment contract, exist in a relationship of subordination with their employer (the company). Also, directors are subject to corporate law, while employees enjoy the protection of labor law. Hence, they may look rather distinct. But such a scenario could exist, at least providing some room for it, namely, the restrictions on the qualifications and conditions for natural person directors do not preclude the possibility that a director is also an employee.

A paradigmatic example would be a managing director who is also performing technical functions distinct from those that the company has authorized him to administer. Case law has held that the same person may carry out both managerial and employee roles if the contract of employment is a real and serious agreement, corresponds to the functions actually exercised, and has an employer-employee relationship of subordination.<sup>13</sup> In this case, the director may receive two remunerations,

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<sup>11</sup> Village de la justice, 'La rémunération des administrateurs de sociétés au Luxembourg', <<https://www.village-justice.com/articles/remuneration-administrateurs,9359.html#:~:text=Cette%20r%C3%A9mun%C3%A9ration%20peut%20%C3%AA%20%C3%89%20%C3%AAtre%20pr%C3%A9vue,r%C3%A9sultats%20de%20l%27exercice%20social>> accessed 4<sup>th</sup> November 2023.

<sup>12</sup> Smart Private Managers, 'Principes Directeurs de la Politique de Remuneration de Smart Private Managers (Luxembourg) S.A.' <<http://www.smart-pm.eu/principes-directeurs-de-la-politique-de-remuneration-de-smart-private-managers-luxembourg-s-a/>> accessed 4<sup>th</sup> November 2023.

<sup>13</sup> The Government of the Grand Duchy of Luxembourg, 'D1a - Contrat de travail en général, D1a17 - Est-il possible de cumuler une activité de salarié avec une activité exercée à titre de mandataire social auprès d'une même société?',

where payment under the employment contract is to be regulated by the provision of the employee's status, i.e., the maximum annual salary paid to an employee in an SIS may not exceed six times the social minimum wage.<sup>14</sup> To be clear, the scope of employee remuneration restrictions is meant to be broadly understood here to include not only wages in the strict sense but also all forms of economic subsidies received, such as bonuses and benefits in kind, etc.<sup>15</sup>

The second is when an employee is a de facto director who governs the company without being appointed as a de jure director. This direct or indirect interference with management is illegal and the de facto director (the employee) is subject to civil and criminal penalties.<sup>16</sup> A de facto director may be as liable to pay the debt as a de jure director. For example, an employee who enters into a contract with a third party on behalf of the company, without the third party's awareness that he or she is not a director, wears the 'cloak' of a director and has been exercising external powers in his or her capacity as a director without ever having been authorized by the company.

In both cases, whether it is the two remunerations received by the director (who is also an employee) or the employee's civil liability for being a de facto director's apparent proxy, they are both liabilities on the balance sheet of the company's annual financial statements under the company and accounting law, which are subject to validation by a professional accountant at the time of their annual approval, and if there is any impropriety in the performance of their duties, the company's auditor may be held responsible.<sup>17</sup> Beyond that, in the first case, the annual report and the extra-financial impact report of the SIS are also supposed to be sent to the Minister of Labor, Employment, Social and Solidarity Economy within two weeks after the general meeting of shareholders.<sup>18</sup>

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<[https://itm.public.lu/fr/questions-reponses/droit-travail/contratstravail/a/a17.html#:~:text=Oui.,possible%20\(cumul%20de%20mandats\)](https://itm.public.lu/fr/questions-reponses/droit-travail/contratstravail/a/a17.html#:~:text=Oui.,possible%20(cumul%20de%20mandats)>)> accessed 4th November 2023.

<sup>14</sup> Loi du 12 décembre 2016 portant création des sociétés d'impact sociétal, s 5 (1).

<sup>15</sup> David Hiez, 'Société D'impact Sociétal : Première Reconnaissance Législative de L'économie Sociale et Solidaire : Loi Du 12 Décembre 2016 Portant Création Des Sociétés D'impact Sociétal' (2017), 52 JTL 110,117.

<sup>16</sup> Alain Steichen, Précis de droit des sociétés (Larcier 2018).

<sup>17</sup> *ibid* 336-375.

<sup>18</sup> Loi du 12 décembre 2016 portant création des sociétés d'impact sociétal, s 6 (3).

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In summary, in terms of the remuneration of directors in social impact companies, there are no specific limitations, in line with commercial companies, where the organ that decides on it is the general meeting of shareholders, and the payment of remuneration is carried out by the board. However, when a director is also an employee, he/she needs to observe the restricted provisions of the SIS employee's remuneration, which indirectly safeguards the company's assets and facilitates the realization of the social objectives and its relevant activities. In the second scenario, both corporate employees and directors are accountable. Additionally, the checking duty from the company's internal auditors and the obligation of continuous reporting of SIS offer regulatory support to the social commitment of the company's purpose.

## ***2.2. Impact of the composition of the assembly of shareholders on Directors' duties***<sup>19</sup>

Directors of Luxembourg social impact companies (SIS) are appointed by the general meeting of shareholders/members.<sup>20</sup> In the event of a vacancy among the directors, the designated residual directors are entitled to fill it temporarily, unless otherwise provided for in the articles of association; in that case, the assembly conducts the final ballot during its first meeting.<sup>21</sup> Although there are minor distinctions between public limited liability companies (S.A.) and private limited liability companies (SARL) in relation to the tenure of directors and the removal of office, the power of removal of a director remains in the hands of the general meeting.<sup>22</sup> Pursuant to this, the determination of the appointment and the removal of directors rests ultimately with the shareholders. Put in another way, the constitution of the board of directors relies on the composition of the shareholders having voting rights at a general meeting in SIS.

Directors therein follow a double democratic principle of 'one share, one vote' and 'majority vote' for the determination of their appointment. But not all shares carry

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<sup>19</sup> This subsection will not talk about all duties of directors but is limited to the duty related to the asset's disposal.

<sup>20</sup> Loi modifiée du 10 août 1915 concernant les sociétés commerciales, ss 441(2) and 710(15).

<sup>21</sup> *ibid.*

<sup>22</sup> *ibid.*

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voting rights.<sup>23</sup> In general, there are two scenarios for the formation of shares in an SIS (case 1 and case 2, cf. section III, subsection 1). In the case of SIS with all impact shares, the composition of the board of directors is most likely to be pro-social, regardless of whether the shares have voting rights or not. Where two classes of shares co-exist in the companies, impact and performance shares, it is only when the voting rights carried by the impact shares exceed that of performance shares that more members of appointed directors may be dedicated to serving the social ends of the SIS, or else, the law mandates that directors fulfill the purposes of the company which would be exploited by those shareholders seeking to benefit themselves and thereby failing to achieve the public benefit.<sup>24</sup> In the latter instance, indeed, the minimum of half of the social impact shares in the SIS required by law provides a very marginal boost to the achievement of the company's social objectives at this level.

Besides its influence on the structure of the board of directors, the underlying rationale behind attaching this importance to the shares in companies lies in the duties of the directors. They have a fiduciary duty and are expected to comply with the duties of care and loyalty. In SIS, as stated earlier, the higher the volume of impact shares with voting rights are, the more willing the designated directors would pursue the company's social missions, the more positively the content of the directors' duties and their management of the company is centered on it; otherwise, even if the directors are obliged to discharge their responsibilities, they may not voluntarily and proactively want to manage the firm for the realization of community benefits.

In addition, directors are supposed to be liable for mismanagement, either by negligence or intent,<sup>25</sup> such as entering into contracts that are obviously not conducive to the accomplishment of the company's aims or engaging in activities that cause the company's assets to suffer a loss. In practice, given that corporate governance is not an accurate science, judges usually show a degree of restraint in assessing the fault.<sup>26</sup> In this

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<sup>23</sup> André Prüm, 'Luxembourg company law – a total overhaul' in Michel Tison and others (eds), *Perspectives in company law and financial regulation: essays in honor of Eddy Wymeersch* (Cambridge University Press 2009).

<sup>24</sup> Loi modifiée du 10 août 1915 concernant les sociétés commerciales, ss 441(5) and 710 (15).

<sup>25</sup> Loi modifiée du 10 août 1915 concernant les sociétés commerciales, s 441(9), s 710 (16) and s 833(18).

<sup>26</sup> Isabelle Corbisier, 'La responsabilité des dirigeants de sociétés au regard des règles de la loi sur les sociétés

case, the presence of a comparatively greater number of non-socially oriented directors in SIS but simultaneously with an extra requirement of pursuing the public interest, in view of this, implies that they may potentially breach the fiduciary duty, which is detrimental to practicing social activities and fulfilling the social objectives of the company.

Furthermore, if a director of SIS has a pecuniary interest, whether directly or indirectly, that is opposed to a transaction within the scope of the remit of the board of directors, the board shall be notified and the statement recorded in the minutes of the meeting, and that director may not participate in the deliberation of and vote on the matter.<sup>27</sup> There is no derogation from the realization of the purpose of SIS.

As a result, with regard to the composition and competencies of directors in Luxembourg's SIS, on one hand, the number of directors wearing 'the social mantle' would depend on the volume of voting shares, optimally with only one type of share in the SIS, i.e., the impact shares. On the other hand, when dealing with contracts or other issues related to the company's assets, directors ought to comply with the fiduciary duty and be responsible for any violation of it. However, it is necessary to note that the likelihood of this kind of break occurring would be lower when there is a high number of pro-social directors, with which the likelihood of the realization of the company's social objectives shows a positive correlation.

### **3. *Members/shareholders***

Following the 2016 law, in the course of the operation of a social impact company (SIS), there is a threefold primary legal apparatus that has been in place against shareholders/members to defend the social objectives of the company, consisting of restrictions on the distribution of profits (perhaps even non-distribution), the negative obligation to forbid the issuance of debt instruments or loans to shareholders/members, and the binding of company's share buybacks from them. Accordingly, this section will

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commerciales et du droit civil', <<https://orbilu.uni.lu/bitstream/10993/49279/1/Exposé.docx.pdf>> accessed 4th November 2023.

<sup>27</sup> Loi modifiée du 10 août 1915 concernant les sociétés commerciales, s 441 (7).

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discuss these three dimensions of the issue separately. In addition, given the situation in the case of the cooperative form of social enterprise, particularly regarding the repurchase of shares and the withdrawal of members, which differs from the other two forms of social enterprise, the concern ought to be warranted.

### ***3.1. Constraints of profit distribution to shareholders/members***

In Luxembourg, SIS was created by the same act that defines the SSE.<sup>28</sup> In accordance with this law, the share capital of an SIS is made up of impact shares and, where applicable, performance shares.<sup>29</sup> Thus, of these two classes of shares, impact shares are core shares, while performance shares are optional.<sup>30</sup> To this end, theoretically, the share capital within such companies consists either entirely of impact shares or the coexistence of impact and performance shares.

In the first case, i.e., the share capital of social impact companies comprises wholly of impact shares.<sup>31</sup> Besides the tax exemption SIS can enjoy,<sup>32</sup> their superiority in safeguarding social targets is evident. The most straightforward demonstration is that the profits assigned to the impact shares should be used specifically for the realization of the objects of these companies and reinvested in full in the maintenance and development of the business.<sup>33</sup> That is to say, in this situation, the total profits of SIS, after deducting various expenses and withdrawing statutory allowances (e.g., reserves), shall be allocated to the shares and fully utilized for the realization of their societal purposes.

Also, the protection of social mission is bolstered by two other requirements for

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<sup>28</sup> David Hiez, 'The Suitability of Luxembourgish Law to B Corp' in Henry Peter and others (eds), *The International Handbook of Social Enterprise Law: Benefit Corporations and Other Purpose-Driven Companies* (Springer Nature 2023).

<sup>29</sup> Loi du 12 décembre 2016 portant création des sociétés d'impact sociétal, s 4 (1). Regarding the expression 'performance shares', it is expressed in the law (art. 4, Loi du 12 décembre 2016 portant création des sociétés d'impact sociétal) as 'de parts de rendement'. Since many scholars have used the term 'performance shares' in academia, this paper also adopts this expression.

<sup>30</sup> Hiez (n 15).

<sup>31</sup> Ministry of Labor, Employment and Social and Solidarity Economy, 'Business Report 2021', <<https://mteess.gouvernement.lu/en/publications.html>> accessed 4th November 2023.

<sup>32</sup> Loi du 12 décembre 2016 portant création des sociétés d'impact sociétal, s 14.

<sup>33</sup> Loi du 12 décembre 2016 portant création des sociétés d'impact sociétal, s 7 (1).

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impact shares. For one thing, holders of impact shares are not entitled to participate in any profits derived by these companies. This means that such shareholders cannot acquire the economic rights of ordinary shares in a traditional for-profit company in the sense that neither do they enjoy any dividend allocation, nor do they earn a share premium.<sup>34</sup> This may lead to the temporary disappearance of the game between the profit-seeking nature of the shareholders themselves and the funds used to achieve social goals. In this sense, this provision serves as a means of preserving its mission, contributing greatly, albeit it is known as a derogation of article 1832 of the Civil Code.<sup>35</sup> For another, the proportion of impact shares shall not at any time be less than 50% of the share capital,<sup>36</sup> up to the maximum of 100%. This not only provides an additional statutory underpinning for the existence of the first instance but allows some room for the survival of the second, where the two shares coexist.

In the second case, both impact shares and performance shares are in SIS concurrently. The limited profitability of performance shares in this scenario, though, leaves a margin for such shareholders' interests to be chased, which may diminish the achievement of the goals of these companies. Nevertheless, such gains are conditional in this instance provided that the social purposes, as assessed by the performing indicators set out in the company's articles of association, have been achieved.<sup>37</sup> Implicit in this provision is indeed a further message, which suggests an SIS can decide not to pay dividends to this group of shareholders or members if its societal purposes remain unfulfilled. Admittedly, restrictions on dividends to holders of performance shares in SIS may discourage 'greenwashing',<sup>38</sup> but this is only an indirect means, and it falls somewhat short of the priority that those impact shares serve for social purposes.

On the other hand, whether it is the 'application form for approval of SIS'<sup>39</sup>

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<sup>34</sup> Hiez (n 28).

<sup>35</sup> Loi du 12 décembre 2016 portant création des sociétés d'impact sociétal, s 2.

<sup>36</sup> Loi du 12 décembre 2016 portant création des sociétés d'impact sociétal, s 4 (3).

<sup>37</sup> Loi du 12 décembre 2016 portant création des sociétés d'impact sociétal, s 4 (1).

<sup>38</sup> Dana Brakman Reiser and Steven A. Dean, *Social Enterprise Law: trust, public benefit and capital markets* (Oxford University Press 2017).

<sup>39</sup> Ministry of Labor, Employment and Social Solidarity and Economy, 'Demende d'agrément Ministériel- En tant

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filled by companies which explicitly requires them to define precisely the performance indicators (at least two) for the Minister's approval, or the 'annual external financial report'<sup>40</sup> drafted by companies that have been recognized as SIS which details the execution of the performance indicators in the statutes for the review of the shareholders'/members' meeting; both are intended to effectively and reliably verify the achievement of the company's objectives. Even so, it remains a bit challenging to evaluate whether such performance indicators have been accomplished validly, as this issue is also intimately tied to the manner in which they are drafted, and the wording used.

In this context, 'performance shares can be converted into impact shares, but the reverse is prohibited'<sup>41</sup> may provide some hope to ease this pressure. According to the 2016 law, which entitles shareholders/members to request such conversions at any time, there are no further explanations on requests after this. As such conversion concerns substantial clauses in the company's bylaws, it is in principle appropriate to rely on the relevant provisions of the various types of commercial companies that can be certified as SIS.<sup>42</sup> Per this, whether it is a public limited company (S.A.),<sup>43</sup> a private limited company (SARL),<sup>44</sup> or a cooperative society (SCOP),<sup>45</sup> requirements for bylaws amendments are outlined in the commercial company law. This conversion accordingly depends on the result of the resolution of the general assembly of shareholders or members, in S.A. and SARL, each impact share and performance share both may give the right to one vote,<sup>46</sup> while in SCOP whose voting rule is a bit flexible: either follow the democratic principles in traditional cooperatives, i.e., one member, one vote,

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que société d'impact sociétal (SIS)', <<https://guichet.public.lu/dam-assets/catalogue-formulaires/creation-societe/demande-agrement-ministeriel-sis/demande-agrement-ministeriel-sis.pdf>> accessed 4th November 2023.

<sup>40</sup> Loi du 12 décembre 2016 portant création des sociétés d'impact sociétal, s 6 (2).

<sup>41</sup> Loi du 12 décembre 2016 portant création des sociétés d'impact sociétal, s 4 (2).

<sup>42</sup> The author argues, however, that the possibility of 'successful conversion at the request of the shareholders/members of the SIS alone, without the necessity of undergoing a general assembly ballot' may not be ruled out completely, when looking purely at the protection of social objectives.

<sup>43</sup> Loi modifiée du 10 août 1915 concernant les sociétés commerciales, s 450 (2).

<sup>44</sup> Loi modifiée du 10 août 1915 concernant les sociétés commerciales, s 710 (26).

<sup>45</sup> Loi modifiée du 10 août 1915 concernant les sociétés commerciales, s 810 (5) 4°.

<sup>46</sup> Draft articles of association SA SIS and Draft articles of association SARL SIS, s 18.

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alternatively, one vote per share,<sup>47</sup> which in the latter instance would be the identical voting as in the preceding two types of commercial companies.

As such, in S.A. and SARL, the exit of shareholders and the transfer of their shares, as well as the transferees of the shares, not only influence the passage of the resolution for such conversions but may add to the cost of, or indirectly impede, the attainment of social goals. For example, in the case of a resolution to convert performance shares into impact shares, when voting thereon, the quorum was less than 50% (or the number of votes cast on this resolution was below the legal requirement: under 2/3 or 3/4), and thus failed to be converted. In this situation, the holder of performance shares may choose to transfer his/her shares to an outsider (third party) who to him/her is deemed to be desirous of adhering to the aims of the company.<sup>48</sup> As the third party is more likely to be motivated by a desire for profits than the original shareholder, though, there is a risk that the transferee will erode the accomplishment of the social aims of the company by passing resolutions in the future. It should be further clarified the waiver of shareholders' rights does not equate to an increase in commitments, nor does it require a unanimous decision.<sup>49</sup> Upon the success of such a conversion, the economic rights of the shareholders are reduced. Yet, this diminution of their rights does not parallel an addition to the shareholders' engagements hence a consensus is not required.<sup>50</sup>

Interestingly, this provision for the conversion of SIS shares is designed to favor an increase in the percentage of impact shares, thereby augmenting the number of votes in the hands of the holders thereof, with the hope of affecting the passing of important resolutions at the shareholders'/members' meetings, and ultimately keeping the power to make decisions at the hands of the impact shareholders. While the success of this conversion is closely related to the attitude of the present shareholders, it depends effectively on the weighting of the voting shares held by the impact shareholders, and

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<sup>47</sup> *ibid* 62.

<sup>48</sup> Since cooperative societies (SCOPs) are prohibited from transferring shares to third parties, therefore examples of them will not be dealt with here. For detailed information, please see the next subsection.

<sup>49</sup> Loi modifiée du 10 août 1915 concernant les sociétés commerciales, s 430 (3).

<sup>50</sup> David Hiez, 'L'économie sociale et solidaire au Luxembourg' (2021) ANN. DR. LUX 197, 243 ; Gratham, Ross, 'The Unanimous Consent Rule in Company Law' (1993) 52 Cambridge L J, 245, 271.

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should this class of shares have fewer voting seats than that of performance shares, such a conversion may well be aborted at this step and the legislator's good wishes would be thwarted. It is therefore that perhaps it would be possible to consider loosening the statutory procedures for share conversion, as well as clarify the relation between the shares and voting rights in the bylaws, in particular, that it is desirable that the votes conferred by impact shares carry more weight than performance shares.

Another question in the second case is emerging: how to ensure at all times that the impact shares remain not less than 50 % of the share capital? The enterprise auditor verifies and certifies annually that the composition of the share capital of SIS complies with the statutory requirements.<sup>51</sup> This, however, does not provide an assurance that SIS always observes this provision. Also, the application of it may have an influence depending on the type of company.

Insofar as the response to this question is concerned, the focus is supposed to be on cooperative societies rather than on the other two types of commercial companies (S.A., SRAL); inasmuch as the latter adhere to the principle of fixed share capital,<sup>52</sup> whereas in cooperatives it is set aside and adopted as the rule of capital variability.<sup>53</sup>

This rule herein is in the same vein as traditional cooperatives, though Luxembourg's cooperatives do not necessarily target members' interests,<sup>54</sup> which are both motivated by the openness of membership.<sup>55</sup> In this sense, cooperatives can create new shares or cancel existing ones without amending the articles of association, frequent entry and exit of members resulting in variations in the kind of shares and capital are in practice unlikely to be fully reflected in the articles of association, and it is, indeed, a challenge to maintain always at least ½ of the share capital of an SIS cooperative society in impacted shareholdings, as well as tracking and checking the compliance with this provision.

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<sup>51</sup> Loi du 12 décembre 2016 portant création des sociétés d'impact sociétal, s 6 (1).

<sup>52</sup> Steichen (n 16) 551-562.

<sup>53</sup> Art. 811-1, loi modifiée du 10 août 1915 concernant les sociétés commerciales.

<sup>54</sup> David Hiez, 'Are Cooperatives Part of Social and Solidarity Economy', in Willy Tadjudje, Ifigenia Douvitsa (eds), *Perspectives on Cooperative Law* (Springer 2022).

<sup>55</sup> Steichen (n 52).

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Besides, while it may be interpreted that this restriction is only directed at the fixed capital component, this exists in cooperatives with the limited liability of members alone,<sup>56</sup> thus, this explanation is somewhat reluctant. Alternatively, a cooperative society could be accredited as an SIS by requiring that all shares (including new shares subscribed by prospective members) should be in the form of impact shareholding. This may seem on the surface to be a once-and-for-all solution, but as innovative as cooperatives are in that they do not have to for the interests of their members, this would suggest that all members ‘voluntarily’ give up their economic interests in the shares otherwise they cannot become a member of them. This restriction is not conducive to the openness of membership and seems to be a bit of overreach.<sup>57</sup>

The result that this variability of capital brings is so intractable to verify may perhaps be relied on the accountants of the enterprise, who, after all, are the *de facto* manipulators of the shares at the time of the entry of new members to subscribe for them, and the withdrawal of existing members to buy them back.

All in all, for the protection of social targets, the scenario in which social impact companies are composed entirely of social shares (case one) is significantly more advantageous than the one in which the two forms of shares are present in the company (case two). The latter situation is more complex, as the inflexibility of the statutory procedure to follow the conversion of performance shares into impact shares adds resistance to the practice of SIS social activities; meanwhile, the legal requirement to guarantee always a percentage of impact shares at least 50% of the share capital, poses pragmatic obstacles to the implementation of cooperative societies (given the variability of their capital), even if legislators strive for their social objectives to be conserved.

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<sup>56</sup> Hiez (n 15).

<sup>57</sup> However, Luxembourg allows SIS on the one hand to carry out some commercial activities and to participate in public procurement tenders, and on the other hand to permit the company to receive public funding from the State. These financial support instruments provide financial backing for the sustainable development of the company and would seem to increase the likelihood that the SIS, in the form of a cooperative, would be entirely composed of impact shares.

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### ***3.2. A ban against shareholders/members (negative obligation of SIS)***

SIS has a negative obligation to refrain from granting loans or issuing debt instruments, directly or indirectly, to its members or shareholders.<sup>58</sup> It is a restriction, notably, that does not forbid the issuance of bonds by SIS, and should these companies do so, only their members or shareholders are not allowed to purchase. If this prohibition is violated, any loan contract with or any debt instrument issued to them otherwise will be invalid.<sup>59</sup>

This rule may affect the financing of SIS to some extent, albeit to a more modest degree, as the ban is merely against the present members or shareholders. Yet it reduces the financial pressure on the debt repayment of the SIS properly and indirectly preserves the company's assets thus contributing to the fulfillment of the company's purpose and social mission. This obligation, on the other hand, also prevents the company from circumventing the constraints on the payment of dividends on performance shares through the first two methods of paying economic benefits to its members/shareholders. Viewed from the perspective of upholding societal goals, this prohibition plays a relatively positive role.

There is another scenario worth exploring. Both a public limited company (S.A.) and a private limited company (SARL) in Luxembourg can issue bonds,<sup>60</sup> and so do cooperative societies (SCOP) except where their articles of association specify that no other type of securities except capital shares shall be created.<sup>61</sup> In the case of S.A. which has been accredited as SIS and issued the convertible debenture, taking the flexible low yield (FLY) as an example: a debt instrument with an appropriate rate of return and a conditional conversion feature.<sup>62</sup> Their conversion may be triggered by the right of FLY holders to claim that these bonds are converted to shares when shareholders inappropriately demand dividends or seek ultra-high ones. In this case, a tricky question arises

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<sup>58</sup> Loi du 12 décembre 2016 portant création des sociétés d'impact sociétal, s 8 (1).

<sup>59</sup> Loi du 12 décembre 2016 portant création des sociétés d'impact sociétal, s 8 (3).

<sup>60</sup> Loi modifiée du 10 août 1915 concernant les sociétés commerciales, s 100 (14).

<sup>61</sup> Draft articles of association SCOP SIS, s 7 (4).

<sup>62</sup> Reiser & Dean (n 38).

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as to whether the shares resulting from such conversion are impact shares or performance shares. The law is silent and in practice, this depends on the specifics of the agreement.

In contrast, though, there are restrictions in SARL, and what has a proximate consequence for this prohibition is the rule on the issuance of convertible debentures by such companies.<sup>63</sup> On the one hand, any subscriber to a convertible bond who is not a shareholder is required to obtain the approval of shareholders at the latest at the time of issuance, while on the other hand, any transfer of a convertible debenture to such a group is subject to SARL's share transfer approval system,<sup>64</sup> provided that an understanding exists whereby the approval may be given upon issuing of the debentures or subsequently. This situation is more complex as compared to S.A.

This is, for one thing, because the threshold for transferring bonds to non-shareholders in SIS has been raised (requiring the consent of shareholders with a minimum of 3/4 of share capital, which may be reduced to 1/2 by statute),<sup>65</sup> this requirement is in effect a censoring of the bond subscribers (transferees), and considering that at least 50% of the impact shares are supposed to be in the SIS, holders of these shares would have more or at least an equivalent voice than performance shareholders with respect to the adoption of this approval, accordingly, theoretically, it may be more probable that the profile of the potential purchasers of such bonds is that of a social impact investor. As a result, the likelihood that the converted shares may be the impact shares would be higher should a conversion of such bonds occur.

For another, shareholders, who, under company law, may purchase these bonds within three months upon the refusal, are blocked from subscribing to these bonds to be transferred by virtue of the existence of this prohibition; thus, they can only be transferred to the company (which may cause a reduction of its capital) or to a third party. In the latter scenario, though, the presence of the system of understanding leads to an increase in the cost of the time for the approval, which may indirectly be detrimental to the conduct of the company's social activities. Also, in the case of a third

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<sup>63</sup> Loi modifiée du 10 août 1915 concernant les sociétés commerciales, s 100 (15).

<sup>64</sup> Pit Reckinger, 'La nouvelle société à responsabilité limitée' in André Prüm (ed), *La réforme du droit luxembourgeois des sociétés* (Larcier 2017).

<sup>65</sup> Loi modifiée du 10 août 1915 concernant les sociétés commerciales, s 710 (12).

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party subscribing to the convertible bonds of SARL, including by acquiring them via transfer, the implications may be nuanced to that of the S.A., i.e., despite that it ultimately depends on the type of shares to which the bonds are converted, nevertheless, the conversion of the bonds into the impact shares appears to be more likely to happen due to the availability of a subscriber (and transferee) screening mechanism in a SARL.

Given that these creditors' (bondholders') main intention behind becoming shareholders is to control and affect the resolutions of the general meeting of shareholders, thereby protecting their own interests and the objectives of the company. To this end, it may be recommended to specify in such agreements (notably in the case of S.A. and SCOP) that the convertible bonds would convert into impact shares instead of performance shares. This would not only increase the stickiness of the social goals but also alleviate the cost of review by the company's internal auditors. In this context, high-yield bonds are analogous, save that they confer on the borrower a kind of payment halt period.<sup>66</sup> For an SIS, the potential to defer interest payments helps to maintain the commitment to its social mission.

In short, it can be seen that this obligation of the SIS is accurate and intact, both in terms of its audience and sanction. Further, the rule is balanced between strictness and leniency. The absolute prohibition of issuance of debt instruments to members/shareholders and the unrestricted issuance to external parties, patch up the financing drawbacks of the former via the latter. In addition, both may protect the societal aims of companies to some degree through distinct two ways (circumventing performance shareholders from indirectly getting dividends, and bondholders' acquisition of control, as well as by depriving them of an essential source of generating profit inducements).

### ***3.3. The repurchase of shares from shareholders/members***

The 2016 law does not offer specific provisions on share repurchases of social impact companies (SIS), but restrictions on share buybacks may vary among various types of companies according to commercial company law.

In the event of cooperative societies (SCOP), the repurchase of equities, usually

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<sup>66</sup> *ibid.*

in the event of the withdrawal of members, and the reduction of the cooperative's capital as a result of such buybacks, is, in principle, a normal operation of these companies, and there is no need to convene a general meeting of the members to take a decision on this matter.<sup>67</sup> There is also a correlation between the repurchase of cooperative shares and the variability of the capital which may go up or down according to the entry and exit of members. In this case (withdrawal of a member), the proportion of impact shares is affected: should the departing member hold impact shares, all else constant, the performance share ratio would increase; vice versa, the percentage of impact shares increases. Thus, the former appears to be riskier than the latter in terms of achieving social goals.

In the case of private limited liability companies (SARL), which is approved as SIS, has few special restrictions on the purchase of its own shares by the company, subject to the provisions of the law.<sup>68</sup> However, if a company has no distributable reserves, its share buyback from shareholders is bound to reduce its share capital.<sup>69</sup> In this case, potential dangers analogous to cooperative societies may also be faced, and the realization of social objectives is consequently hindered. In addition, in the operation of share buybacks, attention needs to be paid to distinguishing a special situation.

Assuming that a shareholder who is guaranteed by his company is insolvent,<sup>70</sup> the company has repaid the debt he owes to the borrower. In this case, since he/she has become insolvent, the value of the claim held by that company is close to zero, which is in effect a de facto reduction of share capital.<sup>71</sup> Unlike a share buy-back, however, such a guarantee will only achieve this result if this shareholder is unable to pay his debts; this, though, cannot be assumed a priori, as the bank is unlikely to lend to him if it knows or expects that the shareholder would be incapable of repaying his debts when due, and so

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<sup>67</sup> Steichen (n 16) 551-562.

<sup>68</sup> Draft articles of association SARL SIS, s 6 (4); Draft articles of association SARL-S SIS, s 6 (4).

<sup>69</sup> Steichen (n 16) 577-624.

<sup>70</sup> An example would be a shareholder whose shares are pledged to a company, and after the company has paid off the shareholder's debt, it is obvious that she/he will not be able to repay its debt, given that the shareholder is insolvent. In this situation, the company would like to offset her/his shares against her/his debt.

<sup>71</sup> Loi modifiée du 10 août 1915 concernant les sociétés commerciales, ss 430 (15) and 1500 (7).

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this transaction cannot be regarded as a disguised share repurchase.<sup>72</sup> If he/she holds impact shares, this will adversely affect the statutory shareholding requirements.

In the case of public limited liability companies (S.A.), though, it is in principle not possible for a company to redeem its shares,<sup>73</sup> except in exceptional cases, e.g., where the purchase of its own shares is necessary to prevent serious and imminent damage to the company,<sup>74</sup> or where a person subscribes for shares in the company in his own name but on behalf of the company, and the subscriber is deemed to be subscribing in his own name, etc.<sup>75</sup>

In sum, besides the protection of the creditors' interests in companies, the share repurchases in SIS require more concern on the influence of capital reduction on the sustainable operation of these entities, the shareholding, as well as the realization of social objectives. Among these three types of companies, S.A.'s restrictions on share buybacks are more stringent than those of SARL and SCOP. However, the share capital reduction resulting from share repurchases tends to be related to the genre of shares repurchased and less relevant to the specific type of company. Hence, in terms of the impact on the achievement of social objectives, it is necessary to judge the repurchase based on the class of shares bought back, and in the case of impact shares, the focus would lie on their statutory shareholding and the potential risk to the attainment of the company's purpose. Given the variability of capital and open membership of cooperatives, though, share buybacks have a lesser impact on cooperative societies.

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<sup>72</sup> Steichen (n 16) 577-624.

<sup>73</sup> Loi modifiée du 10 août 1915 concernant les sociétés commerciales, s 430 (14).

<sup>74</sup> Loi modifiée du 10 août 1915 concernant les sociétés commerciales, s 430 (15).

<sup>75</sup> Loi modifiée du 10 août 1915 concernant les sociétés commerciales, s 430 (14).

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#### 4. *Third parties*

During the running of the SIS, its trade with third parties (outsiders), in terms of the disposition of the company's assets, and guarding social missions, in reality, impinge on both facets of the issue. For one thing, concern is required regarding the business transactions of SIS with third parties for goods, services, and so forth, in which the trading price is of critical relevance. It is also desirable, from the other side, to focus on the transfer of shares in the company, which may affect the accomplishment of the enterprise's targets in view of the different classes of shares and the legal forms in which they are ratified as the SIS.

##### *4.1. The transactions with third parties*

The Luxembourg law on social impact companies (SIS) does not provide any restrictions on transactions with third parties either. Even so, these companies are supposed to be in accordance with the legal provisions and civil customs, as well as the principle of good faith while trading with a third party.

The caveat is that in market transactions, if the SIS defaults, it is the company's own debt, and in the absence of a significant failure or fault of the management, the company is required to assume the debt by itself. In this case, the amount of the company's share capital plays a crucial role in its subsequent development. The minimum share capital of an SIS-accredited company is determined depending on the rules applicable to the legal form of the company. Taking into account that the minimum requirements for the share capital of the companies in those types are, in descending order: S.A. (€30,986.69),<sup>76</sup> SARL (€12,394.68),<sup>77</sup> SARL-S (€1)<sup>78,79</sup> and cooperative societies (no minimum capital), so in this scenario, the likelihood of survival of these firms is positively correlated with this ranking. In consequence, after paying

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<sup>76</sup> Draft articles of association SA SIS, s 5 (1).

<sup>77</sup> Draft articles of association SARL SIS, s 6 (1).

<sup>78</sup> Draft articles of association SARL-S SIS, s 6 (1).

<sup>79</sup> After the reform of the Luxembourgish commercial company law in 2016 (bill no. 5730), the minimum share capital of s.a. and s. à.r.l have amended, with which 30,000 and 12,000 euros.

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off their debts, S.A. has a more favorable pool of assets that may be better equipped to facilitate the implementation of social activities and the realization of public purposes.

On the other hand, it is worth looking at the issue of whether an SIS needs to distinguish between a counterparty's enterprise purpose and an SIS's social objectives in the course of a transaction with a third party, as well as the tax benefits available for such a transaction. Make it tangible, when an SIS trades with non-profit associations (ASBL). The latter belongs to the social and solidarity economy (SSE) and follows Luxembourg's requirements for SSE, whereby at least half of the profits ought to be reinvested in the maintenance and development of the associations.<sup>80</sup> Taking into account that the goals of such associations have a strong sense of social attributes, including but not limited to the promotion and development of social cohesion, the elimination of exclusion and inequalities in health, culture, and economic development, the promotion of gender equality, the protection of the environment, etc.<sup>81</sup>

It is believed that dealing with ASBL will not, in the grand direction, deviate from SIS's inherent purpose of serving social objectives. It is therefore not necessarily the case that SIS must strictly observe the identical rules as other market players when transacting with them: either below or above the market price, as agreed by both parties. The UK CIC's approach to dealing with third parties may provide an inspiration to this end, in that SIS may trade at market price (or even less than the market value) when engaging in market transactions with entities with similar societal objectives. For such transactions, the law has not yet clarified the tax benefits, but it is likely to be a trend in the future for the trade to enjoy an appropriate tax incentive for its initial intent.

To sum up, when social impact companies deal with third parties, where the latter are profit-oriented ventures, market rules for dealings apply, i.e., by mutual consent: the SIS will be expected to honor the terms of the contract. If it defaults, damages for breach may have to be paid (or even fines). The minimum share capital of the company in this case provides not only a cushion for the creditors but assists in the sustainability of SIS and the fulfillment of its social goals. In this respect, S.A. is most reassuring. When SIS transacts with entities who have similar aims, the writer looks

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<sup>80</sup> Loi du 12 décembre 2016 portant création des sociétés d'impact sociétal, s 1(4).

<sup>81</sup> Loi du 12 décembre 2016 portant création des sociétés d'impact sociétal, s 1 (2).

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forward to appropriate loose in the transaction conditions in order to facilitate the conclusion of the transaction, thus advancing the social objectives.

#### ***4.2. The transfer of shares to third parties***

As the 2016 law does not establish a regulatory system for the transfer of shares, it does not prohibit the circulation of these shares.<sup>82</sup> There are two situations in general as far as transfers of shares by shareholders are concerned, internal and external transfers. An inward transfer occurs whereby a shareholder/member transfers his/her shares to another one who also is in this company; the transfer of shares in this case is free. An outward transfer is where someone transfers his/her shares to a non-shareholder/member of this company (i.e., a third party). However, this differs from the former in that, in view of the diversity of legal forms of companies that can be accredited as SIS, the rules for the transfer of shares of such entities to third parties may be distinct which depends on the specific type of company.

In the case of private limited liability companies (SARL), neither shares nor profit shares carrying voting rights may be transferred inter vivos to third parties without the consent of shareholders representing at least three-quarters of the share capital.<sup>83</sup> Yet, if provided for in the articles of association, the percentage of share capital required for the approval may be lower (but cannot be below 50%).<sup>84</sup> In this context, the decision as to the inner pursuance of the societal goals of the transferee of the share rests in the hands of the voting shareholders, and it is predictable that in case of an overwhelming majority of the seats with voting rights held by the impact shares, the third party may well also fall within the category of impact investor. Also, an exception to this is when a shareholder passes away, such approval will not be required for the transfer of share to a descendant, an ascendant, or a surviving spouse.

In the event of public limited liability companies (S.A.), the transfer of shares is not restricted in a particular way under the law on commercial companies. It is worth

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<sup>82</sup> Hiez (n 15).

<sup>83</sup> Loi modifiée du 10 août 1915 concernant les sociétés commerciales, ss 710 (12) and 720 (1).

<sup>84</sup> Loi modifiée du 10 août 1915 concernant les sociétés commerciales, s 710 (12).

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noting that the transfer of registered shares<sup>85</sup> shall have an impact on the company if a declaration of transfer, dated and signed by the transferor and the transferee in the share register, or a notification of the transfer to the company (or the company's acceptance of the transfer) is sent to this company and recorded in a deed of authenticity.<sup>86</sup>

The situation of the two previous types of companies calls for a case-by-case analysis from the perspective of promoting the preservation of the SIS's purpose. Where the transferred shares are impact shares, the third party is constrained by the non-conversion of the impact shares into performance shares upon his/her participation and becomes a new shareholder. This scenario is unlikely to have a detrimental effect on the community purpose, given that both classes of shares are not as susceptible to alteration as compared to their prior shareholding. Should the shares be sold as performance shares, the performance shares may have a chance to be converted into impact shares after the new shareholder enters, so there is a possibility to increase the chances that the social commitment will be realized.

When it comes to cooperative societies (SCOP), these entities are not only expected to follow the provisions of the social impact company law but also to comply with the relevant regulations for cooperatives. Luxembourgish cooperatives are commercial companies all by themselves, as they are regulated by the law of August 10, 1915, on commercial companies.<sup>87</sup> Pursuant to this law, members of cooperatives are prohibited from transferring their equities to a third party,<sup>88</sup> and this is also confirmed

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<sup>85</sup> In an SIS, whether impact shares or performance shares, they are exclusively registered and issued at par. Thus, in the transfer of shares of S.A. that are certified as SIS, it is only necessary to discuss the registered shares (actions nominatives), neither bearer shares (actions au porteur) nor dematerialised shares (titres dématérialisés) will be dealt with here.

<sup>86</sup> The Government of the Grand Duchy of Luxembourg, 'Public Limited Company (SA)', <https://guichet.public.lu/en/entreprises/creation-developpement/forme-juridique/societe-capitiaux/societe-anonyme.html#bloub-11> accessed 4th November 2023.

<sup>87</sup> Hiez (n 50).

<sup>88</sup> Loi modifiée du 10 août 1915 concernant les sociétés commerciales, s 811 (1) ; Bruno Reolants, Capital Building in Industrial and Service Co-operatives in ICA: the Capital Conundrum for Co-operatives, <<https://www.ica.coop/sites/default/files/publication-files/ica-the-capital-conundrum-for-co-operatives-en-1892359719.pdf>> accessed 4th November 2023.

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in the model statute of the cooperative.<sup>89</sup> Consequently, those cooperative societies that have become SIS cannot be transferred to third parties either.

Why do cooperatives forbid the transfer of equity to third parties? A hint may be discovered by comparison. It could be argued that two reasons may lie behind the allowance of transfer of shares to third parties in the first two types of companies: new shareholders wishing to join, or the present shareholders intending to exit. However, since the latter can be accomplished by transferring shares to internal shareholders, the previous one, i.e., the entry of new shareholders, may seem to be better explained herein. Whereas in a cooperative, nevertheless, new members can obtain membership by subscription, and members who want to quit do not need to transfer their shares, but can be repurchased by the cooperative, besides transferring them to other members. Consequently, in the case of SCOP, there is no necessity to have a separate clause that permits members to transfer to a third party.

In summary, the sale of shares to third parties in the case of S.A. and SARL is theoretically conducive to the accomplishment of the purposes of social impact companies (SIS). But in the case of cooperative societies, due to the prohibition on the transfer of shares to third parties, though the provision is aligned with that of traditional cooperatives, in which the percentage of shares within the company is also indeterminate, given the variability of the cooperative's capital and, as a result, it is highly probable that at one moment the impact shares will account for less than one half of the capital without anyone being aware of it. For this reason, the SIS of the cooperative society is inferior to the first two types of companies in terms of the benefits of transferring shares to a third party for the protection of social objectives.

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<sup>89</sup> *ibid* 62.

## 5. *Conclusion*

This paper considers and analyzes distinct scenarios in which the asset lock during the regular operation of social impact companies (SIS), and the possible implications of this legal mechanism on the fulfillment of the societal purpose of the company, covering four main areas.

Firstly, regarding the link between the defense of the social mission and the duties of directors. On the one hand, as the law requires that the articles of association of SIS specify its objectives and visualize performance indicators, in this sense, in addition to the content of the fiduciary duty inherent to commercial companies, the directors are expected to guard the social purpose of these companies. As a consequence, directors are responsible for the contravention of any of these requirements.

On the other hand, the daily management of the company and the disposal of its assets are ostensibly under the control of directors, whereas, *de facto*, it remains the ultimate discretion of voting shareholders/members to determine the handling of all properties in these companies (as the appointment of directors rested on the decision of shareholders'/members' assembly). In order to protect the social orientation of such companies, shareholders/members dedicated to this emphasis necessarily keep a controlling stake; in SIS, the optimum situation would be for a company to hold only impact shares, whereby all shareholders stayed committed to it, and where there were few instances of shareholders 'defecting' in the quest for economic gain, and thereby destabilizing the core promise of social enterprises.

The second concerns the nexus between restrictions on the distribution of profits to shareholders or members and the safeguarding of the social purposes of the company, which entails not only the constraints on the dividend allocation to shareholders but requirements on the ratio of impact shares and share conversion, that affect the interests of the community.

For one thing, sorted by the degree of contribution to the pursuit of the social benefits, these are, in SIS, theoretically, in descending order of strength, for which there are three scenarios: i) where there are only impact shares in the company; ii) a coexistence of both types of shares, with performance indicators not reached; and iii) where both types of shares are present, and performance indicators are met. Needless

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to say, the first two situations contribute substantially to the realization of social missions from the perspective of the destination and usage of the assets, while in the last one, owing to the distribution of dividends, not all of the company's net profit would be used for the public interests.

Alternatively, as far as the single-way share conversion and the proportion of impact shares requirements are concerned, both provisions may be applied only where the two types of shares co-exist, and both are confined in practice. Whether the desire to convert performance shares into impact shares can be achieved depends on two variables, the voting rights of the shares specified in the company's operating agreement or charter, together with the passage of the resolution. It would appear that a minimum of half of the share capital for impact shares seems to be challenging to implement and validate in cooperative societies. Hence, both requirements, while on the surface designed to facilitate the fulfillment of the social purpose of SIS, may still face some hardships and challenges in practice.

Thirdly, regarding the implications for the pursuit of social aims of companies of the negative obligation to forbid granting loans or issuing debentures to shareholders/members. One of the main effects of the ban is to prevent shareholders from indirectly obtaining economic gain and thereby may not be productive to the attainment of the company's objectives. Beyond this, the negative obligation provides some room for the issuance of convertible bonds. In practice, whether such bonds can indeed be converted into what type of shares depends virtually on the agreement. If, however, the convertible bond has undergone a transfer prior to conversion, the result may vary by company form, whereby a private limited liability company (SARL) has an edge over a public limited liability company (S.A.) and a cooperative society. The provisions governing the SARL proper provide, ipso facto, a pro-social screening system for transferees, and such bonds are more likely to be converted into impact shares in the event that the condition for conversion is triggered.

In addition, with regard to the impact of share buybacks on SIS social targets depends on the type of company. Repurchases of shares by cooperative societies are closely associated with the exit of members from traditional cooperatives, which may unfavorably impact the shareholding requirement if this exiting member holds impact shares. The share buybacks by the other two kinds of companies may indirectly

undermine the realization of community benefits, apart from causing a reduction in share capital that is detrimental to the repayment of the company's liabilities.

The last aspect deals with the consequences of SIS transactions with third parties or the transfer of shares by its shareholders to them on the company's social objectives. The former relates to the type of entities to which the third party belongs and the aims they pursue. It may be within the boundaries of what the law would tolerate in the case of trading with organizations under the social and solidarity economy sector or with another company with similar missions at a price lower than the market price; otherwise, may adversely affect the utilization of assets in favor the social aims of the company. The transfer of shares by shareholders to a third party as such is not allowed in the case of cooperative societies. Insofar as that transfer is a quest for the future social objectives of the company, SARL has an advantage over S.A.