

Law Commission Review of Co-operative Law

Anthony Collins Briefing Notes

Briefing Note 4: Utilities: Market, State or Neither?

This Briefing Note focusses on how co-operation can provide a basis for the public ownership of utilities. It looks at the following:

1. Recent history and nature of utilities
2. Corporate ownership, mutuality and the politics of mutuality
3. Changes needed to UK co-operative law

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[The Law Commission](#) has been invited by Treasury to review the legal framework governing co-operatives and community benefit societies.¹ It has been asked to consider whether the current statute law which governs these organisations is *fitting to their nature and needs*, and *whether the current form of regulation is proportionate*.

The [All Party Parliamentary Group for Mutuels](#) has also announced that it will spearhead a campaign to co-ordinate a cross mutual sector response to the review.

We are producing these briefing notes because Anthony Collins is keen to support the Law Commission itself, the APPG process and all those who may wish to contribute to the review. The briefing notes are intended to assist by helping to raise awareness of this Law Commission review, providing some background information and describing the context for the review and encouraging conversation about important areas that might be included.

These notes are not intended to put forward particular changes to the law; but they are intended to provoke discussion. The aim is to stimulate dialogue within your sector and your apex or trade bodies about potential changes, so that this important opportunity isn't missed.

If you would like to talk to us about anything in the briefing notes, or anything else that might help you in engaging with the review, please contact one of us.

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¹ Historically known as "industrial and provident societies"

Anthony Collins Briefing Note 4: Utilities

1. Recent history of utilities

During the 1980s and 90s, telecoms, oil, gas, electricity and water were all transferred into private shareholder ownership alongside the establishment of a public regulator. These and other privatisations were driven at the time by an ideological opposition to public ownership, the aim to stimulate private investment, and an ambition to widen the ownership of core services to achieve 'popular capitalism'. These are the utilities we have today.

There are now multiple calls for renationalisation, particularly in the water sector where the parlous state of Thames Water and the refusal of shareholders to invest more capital appear to put the sustainability of these arrangements in doubt. The privatisations, as well as being a reaction against central economic planning, were also an attempt to address the monolithic providers of nationalised services: where the separation of ownership and control within state ownership had resulted in opaque governance arrangements which lacked real accountability and resulted in a poorly managed workforce.

These were all serious problems; but the nationalisations which had created them a few decades before had been part of a popular² programme of rebuilding the shattered post-war economy, which required decisive government intervention. Modern states were expected to ensure the provision of essential services, and a top-down command-and-control (military) approach had just proved itself. The nationalisation of coal, iron and steel, electricity and gas, rail transport, roads and inland waterways, civil aviation, alongside the establishment of the National Health Service and the welfare state were a massive step forward.

We seem to be left today with a polarised debate about ownership: public or private, the state or the market; if one fails, the other must be the solution. But this is a stalemate; the reality is that both approaches have serious challenges. Making ownership the starting point and a way to frame the debate entrenches that debate in the past. It limits both the scope of discussion and the imagination needed to explore alternative approaches. It is to be hoped that a broader range of solutions might be explored in the 2020s than in the 1940s and 80s.

Ownership and governance arrangements are simply a means to an end; there is a prior question to be considered first. Are core utilities to be founded on the basis of the pursuit of private benefit (the profit motive), or something else? That is a question about *purpose*, which relates to the fundamental nature of utilities, and this needs to be considered before turning to the design of ownership and governance arrangements.

The nature of utilities

Whilst there are multiple differences to be considered amongst the various utilities, there are perhaps two core features which they share:

² Labour won the 1945 election on a [manifesto](#) promising transfer into public ownership of "fuel and power industries, ... inland transport ... iron and steel ..."



1. a service which is essential to everyday living for everyone including private individuals, businesses, organisations and institutions. Utilities are those things which a resident or visitor would expect to be available today, on a fair, reliable, efficient and safe basis.
2. the nature of the basic infrastructure needed to enable such core utilities to be available now and into the future requires long-term or permanent assets which interact with and impact on both the natural and the built environment. Such interaction and impact must take account of the needs of current and future generations.

Given this universal need and asset-intensive nature, the operational arrangements must meet some basic requirements:

- long-term stability and some state oversight consistent with and appropriate for national interests including international relations and national security
- meeting essential quality standards
- responsiveness to those whose needs and interests should be taken into account, including users (customers), workers, adjacent owners and residents, and future generations
- appropriate motivation and incentive within the organisation to attract funding:
 - to cover the maintenance, replacement and installation of new or different infrastructure to meet changing human and environmental needs, and emerging science, and
 - to drive its efficiency and success in achieving its ultimate purpose.

Our investor-owned and publicly regulated utilities currently appear to be struggling to meet some or all of these essential requirements. A market-based approach would at least be expected to be able to attract funding but the case of Thames Water illustrates that even this is failing. The long-term stability required by national interests is then in doubt.

Some might argue that the failure is in the design of the regulatory framework. There can be a popular misconception that a regulator's job is to protect the public interest. A regulator's job, which is precisely set out in (and limited by) the wording of statute, is to regulate the target bodies according to that wording. This usually includes the power to stop a particular body from operating in the sector if it fails to comply; but it doesn't give the regulator a generic power to enforce public benefit over against private benefits for shareholders.

The regulated utilities (water, energy and telecommunications) all take shareholder primacy as the starting point and introduce a series of duties on regulators to enforce particular statutory requirements on providers. Much though we might wish it had, the legislation did not give the regulators the general power to rein in distributions when investors seemed to be doing rather well at the expense of customers and future generations.³ Such arrangements would not have attracted investors in the first place, and a market-based approach is predicated on their support.

³ The first specified duty of the water regulator is to protect the interests of consumers wherever possible by promoting effective competition; the second is to secure that water companies properly carry out their statutory functions; and the third is to secure that water companies can finance their functions through securing reasonable returns on their capital. (section 2 Water Industries Act 1991 as amended)



There is a strong counter-argument based on the evidence now of a number of decades that a market mechanism with a regulatory overlay does not adequately protect the public interest in a monopoly service. If that argument is correct, then the failing of the 1980s privatisations was an intellectual one: investor ownership is a system designed to deliver a private benefit to investors, or shareholder value; the interpolation of a public regulator does not change an investor-owned company into something that exists for a public purpose. A business either operates for private or public benefit: one or the other must come first, and refusal to acknowledge that truth is a fudge.

2. Corporate ownership

Calling for renationalisation in response needs to take account of what has already been learned about state ownership. Although a single national provider might minimise duplication and avoid the costs of creating some sort of competitive environment, having the state as a single owner has its own disadvantages. Politics and the media complicate the role of the state as owner. Other calls on public funds make investment difficult to justify.

Inherent in all forms of corporate ownership, whether private or public, is the separation of ownership and control. This refers to the fact that those individuals or managers responsible for running a business aren't its owners: they are agents appointed by the owners and hired to run it on their behalf. The risk created by separating ownership and control, recognised at least as long ago as 1776 by Adam Smith in the *Wealth of Nations*, is that managers fail to deliver the aims of the owners and instead pursue their own or some other agenda.

Company law is a highly developed mechanism formalising the relationship between owners (shareholders) and managers (directors), and is designed amongst other things to address this risk. These legal arrangements make directors directly accountable to shareholders who have the power to remove them. This, together with high levels of executive remuneration today ensure that directors deliver both the company's purpose and what investors want: shareholder value. The published share price is a constant monitor of their effectiveness.

Under state ownership, there are no investor shareholders. There is no share price telling would-be investors how the business is performing from a shareholder value point of view. Without investors holding managers to account, accountability remains in the hands of government, subject to all the complications of departmental responsibility and their competing interests, not to mention everyday politics. The only mechanism which customers, workers or other interested citizens have to express their views is the ballot box.

With hindsight, we may not like the privatisation solution adopted from the 1980s onwards, but the issues which it attempted to address were real and important.

Mutuality

Mutuality is an alternative form of corporate ownership. Rather than being owned by investors, mutuals are owned by those dependent on them, generally users or customers, and sometimes the workforce as well. A board and executive management are responsible for the business as is the case in a company, but instead of being accountable to investor



shareholders, they are accountable to the members. Aside from these structural differences, mutuals are different in nature from investor-owned companies, as is clear from their history.

Mutuality came into existence in the early 19th century because traditional corporate ownership, based on shareholder value and the profit motive, was failing to provide many people with access to the basic goods and services which they needed.⁴ Building societies made capital available to people wanting to buy their own homes; friendly societies helped to provide protection against sickness, accidents and other risks, and co-operative societies provided a general mechanism for trading in multiple different sectors. Co-operation primarily became established in food retail.

Mutual enterprise is characterised by collective self-help, where a group of people come together to provide access to something they and others in their community need. The principal objective is not, therefore, the making of a profit for anybody's private benefit; rather the objective is to provide the goods and services to those who need them. Making a profit, ensuring that income exceeds expenditure, is a necessary requirement for any business if it is to survive. But *maximising* profit is not the purpose of a mutual.

The essential purpose of a co-operative, the generic mutual trading mechanism, is to provide access to essential goods and services to anyone who needs them, without providing any special reward to anybody. Since being profitable is an essential requirement for a sustainable business, what happens to the profits that are generated in a mutual? The first answer is that they need to be reinvested to build the business and ensure that it survives to serve current and future generations. After that, there is a range of possible options.

- It may decide that it has made a greater profit than intended because effectively it has overcharged customers. The intention was to charge a fair amount to cover costs and overheads, and so a significant profit indicates that customers needed to be reimbursed. That is the purpose of the co-operative dividend, an ex post facto price adjustment to get back to a fair price. The dividend was paid to customers in proportion to their purchases, all of which were recorded in a ledger.
- Alternatively, workers may have been underpaid, and deserve further payment on the same basis.
- The co-operative may decide that it wishes to provide education to customers or workers, or access to books and newspapers; or to support the establishment of schools or medical facilities or other facilities for the benefit of the local community.

In other words, co-operation aimed to provide access to goods and services on a basis that was fair and equitable to everyone. Democratic ownership was the foundation for this to ensure that no one individual or group of individuals could capture the organisation for their own private benefit. A set of values and principles was developed as a way of building a movement of such businesses, to widen access to as many people as possible.⁵ This could equally be the basis for the ownership of public utilities. So why has it not happened before?

⁴ The [Rochdale Society of Equitable Pioneers](#) is regarded as the first co-operative, founded in 1844

⁵ The so-called Rochdale Principles, now enshrined in the [Co-operative Identity Statement](#)



Recent history

Mutuality thrived for more than a century, and played an important role in providing working class education and opportunity. Together with the charitable and voluntary sector, it was the foundation of the welfare state and the creation of the NHS, alongside the nationalisation programme referred to above. But with the rise of the investor-owned supermarkets and banks, co-operatives and mutuals became marginalised. The age of individualism and the pursuit of personal goals and gains saw limited attraction in collective, community-based self-help, which declined significantly in the second half of the 20th century.

By 2001, co-operation and mutuality were in the doldrums. With the building society sector decimated by demutualisation⁶, a recently failed attempt to demutualise Co-operative Wholesale Society (now Co-op Group)⁷ and co-op food market share having declined from a post-war high of over 30% to below 10% and decreasing, the UK Co-operative Movement had been involved in its own soul-searching. This resulted in the report of the Co-operative Commission to Prime Minister Tony Blair in January 2001, which certainly acted as a wake-up call to the movement.⁸ But it was the financial crisis of 2007-8 which had a major impact, as the systemic weakness of an economy dominated by and dependent on investor-ownership and the pursuit of private benefit became more widely recognised.⁹

In their manifestos for the 2010 general election, all three main parties were pro-mutual, and the Coalition's subsequent programme for government included a commitment to "support the creation and expansion of mutuals, co-operatives, charities and social enterprises, and enable these groups to have much greater involvement in the running of public services".¹⁰ But there was a political difficulty with mutual ownership.

Most public services had historically been conceived by municipal or state bodies to meet citizens' needs in the public interest. This had guaranteed levels of service for decades but had also led to a strong view, mainly on the left, that this was the appropriate or even the only way to deliver public services. This became entangled with the historical Labour Party commitment to common ownership¹¹, with which public (i.e. state or municipal) ownership became synonymous.¹²

But this was only ever one interpretation. In an article in the Observer in 1917, the author of the Labour Party constitution Sidney Webb sought to clarify that by 'common ownership', he intended to leave it open "to choose from time to time whatever forms of common ownership, from the co-operative store to the nationalised railway and whatever forms of [governance] that may in particular cases commend themselves".

⁶ <https://www.theguardian.com/business/2008/sep/29/bradfordbingley.creditcrunch>

⁷ Andrew Regan's failed attempt in 1997

⁸ https://en.wikipedia.org/wiki/Co-operative_Commission#:~:text=It%20was%20the%20second%20review,operative%20businesses%20in%20January%202001.

⁹ <https://www.mutuo.coop/ownershipcommission/>

¹⁰ https://assets.publishing.service.gov.uk/media/5a74a4b3e5274a5294069025/coalition_programme_for_government.pdf

¹¹ <http://www.labourcounts.com/>

¹² See Post Office: Made Mutual <https://www.mutuo.coop/post-office-limited-should-be-a-mutual/#:~:text='Post%20Office%3A%20Made%20Mutual',is%20just%20as%20relevant%20today.>



Mutuality and co-operation provide an alternative option to investor ownership capable of appeal across the political spectrum. It would be historically and conceptually inaccurate to regard it as either anti-statist or anti-capitalist. The important factor is that it provides a mechanism for enterprise which is neither controlled by the state, nor the market. It is driven not by the profit motive, but by the imperative to provide goods and services on a fair and equitable basis to all who need them, for the benefit of current and future generations.

Mutuality was briefly considered as a possibility in July 2000, when a planned transfer of Yorkshire Water into mutual ownership was withdrawn because of objections raised by the water regulator, Ofwat. Those objections were more concerned with process (insufficient involvement of customers), than with the idea of mutual rather than investor ownership.

Six months later in January 2001, Ofwat approved a proposed transfer of Welsh Water to Glas Cymru, which went ahead in May 2001.¹³ This transaction resulted in a company limited by guarantee, which therefore had no equity shareholders. This demonstrated, and still demonstrates today that equity funding isn't the only option for utilities.

But Glas Cymru isn't mutual. Instead it has a membership of about 70 individuals, appointed by an independent membership panel, with appropriate qualifications to fulfil the duty to promote the good running of the company in the best interests of its customers and the community of Wales. These arrangements were designed to meet the needs at that time and were chosen in preference to mutuality which was out of fashion and out of favour at the time as described above.

With the stalemate reached in the public/private debate, and Glas Cymru as clear evidence of the ability of a water company to survive for more than two decades without investor shareholders, there can be no reason why a future government should not explore mutuality as an option for the future ownership of a range of public services which share the core features referred to above. This leads to the important question of what changes are needed to co-operative law to make this more likely.

3. Changes needed to co-operative law

The first change is to modernise the legislation so that it is fit for purpose for today's needs. Whereas company law has had the benefit of extensive Parliamentary attention over its 180 year life, co-operative law has had very little. A number of important updates were made through private members bills from 2003 onwards, but these were effectively piecemeal. Comprehensive modernisation is required and is being carefully considered by the Law Commission to ensure its fitness for purpose for today's business environment.

Capital

One area where substantive change to the law is needed is in relation to share capital. Unlike company capital which is fixed and permanent (subject to more recent powers of redemption or repayment) co-operative capital is variable and commonly withdrawable by members. Although debt-funding is clearly an option, the ability to issue risk capital is an important facility, and any areas of uncertainty concerning co-operative capital need to be removed.

¹³ <https://corporate.dwrcymru.com/en/about-us>

The nature of co-operative capital is different from company capital: with one member, one vote, it does not allow control to be bought. Another difference is that on a solvent winding up, the members of a co-operative are entitled to a return of their capital, but generally have no entitlement to any share in the increased value of the business. The capital surplus is held by the members, as it were, on trust for future generations for the continuity of the business; or if the business is to be wound up, to fund other co-operative activities as the rules provide or the members decide.¹⁴

It is important that changes to legislation take into account these differences in nature, whilst at the same time ensuring that the capital provisions provide the certainty and the flexibility which is needed and expected today for institutional funding.

There is another important issue concerning the capital surplus, or heritage asset that has been accumulated over time from members' trade. This is the prize which predators wish to unlock, usually by the conversion of a co-operative into a company with no restriction on the distribution of the surplus.

Protection against demutualisation is an important factor in ensuring the robustness of such a mutual business. For mutuality to be a credible option for the ownership of mainstream utilities, it would be important for all parties including government and funders to have confidence that the organisation was not at risk of demutualisation. This was one of the reasons why Glas Cymru did not choose mutuality for its ownership and governance structure.

A further matter for legislation to clarify is the purpose or definition of co-operative. Company law now defines the purpose of a company as being for the benefit of the members, unless the articles of a company specify otherwise.¹⁵ Whilst a co-operative also exists to meet the needs of its members, it is not for their *private benefit*, in the way that a company carries on business for the benefit of its shareholders.¹⁶ Open membership is one mechanism by which co-operation avoids private benefit. Another is the form of disinterested ownership inherent in the nature of co-operative capital.

¹⁴ This approach to ownership is sometimes referred to as “disinterested ownership”, indicating that it is a form of ownership which is not for private benefit

¹⁵ Section 172 Companies Act 2006

¹⁶ It is interesting to note that Glas Cymru's purpose, as specified in its articles is to “provide high quality and better value drinking water and environmental services, so as to enhance the well-being of our customers and the communities we serve, both now and for generations to come.”

