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UK National Report on PECOL chapter 5
“Cooperation among Cooperatives”
(October 2014)

SUMMARY: 1. Cooperation Among Co-operatives – 2. UK Legal Provisions – 3. UK Practice. – 4. Lessons from UK Experience. - 5. Bibliography

1. Co-operation Among Co-operatives and UK Laws

This paper examines the implications of the UK's liberal system of business organisation law and extensive by-law freedom for the practice of inter-cooperation. It uses legal and historical analysis to address that issue.

1.1. The Concept

The principle of cooperation among cooperatives, or inter-cooperation, can be found in all the major international legal documents and instruments relevant to UK Cooperative Law¹. It was also intimately linked to the development of the cooperative movement in the UK. The explicit reference to this principle was only added to the ICA Statement at the Vienna Congress in 1966 but it was adopted without dissent and had been fundamental to the earliest UK cooperatives². That was particularly exemplified by the development of the Co-operative Wholesale Society Ltd and the Co-operative Union Ltd which, in their current manifestations, are analysed in part 3 of this paper to illustrate the operation in practice of UK legal provisions relevant to inter-cooperation. The development of the legal rules governing relationships between co-operative societies was strongly influenced in the mid- and late nineteenth century by the needs of those two growing organisations and those who originally promoted them³.

1.2. Types of Inter-Cooperation and the Role of Law

Inter-cooperation can, in principle, be classified into groupings (often called “federations”) concerned with protecting and promoting the interests of co-operatives in a socio-political sense. That is referred to in this paper as “horizontal inter-cooperation”. Long term groupings and relationships between cooperatives to pursue economic or commercial objectives are referred to in this paper as “horizontal inter-cooperation”⁴. In each case cooperative law

1 See ICA Statement of Cooperative identity, values and principles which refers to the value of “solidarity” and to the principle that cooperatives “serve their members most effectively and strengthen the co-operative movement by working together through local, national, regional and international structures”; ILO Recommendation 193 on the Promotion of cooperatives which reiterates the ICA Principles, and Council Regulation (EC) No 1435/2003 of 22 July 2003 on the Statute for a European Cooperative Society (SCE) which in art 2 facilitates the formation of an SCE by other co-operatives

2 W.P. Watkins, *Co-operative Principles Today and Tomorrow*, Cooperative Union, 1986, Chapter 2.

3 See J.F. Wilson, A. Webster & R. Vorberg-Rugh *Building Cooperation*, OUP 2013, pp 42-52; A. Bonner, *British Co-operation*, Co-operative Union Ltd, 1970, pp 78-86.

4 See, for example, C. Gide, *Consumers’ Co-operative Societies*, trans. Dublin Co-operative Reference Library, pub Co-operative Union, Manchester, 1921 p. 122.

influences the means used to pursue inter-cooperation, if only by setting limits to what is permitted and determining the advantages and disadvantages of available options.

A further division can be made according to the different legal relationships possible under national laws. Those arrangements may fit a spectrum ranging from complete integration e.g. by merger into one corporate body, via groups of enterprises, to loose contractual arrangements of varying degrees of permanence. They may leave different degrees of autonomy to the parties and be established for longer or shorter periods. Cooperatives collaborating to pursue economic or commercial activities are probably more likely to use the full range of possible legal structures or arrangements. However, if a legal system permits such variation, collaboration between cooperatives to pursue socio-political objectives could also take a range of legal forms. Independent co-operative societies usually form a federation, with its own corporate personality and financial and governance systems, to pursue their socio-political aims on behalf of its member societies and the UK cooperative movement historically followed that path for both types of inter-cooperation despite the legal system's flexibility in permitting other choices for the pursuit of both economic and socio-political objectives.

A legal system may pursue a policy of permitting, facilitating, or actively encouraging inter-cooperation. That is another spectrum to be considered. The UK system permits a wide range of options. Some of its provisions specifically facilitate inter-cooperative relations if the cooperative society structure is used both for the cooperatives establishing the secondary structure and for the secondary structure itself. However, few of its rules actively encourage inter-cooperation or facilitate the concentration of funds in the cooperative movement.

2. The UK Legal Provisions

2.1. The Legislation

(a) The Legislative Background in 2014

As noted in previous UK national reports for PECOL and elsewhere⁵, the issue of co-operative identity in UK Law is largely a matter of administrative discretion for co-operatives registered under the Co-operative and Community Benefit Societies Act 2014. That Act consolidated the previous primary legislation. The most significant change was the introduction from 1st August 2014 of a requirement to register a society under that Act either *as* a co-operative or as a community benefit society rather than registering it as a society on the basis that it fits one of those two categories⁶. However, the role of the Financial Conduct Authority (FCA) as registrar of societies remains and the approach of allowing substantial freedom to society statutes (or “rules” as they are called) to make their own arrangements continues, subject to the overriding requirement that, in the case of a co-operative, the society meets the registration requirement of co-operative identity on and after registration.

The freedom to use any of a number of different business structures for a co-operative also remains under the new legislation and applies in principle to structures that could be used for

5 See I. Snaith, *United Kingdom*, in D. Cracogna, A. Fici, H. Henry (eds.), *International Handbook of Cooperative Law*, Springer 2013, pp. 735-757; and I. Snaith, *Handbook of Cooperative and Community Benefit Society Law*, Jordan Publishing, 2014, pp 62-65.

6 Co-operative and Community Benefit Societies Act 2014 (CCBSA 2014) s 2(1) which implements and replaces the Co-operative and Community Benefit Societies and Credit Unions Act 2010, s 1.

either horizontal or vertical inter-cooperation. This report deals almost entirely with co-operatives registered as societies⁷. However, it is important to note that for horizontal, (or economic) inter-cooperation, the use of companies of various kinds has been quite common in the UK.

Some of the problems associated with the 2013 demutualisation and “bail in” rescue of the Co-operative Bank PLC and its serious knock on effects on the financial position of The Co-operative Group Ltd can be attributed to the use of a PLC subsidiary for that important aspect of horizontal inter-cooperation. More important causes of those problems can, however, be found in the Governance failings that developed in The Co-operative Group and its bank subsidiary as it evolved from CWS Ltd⁸.

In this part of the report, the framework provided by legislation and FCA Guidance are considered first and the statutes (rules) of the major secondary co-operative society as an example of economic integration and of the dominant UK federation are then used to indicate the concrete structures developed within that framework.

(b) Inter-cooperation under CCBSA 2014

While no separate registration status is set out for either horizontal or vertical inter-cooperation, whether economic or socio-political, CCBSA 2014 permits the creation of both types of structure within its general framework.

(a) Registration

A co-operative society can be registered with only two members rather than the usual three if both members are other societies⁹. The registration must be as a co-operative society if the purpose is to serve its own member societies rather than to benefit a non-member community. For any society, whether primary or secondary co-operative or community benefit society, registration must be “for carrying on any industry, business or trade (including dealings of any kind with land)”¹⁰. That requires a fairly wide definition to accommodate the role of a trade association or promotional association. However, Co-operatives UK and, before it, the Co-operative Union, have been registered on that basis by successive registrars.

Another encouragement to inter-cooperation is the availability of “Model Rules” (or “statutes”) supplied by sponsoring bodies, many of which are federal bodies. The use of these pre-approved rules with a limited number of changes substantially reduces the registration fee for setting up a cooperative society. That facilitates the registration of new cooperatives and supports federal bodies¹¹.

(b) Membership and Shares

7 See I. Snaith, *Handbook of Cooperative and Community Benefit Society Law*, Jordan Publishing, 2014, Chapter 1 for a discussion of different structures in this context.

8 P. Myners, *The Cooperative Group: Report of the Independent Governance Review*, pub. Cooperative Group Ltd, 7th May 2014 and see C. Kelly, *Failings in Management and Governance: Report of the independent review of events leading to the Co-operative Bank's capital shortfall*, The Co-operative Group 30th April 2014.

9 CCBSA 2014 s2(2)(b)

10 CCBSA 2014 s2(1)

11 See I. Snaith, *Handbook of Cooperative and Community Benefit Society Law*, Jordan Publishing, 2014, pp 76-77.

The CCBSA 2014 explicitly acknowledges that a corporate body of any kind, such as another society or a company, can be a member of a society and hold shares in it. Societies are also empowered to invest in the shares or on the security of other registered societies and enjoy the same limited liability for business debts as other society members¹². Where one society is a member of another, specific provision is made for the secretary and two committee members to make or sign documents on its behalf and there is no limit on the value of the shares that can be held by the member society, even if they are withdrawable¹³. The limit on the value of the withdrawable shares held by one society in another was specifically removed in 1867 to facilitate the development of the nascent Co-operative Wholesale Society Ltd as a secondary co-operative with the economic objective of collective purchasing on behalf of primary consumer co-operatives¹⁴. Those provisions apply to both primary and secondary co-operatives with other societies as members, regardless of whether their objectives are economic or socio-political.

The possibility of investment by one society in the withdrawable shares in another without any limit on the holding has always been an important element in the concentration of cooperative capital as an aspect of inter-cooperation and was particularly helpful in the development of the Cooperative Wholesale Society Ltd in the nineteenth and early twentieth century. Its corporate members could hold provide significant share capital. Since April 2014, the limit on holdings of withdrawable shares by society members has been raised to £100,000 and, from 2011, the limit on holdings of non-withdrawable shares in societies was removed for all members¹⁵.

The prohibition¹⁶ on any society, other than a registered credit union, operating a banking business if it has withdrawable share capital applies to both primary and secondary societies. That was why the CWS established the Co-operative Bank as a wholly owned subsidiary company, rather than a society, in 1972. The CWS Bank had functioned for 100 years as a department of CWS Ltd¹⁷. The registration of credit unions under CCBSA 2014 is governed by the Credit Unions Act 1979¹⁸ which acknowledges the different role of socio-political support co-operatives formed by credit unions by permitting the use of the words “credit union” in the name of any person or association which has the written permission of the FCA to use the name even if they do not actually operate in the financial services business by lending to their members. The FCA will normally only give that permission to associations or groups of credit unions.

(c) The Role of Society Statutes (Rules)

The CCBSA 2014 requirement that any registered society must have rules that contain provisions on the matters listed in section 14 of CCBSA 2014¹⁹ applies to both primary and secondary co-operatives. The listed provisions allow for the registration of societies with

12 CCBSA 2014, ss 27, 32 & 124

13 CCBSA 2014, ss 33 & 24(2)

14 See I. Snaith, *Handbook of Cooperative and Community Benefit Society Law* op.cit. P 35; J.F. Wilson, A.Webster & R. Vorberg-Rugh *Building Cooperation*, OUP 2013, p51; and A. Bonner, *British Co-operation*, Co-operative Union Ltd, 1970, pp 72-75.

15 CCBSA 2014 s 24

16 CCBSA 2014, s 4(1)

17 See A. Bonner, *British Co-operation*, Co-operative Union Ltd, 1970, pp 104-106, 170-171 & 361-362; and C. Kelly, *Failings in Management and Governance: Report of the independent review of events leading to the Co-operative Bank's capital shortfall*, The Co-operative Group 30th April 2014 pp 139-141.

18 CCBSA 2014, s 2(4) and Credit Unions Act 1979 s1(1).

19 CCBSA 2014, s 2(2)(c)

other societies, companies or individuals as members and give scope for a range of governance, share capital, profit distribution and membership arrangements which accommodate secondary co-operatives and associations of co-operatives for either economic or socio-political purposes²⁰. However, as is the case with primary co-operatives, the administrative discretion of the FCA about whether or not a society is a “bona fide co-operative” governs the content of those rules²¹. In Part 2.2 below the latest Guidance from FCA is used to flesh out their approach to this question and in 3 below the rules of the two major secondary co-operatives in the UK, The Co-operative Group Ltd and Co-operatives UK Ltd are used to illustrate how the flexibility provided by the legal rules is used.

(d) Agricultural Loan Societies

Section 22 of CCBSA 2014 specifically refers to secondary co-operatives in the context of agricultural and horticultural societies. It provides that societies consisting mainly of organisations of agricultural or horticultural producers or of persons engaged in forestry, like primary societies of that kind, can be registered to lend to their members without security if the society's object is to do that. That provision was introduced in 1961 to facilitate the use of primary and secondary co-operatives to finance the businesses of their farmer members²².

(e) Undistributable Reserves

An obstacle to the full development of undistributable reserves by co-operative societies using the CCBSA 2014 legal regime is their inability to adopt an “asset lock” which imposes a strict limit on the uses that can be made of assets. That device is only available to societies registered as community benefit societies. Other legal devices such as trusts can be used to achieve the same result but the inability of societies registered as co-operatives to use the device provided in CCBSA 2014 presents makes the achievement of a watertight dedication of a co-operative's assets to particular purposes more difficult and expensive to achieve than is the case for a community benefit society registered under the same regime or if a CIC is used with co-operative democratic control built into its constitution²³. The rules of many co-operative societies, including both Co-operatives UK and The Co-operative Group Ltd²⁴, prevent any distribution of surplus assets to members on their dissolution. However, without an asset lock, it remains legally possible for a 75% majority of members voting on a 50% turnout to vote to convert the society into an investor owned, non-cooperative company²⁵.

(f) Group Accounts

The most detailed treatment of secondary co-operatives and groups is to be found in the provisions about Group Accounts. A society which has one or more subsidiaries at the end of a year of account must ensure that group accounts are prepared for that year²⁶. As with

20 See, in particular, CCBSA 2014, s 14 paras 4 “Membership”, 5 “Meetings, voting and changes to rules”, 6 “Committees and officers”, 7 “Maximum shareholding”, 8 “Borrowing powers etc.”, 9 “Shares”, and 12 “Application of profits”.

21 CCBSA 2014, s 2(2)(a)

22 Industrial and Provident Societies Act 1961, s 2

23 CCBSA 2014, s 29 and the Community Benefit Societies (Restriction on Use of Assets) Regulations 2006 SI 2006/264

24 See Co-operatives UK Rule Book 2013, rule 76 and The Co-operative Group Rules registered September 2014, rule 124.

25 CCBSA 2014, ss 112-114

26 CCBSA 2014, s 98(1) & (2)

revenue accounts for a society, these group accounts must give a true and fair view of the state of affairs and income and expenditure of the group as whole so far as the members of the society are concerned²⁷.

To decide whether a society has a subsidiary, the test is whether the holding society either (1) is a member of the other society and controls the composition of its committee or (2) controls of a majority of the votes to which members are entitled under its rules. If either test is satisfied one society is a subsidiary of the other. In a secondary co-operative in which the principle one person one vote does not apply, it is possible for another society to hold control²⁸. This test applies in principle to both horizontal and vertical inter-cooperative structures but is more likely to arise in the case of horizontal structures.

(f) Available Legal Relationships for Inter-cooperation and their problems

Under general contract law and corporate law it is open to societies to use the full range of corporate and contractual relationships with each other and with other business entities. They can own company or society subsidiaries 100% or have a smaller stake in them. Those relationships can be combined with contractual relationships just as they can for any other business operating in the UK.

In particular, co-operatives can set up joint ventures in the form of special vehicles partly owned by each of the parties to the venture or by detailed contractual arrangements short of establishing a separate corporate body. Those facilities have been widely used by the UK consumer cooperatives and continue to have an important role.

Here I shall focus on issues that have arisen recently as a result of aspects of the broad freedom enjoyed by UK cooperatives. It focuses on the protection of cooperative identity in the light of the freedom to enter these commercial relationships.

The intellectual property of a society in the form of trade marks, copyright and brand identity can be transferred, licensed or jointly owned under the general law applicable to such property. That system was used by the Co-operative Group to develop a co-operative brand “The Co-operative” for use by the Group and all the other independent consumer co-operative societies that chose to sign up to that arrangement. As a commercial move, that was intended to provide a unified image for marketing purposes and that process was allied to the development of the Co-operative Retail Trading Group as a purchasing organisation for those consumer co-operatives wishing to sign up to it. Complex contractual arrangements between societies and with their suppliers underpin the brand and its use. All of those arrangements operate as part of the general laws governing contract and intellectual property rights and are outside the direct scope of the legislation under which co-operatives are registered. The use of this system, developed and extended to enhance the movement's business success on the recommendation of the Monks Commission in 2001²⁹.

When the Cooperative Bank was demutualised in its 2013 rescue, those arrangement entitled the investor owned bank to continue to use the trade mark and name despite no longer having the status of a co-operative in accordance with ICA Principles, being registered as a society, or

27 CCBSA 2014, s 98(3)

28 CCBSA 2014, s 101

29 See Cooperative Commission, *The cooperative advantage, The Report of the Cooperative Commission 2001*, Co-operatives UK, 2001

meeting the criteria of ownership for a co-operative. Under the Companies Act 2006, the protection of the name “Cooperative” applies in its strict form only at the point of registration of the company³⁰. The only power to require the bank to change its name to remove the title “cooperative” lies with the Department of Business Innovation and Skills and that generally applicable power requires the Minister to believe that the name misleads the public before he can order a name change³¹. That power has not been used and Cooperatives UK has announced the admission of the investor owned Cooperative Bank as an associate member which is a non-voting membership based on the bank’s commitment to support “the purpose and objects of [Co-operatives UK], [and] co-operative principles and practice”³².

The Co-operative Group, which has an ownership stake of approximately 20% of the share capital in the investor owned Bank, is the largest single member of Cooperatives UK and is clearly concerned to maximise the Bank’s value on the Stock Market to offset the large capital injections it has had to make into the bank as part of the rescue package. The Cooperative Bank’s business strategy is to continue to market itself as an ethical business and any obstacle to that might adversely affect its share price on the Stock Market and therefore the value of the Co-operative Group’s stake. This was a more acute example of a problem that had already emerged when the Group decided to leave the travel business through a joint venture with Thomas Cook a subsidiary of the large HSBC Bank. That involved outlets labelled and branded “Cooperative Travel” operating under the majority and eventually complete effective ownership of Thomas Cook.

Both examples indicate that without specific legislative protection of the word “cooperative” across a range of legal areas, beyond business names, it will be difficult to prevent its misuse through the transfer of intellectual property and contractual rights and changes of ownership of legal entities using the name. The recent history also raises important issues about the role of federal organisations when a single cooperative member has a dominant position in the market and, accordingly, in the Federal if votes and subscription levels relate to turnover or trade. The ICA has begun to address this issue with its adoption of a “coop marque” which was launched in 2013³³.

(g) Merger of Cooperatives

CCBSA 2014 provides for the reorganisation of societies and permits inter-co-operation by merger. That is a highly integrated form of inter co-operation and requires the agreement of the members of at least one of the societies by special majority as it goes beyond the purely contractual and affects the existence of the society and the rights of its members.

It is possible for a society to transfer its engagements to, or amalgamate with, another society or a company; or to convert into a company and for a company to convert into a society³⁴. In no case does the legislation impose rules about the destination of assets or surplus. The “asset lock” system which deals with that issue applies only to community benefit societies and not

30 Companies Act 2006, s 56 and The Company, Limited Liability Partnership and Business Names (Sensitive Words and Expressions) Regulations 2009 SI 2009/2615

31 Companies Act 2006, s 76, *Association of Certified Public Accountants of Britain v Secretary of State for Trade and Industry* [1998] 1WLR 164 and see my comment at <http://www.iansnaith.com/?p=670>

32 Co-operatives UK Rule Book 2013, rule 6 and see Cooperatives UK press release of June 2014 at <http://uk.coop/pressrelease/co-operative-bank-joins-co-operatives-uk>

33 www.identity.coop

34 CCBSA 2014, ss 109-111

to co-operative societies³⁵.

A transfer of engagements usually involves a transfer of the whole business of a society with all of its assets and liabilities to another society or a company. The transferring society is usually then removed from the register as it no longer has any property, obligations or members. It is possible for a society which transfers its engagements to retain some of its assets and to remain in existence but this is rarely done. An amalgamation of societies or a society and a company results in the two entities becoming one entity and the property of both of them vesting in the one. A conversion from a society to a company or vice versa results in the continuing existence of the same entity as a different type of corporate body with removal from one register at the moment of registration on the other.

A higher majority is required for any of these procedures if they involve transformation into, or transfer of engagements to, a company rather than another society. Then, the resolution must pass by a majority of three quarters of the qualifying members who vote in person (or, if the society's rules permit it, by proxy) in a vote in which not less than half of the society's total qualifying membership voted³⁶.

Such a transformation involving another society requires only a two thirds majority to pass the resolution and has no requirement about the proportion of the total membership which participates in the vote³⁷. In both cases, the procedure involves two separate meetings of the society. The first meeting must pass a special resolution which requires a three quarters or two thirds majority plus, if transformation is into a company, participation by at least half of the membership. The second meeting confirms the decision of the earlier meeting by an ordinary resolution with a simple (50% plus) majority and no turnout requirement. The higher majority and turnout requirements apply to a transformation into a company regardless of whether the company is investor controlled and "for profit" or another co-operative or a Community Interest Company (CIC). The deciding factor is the legal form not how profit or surplus is dealt with.

The legislation says little about the detailed nature, operation and consequences of these procedures. It concentrates on the procedure used to carry them out and any detailed provisions are generally found only in the resolutions which carry out the restructuring. This reflects the liberal approach of the UK system which leaves the choice to members when they vote for or against the resolution. The legislation also provides few detailed obligations about the information to be provided to members when they vote on the reorganisation. That is a matter for the rules of the society resolving to carry out the procedure. The members of a co-operative are, as far as the legislation is concerned, free to choose to demutualise or otherwise reorganise their society providing the correct procedure is used and the resolution is passed by the majority required by the legislation.

Since April 2014, it has also been possible for societies to reorganise themselves by using the procedure open to companies under Part 26 of the Companies Act 2006. The Part 26 procedure applies to permit societies, by a combination of court-ordered meetings of classes of shareholders or creditors, weighted voting by those groups at the meeting, and a final court approval of the scheme agreed, to make a binding compromise or arrangement between the

35 CCBSA 2014, s 29 and the Community Benefit Societies (Restriction on Use of Assets) Regulations 2006 SI 2006/264

36 CCBSA 2014, ss 112-114

37 CCBSA 2014, s 111

society and its members or any class of them or the society and its creditors or any class of them. This can be used for corporate rescue or for restructuring. It applies to both solvent and insolvent societies.

Part 26 has applied to societies from 6 April 2014 with provisions to require FCA certification that it is not contrary to the society's rules or the provisions of CCBSA 2014 or CUA 1979 and to ensure that the FSCS, the PRA and the FCA are involved if the society is an authorised person³⁸. Like administration and CVAs, this procedure is not available to societies operating as private registered providers of social housing or registered as social landlords.

This procedure is likely to be used only by large societies in complex situations in which no other procedure is available because it is expensive and slow.

2.2. FCA Guidance on the Registration of Cooperative Societies

In October 2014 the Financial Conduct Authority (FCA) which is the registrar of co-operative societies, issued a formal Consultation Document containing its proposed Guidelines about how it intends to exercise its discretion in respect of the registration of co-operatives under the CCBSA 2014. Since it seems likely that the wording of that document will be subject to limited change before it is formally adopted early in 2015, this paper uses it as a basis for comments on the FCA's approach to inter-cooperation. Under the UK system the FCA's administrative discretion is central to the operation of the legislation and is vital in determining when co-operatives can be registered and whether they can remain registered under CCBSA 2014.

The FCA indicates that the key requirements for registration as a co-operative are “partially aligned to” the ICA Statement which is set out in full in an Appendix to the Draft Guidance³⁹. Accordingly, the FCA generally require registered societies to operate on the basis of one member one vote (OMOV) but accept that in secondary co-operatives it may be fairer to base voting on trade between societies. They also accept that member votes may be weighted in a way different from OMOV in multi-stakeholder or hybrid co-operatives with different classes of member. However, the aim of any departure from the OMOV principle must be the protection of non-investor member rights and measures that link votes to the amount held in shares will not be accepted⁴⁰. This reflects the ICA Principle and underlines the importance of de-emphasising the role of capital in co-operative societies, whether primary or secondary.

The FCA Guidance also provides that “subsidiaries wholly owned by a co-operative parent should still remain fully committed to the co-operative values and principles”⁴¹. That emphasises the actual functioning of the business in the subsidiary and the relationship of the holding cooperative's members with the subsidiary when they transact business with it. This applies to both subsidiary companies and subsidiary societies.

Para 4.6 adds The Guidance adds the important new qualification that a society will not “generally” be considered a co-operative if most of its goods or services are sold or delivered to non-members, its business benefits non-members, and more than 25% of the members are

38 The Industrial and Provident Societies and Credit Unions (Arrangements, Reconstructions and Administration) Order 2014 SI 2014/229 article 6 and Sch 2

39 Financial Conduct Authority, *Guidance on the FCA's Registration Function under the Co-operative and Community Benefit Societies Act 2014*, CP 14/22, October 2014, paragraph 4.4.

40 Ibid. para 4.4.4

41 Ibid para 4.5.

simply investors and have no other relationship with the society. This underlines the significance of specifically co-operative transactions and the need for a relationship based on more than simply holding capital⁴². This provision originates from concerns about the emergence of renewable energy “co-operatives” which are technically unable to sell the energy that they generate to their members as it is sold into the national electricity grid. Some of these societies have raised funds by issuing shares to members who have no relationship with the society as producers or consumers. Such societies should be registered as community benefit societies rather than cooperatives.

The new Guidance indicates that the FCA is becoming more proactive in its role of ensuring that only bona fide co-operatives are registered. That will affect both vertical and horizontal secondary cooperatives.

3. The UK Practice

3.1. Cooperative Union, ICOM and Cooperatives UK

(a) Historical Development Leading to Co-operatives UK

The origins of the UK's main federal co-operative can be found in the earliest days of the UK consumer co-operative movement and it emerged from the early Co-operative Congresses. A central board was established in 1870 but the society which remains as Cooperatives UK was first registered in 1889 as a federation of societies. Its membership was dominated by the consumer co-operatives, although it also served the few worker cooperatives in existence at that time⁴³. However, in the 1970's a significant number of small worker co-operatives were established and most of them were members of the Industrial Common Ownership Movement and used a model under which all assets were collectively held and could not be handed over to members but were rather passed on the other co-operatives. Their members held only a token £1 share each. By the 1980's there were 1400 of these co-operatives and many local authorities funded Co-operative Development Agencies to promote the model, alongside a the national Co-operative Development Agency⁴⁴.

In 2001 the Co-operative Union and ICOM merged to form the present Cooperatives UK which has consumer cooperatives, worker cooperatives and cooperative development organisations as members and seeks to comprehensively represent the whole UK Movement. Its current rules and governance structure reflect that history.

(b) Co-Operatives UK current Rules⁴⁵

Rule 2 sets out the purpose of the organisation:

“The purpose of the Society is to be a successful co-operative enterprise providing support for the creation and maintenance of businesses and enterprises which:

- reflect the aspirations of the founders of the Society to the creation of a Co-operative Commonwealth; and

42 Ibid para 4.6.

43 See A. Bonner, *British Co-operation*, Co-operative Union Ltd, 1970, pp 81-83 & 116-118

44 J. Birchall, *Co-op: the people's business*, Manchester University Press, 1994 p 196

45 See generally, Co-operatives UK Rule Book 2013 available on their website

- are founded upon principles of social justice and democratic control, such as the International Co-operative Alliance (“ICA”) Statement on the Co-operative Identity, the Co-operative Principles published from time to time by the ICA or the principles of common ownership contained in the Industrial Common Ownership Act 1976.”

Its objects include:

“spreading knowledge about, and promoting the values and principles of Co-operation; supporting the growth and development of enterprises based on principles of social justice and democratic control; representing its membership at a national level and with the European and international co-operative movements; promoting the interests of its members and the principles of social justice and democratic control at all levels of government including local, regional, national and European; strengthening and enlarging the co-operative movement; and fostering a sense of shared ownership and interdependence amongst its members.”
(rule 3).

Membership is open to bodies corporate (which includes societies, companies, and LLP's), firms, and organisations on the basis that they support that purpose and co-operative principles and practice. Member groupings for voting purposes include: consumer co-operatives; worker owned co-operatives; enterprise owned co-operatives (including consortium, agricultural and secondary co-operatives); mixed ownership co-operatives such as multi-stakeholder co-operatives; Mutuals; co-operative development bodies; federations and associations representing sectoral co-operative or mutual interests; and, even more broadly, associate members (rules 6 and 7). The governance rights of worker and consumer co-operatives and co-operative development bodies in the Rules can only be changed by a general meeting resolution or referendum but the rights of other categories of member are fixed by the board from time to time (rule 8).

Each member holds only one non-withdrawable and non-transferable share of 25p and must pay an annual subscription based on their trade with the society and the scale of their business. Subscription levels are fixed by the board according to the categories of member (rules 12-13). membership sections are established to form the basis of meetings, voting rights and the election of directors. Every member has one vote by virtue of their membership plus extra votes in proportion to their subscriptions (calculated twice yearly), with a cap of 40% of total votes (rule 26).

The Co-operatives UK board consists of members appointed in various numbers (fixed in the rules) by different categories of member and according to the size of the larger consumer co-operatives. The Co-operative Group appoints six, the two next largest consumer co-operatives appoint one each and other consumer co-operatives appoint four between them. Two represent worker co-operatives. Mixed ownership co-operatives, enterprise owned co-operatives, non-retail consumer co-operatives, members that are federations, and co-operative development bodies have one director each. That division of board places is reviewed every four years but any proposed change must be agreed, like other rule amendments, by the society general meeting by a two thirds majority based on the Sections' weighted voting rights (rule 28).

Profits are not distributed to members but held in a reserve fund for the pursuit of the purposes of the society (rule 56). On dissolution, any surplus is passed to a co-operative which pursues the same objectives and purpose or to a member society with a similar rule preventing surplus distribution to its own members, in each case, chosen by the members in general meeting (rule 76).

These rules demonstrate the diversity of the structures used by cooperatives and the complexity of any effort to represent them proportionately. The flexible and open nature of the legal regime has allowed this complex structure to develop.

3.2. Co-operative Wholesale Society and The Co-operative Group

(a) History of CWS & The Co-operative Group

We noted above the importance of the Co-operative Wholesale Society Ltd in the early development of the UK Co-operative Movement. As the number of societies reduced due in part to a policy of encouraging merger when societies were performing badly, the UK consumer co-operative movement became concentrated in a few societies. Co-operative Retail Services was established as a subsidiary of CWS to develop co-operatives in areas without them. It became an “ambulance” into which unsuccessful societies transferred their engagements. As that happened, the proportion of the board and of votes at the general meeting representing individual members grew and the role of CWS in CRS shrank. Eventually each society went its own way and by 2000 CRS was in such serious financial difficulties that it had to merge with The Cooperative Group. That gave individual members majority control of the Group and meant that the independent societies became a minority.

In the case of both CRS in the late 1990's and the Co-operative Group up to 2013, there was a catastrophic failure of the directors elected by the individual members to hold the societies executives to account for poor business decisions or to improve the quality of the executives⁴⁶. It was this failure which led to the crisis of 2013 and resulted in the reform of Cooperative Group governance along the lines common in listed PLC's with a majority of Independent Non-Executive Directors and a requirement of business competence as well as co-operative membership and commitment for all directors⁴⁷. For individual member decisions there has been a move away from a complex three tier delegate system of member democracy to a system of one member one vote. That is combined with votes according to trade for the remaining corporate members.

A Members' Council has powers to hold the board to account, to report to members and controls all membership matters. It is intended to ensure that the board operates in accordance with co-operative principle and values. The Council is empowered to promote active membership and to be a bridge between the board which deals with business matters and the wider membership who elect and remove directors and make key decisions. It is hoped the system will avoid the problem of member inactivity and apathy in the one member one vote

46 For a detailed history of that process see J.F. Wilson, A. Webster & R. Vorberg-Rugh *Building Cooperation*, OUP 2013, pp 298-387

47 For an analysis of the governance failings and recommendations on which the new governance structure is based see P. Myners, *The Cooperative Group: Report of the Independent Governance Review*, pub. Cooperative Group Ltd, 7th May 2014. C. Kelly, *Failings in Management and Governance: Report of the independent review of events leading to the Co-operative Bank's capital shortfall*, The Co-operative Group 30th April 2014 also has useful pointers to how the problems affected the Bank.

direct election context.

That change was implemented in October 2014 and the rules that embody it are outlined below. This is relevant to your concern with cooperation among cooperatives as the system resulted from the UK's historical approach to secondary cooperatives.

(b) RULES OF THE CO-OPERATIVE GROUP – 2014 version⁴⁸

From October 2014 the Co-operative Group has a completely new governance system and its revised rules implement that. However, the new rules still reflect the hybrid nature of the Group as consisting of both individual members and corporate members.

The purpose of the Group is “to serve its Members by carrying on business as a co-operative for the benefit of its Members in accordance with the Values and Principles” and in accordance with any agreed expression of purpose recommended by the board and council and approved by members' meeting from time to time (rule 5). Its objects and powers are to operate businesses “in accordance with its purpose” (rules 6-7). The governance structure involves an allocation of powers between the members' general meeting, the Council and the Board. The Board consists of seven independent non-executive directors nominated by the board after a recommendation by its Nominations Committee and endorsed or rejected by a majority vote at the general meeting without a contested election. A minority of three directors are nominated by members and elected in contested elections in which all members can vote. Two directors can be executive directors (the Chief Executive and one other).

In the election process individual members who meet a minimum purchasing qualification have one vote each across the whole society but collectively hold a proportion of votes determined by the trade of individual members as a whole as a proportion of total trade. Independent society members each have a number of votes depending on their trade with the society. That same voting process applies in society general meetings and in referenda about resolutions and policy issues. Members not present at a members' meeting can vote by appointing a voting representative but must instruct that person how to vote on each resolution to be considered at the meeting (rules 38 to 41).

The independent society members are entitled to fill 20% of the seats on the Senate of the Council. The Council and Senate operate as guardians of members' interests by vetoing certain rule changes and particularly any attempt to demutualise the society, reporting annually to the members on the society and the board's performance in upholding values and principles, and determining eligibility for membership. It also has extensive rights to hold the board to account by insisting on information, reporting to members on whether or not directors should be re-elected, being consulted by the board and seeking to influence its decisions. It also engages in consulting members and representing the society. The purpose of these bodies is to provide members with recommendations and information to help them in exercising their democratic control of the society and to influence board policy and decisions by the power to report to members on board performance and whether or not particular directors should be re-elected.

4. Some Conclusions from the UK Experience

⁴⁸ See generally The Co-operative Group Rules registered September 2014 available from the Co-operative Group website.

- The absence of clearer legal constraints and requirements for cooperation among cooperatives allowed considerable diversity and variation
- It also allowed the formation of an enormously concentrated horizontal secondary/hybrid cooperative in the Cooperative Group
- The practice of merging unsuccessful cooperatives with surviving societies concentrated the problems of horizontally integrated secondary cooperatives.
- The vertical federation has moved towards more comprehensive membership by including cooperatives of all kinds and emphasises the provision of services to cooperatives and the promotion of more cooperatives.
- This story may indicate the problems and limits of a liberal legal approach to cooperative structures which permits the use of a range of structures including companies
- The availability of contract and intellectual property laws which do not offer protection for the name “cooperative” may be a problem that needs to be addressed although the ICA's new “coop marque” initiative may help over time.
- The registrar of societies appears to be moving towards a stricter approach but that only applies to cooperatives registered as societies and other legal models continue to be available for cooperatives to use.
- The Cooperative Group's use of a governance model based on board business expertise and the separation of member participation from direct business decision-making seeks to address the agency problem in a cooperative context.
- Only time will tell whether this will lead to greater “companisation” of UK cooperative practice and how effectively the classic problem of expertise vs member control is addressed by the new system.

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