

# Overview and Scrutiny

## Short Review into Mutualism

### Public Accounts Select Committee

March 2011

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#### **Membership of the Public Accounts Select Committee:**

Councillor Alexander Feakes (Chair)

Councillor Jim Mallory (Vice - Chair)

Councillor Christine Allison

Councillor Skip Amrani

Councillor Janet Daby

Councillor Vicky Foxcroft

Councillor Helen Gibson

Councillor Sven Griesenbeck

Councillor Michael Harris

Councillor Madeliene Long

# Contents

1. Chair's introduction
2. Executive summary
3. Purpose and structure of review
4. Background

What the Committee means by mutual  
Advantages and disadvantages of mutuals  
Policy context  
Support for mutuals  
Legal considerations  
Community interest in providing public services

5. Findings

**Mutuals to deliver public services:**

Sustainability  
Willingness of potential participants  
Skills of potential participants  
Scale  
Agreeing a framework  
Encouraging proposals  
External expertise  
Assets

**Mutuals in the wider economy:**

Support  
Entrepreneurialism

6. Recommendations
7. References
8. Appendices

## 1. Chair's Introduction

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Cllr Alex Feakes  
Chair of the Public Accounts Select Committee

## **2. Executive Summary**

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### 3. Purpose and Structure of Review

3.1 The Committee agreed that its review would aim to:

- Start the process for considering (a) whether any assets or services currently owned or run by the Council are suitable for employee, service user or community control or ownership; (b) whether the Council should be promoting this; and, (c) if so, how it can do this and what practical assistance it can offer.
- Consider whether the Council should be promoting and supporting mutualism in the wider borough economy for both 'not for profit' and 'for profit' enterprises; and, if so, how it can do this and what practical assistance it can offer.

3.2 The review was scoped in September 2010 and a special meeting was held in January 2011 to consider a background report on the issue and hear from three expert witnesses:

- Barry Quirk (Chief Executive, London Borough of Lewisham)
- Karen Wilkie (Deputy General Secretary of the Co-operative Party)
- Sergio Olivares (Director of Greenwich Co-Operative Development Agency).

3.3 The Committee agreed its recommendations in March 2011.

### 4. Background

#### What the Committee means by 'mutual'

4.1 Although the key values, beliefs and commitment to member ownership are the same for both mutuals and co-operatives, the two types of organisation are different.

4.2 *Mutual organisations* are organisations owned and controlled by their members (typically employees or customers of the organisation in question). Mutuals raise funds from their members in order to provide their members with services; and any profits are normally reinvested for the benefit of members. The members of a mutual are normally members because they receive a particular service or product. (e.g. a mutual building society)

4.3 *Co-operatives* are very similar to mutuals but they are democratically controlled by their members and normally have open membership. They often deal with more tangible goods than mutuals and members are normally members because they join. (e.g. The Co-operative Group)

4.4 Mutuals and Co-operatives are not to be confused with *Social Enterprises*. Social enterprises are businesses driven by a social or environmental purpose and they are not necessarily mutuals or co-operatives, although they may choose to operate in a mutual way. They are often limited companies, charities or community interest companies, where profits are re-invested to sustain or further the business's mission for positive change. Whereas mutuals generally exist to distribute benefits to a closed group of members

rather than the wider community, social enterprises do not generally restrict their services in this way.

- 4.5 Mutuals, co-operatives and social enterprises can be governed and legally constituted in a variety of different ways. More information on this can be found at **Appendix A**.
- 4.6 The Committee focused its scrutiny review on mutuals. The review considered:
- Employee-led, service-user led and community-led mutuals
  - Mutuals involving asset transfer and mutuals not involving the transfer of assets
  - Mutuals providing services traditionally provided by the public sector
  - Mutuals providing services in other sectors (both 'not for profit' and 'for profit').
- 4.7 Ownership of a mutual can be direct or indirect. Direct ownership means employees/service users/ the community purchase or are given shares. Indirect ownership means the relevant equity is placed in trust or other type of mutual society, which acts on behalf of the employees/service users/ the community.

#### **Advantages and disadvantages of mutuals**

- 4.8 The following bullet points are often cited as being among the benefits of mutuals:
- Mutuals which provide services currently provided by the public sector might allow public organisations to protect the delivery of key services in the context of significantly reduced funding. Funding can be focussed on priority areas, with the community and voluntary sector providing other services.
  - Mutuals might produce more tailored and effective services as service users/the community/employees might have a greater appreciation of need.
  - Employee-led mutuals might increase efficiency as front line staff might be better placed to see how things can be done better; and might be more motivated as the business will belong to them. They might also be cheaper as they will be free of (a) corporate recharges such as the cost of democracy, (b) corporate management overhead costs, (c) the cost of corporate insurance and so on.
  - The development of mutuals might empower the local community and help foster civic engagement and community volunteering.
- 4.9 The following bullet points are often cited as being among the drawbacks of mutuals:
- Employees, Service Users and the local community might not necessarily have the capacity, ability or the desire to run services and/or take on assets. Fostering an ethos of community engagement and involvement and empowering the local community to run services will take a great deal of time and effort. Communities will need to be prepared and ready to take on responsibility for resources and it will take time to foster co-

operatives based on a strong sense of membership and belonging and a shared understanding of purpose.

- A recent review by the Third Sector Research Centre suggests that, at present, there is little independent evidence to suggest that public services provided by the community through voluntary sector organisations are better for users<sup>1</sup>.
- Mutuels delivering services formally delivered by the public sector might be viewed negatively as an attempt by the public sector to offload the responsibility for social provision from the state and on to other sections of society.
- It may be difficult to persuade public sector employees to form mutuels if they offer no extra guarantee of stability or job security. Mutuels are subject to the same market pressures as normal businesses and may fail. Whilst normal shareholders have the option of selling their shares if they sense the business is failing, employees do not have this option.
- Employee-led mutuels will not necessarily be cheaper than keeping the service in house, as all service providers need to bear the cost of overheads including HR, accounting, governance, audit, liability (and other) insurance, as well as relevant management and asset costs; and economies of scale might make it cheaper to provide these corporately.

4.10 When weighing up the pros and cons for establishing mutuels to deliver services currently provided by the Council, practical considerations need to be taken into account such as conflicts of interest, TUPE<sup>2</sup>, redundancy terms and so on. Central to any consideration about the viability of establishing mutuels to provide services currently provided by the public sector, is the risk to service users of service failure.

4.11 When weighing up the pros and cons for establishing mutuels in any sector it is important to ensure that, if mutualism is to succeed, the ownership structure is tailored for the long term, the financial structure is tailored to support the businesses during the buyout process, and the leaders of the mutual understand the potential of co-ownership and are committed to making it work.

### **Policy context**

4.12 In May 2010 the new Government released “Building the Big Society”<sup>3</sup>, which included proposals to:

- Support the creation and expansion of mutuels, co-operatives, charities and social enterprises
- Support the above to have much greater involvement in running public services
- Give public sector workers a new right to form employee-owned co-operatives and take over the services they deliver.

4.13 In August 2010, the government launched a Pathfinders scheme to support twelve pilot ‘spin out schemes’ where public sector staff took on the running of specific services. The aim was to allow the Government to assess what type

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<sup>1</sup> See: <http://www.tsrc.ac.uk/LinkClick.aspx?fileticket=kIUJDyaqTs%3d&tabid=712>

<sup>2</sup> Transfer of Undertakings (Protection of Employment) 2006 - a piece of legislation that protects employees' terms and conditions of employment when a business is transferred from one owner to another

<sup>3</sup> See: <http://www.cabinetoffice.gov.uk/media/407789/building-big-society.pdf>

of support and structures would best enable the development of employee-led mutuals, which could provide better services for less money on an ongoing basis.

- 4.14 Following on from this, the Government announced in November 2010, prior to the publication of the Localism Bill, that it would roll out new 'Rights to Provide' across public services, with employers being expected to accept suitable proposals from front line staff who want to take over and run their services as mutual organisations. Support for public service 'spin-outs', building on the Government's Pathfinder programme includes:
- Over £10million to help the best fledgling mutuals reach investment readiness.
  - A new information line and web service for interested staff, provided by Local Partnerships, the Employee Ownership Association and Co-ops UK.
  - A 'challenge group' involving employee-ownership experts to investigate ways to improve regulation.<sup>4</sup>

The Government has indicated that any mutual proposals will be expected to deliver savings to the taxpayer and maintain or improve the quality of services.

- 4.15 The Localism Bill was introduced to Parliament on 13 December 2010 containing a number of packages of measures around strengthening powers for communities, including the 'Right to Provide' – as mentioned above, the right of public sector workers to form mutuals and bid to take over the services they currently deliver; the 'Right to Challenge' – the right of communities to express an interest in taking over the running of a local service; and the 'Right to Buy' – the right of communities to organise a bid and raise money to buy a public asset threatened with closure. Linked to this, the Green Paper *Modernising Commissioning*,<sup>5</sup> also published in December 2010, lays out plans for supporting the creation and expansion of mutuals, co-operatives, charities and social enterprises and enabling these groups to have much greater involvement in running public services through the creation of a level playing field for those wishing to bid for public service contracts. A Public Service Reform White Paper, building on this, is expected later in the year.
- 4.16 At a central Government level, it was announced by the Government in November 2010 that, where public procurement processes allow and where savings are properly agreed, it will be possible for civil service staff forming a mutual to be awarded a contract to continue providing services without going through the full tender process<sup>6</sup>.
- 4.17 In a local government context, mutualism could mean, for example, allowing Council employees to run a particular service (such as a children's centre); allowing residents in a given ward or geographical area to run a local community facility (such as a community centre); or service users to run a particular local service (such as a library). However, some public services might not be suitable for mutualisation. Unsuitable services might include (a)

<sup>4</sup> See: <http://www.cabinetoffice.gov.uk/news/big-society-plans-better-public-services>

<sup>5</sup> See: <http://www.cabinetoffice.gov.uk/sites/default/files/resources/commissioning-green-paper.pdf>

<sup>6</sup> See: <http://www.cabinetoffice.gov.uk/news/big-society-plans-better-public-services>



some priority service areas, where there might be statutory standards of delivery and where the consequences of failure would be significant (such as safeguarding); or (b) services where there is not a great deal of community or service user interest in taking control (e.g. refuse collection) or employee interest (e.g. services where start up costs are significant). The legal considerations involved in Council employees running a particular service are considered at paragraph 4.28.

- 4.18 The Council has stated that decisions taken in relation to the Council's budget strategy will be underpinned by nine guiding principles, including encouraging self-reliance, mutualism and cooperation<sup>7</sup>.
- 4.19 Mutualism is a key policy area for the new Government and national policy on mutualism is still being developed.

### **Support for mutuals**

#### **(a) Local support**

- 4.20 The Council's Business Advisory Service (delivered by South East Enterprise, an external organisation) currently provides a free service to help residents start up in business, or become self employed, and this includes residents wishing to establish a mutual organisation. It has recently been agreed that Council employees facing redundancy can also access this start up support. The service is able to provide generic advice but is not able to respond to specific queries from Council employees about employees wanting to start mutuals, and the Committee understands that the Communications Team is currently looking at developing some guidelines for managers on this matter.
- 4.21 In addition to start up support, the service also provides information, advice and mentoring for existing businesses, including mutuals, to help them survive and grow. Around 10-20% of the pre start up clients of the service are interested in starting up a mutual or not for profit organisation. There are various legal structures which need to be considered (see Appendix A), but the majority of the advice and support needed for starting a mutual/not for profit organisation is the same as for any business.
- 4.22 However, the budget for the Business Advisory Service is being reduced by 80% in April 2011, so the level of support available from this point will be significantly reduced. It is likely that residents and employees will need to be referred to any online support that is still available. Currently the social enterprise support available through Business Link London includes free workshops and one to one support. Other sources of support available locally include support provided by Social Enterprise London and Co-operatives London.
- 4.23 In 2009/10, the Council's Community Sector Unit was provided with £100k of funding by the Mayor to facilitate the development of social enterprise in the borough. The funding was used to (a) support local entrepreneurs to set up social enterprises in the borough through a training programme run by the School for Social Entrepreneurs, with additional support from the Community

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<sup>7</sup> See: [http://www.lewisham.gov.uk/NR/rdonlyres/70C7CD29-FC3A-40BE-BC17-AB11AA8BAF74/0/LBL\\_guidingprinciples.pdf](http://www.lewisham.gov.uk/NR/rdonlyres/70C7CD29-FC3A-40BE-BC17-AB11AA8BAF74/0/LBL_guidingprinciples.pdf)

Business Support Service; and (b) create a social enterprise development fund of £55k. The fund supported new initiatives along with organisations that might be suffering a financial 'blip', where a small injection of money will enable long term sustainability. In 2010/11 the fund stood at £238k, made up of some unspent funds from the previous year's allocation of £55k and some unspent funds from the £2.175m that had been set aside to help mitigate the effects of the Economic Downturn as part of the 2009/10 budget, and held in central provisions. In January 2011 Mayor and Cabinet agreed to grants of just over £117k from this fund to provide one off support to a selection of social enterprises to help with capacity building.

4.24 Co-operative Development Agencies operate across the country and locally, the Greenwich Co-operative Development Agency works to promote, develop and support cooperatives and social enterprises as part of a local sustainable economic development programme. The agency provides support to a broad range of initiatives but its primary areas of expertise are:

- Collaborating to establish enterprises that are owned and shared by the communities that work in, or benefit from, them.
- Assisting in co-operative trading activities, business planning, financial planning, marketing plans, feasibility studies and enhancing the supply chain of goods and services within communities.
- Aiding in the development of a trading arm for voluntary sector organisations.
- Assisting the long-term development of protected trading organisations by establishing legal structures that encourage democratic ownership.
- Establishing businesses and organisations enhancing social objectives and programmes.

#### National support

4.25 The Government has announced that it will make available a fund of £10m to help in the establishment of employee-owned mutuals in hospitals, schools and a range of other public services as part of the Big Society programme. The Government hopes to establish a 'Big Society Bank' by April 2011 that will be funded by private sector investment and money from dormant bank accounts. The bank will invest in financial intermediaries in the social investment market, who in turn will increase access to finance for frontline, social organisations. Historically, private investors have been reluctant to invest in organisations such as mutuals, as they have been put off by what they perceive as weak business models and uncertain cashflows. The Big Society Bank will help by providing capital seeking social returns, rather than purely financial upside. However, as a wholesale bank, it must provide finance through intermediaries and this market remains in its infancy. Organisations such as Social Finance<sup>8</sup> are currently experimenting with new funding models such as social impact bonds and it is hoped that this kind of financial innovation will become commonplace.

4.26 The Government has also pledged to set up a new information line and web service for employees interested in establishing a mutual, which will be

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<sup>8</sup> See: <http://www.socialfinance.org.uk/>

provided by Local Partnerships, the Employee Ownership Association and Co-ops UK; and a 'challenge group' involving employee-ownership experts to investigate ways to improve regulation.

- 4.27 Other sources of support include that provided by the Development Trusts Association and Social Firms UK.

### **Legal considerations**

- 4.28 There are several legal structures that lend themselves to mutual and co-operative organisations (and social enterprises) and more information on this can be found at **Appendix A**. In terms of the powers available to Local Authorities to establish or assist in the establishment of mutuals, an extract from "Developing a Mutual for Local Authority Service Delivery: A Special Report from TPP Law", November 2010 is attached at **Appendix B**.
- 4.29 It is clearly the Government's intention that it is to be made easier for mutuals and social enterprises to be responsible for services which have, to date, been Council services. Though the detail is yet to be fleshed out, this will be given expression in various ways – for example the right for employees to come forward with proposals for mutuals to provide services, and for those to be given consideration; a likely softening of the Government's guidance on TUPE; further measures on contract evaluation criteria favouring social enterprises; and new rights for community bodies to be given the opportunity to seek the transfer of Council assets to them. Proposals in the Localism Bill are not yet law, and may change on their way through Parliament.
- 4.30 The Committee has been advised that:
- In deciding how to encourage and handle proposals for alternative methods of service provision, the Council will need to have regard to the law, which will change significantly if and when the Localism Bill becomes enacted, and when the necessary secondary legislation is in place to give it effect.
  - The Council will need to be mindful that there are a number of circumstances in which a mutual/social enterprise may be a possible alternative to Council provision. For example, it may be that the service in question is one which the Council seeks to retain responsibility for (perhaps because of the nature of its statutory duties) but where it seeks to contract with an outside organisation to provide it with a view to seeking efficiencies and greater community involvement. There would then need to be a procurement process in accordance with the Council's own standing orders, and the EU public procurement regime where appropriate. In any event, the Council would always need to satisfy its duty of best value.
  - On the other hand, it may be that the Council is of the view that the service is one for which it no longer seeks to retain responsibility, but rather that it be provided outside Council responsibility. In this case there would be no contract between the Council and the organisation as the Council would be divesting itself of that responsibility altogether. It may instead consider giving support to that external organisation, either through some form of pump priming grant or the making of an asset available probably on a leasehold basis. The intention here would be that no contract existed, but even in these circumstances the legal distinction may be a fine one.

- The way in which such matters will be dealt with will depend on the particular circumstances of each proposal, but in each case the Council will have to take a decision in the round, that takes into account the advantages and risks associated with the proposal, not simply from the point of view of the external body, but that of the Council itself and the wider community, on a consideration of all relevant matters at the time.
- Issues also arise in relation to the handling of potential conflicts of interest for employees who are employed on contracts which require that they give their whole time to their employment, and who are interested in developing proposals that would take over responsibility for Council services. Their personal and Council interest may easily come into conflict, particularly if what they seek is a contract from the Council to an organisation they propose to establish.
- This is one of the reasons why the Council needs to establish a process by which any proposals emerging from employees need to be handled to minimise the potential for these conflicts and breaches of the employee code of conduct. It is very likely to involve an early assessment of whether the proposal if developed may have advantages, and provided the Council wishes to see the proposal pursued, then a separation of the employee concerned from the area of work to which their proposal relates to avoid potential conflict or misuse of Council information for their own purposes. The employees themselves then need to commit their own time and resources to developing their proposal.
- Generally, where a proposed organisation seeks to operate under contract with the Council, there will need to be a robust procurement process in accordance with standing orders, and EU law where necessary, and the Council would have to ensure that it does not fall foul of the law relating to State Aid. TUPE applies on the transfer of an undertaking so that employees engaged in the undertaking transfer to the new employee with their terms and conditions intact. This may very well apply on the transfer of any of the Council's services, depending on the circumstances of the proposal.
- The establishment of a mutual is a risky business for those involved in it. It may fail, and many personal resources may have been committed to it in a time of austerity. Those concerned with establishing such an organisation need to be conscious that once they move out of the Council they are effectively in the same position as any other external organisation. If the Council is to avoid challenges of anti-competitiveness in contracting, it must then treat them no more favourably than any others.

### **Community interest in providing public services**

4.31 The recent *Our Lewisham, Our Say* (OLOS) public consultation was designed to explain to residents the budget challenge that the Council would face in the coming years, and to test opinions on some of the solutions the Council would have to consider to meet that challenge. Solutions included:

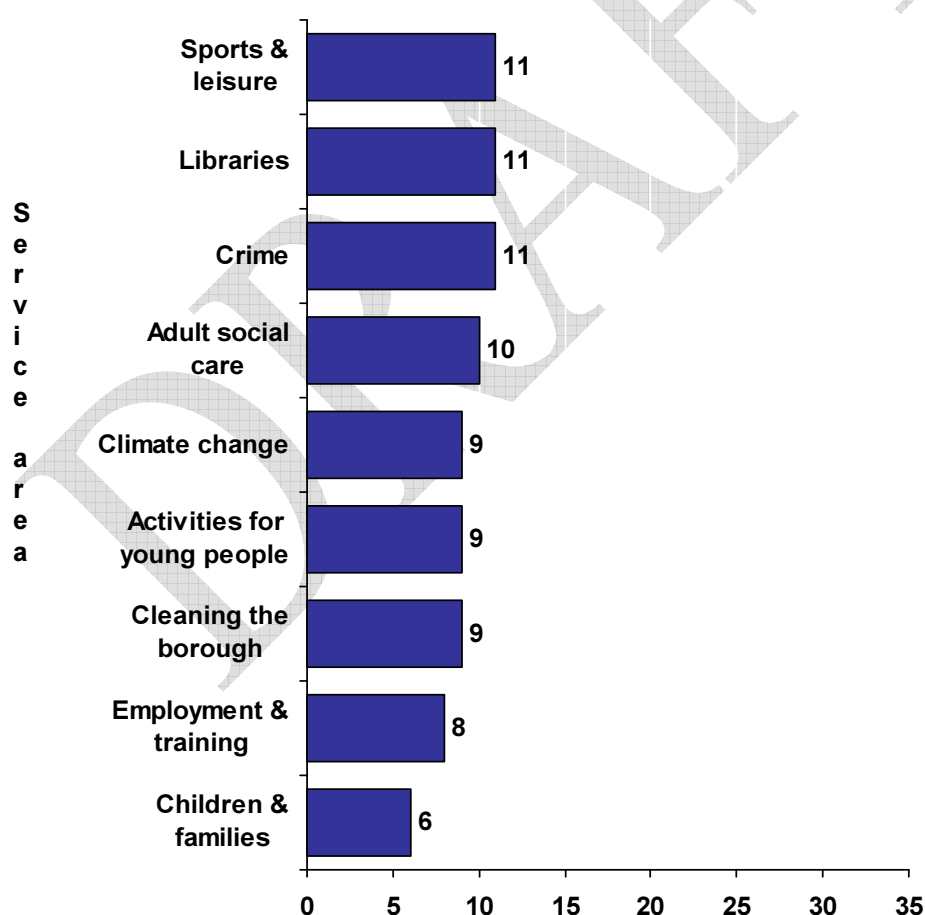
- Reducing some levels of service
- Increasing charges for some services
- Residents and community groups playing a greater role, including volunteering to deliver services.

- 4.32 The results of the consultation could therefore be used to consider whether residents had any interest in getting involved in service delivery. Although the survey revealed that residents thought the Council should help people to do more themselves, in general residents felt that the capacity and the desire to volunteer or provide services themselves did not currently exist. The following quote exemplifies the sentiments expressed:

*"If volunteering and befriending can be increased, dependence of local services can be reduced. However, the council would need to foster new networks and hubs around which communities could become more active. There's a role for the existing third sector, but new community ventures would need to be created." (In relation to adult social care)*

Evidence of general perceptions towards volunteering could be found in the results of the online survey. This, for eleven service areas, described current provision and, having explained that spending may have to be radically reduced, set out options for coping with that, including charging more for services or relying on residents doing more themselves. The chart below sets out the proportion of residents who chose the volunteering option, suggesting that it would be ok to make reductions because residents would do more themselves:

**Our Lewisham Our Say: Proportion of residents choosing the volunteering option, by service area**



**Percentage of residents choosing the volunteering option**

- 4.33 As the chart demonstrates, about one in ten respondents chose the volunteering option, with the greatest proportion saying this in relation to

sports and leisure (joining a local sports club), libraries (volunteering to work in a library), and crime (volunteering to prevent crime locally). To put this in context, between two in ten and three in ten respondents stated that they would pay more to protect services, and between six in ten and seven in ten stated either that it would be ok to make cuts or that no cuts should be made at all. The voluntary option was therefore the option that received the fewest responses, and it should also be noted that residents were making *in-principle* statements and not actually putting themselves forward for voluntary work. However, if the response rate of one in ten is taken to be representative of the borough, that would point to a pool of about 18,000 residents (one in ten adult residents) who have some propensity towards being more involved in services such as these.

- 4.34 Local assembly discussions gave residents the chance to discuss some of these issues in more detail, and to test their ideas and preferences with one another. Table discussions were held at all assemblies, and all groups discussed the following questions (or variations on these, to reflect local priorities):
- Are there things that the Council could do differently to save money?
  - Are there things that individuals and groups could do to help if the Council has less money to spend?

- 4.35 The table discussions generated considerably more feedback on what the Council could do differently than on what the individuals and groups could do themselves. More than 300 group responses were received for the first, and only 64 were received for the latter. Furthermore a number of responses under “what can individuals and groups do” made suggestions for things that the Council should do, possibly indicating that residents were not entirely convinced by the concept or felt that the responsibility lay with the Council instead.

- 4.36 The 64 comments under the second question were comprised as follows:

***“Are there things that individuals and groups could do to help if the Council has less money to spend?”***

- Volunteer (24 responses)
- Clean locally (23 responses)
- Run community services (7 responses)
- Look after family, friends and neighbours (6 responses)
- Fundraise (4 responses)

These findings correlate with the earlier general finding that residents tended to suggest that they could be involved more in smaller scale activities, such as cleaning outside their properties and looking after family and friends, rather than getting involved in activities that demand much greater commitment such as community led services.

## 5. Findings

### A: Mutuals to deliver public services

- 5.1 The Committee found that the Council had undertaken some work in this area and was responding both to national policy development and local initiatives, whilst waiting to see how national policy would develop. For example, the Council was hoping to find organisations and community groups interested in taking over one or more of the five library buildings being considered for closure in 2011/12. The Council was exploring ways in which community library services could continue to be provided with the Council providing books as well as visiting library services, such as storytelling, homework sessions and reading groups. It was noted that the relationship between the anchor organisation and the Library Service was likely to take the form of a partnership agreement, where the Library & Information Service would contribute the specialised equipment and expertise, while the partner organisation would be responsible for maintaining the building, guaranteeing access and providing the management systems necessary for the running of a safe and successful community facility. The Committee heard that the Council was prepared to transfer buildings to organisations on a lease (or freehold basis if appropriate). Interested organisations had been asked to prepare a business case setting out how the ongoing running costs would be funded; and whilst continued community use would be a requirement, the buildings could also be used for other purposes that could generate revenue.
- 5.2 In early November over one hundred and forty council employees attended a "New Directions" event which provided information on the savings the Council was being required to make and the impact that this might have on the direction of the Council going forward. In response to queries received via the staff suggestion scheme, new models for the delivery of council services were discussed at the event including co-operatives and social enterprises. The Committee heard that officers in Human Resources were developing a new "People Strategy" and that one priority would be "new ways of working to facilitate innovative provision through an agile and flexible workforce". Under this priority there would be a number of actions related to supporting staff to be able to work in different ways, across different delivery models and in new areas as potential service models that staff might work in, in the future, was likely to include shared services, partnerships and 'spin outs'. As a consequence, the Committee was informed that the Head of Law was preparing a guidance paper for staff wishing to consider "spin-outs" from public sector bodies.
- 5.3 The Committee noted the Chief Executive's view that a key question for the Council to consider was how to respond to cases made by employees or service users for alternative models of provision, and he submitted that the type of value the service provided needed to be considered:

*Private value* – of value to individuals

*Public value* – of value to everyone

*Social value* – of value to a particular group of people.

Public and Social value were different and the Chief Executive was not convinced that social value always led to public value (e.g. the argument propounded by Edmund Burke that if a person valued their local group, they

valued their nation etc.). He commented that, in some instances, it might not be felt appropriate to use public money to help fund new community-run services if they only had a social value, i.e. were only used by a particular group of people. The Committee recognised that in the context of reduced budgets, the Council might need to be more selective about how and on what terms, it provided funds for community organisations or funding for new enterprises such as staff or service user mutuals.

5.4 The Chief Executive also suggested that, whilst commentators such as Philip Blond believed that mutuals had many advantages in the provision of public services, such as being cheaper due to a reduction in overheads; this was not necessarily the case as many overheads (such as insurance, complying with health & safety legislation etc.) could not be stripped away. It was also the case that the public expected a certain level of state provision and this level had grown over the years and would be difficult to reverse.

5.5 The Committee noted Karen Wilkie's view that mutuals did not always work in the public sector, although some areas were particularly suitable for mutuals, including housing and leisure. Karen also suggested that the national agenda was changing rapidly with regards to this policy area and this posed two major risks to the co-operative movement:

- The movement might become associated with failure due to the creation of 'crisis co-ops' (where services failing in either the public or private sector were mutualised but still fail – because if a service is failing it is likely to fail in any sector).
- Co-operatives were currently a 'big idea' across the political spectrum, which might lead to a proliferation of new co-ops, but they might not all truly subscribe to co-operative values and models, thus diluting the co-operative 'brand'.

5.6 Sergio Olivares suggested to the Committee that the key ingredients for a successful mutual included:

- A highly motivated workforce
- A good model of leadership
- A group of people willing to 'champion' the mutual model
- Political support.

For a mutual model to be successful several elements needed to work together and collective action was required. Mutuals were not always successful but they were a proven model and they might help to avoid public assets transferring to the private sector in a time of reduced public resources.

5.7 The Committee asked the three witnesses to comment on what sort of services they felt were most suitable for delivery by mutuals and which areas did not work. The following points were noted in response:

#### ***The Chief Executive***

- When considering the feasibility of a mutual proposal the following things should be considered: (a) the capital required to start the mutual; (b) the working capital required (to pay salaries etc.); (c) the revenue streams that can be expected and the value of those streams; (d) the risk to



service users arising from the proposal; and (e) the risk of the business failing.

- No services should be deemed 'off limits', each proposal should be judged on its own merits.
- The state of the market needed to be considered (e.g. residential care was a growing market and libraries were a declining market – even if you did want to maintain them for social reasons). Liabilities could be transferred as well as assets, in which case consideration might have to be given to using the asset for a range of services, including the one you wish to continue, so the proposition becomes viable.
- When assessing proposals, the Council would need to consider whether it could commit to a sponsored service and asset transfer (with the Council agreeing to partially fund the service into the future) or a straight transfer (with the risk that the Council was, in fact, transferring a liability).

#### ***Karen Wilkie***

- Successful mutuals often had the following elements in common: (a) assets; (b) reliable revenue streams; and (c) staff who transferred with the service.
- The question of asset transfer was key. If it was agreed to transfer the assets, consideration would need to be given to 'asset locking' to retain the asset for community use.
- The formation of mutuals was a 'bottom up' activity and would not work unless there was a strong willingness on the part of employees/service users to form a mutual. People needed to care not just enough to use a service, but to run it. In this sense, size only mattered in so far as you had enough people who cared enough to run the service (and enough people to care in the future, once the initial people had moved on).

#### ***Sergio Olivares***

- Capitalisation was a key issue. If the service had large assets this might be a problem for those wishing to establish a mutual unless favourable lease arrangements were in place. Buildings required a certain level of capital investment and this might not be attractive to everyone. If the organisation was going to take on debt from day one, a robust model of support would be required.
- Mutuals can be successful in any sphere. It was not the type of service which made the mutual successful but the circumstances, i.e. if the ingredients for success were all present

- 5.8 The Committee considered if the Council was too risk averse when considering potential service providers and found it easier to go to private sector firms when commissioning services, than to local community and interest groups. The Chief Executive suggested that risk needed to be taken into consideration, together with practical considerations such as procurement rules. However, he accepted that the Council could do more to foster engagement, link up engaged organisations and help develop capacity.
- 5.9 After considering all the evidence presented at the meeting and in the reports and background papers supplied, the key findings of the Committee were as follows:

## **Sustainability**

- 5.10 It is clear that sustainability is a key issue for public sector mutuals and many Chief Executives are rightly sceptical about the sustainability of staff mutuals or 'self-appointed volunteer groups'<sup>9</sup>. In order for a public sector mutual to be successful it must be sustainable. It must have a secure and sufficient revenue stream, access to finance, appropriate assets and a robust business plan. Ideally, it will need to have the ability to expand and to win contracts from other organisations or local authorities so it can run a more efficient service. Although the initial contract with the Council might not be competitive, under EU procurement rules, any subsequent contract will be open to competitive tender so the sustainability of the mutual will be key to ensuring its continued success. The ability to diversify might also make the mutual a more sustainable prospect.

## **Willingness of potential participants**

- 5.11 Whilst people in Britain are very willing to donate their money, they are generally less willing to donate their time and it can take a long time to change people's mindsets. Establishing and running a mutual is not an easy task and requires a lot of physical, mental and emotional energy, a large time commitment and a determination to make the proposal work. Finding suitable premises, securing finance and building a team will be a challenge. A recent survey of 15 Chief Executives found some concern about levels of engagement which they felt undermined the business case for community involvement in service delivery<sup>10</sup>. However, the Committee does note Karen Wilkie's view that if a service is going to be lost anyway, it might be worth granting people a 'right to try' to run the service themselves. If the Council wishes to take a proactive approach to this agenda, it may wish to identify potential 'mutual champions' within its own workforce and the Voluntary and Community Sector (VCS); people who are enthusiastic about the opportunities afforded by mutualisation and who are willing to explore these opportunities, with support from the Council, and encourage others to do the same.

## **Skills of potential participants**

- 5.12 The proposed staff of the public sector mutual must have appropriate skills and abilities. The skills required to deliver a service successfully in the public sector or VCS are not necessarily those required to deliver a similar service in the private or co-operative sector (e.g. entrepreneurialism). Managing a mutual business and competing for contracts can be a very different process to managing a service in a public sector or VCS setting and it will require a different mindset and set of skills.

## **Scale**

- 5.13 To increase the chance of a mutual succeeding, it should ideally (a) be of a sufficient size; (b) have a variety of contracts, rather than a single contract; and (c) provide a variety of services rather than a single service. For this

<sup>9</sup> See: [http://www.deloitte.com/view/en\\_GB/uk/industries/government-public-sector/97deff07fd29d210VgnVCM2000001b56f00aRCRD.htm](http://www.deloitte.com/view/en_GB/uk/industries/government-public-sector/97deff07fd29d210VgnVCM2000001b56f00aRCRD.htm)

<sup>10</sup> See: [http://www.deloitte.com/view/en\\_GB/uk/industries/government-public-sector/97deff07fd29d210VgnVCM2000001b56f00aRCRD.htm](http://www.deloitte.com/view/en_GB/uk/industries/government-public-sector/97deff07fd29d210VgnVCM2000001b56f00aRCRD.htm)

reason VCS mutuals might best be formed by a number of smaller VCS organisations banding together or by a small but reliable VCS organisation expanding. Similarly, staff spin outs might be more successful if they take on the delivery of a group of services rather than a single service. It will not always be feasible for a small service to be delivered successfully by a mutual, whereas if a group of services are jointly delivered, economies of scale can be exploited. Size is important in ensuring that the mutuals have the capacity and breadth of experience to deliver public services. Furthermore, if the mutual can secure contracts with a number of organisations or local authorities it will be better placed to benefit from economies of scale and avoid duplication of back office services. A larger organisation providing a number of services via a number of contracts will be less vulnerable – it should be able to survive a single contract not being renewed if it has others to keep it going.

### **Agreeing a Framework**

- 5.14 In order to assess proposals for mutuals and spin outs, the Council needs to have a clear idea of the framework within which it will consider proposals including the key criteria that must be met.

**Draft Recommendation 1: *The Council should develop a framework for assessing proposals to ensure that they will:***

- ***be sustainable (e.g. they have appropriate revenue streams, are an appropriate size, staff have appropriate skills and abilities etc.)***
- ***provide services which meet defined quality standards***
- ***provide acceptable employee conditions (e.g. pay the London living wage)***
- ***protect any relevant assets***
- ***adhere to agreed principles (e.g. Sustainable Community Strategy principles).***

***Consideration should also be given to the accountability framework – how will new service delivery models be scrutinised and made accountable?***

- 5.15 Once a framework for assessing proposals has been agreed, the opportunities for public sector mutuals can be considered. In order to allow officers and members to begin to assess the opportunities for mutual and cooperative organisations (including ‘spin outs’), to deliver services currently provided by the Council, a comprehensive service audit should be carried out. The Council will need to identify which services represent low risk areas where an alternative service delivery model might be introduced safely.

**Draft Recommendation 2: *The Council should conduct an audit of each service (or service group) provided by the Council to assess whether it is suitable for mutualisation. The audit should include information on:***

- ***the implications of the service ending for service users***
- ***the assets required by the service (including start up capital, working capital and whether an asset lock would be required) and any attached liabilities***
- ***the relevant revenue streams and their size and security***
- ***the level of existing staff expertise and entrepreneurialism and whether any mutual ‘champions’ can be identified***
- ***whether there is relevant community interest and expertise and any***

**relevant mutual ‘champions’ within the VCS sector**

- **what the start up and transfer costs would be if the service was mutualised**
- **what the TUPE and procurement (e.g. OJEU) implications would be**
- **whether any expressions of interest in running the service have been received.**

**Encouraging proposals**

- 5.16 Sustainable public sector mutuals might have many benefits for the Council. They should result in the provision of more efficient, tailored and effective services as service users/the community/employees will be able to utilise their ‘front line’ appreciation of what is needed and their increased motivation (as the business will belong to them). In addition, if successful, public sector mutuals can act as catalysts for the wider regeneration of the local economy, as they tend to be flexible and stable organisations that retain profits in the area which in turn helps support other jobs. The Council might, therefore, want to encourage proposals that meet the criteria in its agreed framework and consideration needs to be given to how this might be done.
- 5.17 Capacity building is one area that the Council may wish to get involved in, in order to encourage proposals. For example, whilst many employees have high levels of professional expertise in their field, they do not necessarily have the business planning experience to support a ‘spin out’ proposal. Interested employee groups will need advice on business planning, accounting, building relationships with commissioners, payment by results etc.
- 5.18 Similarly, if the Council wishes to encourage the delivery of public services by mutual organisations, such organisations will need support to be in a position to put forward sustainable proposals. Many such organisations lack capacity in business and strategic planning and the resources for service and organisational development.
- 5.19 The Local Government Group, in its response to *Decentralisation and the Localism Bill: an essential guide*, noted that:
- There is a particular need to build capacity among voluntary bodies and social enterprises, both to bid, but also to navigate their first few months and years of holding a public contract. The reality is that many bodies taking on newly contracted out public sector functions face a stiffer challenge than the average start-up business because of the processes and procedures they inherit. Yet the tolerance of the public sector and of customers for failure by delivery bodies is lower than is generally the case in the private sector. Supporting the bodies that will make up a new supplier base is just as important as ensuring contracts are made available in the first place. This is made all the more challenging when held up against the significant cuts in funding to local government.<sup>11</sup>*
- 5.20 When the Audit Commission researched the results of commissioning from the voluntary sector in 2007, it concluded that despite ‘the often claimed assumption that the sector adds value...there is no evidence either for or against the argument that, at an aggregate level, voluntary organisations

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<sup>11</sup> See: <http://www.lga.gov.uk/lga/aio/16742200>

provide better or worse value for money in the provision of public services than either public sector or private sector providers'.<sup>12</sup> Similarly, a recent review by the Third Sector Research Centre suggests that, at present, there is little independent evidence to suggest that public services provided by the community through voluntary sector organisations are currently producing better outcomes for users.<sup>13</sup> This underlines the need for capacity building if voluntary and community sector organisations are going to take on the provision of more public services.

- 5.21 The Council may wish to adopt an assertive approach in which it encourages smaller organisations to merge or collaborate to ensure they have the capacity and breadth of experience to deliver public services. Similarly, reliable organisations could be encouraged to expand. Consideration could also be given to providing time limited support to organisations and staff to help them develop the expertise and capacity to deal with core business areas such as Human Resources, legal considerations, Health and Safety, Insurance, IT, marketing etc. The Council will, of course, need to ensure that the cost of supporting community and staff mutuals in this way does not outweigh future savings or benefits achieved through the divestment of services to the mutuals it has supported.

***Draft Recommendation 3: The Council should ensure that the support offered to voluntary and community sector organisations and employees considering spin outs, reflects the changed public service delivery climate. This should include support for organisations wishing to expand or merge to ensure they have the capacity to provide public services. More support needs to be provided to enable such organisations and groups to (a) tender for services that the local authority commissions and (b) make sustainable proposals under the 'Right to Provide' and 'Right to Challenge'. Specialist support could be offered to such organisations for a time limited period to build capacity for dealing with Human Resources, legal considerations, Health and Safety, Insurance, IT, marketing etc.***

- 5.22 Access to finance might be a particular barrier to the setting up of public sector mutuals and the Council might want to consider how it can support proposals in accessing appropriate finance. Until a contract is awarded it can be difficult to obtain the necessary financial backing as there will be no guarantee of future business. Without suitable finance in place, it can be difficult to win a contract.<sup>14</sup> Mutuals might seek to access some of the £10million of funding the Cabinet Office has said will be available to help the best fledgling mutuals reach investment readiness<sup>15</sup> or hope that the Big Society Bank will encourage the social investment market, so capital can be more easily accessed. Alternatively, the Council might consider meeting some of the start up costs itself, using wellbeing powers.
- 5.23 In order to encourage a more open discussion with staff and the local community about mutualism, and encourage proposals to come forward, more information on mutualism should be made publically available.

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<sup>12</sup> See: <http://www.audit-commission.gov.uk/SiteCollectionDocuments/AuditCommissionReports/NationalStudies/WorkingeffectivelyvoluntarysectorfinalproofREP.pdf> p21

<sup>13</sup> See: <http://www.tsrc.ac.uk/LinkClick.aspx?fileticket=KIUJDyaqxTs%3d&tabid=712>

<sup>14</sup> See: [http://www.cipfa.org.uk/pt/cjc/download/staff\\_mutuals\\_feb2011.pdf](http://www.cipfa.org.uk/pt/cjc/download/staff_mutuals_feb2011.pdf) p2.

<sup>15</sup> See <http://www.cabinetoffice.gov.uk/news/big-society-plans-better-public-services>

**Draft Recommendation 4: The Council website should have a section on mutualism containing information on (a) the policy framework and relevant legislation (e.g. the Right to Challenge and the Right to Provide etc.); (b) the support available for interested parties from the Council and local & national organisations (including links to support organisations and guidelines on tendering for council contracts, submitting 'rights to challenge' etc.) The material should include examples of successful mutuals as case studies. The Council intranet should have clear information for employees considering a spin out proposal.**

### **External Expertise**

- 5.24 The Committee was interested to hear the Chief Executive's comments that it might be possible to 'hire expertise' from outside the borough and engage willing people in the provision of local services, even if they are not local themselves, if these services are 'at risk'. The Committee agrees that proximity (closeness to service users, local knowledge, a sense of local affiliation) can be less important in service delivery than capacity to deliver, efficiency and willingness.

### **Assets**

- 5.25 The Committee noted that, when setting up a mutual, it might make sense for the physical assets associated with the service being run by employees / service users / the community to be transferred to them. However, as services that depend crucially on asset transfer normally require those managing the service into the future to bear the capital cost of asset renewal and maintenance, this might not be a very attractive option for those seeking to run a particular service as a mutual. In addition, if the asset is currently owned by the public sector there might be a concern around future asset-stripping and consideration would therefore need to be given as to whether an "asset lock" was required to guarantee that the public interest is protected. In a similar vein, groups which take on full ownership and liabilities of public amenities will have to devote their main energies to making them work as businesses. It is worth noting that this might mean that they are forced to price out smaller groups which have limited resources to pay commercial rates for use of the amenity<sup>16</sup>.

### **(B) Mutuals in the wider economy**

- 5.26 Most of the national policy developments on mutualism relate to public services. However, the Committee notes that mutualism is also an option favoured by many private sector businesses and 'not for profit' organisations, for a variety of reasons. Private businesses might wish, for example, to share the responsibility of ownership and control, or they might feel that mutualism will increase efficiency, as workers might have more incentive to be productive if they 'own' the firm and benefit economically from its success.
- 5.27 One form of co-operative which might be particularly attractive to the self employed or to small business owners is where each member owns a small business or is self-employed in their own right, but is part of a larger co-

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<sup>16</sup> See: <http://www.keystonetrust.org.uk/documents/128.pdf> p54



operative so resources can be pooled (for example, to allow group purchasing to reduce costs).

- 5.28 Mutualism also exists in the 'not for profit' sector. Insurance and indemnity organisations in particular are often mutual not-for-profit organisations which exist to pool risk. Members pay subscriptions which are put in a fund owned by the members which is held in trust for the members, and used for the specific insurance/indemnity purposes for which members have paid their subscriptions.
- 5.29 In Britain, around 20 per cent of workplaces currently operate some type of employee share ownership scheme and this covers 32 per cent of all individuals in employment.<sup>17</sup> Banking, agriculture, and retail and hospitality are all areas where there is a significant mutual element. It has been suggested that one area with largely untapped potential for greater employee ownership is professional services and knowledge intensive industries<sup>18</sup>. These are types of business where the cooperation, commitment and innovation of employees are most important and where the business is little other than its 'human capital', so there are strong social and economic reasons why employees might expect to share in the profits of their skills.

### **Support**

- 5.30 In order to foster and encourage mutualism across the borough's economy, the Committee feels that the support available to people and businesses interested in establishing mutual and co-operative organisations needs to be better advertised and updated to reflect new policies, as and when new legislation is enacted.

**Draft Recommendation 5: *The support and advice provided by the Council, including through the Council website, to people interested in establishing mutual and co-operative organisations needs to be updated and more widely advertised.***

### **Entrepreneurialism**

- 5.31 The Committee believes that fostering mutualism depends to some extent on the presence of entrepreneurialism in the local economy. The Committee notes that, apart from notable exceptions such as Goldsmiths and the Laban development, the borough does not have any real business hubs, which impacts upon entrepreneurialism. The Committee therefore wonders if the Council could assist in the provision of suitable premises.

**Draft Recommendation 6: *The Council should consider whether any Council buildings not in use or not in full use (e.g. space released by the worksmart/office rationalisation programme; or buildings vacated and earmarked for disposal when market conditions are more favourable) could be leased on a short term basis to business start ups.***

<sup>17</sup> See: <http://www.nber.org/papers/w14235.pdf>

<sup>18</sup> See: <http://www.demos.co.uk/publications/reinventing-the-firm>

## 6. Summary of Draft Recommendations

6.1 The Committee would like to make the following recommendations:

### **A: Mutuals to deliver public services**

1. In order to assess proposals for mutuals and spin outs, the Council needs to have a clear idea of the framework within which it will consider proposals including the key criteria that must be met.

***The Council should develop a framework for assessing proposals to ensure that they will:***

- ***be sustainable (e.g. they have appropriate revenue streams, are an appropriate size, staff have appropriate skills and abilities etc.)***
- ***provide services which meet defined quality standards***
- ***provide acceptable employee conditions (e.g. pay the London living wage)***
- ***protect any relevant assets***
- ***adhere to agreed principles (e.g. Sustainable Community Strategy principles).***

***Consideration should also be given to the accountability framework – how will new service delivery models be scrutinised and made accountable?***

2. In order to allow officers and members to begin to assess the opportunities for mutual and cooperative organisations (including 'spin outs'), to deliver services currently provided by the Council, a comprehensive service audit should be carried out.

***The Council should conduct an audit of each service (or service group) provided by the Council to assess whether it is suitable for mutualisation. The audit should include information on:***

- ***the implications of the service ending for service users***
- ***the assets required by the service (including start up capital, working capital and whether an asset lock would be required) and any attached liabilities***
- ***the relevant revenue streams and their size and security***
- ***the level of existing staff expertise and entrepreneurialism and whether any mutual 'champions' can be identified***
- ***whether there is relevant community interest and expertise and any relevant mutual 'champions' within the VCS sector***
- ***what the start up and transfer costs would be if the service was mutualised***
- ***what the TUPE and procurement (e.g. OJEU) implications would be***
- ***whether any expressions of interest in running the service have been received.***

3. If the Council wishes to encourage the delivery of public services by mutual organisations, local mutuals, co-operatives, social enterprises, and charities will need support to be in a position to put forward sustainable proposals.

Many such organisations lack capacity in business and strategic planning and the resources for service and organisational development. Similarly, whilst many employees have high levels of professional expertise in their field, they do not necessarily have the business planning experience to support a 'spin out' proposal. Organisations and employee groups will need advice on business planning, building



relationships with commissioners, payment by results etc. The Council may also wish to adopt an assertive approach in which it encourages smaller organisations to merge or collaborate to ensure they have the capacity and breadth of experience to deliver public services. Consideration should be given to providing time limited support to organisations to help them develop the expertise and capacity to deal with matters such as HR, legal, health and safety, insurance, IT etc.

***The Council should ensure that the support offered to voluntary and community sector organisations and employees considering spin outs, reflects the changed public service delivery climate. This should include support for organisations wishing to expand or merge to ensure they have the capacity to provide public services. More support needs to be provided to enable such organisations and groups to (a) tender for services that the local authority commissions and (b) make sustainable proposals under the 'Right to Provide' and 'Right to Challenge'. Specialist support could be offered to such organisations for a time limited period to build capacity for dealing with Human Resources, legal considerations, Health and Safety, Insurance, IT, marketing etc.***

4. In order to encourage a more open discussion with staff and the local community about mutualism, and encourage proposals to come forward, more information on mutualism should be made publically available.

***The Council website should have a section on mutualism containing information on (a) the policy framework and relevant legislation (e.g. the Right to Challenge and the Right to Provide etc.); (b) the support available for interested parties from the Council and local & national organisations (including links to support organisations and guidelines on tendering for council contracts, submitting 'rights to challenge' etc.) The material should include examples of successful mutuals as case studies. The Council intranet should have clear information for employees considering a spin out proposal.***

#### **B: Mutuals in the wider economy**

5. The Committee feels that the support available to people interested in establishing mutual and co-operative organisations needs to be better advertised and updated to reflect new policies, as and when new legislation is enacted.

***The support and advice provided by the Council, including through the Council website, to people interested in establishing mutual and co-operative organisations needs to be updated and more widely advertised.***

6. Fostering mutualism depends to some extent on the presence of entrepreneurialism in the local economy. The Committee notes that, apart from notable exceptions such as Goldsmiths and the Laban development, the borough does not have any real business hubs which impacts upon entrepreneurialism.

***The Council should consider whether any Council buildings not in use or not in full use (e.g. space released by the worksmart (office rationalisation) programme or buildings vacated and earmarked for disposal when market conditions are more favourable) could be leased on a short term basis to business start ups.***

## Appendices

### Appendix A: Governance and Legal arrangements

**Appendix B:** Do we have the power to set up a mutual? Powers and Governance Issues – extract from “Developing a Mutual for Local Authority Service Delivery”; A Special Report from TPP Law, November 2010

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### **Governance and Legal arrangements**

#### **Key Governance Issues**

The following governance issues are pertinent to the setting up of a mutual or co-operative:

- What are the objectives of each of the stakeholders?
- Are these all aligned?
- Will the organisation be financially sustainable?
- Is this demonstrated by a robust Business Plan?
- Will the local authority or other sponsoring body appoint directors to the board of the new entity?
- If so, how will potential conflicts of interest be managed?
- If the mutual is a Company, the directors will be subject to a variety of duties and obligations arising under the Companies Act 2006, some of which can give rise to personal liability - what protection should they seek?
- Are the directors appointed by the sponsoring body to be paid?
- What will the shareholding arrangements be, and will a Shareholders Agreement be required?
- If a mutual contracts with a local authority, will any staff transfer to the mutual under TUPE? If so, how will their employment and pension rights be protected?
- If the mutual contracts with a local authority, will any assets (including property) be transferred to the mutual? If so, an Asset Transfer Agreement may be required.
- The Tax and VAT implications of the transfer will need to be identified and dealt with in the legal documentation.
- The legal agreement between the parties will need to incorporate provisions dealing with monitoring, review, reporting and exit arrangements.
- If the new mutual is intended to contract with the Local Authority, what procurement procedure needs to be followed by the Authority and how will the Public Contracts Regulations 2006 apply?
- How will the mutual be funded? Will it require to raise a bank loan? What security can it offer the lender?

#### **Legal arrangements**

There are several legal structures that lend themselves to mutual and co-operative organisations and social enterprises.

All of the forms below can be used for social enterprises. Mutuals and co-operatives can use the same forms providing their constitutional documents incorporate the necessary features of mutualism:

1. There is a shared purpose (to serve a closed community of members who share economic benefits among them, or to serve an altruistic community purpose).
2. The organisation is 'owned' by its members.
3. The operation of the organisation is normally based on a democratic voting system.

4. The organisation has a governance structure which ensures that different stakeholders can play an appropriate role in running the organisation.

These four features will be present to some degree in all mutuals, depending on the circumstances and the specific purpose of the organisation.

Alternative structures offer varying levels of flexibility as to how an organisation operates, and how its management and membership is organised. Some structures are subject to more onerous formal reporting requirements and may need to file annual returns and accounts which can be accessed by the general public. For members to obtain the benefit of limited liability, it may be preferable to create a separate legal entity to hold, manage and protect the organisation's assets, employ people, enter into contracts, leases and raise finance – this would require an incorporated vehicle for the mutual.

Mutuals may also apply for charitable status. Charitable status tax is an important consideration for some organisations where the retention of surpluses is essential, particularly if they can't take on equity. In these cases the tax breaks associated with charitable status can be an important factor.

### **Incorporated vehicles**

- ***Industrial and provident society (IPS)*** This is the usual form for co-operatives and community benefit societies, and is democratically controlled by their members in order to ensure their involvement in the decisions of the business.

IPSs have a separate legal personality and limited liability for participants, and fall into two categories:

*The 'Bona Fide Cooperative' mutual model* (to be renamed 'Co-operative Societies'). Such a society is formed for the benefit of its members, rather than society at large, and respects the core values of a cooperative. There is scope for distributing dividends amongst society members, although this might not be suitable for some mutuals. Membership could be restricted to the mutual's employees who will determine how the organisation is run.

*The 'Society for the Benefit of the Community'* (to be renamed 'Community Benefit Societies'). Such a society pursues a wider public good, rather than just its members' interests. It cannot distribute profits to members. Membership is generally open to all persons able to use their services and willing to accept the responsibilities of membership, subject to limited qualifying criteria.

The flexibility of an IPS makes it well-suited to being a vehicle for mutuals. Members can actively control the organisation by setting policies and making decisions. Members have equal voting rights regardless of their shareholding and benefit from limited liability. The management structure is essentially two-tier with a committee or 'board' accountable to a wider membership. Unlike the company structure, there is very little statutory interference in the role of the board and membership. The detailed distribution of powers and functions between the board and the membership is highly flexible and a matter for the IPS's Rules; they can therefore be tailored to particular circumstances. It is possible for community benefit societies (but not co-operatives) to apply a statutory 'asset-lock' which prevents any assets or cash from being distributed other than to creditors on a winding up or to another asset-locked body, such as a charity or a community interest company.

**Companies limited by guarantee or shares** These are the most common legal structure for businesses and often considered to be the most flexible, particularly companies limited by shares. To operate as a mutual, the articles of association need to adhere to the principles of a mutual, whereby the membership community 'owns' the mutual collectively, a democratic voting system is in place and stakeholders can play an appropriate role. Limited companies are governed primarily by the Companies Act 2006 and exist in two forms:

The Company Limited by Guarantee - the members of the company give a guarantee for a nominal sum, which will be the maximum amount that they will be liable to contribute if the company is wound up.

The Company Limited by Shares - the members own shares in the company which they either purchase or may be given (for example, through an employee share scheme). If the company is wound up, the maximum amount that they will be liable for is the amount payable for the shares.

Companies represent a universally recognised structure for a mutual, and provide for transparency since company documents are available for public inspection. A company will have a duty each year to file annual accounts (containing the directors' report) as well as an annual return detailing membership and directors, and other key information. Mutuels formed as limited companies must be able to deal with the administrative requirements, such as the various forms that have to be signed and filed if there is a change in the company structure. Smaller organisations may find this too cumbersome and consider that it outweighs the benefits that limited liability brings.

- **Community interest company (CIC)** A CIC is a legal form created specifically for social enterprises. It has a social objective that is "regulated" ensuring that the organisation cannot deviate from its social mission and that its assets are protected. It is suitable for a business with primarily social objectives, where the surpluses are reinvested in the business or the community rather than being driven by the need to make profits for the benefit of the members. As such, a CIC is a potentially suitable vehicle for a mutual. CICs are subject to dual regulation by both the CIC Regulator and Companies House. They have the same governing documents as a normal company and are generally subject to the same procedures. CICs may be limited by either shares or guarantee; in the case of a CIC limited by shares, dividend payments are possible - but restricted by a dividend cap. This means that there is a maximum amount that can be paid on each share regardless of how well the CIC is performing. A main principle of a CIC is the 'asset lock' – assets, cash and property can only be used for the stated community purpose. Organisations must name another 'asset-locked' body to receive any surplus assets upon winding up. If no such body is named, the CIC Regulator will award the assets to an asset-locked body which has the most similar objects. CICs must satisfy the 'Community Interest Test', demonstrating that a reasonable person would perceive their activities as being in the interests of the community.
- **Limited Liability partnerships (LLP)**

A Limited Liability Partnership (LLP) might be described as halfway between a company and a simple partnership. With its own corporate identity and limited liability for its partners, an LLP has the advantages of a company, but provides the flexibility to allow the partners to tailor its internal workings. An LLP is taxed

as a partnership, rather than as a company – meaning the partners individually pay income tax rather than the organisation paying corporation tax. There is no legal requirement for an LLP to have a formal constitution, although it is common to set down at least basic organisational rules within an ‘LLP agreement’ which can be kept private if so wished. Regulated by Companies House, LLPs must be run to make a profit and might be considered an unconventional model for a mutual. However, their flexibility and potential tax advantages could make the LLP a viable alternative.

## **Unincorporated vehicles**

- ***Unincorporated association***

An unincorporated association is a group of individuals who have come together to pursue a shared goal, whether that be to benefit the members only, or for wider public benefit. As with incorporated vehicles, an unincorporated association would need rules that adhere to the principles of a mutual, i.e. the mutual is ‘owned’ collectively by the membership community, there is a democratic voting system in place and stakeholders can play an appropriate role. An unincorporated mutual provides the most flexibility in terms of structure and the way it operates because it is not subject to any regulation by company law. There are no applicable regulators, unless the organisation is registered as a charity – in which case the Charity Commission will be the regulator. An unincorporated mutual may be relatively simple and inexpensive to set up. However, an unincorporated mutual has no legal personality of its own, so it cannot enter into contracts or hold property in its own name and may find it difficult to borrow money. An unincorporated mutual would also have unlimited liability, meaning the individual committee members may be pursued for any outstanding debts or liabilities run up by the organisation. As such, it is not likely to be an attractive option for running a significant trading enterprise.

*The information in this appendix has largely been taken from “Developing a Mutual for Local Authority Service Delivery”; A Special Report from TPP Law, November 2010*

**Do we have the power to set up a mutual? Powers and Governance Issues – extract from “Developing a Mutual for Local Authority Service Delivery”; A Special Report from TPP Law, November 2010**

- 1) There are two perspectives for this issue. One is from the point of view of a Local Authority setting up a mutual so that the mutual can trade, and the other is from the point of view of a mutual being set up independently of a Local Authority, but with the intention of trading with one or more Local Authorities. Dealing first with the Local Authority setting up a mutual, identifying the power to establish or participate in a mutual will need to be an early and important consideration.
- 2) In the Local Government sphere, the first points of reference will be the wellbeing powers in section 2 of the Local Government Act 2000 and the ancillary powers in section 111 of the Local Government Act 1972. These are expected to be superseded by the general power of competence proposed in new legislation (expected to be the Localism Bill) to be introduced in Parliament very soon, in autumn 2010.
- 3) In the meantime section 2 gives local authorities power to do anything they consider likely to achieve the promotion or improvement of the economic social and environmental well being of their area. Guidance issued by the Secretary of State in connection with this provision states that the power enables local authorities to form and participate in companies, trusts or charities including joint venture companies.
- 4) The power in section 111 gives a local authority power to do anything (including spending money or acquiring/disposing of any property or rights) calculated to facilitate, or which is conducive or incidental to, the discharge of any of its functions.
- 5) Local authorities may also be able to rely on section 1 (1) of the Local Government (Contracts) Act 1997 which provides that every statutory provision conferring or imposing a function on a local authority confers power on the authority to enter into a contract with another person for the provision of assets or services in connection with the discharge of the function by the local authority.
- 6) The corporate form for a mutual might be a company limited by shares or by guarantee, but there are some alternatives to this, notably an industrial and provident society or a community interest company. If a company is to be the form, some thought needs to be given to the involvement which the Local Authority seeks. If the company is controlled or influenced by the Local Authority, the provisions of Part V of the Local Government and Housing Act 1989 and the Local Authorities Companies Order 1995 will apply. In the context of the NHS, different statutory provisions are applicable, at least for the time being.
- 7) Section 223(1) of the National Health Service Act 2006 provides a power for Primary Care Trusts (subject to certain limitations) to form and invest in companies to provide facilities or services to persons or bodies exercising functions or providing services under the NHS Act. ‘Companies’ for this purpose would not include an industrial and provident society.
- 8) The NHS Act 2006 also provides PCTs, NHS Trusts and NHS Foundation Trusts with the express power to generate additional income by forming companies.
- 9) Following the White Paper “Equity and excellence: Liberating the NHS” published in July 2010, a new National Health Service Act is to be introduced. The Bill is expected to be in Parliament late 2010/early 2011. Amongst the radical and far-reaching organisational

reforms to be contained in this will be the merger of the public health functions of Primary Care Trusts with local authorities.

- 10) While the following point may be superseded if the general power of competence for local authorities is enacted, a word of caution is appropriate at this point in relation to powers: the scope of the power needs to be considered.
- 11) In June 2009 the Court of Appeal gave judgment in *Brent LBC v. Risk Management Partners Limited* with *London Authorities Mutual Limited* ("LAML") and *Harrow London Borough Council* as interested parties. The Court found that local authorities could not in reliance on well-being or incidental powers set up and participate in a mutual insurance company. This decision is subject to an appeal to the Supreme Court.

#### **Issues to consider following the LAML Judgment**

##### **Well-being**

- 12) Whilst the extent of section 2(1) is wide, it should be noted that the Courts expect to see 'some reasonably well-defined outcome' which the authority considers will promote or improve the well-being of the area. So it is wise to identify the specific outcomes in question which are proposed to promote or improve the relevant element of well-being. It is also wise to identify which strands of well-being the activity or outcome is designed to promote or improve and how it will be envisaged to do this by setting up a mutual. The actions proposed must be objectively reasonable in the light of the authority's fiduciary duty. Another key consideration in the decision of the Court of Appeal was the risk to the public purse. As Lord Justice Pill indicated, the well-being power:  
'...does not extend to a power to enter into the complex and somewhat speculative attempt to save money which is the mainspring of the LAML arrangement'.  
and  
'...the substantial speculative element cannot be ignored'.

A speculative highly risky venture without a clear business plan is more likely to be called into question.

- 13) Key points to bear in mind in relation to the use of this power are:
  - Section 111 is a subsidiary and not a substantive power and should not be used to cover ground already provided by a substantive statutory measure;
  - It is essential to identify a primary substantive function to which section 111 can reasonably attach, i.e. there should be a reasonable, direct link between the primary and the incidental power in section 111. As the Court pointed out, the further any arrangements put in place by an authority for the performance of its primary functions 'depart from the simple acquisition of the benefits in question, the greater the likelihood that they will fall outside its powers'.
  - It is also essential to ensure that the incidental power sought to be exercised relates to a clear primary function or functions of the public authority.
- 14) Whilst LAML is primarily a case about the use of local authority powers, its finding in relation to the use of subsidiary or ancillary powers will also be relevant to the use by NHS bodies of similar powers given to them, for example, in the NHS Act 2006. For Local Authorities, it remains to be seen whether the Coalition Government's new legislation will lay this issue to rest.