

# What Is an Industrial and Provident Society?

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This paper examines the origin of the definition of an industrial and provident society in section 1(2) of the Industrial and Provident Societies Act 1965 (IPSA) and argues that its legislative history and the development of co-operative principles in the twentieth century displays an evolution towards a wider and more flexible definition of co-operative and mutual enterprises with implications for the law reform advocated in a number of the recommendations of the Co-operative Commission Report of February 2001.<sup>1</sup>

Those wishing to establish a business structured and operated as a co-operative or for the benefit of the community usually register an industrial and provident society. This legal structure has the advantage over a company that the regulator under the IPSA<sup>2</sup> has a duty to ensure that the society, on registration and subsequently, operates as a co-operative or benefit of the community society (bencom). Initial registration or later rule amendments will be rejected if that requirement is not met, and the regulator has power to remove a society from the register on that ground.<sup>3</sup> IPSA provides business defined social aims, both a special legal regime and a regulator to secure continued pursuit of that purpose. The legislation also provides some more technical advantages such as: the power to use withdrawable share capital; easy restructuring by transfer of engagements; and a useful relaxation of some of the rules about the supply of information to investors imposed on other legal structures.<sup>4</sup>

By IPSA section 1(1)(a) & (2) registration of a society is only possible if it either:

- (a) "is a bona fide co-operative" or
- (b) is to conduct its business "for the benefit of the community" and can show special reasons for registering under IPSA 1965 and not as a company.

Broadly, the regulator sees this distinction as focusing on services to members (a bona fide co-operative) or services to non-members (bencom).<sup>5</sup>

How did this distinction arise and how fundamental was it ever intended to be? Between 1852 and 1939 no such test existed in industrial and provident (I&P) society legislation. The focus of the

definition at that time was the business activity of the registered society. In the first (1852) Act, the requirement was that a society was "carrying on or exercising in common any labour, trade or handicraft," with exceptions such as mining and banking which were later dropped or modified. In 1862 the vital words "whether wholesale or retail" were added to allow for the development of the Co-operative Wholesale Society Ltd. By IPSA 1965 this element of the definition had become: "carrying on any industry business or trade (including dealings of any description with land), whether wholesale or retail" but the requirements of what is now section 1(2) had also been added.<sup>6</sup> Why was this new requirement to operate as a bona fide co-operative or for the benefit of the community added by the Prevention of Fraud (Investments) Act 1939?

The origin of this fundamental definition in our legislation was a matter of pragmatism rather than principle. In the 1930s concern developed about "share pushing" schemes. Property and share investment I&P societies were set up to avoid the Companies Act prospectus requirements. They advertised in the national press. The public were duped by abuses such as: providing insufficient information to potential investors; making misleading claims about the status of the auditors of society accounts; showing profits boosted by property revaluations; and disseminating information based on the full market value of mortgaged property investments rather than the value of the equity. As a result, many small investors suffered serious losses and sections of the national press campaigned for legislation to curb the abuses<sup>7</sup>. In 1936 the Anderson Committee noted the problem. It recommended that: 'steps should be taken to bring the prospectus provisions of those Acts [IPSA 1893 to 1928] into line with those of the Companies Act'.<sup>8</sup>

The solution found by the Government of the day did not apply the Companies Act prospectus provisions to societies but instead introduced the criteria now found in section 1(2) & (3) of IPSA 1965. As Capt. Wallace, the President of the Board of Trade, put it when answering a debate on share pushing in 1937:

We must remember that the particular societies to which criticism has been directed this afternoon represent only a small fraction of the societies registered under the Industrial and Provident Societies Acts. The societies registered under these Acts comprise the co-operative movement, housing societies, working-men's clubs and a large number of bona fide and beneficent activities which it would not be either fair or desirable to restrict; I can imagine the trouble that we would get into here if we attempted to interfere with what may fairly be described as 'the Co-operative charter'.<sup>9</sup>

At the Commons Committee Stage of the Prevention of Fraud (Investments) Bill 1939 which introduced a regime for the regulation of unit trusts and the current criteria for the registration of I&Ps the President of the Board of Trade confirmed the limited objectives of the legislation and the absence of any attempt at wider reform of the IPSAs:

... in so far as industrial and provident societies have in the past been used as a medium for share-pushing the Bill will make that impossible in the future. That is what the Bill is concerned with, and I submit that it is at that point that we ought to leave whatever we do concerning industrial and provident societies under this Bill...<sup>10</sup>

Thus, the aim of the 1939 reform was to include all societies then registered - mainly clubs, co-operatives, and housing societies - and to exclude those engaged solely in the investment business. This was done by excluding the latter from the definition of a co-operative and introducing the need to prove a "special reason" for a society to be allowed to register as a bencom rather than as a company. In one of its few minor changes to the previous law, the consolidating IPSA 1965 dropped the 1939 references in the community benefit condition to improving the "living conditions" and "social well being" of "members of the working classes" as obsolete and fully covered by the wider "benefit of the community" phrase<sup>11</sup>.

Currently, many conditions of registration are common to bona fide co-operatives and bencoms: one member one vote (OMOV) or member control, limited or no return to capital; and no artificial restriction on membership. Others differ: co-operatives benefit members while bencoms benefit a community; co-operatives can distribute profits by transaction, but bencoms cannot distribute. However, the common roots of the two categories of society and the pragmatic origins of the distinction between them are clear from history.

If this suggests a closer relationship between co-operative and community benefit "mutual" structures than many have previously acknowledged, the evolution of co-operative principles suggests a similar convergence. The ICA Co-operative Principles agreed and formally made explicit in 1937, 1965 and 1995 display an interesting pattern<sup>12</sup>. Some Principles persist through all three versions:

- Open and Voluntary Membership - 1937, 1966 & 1995.
- Democratic Control - OMOV- 1937, 1966 & 1995.
- Limited Interest on Capital-1937, 1966, & 1995.
- Dividend on Purchases -1937, 1966, & 1995.
- Promotion of Education -1937, 1966 & 1995.

Others have been "lost" since 1937:

- Cash Payments in Buying and Selling - 1937 only.
- Neutrality in Politics and Religion - 1937 - which only applies as non-discrimination on membership by 1966 & 1995.

Some "New" principles have emerged over the years:

- Co-operation Among Co-operatives - 1966 & 1995.
- Autonomy – 1995.
- Sustainable Community Development – 1995.
- The Expression of "Basic and Ethical" Values – 1995.

It may be dangerous to take texts and agreed definitions out of their historical context, but this brief overview suggests a move towards wider and more fundamental principles properly so called. Principles of co-operation among co-operatives, community development, and autonomy emerged; basic values of self-help, self-responsibility, democracy, equality, equity, and solidarity; and ethical values of honesty, openness, social responsibility and caring for others were made explicit. This fits the pragmatic nature of the legal development of criteria for registration and shows that the division between co-operatives and other social or "mutual" enterprises is less marked than many had assumed.

How does this history fit the new co-operative opportunities available today? The Co-operative Commission <sup>13</sup> has made a number of relevant recommendations in this area:

- *Recommendation 53*: envisages the Social Economy Task Force addressing "the current legal limits in the UK on the scale of Co-operative shareholdings" (£20,000) and tackling the absence of a suitable legal framework for the "social enterprise and mutual sectors as a whole".
- *Recommendation 50*: argues for a review of "the future legal framework of the social enterprise and mutual sectors as a whole" aiming at "a simple, modern, efficient, and cost-effective legal framework for carrying out business activity and meeting the social goals of these sectors ... within the lifetime of the next Parliament".
- *Recommendation 51*: advocates "a modernising Bill ... to recognise in law the Co-operative form of common ownership" and to "secure co-operative assets".
- *Recommendation 60*: emphasises the process of "reinterpretation and reinvigoration" of co-operative principles

by the movement itself "to make them relevant to the present day".

From these recommendations and the current development of new "mutuals" a number of conclusions can be drawn. History shows the links between bencoms and co-operatives and the pragmatic origin of the distinction between them. This points to a more open-minded approach to structures for new and existing social or mutual enterprises.

The Commission recommends a review of the whole legal regime for "Social and Mutual Enterprises" and recognises the benefits of a legal regime reflecting the "Social Economy" as a whole. This work must begin with an understanding of how history brought us to the present position and develop as a thorough analysis of the needs and objectives of the wider "social" or "mutual" sector while acknowledging the role of a new "co-operative" legislative framework within that wider regime.

In the late twentieth century co-operatives articulated a community development objective and wider ethical and basic values. This links them to the culture of other organisations in the wider social economy. Is this the direction for the further revision and renewal of co-operative principles foreshadowed in the Commission Report?

When one combines these developments with the growing perception of consumer co-operatives as multi-stakeholder enterprises reflected elsewhere in the Commission Report<sup>14</sup> and the need for flexibility in legal structure to meet the practical needs of the new sectors in which mutuality is operating - such as football clubs, health care, and the utilities - the challenge and the opportunity are clear. We must reform the law to preserve co-operative identity within the wider social and mutual sector while encouraging diversity and creativity in developing new structures to apply people based and socially orientated solutions to twenty first century problems. That is how the "social economy" will grow.

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## **Notes**

- 1 Co-operative Commission, *The Co-operative Advantage: The Report of the Co-operative Commission*, Co-operative Commission, London, 2001
- 2 Currently the Registrar of Friendly Societies but, from a date to be appointed under the Financial Services and Markets Act 2000, the Financial Services Authority.

- 3 IPSA 1965, section 16(1)(c)(ii)
- 4 IPSA 1965, section 1(1)(b) and Schedule 1 paragraph 9; IPSA 1965 section 51; Financial Services Act 1986 section 1 and Schedule 1 paragraph 1 (note); and Public Offers of Securities Regulations 1995 SI 1995/1537 regulation 7(1) & (2) (q)(iii)
- 5 Snaith Ian, *Handbook of Industrial and Provident Society Law* Holyoake Books, 1993, Chapter 3 section 3.3
- 6 Ibid section 2.1
- 7 Advertising Association, *Advertisements of Properly Investment Societies, Observations and Recommendations of the Expert Committee Appointed by the Advertising Association*, Advertising Association, London, 1937
- 8 *Fixed Trusts, Report of the Departmental Committee Appointed by the Board of Trade*, 1936 Cmd 5259 paragraph 47(5), page 20.
- 9 House of Commons Official Report 15<sup>th</sup> December 1937 Vol 330 No 37 col 1221
- 10 Standing Committee A *Official Report Prevention of Fraud (Investments) Bill* 8<sup>th</sup> December 1938, cols 70-71
- 11 First Report by the Joint Committee on Consolidation Bills Proceedings and Minutes of Evidence for 10<sup>th</sup> February 1965, paragraphs 252-254, and Lord Chancellor's Memorandum, "Consolidation of Certain Amendments Relating to Industrial and Provident Societies", Proposition 47, House of Lords Sessional Papers 1964-65 Vol V Miscellaneous.
- 12 See Watkins W P, *Co-operative Principles Today and Tomorrow* Holyoake Books, Manchester, 1986 at pages 5 to 9 and ICA, *Statement on the Co-operative Identity* (ICA, Manchester, 1995)
- 13 Co-operative Commission, *The Co-operative Advantage: The Report of the Co-operative Commission*, Co-operative Commission, London, 2001
- 14 Ibid recommendations 28 and 31.2