

# **Co-operative Corporate Partnerships**

## **A Very British Revolution**

## Summary

The unintended consequences of UK Partnership legislation have created, for the first time, a Corporate body with collective limited liability which is also a Partnership – the UK ‘LLP’.

Firstly: a Partnership is an inherently Co-operative model. Secondly: such LLP’s may be made ‘Open’ by extending Membership to all stakeholders. Thirdly: through ‘Temporary Equity’ – a proportional share owned for a defined period of time – a new form of ‘Open’ Capital may be created outside the current paradigm.

The incorporation of Co-operative Principles gives us a Co-operative Corporate Partnership: this entity is capable of underpinning a truly Co-operative Society.

## **Introduction**

If it is true that the road to Hell is paved with good intentions, then perhaps the road to Heaven is paved with bad ones. The story begins in that bastion of democracy – Jersey. In the early 1990’s major professional partnerships such as Andersen became increasingly concerned at the risks run by individual partners of bankruptcy caused by their unlimited liability for actions or omissions by their fellow partners and unsuccessfully lobbied the UK government for legislation.

Two of the leading UK professional partnerships commissioned a major City law firm – at a rumoured cost in excess of £1m - to draw up an Act of the Jersey “States” Parliament establishing a new form of Limited Liability Partnership (“LLP”). Suitably placed UK press articles raised the spectre of a mass migration by professional firms to Jersey and the Conservative Minister Michael Heseltine then in office ordered the commencement of the consultative and legislative process subsequently continued by New Labour which eventually resulted in the UK’s Limited Liability Partnerships (2000) Act which came into effect on 6 April 2001.

In the December 2002 Journal Cliff Mills set out the challenge inherent in protecting public or community assets so that they are ‘safe and committed to a common purpose’. His article was a masterly analysis of the inadequacy of current Companies Law, and related legislation covering Industrial and Provident Societies. The author believes that the far-reaching and entirely unintended consequences of this recent innovation in UK Partnership Law not only solves the problem of which Cliff wrote but has enormous potential for the Co-operative movement in particular and Society in general.

## **Enterprises Generally**

### *Definitions*

An 'Enterprise' is defined for the purposes of this article as 'any entity within which two or more individuals exchange Economic Value' which, like Beauty, is in the eye of the Beholder and is defined for the purposes of this article as:

- 'Material Value' – such as Land, Commodities, Goods and Services;
- 'Intellectual Value' – such as music, video, the written word and software, which exists in the form of data, electronic or otherwise;
- 'Emotional Value' – at its most basic, the need to love and to be loved, but extending into the concept of Society;
- 'Spiritual Value' – who am I? Why am I here? Questions in relation to God and the relationship with the eternal.

Three forms of Enterprise are identified:

- the 'Charitable' Enterprise – where Material and Intellectual Value are exchanged for the Spiritual and Emotional Value of giving;
- the 'Social' Enterprise – a 'Public' Enterprise open to all, where Material and Intellectual Value is freely exchanged;
- the 'Commercial' Enterprise – a 'closed' or 'Private' Enterprise where Material and Intellectual Value is exchanged between a limited number of individuals but may be retained or distributed in whatever way the Members agree.

### *A Brief History of the Enterprise*

Early enterprises were partnerships and unincorporated associations. However, the need for institutions which outlived the lives of the Members led to the development of the Corporate body with a legal existence independent of its Members. In the UK the earliest Corporates were created by Royal Charter – a possibility which exists to this day.

The key development in the history of Capitalism was the creation of the ‘Joint Stock’ Corporate with liability limited by shares of a ‘Nominal’ or ‘Par’ value, typically £1.00. The UK Industrial Revolution was fuelled by Capital raised through Joint Stock Corporates largely created by Act of Parliament. From 1844 onwards, the creation of Corporates through registration under Companies Statutes further streamlined the process and over the next 150 years the Limited Liability Corporate evolved into the Public Limited Liability Corporate at the heart of the malaise deriving from the process we know as ‘Globalisation’.

### *The ‘Closed’ Public Corporate*

In his essay ‘Economies for Life’ (1) the Economist David C Korten characterises the PLC as a key component of a ‘Suicide Economy’:

This corporate form is legally structured to allow virtually unlimited concentration of power to the exclusive financial benefit of absentee shareholders who have no knowledge of, or liability for, the social and environmental consequences of the actions taken on their behalf. It is a legally sanctioned invitation to benefit from behavior that otherwise would be considered sociopathic—even criminal.

The problem with the 'Closed' Corporate - as I propose to term it due to its essentially proprietary character - is the fundamental conflict between the interests of the owners of the "closed" or Fixed Capital base – inaptly denominated 'Equity' – and the interests of all other stakeholders such as suppliers, customers, management, staff and in the case of major global corporates, the public at large.

The latter are essentially 'costs' external to the (absentee in the case of a Public Corporate) owners of the Enterprise and the resulting drive to maximise 'Shareholder Value' through a combination of 'cutting costs' and growth at any price has brought us the Wall Street/City analyst-driven management excesses typified by Enron and Global Crossing.

There is a fault-line within the 'Closed' Corporate. It has the characteristics of what biologists call a 'semi-permeable membrane' in the way that it allows Economic Value to be extracted from other stakeholders but not to pass the other way. So while Capitalism may not, as its critics aver, be 'broken' – Capital most certainly *is* and always has been - through the discontinuity between:

- 'Fixed' Capital in the form of shares ie Equity; and
- 'Working' Capital in the form of debt finance, credit from suppliers, pre-payments by customers and obligations to staff and management.

Due to this discontinuity between permanent Capital and Capital of defined duration the exchange of Economic Value in a Closed Corporate is made difficult and the true sharing of Risk and Reward which constitutes a true partnership - rather than

a joint venture, supplier/customer relationship or strategic alliance - is simply not possible.

Society is crying out for a 'Third Way' between the co-operative/collaborative and the competitive: the public and the private: the paradox of the modern world: that humans have never been more inter-dependent in our needs, or more individualist in our outlook. No Enterprise Model has been capable of resolving this dilemma. Until now.

### **Open Corporate Partnerships**

#### *The UK Limited Liability Partnership ("LLP")*

From 1844 onwards in the UK it has been mandatory for partnerships with more than 20 partners to be incorporated – the result being Corporate Partnerships with unlimited liability. In 1907, it became possible for Partners to limit their partnership individually rather than collectively within a UK partnership at the cost of being unable to participate in the management of the partnership. This model routinely continues in the USA where it is the normal structure for professional partnerships.

In the late 1990's UK professional partnerships, faced with the prospect of individual bankruptcy as a result of litigation against the firm, successfully lobbied for protection, which arrived in the shape of the Limited Liability Partnerships Act 2000 and came into effect on 6 April 2001. Since then over 7,000 UK LLP's have been incorporated, for the most part from conversions of partnerships previously with unlimited liability.

The UK LLP is supremely simple and remarkably flexible. The only requirements are for two "Designated Members" to complete an Application Form obtainable at the Companies House web-site and to return it with the requisite fee of £95. There is no requirement for the mandatory and arcane Victorian vintage Memorandum of Incorporation and Articles of Association – the prescriptive Contracts between Members laid down by Statute – and no need for a supplementary Shareholder Agreement tailoring these Contracts to the precise present day needs of the Members in the relevant Enterprise. All that is needed is a simple ‘Member Agreement’ – a legal protocol which sets out the Aims, Objectives. Principles of Governance, Revenue Sharing, Dispute Resolution, Transparency and any other matters which Members agree should be included. Amazingly enough, this Agreement need not even be in writing, since in the absence of a written agreement Partnership Law is applied by way of default.

While a UK LLP should be a business run "With a View to Profit" the proposed Enterprise Model redefines the relationship between stakeholders in a way that literally removes the very concept of Profit and Loss – a subject to which we will return. The ease of use and total flexibility enables the UK LLP to be utilised in a way never intended – as an ‘Open’ Corporate partnership.



## **The ‘Open’ Corporate Partnership**

There are two innovative concepts which characterise the ‘Open’ Corporate Partnership. Firstly: the realisation that it is now possible for any stakeholder to become a Member of a UK LLP simply through signing a suitably drafted Member Agreement: this puts the ‘Open’ in the Open Corporate. So instead of a supplier signing contractual terms of business negotiated adversarially or an employee being confronted with a Contract of Employment they may instead become true Partners in the Enterprise with their interests aligned with other stakeholders. The result is that there are no ‘externalities’ in an Open Corporate Partnership, which therefore means that Economic Value may be exchanged within the Enterprise in conformance with the Member Agreement.

The second innovation is the concept of ‘Open Capital’ itself. This concept arose out of the realisation that proportional shares (such as one half, three fifths, five millionths) in an Enterprise constitute an infinitely divisible, flexible and scaleable form of Capital capable of distributing or accumulating Value organically as the Enterprise itself grows in Value or chooses to distribute it. Furthermore, proportionate shares may be sold to raise Capital either outright – for an indefinite period – or, through a Sale and Repurchase (‘Repo’) agreement, for a defined period of time – creating ‘Temporary Equity’. Where an Equity share is ‘repo’d’ in this way the investor participates in the increase in Value whether distributed as dividend or not, but retains the risk that his Equity stake may in fact decrease in Value over the period. In simple terms: Debt and Interest are replaced by Equity traded forward: the result is ‘Temporary Equity’ and the fault-line dividing the ‘Closed’ Corporate disappears.

## **Open Corporate partnerships in practice**

The optimal nature of the UK LLP is already becoming apparent, and a number of technology start-ups have utilised the form. Moreover, a transaction entered into in late 2002 by the Hilton Hotel Group serves as an example of how 'Temporary Equity' may operate in practice (although it is extremely doubtful that the parties realised quite how ground-breaking their transaction was to be).

The Hilton Hotel Group sold a portfolio of 10 hotels for some £350m to an LLP in which Hilton (the Occupier) hold 40% and the balance of 60% is owned by another LLP linking the 3 Investor Members - one of whom is Bank of Scotland. The Investors receive for 27 years 28.8% of the gross revenues from these hotels plus a further £3m pa all subject to a floor of £17.5m pa or 5%.

Note firstly that there is no Debt and no Interest in this structure and the risks and rewards are shared as in all true partnerships. The outcome is therefore to create 'Temporary Equity' with a 27 year term. Note secondly that it is in the interests of both Occupiers and Investors to co-operate in order to create the maximum flow of revenue over the period of the agreement. The Hilton transaction is a close relation of the 'Property Investment Partnership' set out below which was created as an Islamically sound method for property purchase.

### *Property Investment Partnership ('PIP')*

A PIP constitutes an 'Open' Corporate LLP between and one or more Investors in the LLP and one or more Occupiers of the property it acquires.

eg a property purchased for £100,000, of which £80,000 is financed:

- the Occupier/Investor receives 20 shares and the Financier/Investor 80 shares at a value of £1k each. (or 200/800: 2000/8000 etc - it is the 20%/80% proportions which matter, there being no par or nominal value to these shares)
- there is an Exchange of Value: in return for the use of the Property, the Occupier(s) pays a Rental to the LLP which in turn pays the Investor (s) for the use of the Capital.
- so a rent of £6,000 pa is agreed for two years for the above property: the Occupier pays net £4,800 pa; the Investor receives net £4,800 pa.

After two years, the Occupier wishes to invest £12k in the Property: at £120k valuation he buys a further 10%; at £96k valuation he purchases 12.5% and so on.

Note:

- there is no Debt and no Interest (hence the Islamically sound nature);
- because a PIP is specific to a property, it need never again be sold; merely a change of Occupier or of Investors;
- repossession only takes place when continued failure to pay rental erodes the Equity held in the property;
- increases in Value arising from agreed improvements would be apportioned between those providing the necessary Investment;
- an Occupier may build up a portfolio of investments in the properties in which he lives, which may then be flexibly liquidated upon his retirement. ie a vast improvement on current "equity release" schemes;

- partners who choose not to marry may yet protect their interest in a property (and indeed other assets) through a suitably framed Member Agreement – thereby solving a problem which has been vexing the Law Society for years.

### **Open Corporate Partnerships and Co-operatives**

A Co-operative is not an enterprise structure: it is a set of Principles that may be applied to different types of enterprise structure. Considering firstly Limited Companies operating under the Companies Acts:

- the ‘For Profit’ Company Limited by Shares is particularly unsuited to being a Co-operative for reasons outlined above;
- the ‘mutual’ company Limited by Guarantee is restricted in its ability to raise Capital or pay dividends.

Enterprises operating under the Industrial & Provident Societies legislation, while better able to comply with Co-operative Principles:

- suffer from the ‘asset locking’ defect identified by Cliff Mills;
- in that they favour the interests of other stakeholders, are relatively restricted in accessing investment;
- are arguably deficient in incentivising innovation.

Consider Partnerships however: the very word ‘partnership’ is redolent of collaboration and co-operation in the mutual pursuit of ‘maximising value’. Partners do not compete with each other – they collaborate together, sharing risks and rewards, rather than seeking to maximise reward and minimise risk at each other’s expense. We are daily bombarded by marketing material referring to ‘partnerships’ which are

nothing of the kind, being rather supplier/customer relationships, strategic alliances, joint ventures and the like.

While a partnership is an inherently Co-operative model in the way that risks and rewards may be shared, the crippling factors in practical terms have been, inter alia:

- the liability to which Member partners are exposed from the actions of their co-partners on their behalf;
- limited ability to raise capital.

The ‘new’ LLP was expressly created to solve the former problem by limiting the liability of Member partners to those assets which they choose to place within its protective ‘semi-permeable membrane’. However, through the phenomenon described as ‘Temporary Equity’ the author believes that the ability to raise capital *without borrowing at Interest* confers this new entity with a property which may render it superior to others.

Furthermore, the ‘Open’ nature of the LLP - in terms of the way that any stakeholder may become a Member – allows a resolution of the ‘Asset locking’ problem. The relationships between the LLP and its Members, and between the Members themselves, are covered by the LLP Agreement – which says whatever the Members agree. In the absence of a written agreement, existing Partnership Law applies, and this does not – as the IT community put it – ‘scale’ at all well so that for instance:

- all Members have to agree to the admission of a new Member;
- all profits are shared equally;

both of which would give rise to problems in anything other than a small partnership.

However, it will be seen that the creation of a ‘Co-operative Corporate Partnership’ (‘CCP’) requires only the drafting of a suitable LLP Agreement. Firstly, a CCP would incorporate in its LLP Agreement the Statement of Co-operative Principles published by the International Co-operative Alliance. Secondly, the LLP Agreement would define the different classes of stakeholder Members (eg supplier, customer, investor) and then, through suitable provisions covering majorities (>50%) or super-majorities (>(say) 75%), it would be possible to ensure that certain events, such as amendments to Aims and Objectives, or the disposal of key assets, could not take place without the agreement of all constituencies of stakeholder. Thirdly, as in all partnerships, the revenues net of costs external to the enterprise (ie the ‘surplus of income over expenditure’ or ‘profit’) would be divided among Members in accordance with the LLP Agreement. This means that all Members share a common interest in collaborating/co-operating to maximise the value generated by the LLP collectively as opposed to competing with other stakeholders to maximise their individual share at the other stakeholders’ expense.

In summary, the new UK LLP form appears ideally suited for use by Co-operative enterprises: however, there is one major legal stumbling block against the widespread adoption of the LLP, particularly in “Social Enterprises” and that is that the legislation provides that a UK LLP must operate ‘With a View to Profit’. The measure of the importance of the use of the UK LLP as an ‘Open’ or ‘Co-operative’ Corporate Partnership is that it transcends the very concept of ‘Profit’ and ‘Loss’ and

obliges us to look again at exactly what we mean by ‘Social Enterprises’ and ‘Charities’.

### **‘With a View to Profit’**

A profit is a surplus of income over expenditure available for distribution in Money to the ‘owners’ of an enterprise and in partnerships profits are distributed in proportional shares as set out in the partnership agreement. In ‘closed’ limited liability Companies distribution is by way of dividend. However, many companies choose not to pay dividends and to retain the profits, which will be reflected in the net assets of the company. A shareholder may be able to realise such retained profits by selling his shares, particularly where the company is a public company listed on a Stock Exchange.

‘Mutual’ companies – limited by Guarantee and without a Share Capital – are denominated ‘Not for Profit’ in that while many will retain very significant accumulated surpluses both for capital investment and current operating expenditure these reserves are not for distribution to Members. Industrial & Provident Societies operate in a very similar way except that a constituency of investors may receive a limited return on their investment.

We are currently seeing a new wave of ‘Social Enterprises’ particularly in the fields of health, housing and transport which will operate on a ‘Not for Dividend’ basis. In other words the objective is to allow service providers and investors to cover costs and make a reasonable return on their investment, but without yielding excess profits. The conflict of interests between stakeholders outlined above remains,

however, and is manageable only by a complex layer of statutory protection and prescriptive contractual provisions or, in the case of Charities, a complex layer of Trust documentation and case law.

The wave of 'Trusts' – which are for the most part Industrial and Provident Societies or 'Public Interest' Companies - apply a Co-operative veneer to an inherently divided and flawed form of Capital infrastructure. At best this is a 'least worst' solution: the 'Open' capital base of 'Open' Corporate Partnerships, on the other hand, creates an entirely new capital paradigm.

### **'Profit' and the 'Open' Corporate Partnership**

If we open up the Membership of an LLP to include other stakeholders who were formerly 'external' to the enterprise then 'profit' takes on an entirely new perspective. Firstly we can create a "Charitable Enterprise" –as defined above - quite simply by allowing the beneficiaries to become Members. The result is an extremely 'profitable' enterprise in Money terms – since its income is donated. However, the LLP agreement would specify that these "profits" will be distributed only to a particular segment of Members.

Secondly, in a 'Social' Enterprise, we see two constituencies of Membership: a co-operative of service providers and a co-operative of service consumers. The latter will be 'open' in that it is open to anyone in the relevant community, and will pay an agreed amount in return for an agreed level of service. Moreover, through investment in 'Temporary Equity' – users of Social Enterprises will be able to invest in the secure income stream of such utilities, drawing down upon their partnership



capital account when they utilise the service provided. A season ticket in a transport utility is an exact analogy. Such Social Enterprise LLP's are again for the mutual Profit of all Members, even though this may not manifest itself in Money terms for all of them: for service consumers, the dividend takes the form of the service provided.

Finally, there is the 'Commercial' Enterprise LLP – where the object is for a closed group of individuals to maximise the value generated in their partnership. There are already over 7,000 of these.

In essence, the Profit generated in a competitive economy based upon shareholder value and unsustainable growth results from a transfer of risks outwards, and the transfer of reward inwards, leading to a one way transfer of Economic Value. This, depending on the degree of imbalance in economic power between the parties, will very often impoverish one or more constituency of stakeholders materially, intellectually, spiritually or emotionally. A partnership, however, involves an exchange of value through the sharing of risk and reward. Whether its assets are protected within a corporate entity with limited liability or not, it will always operate co-operatively – for mutual profit.

### **Towards a Co-operative Society?**

It is possible to envisage a Society within which individuals are members of a portfolio of Enterprises constituted as LLP's. Some will be charitable, or voluntary, to which individuals give their time, Money or other value freely. Others will be 'social' where individual citizens will invest in and subscribe to (say) health, education, transport and other utilities through functionally decentralised partnerships

operating at the neighbourhood, community, area, regional or national levels. These will essentially be partnerships between co-operatives of service providers and co-operatives of service consumers ie the public. Finally, individuals will be Members of 'Commercial' enterprises of all kinds aimed at co-operatively working together to maximise value for the Members.

A pipe-dream? In fact, the process has already begun. The current form of competitive Capitalism was not planned: it is what is known as an 'emergent' phenomenon which continues to exist because it has demonstrated itself to be superior – despite its manifest and documented flaws – to all other models, such as Socialism.

It can only be replaced by another 'emergent' phenomenon, which is adopted 'virally' because any Enterprise which does not utilise it will be at a disadvantage to an Enterprise which does. By way of example of 'emergent' phenomena, we have seen how a 19 year old US programmer has single-handedly destroyed the entire business model of the global music industry through inventing on-line sharing of music in a network which grew to 60 million users within 18 months. In the same way, the small but powerful community of traders in physical oil moved their negotiations from the telephone into Yahoo instant messaging "chat rooms" without their management even being aware of the fact. They did so because it was free, because they could, and because *it worked*

The 'Open' Corporate Partnership is: capable of linking any individuals anywhere in respect of collective ownership of assets anywhere; extremely cheap and simple to operate; and because one LLP may be a Member of another it is organically

flexible and ‘scaleable’. The phenomenon of ‘Temporary Equity’ – which is already visible in the form of significant commercial transactions - enables an extremely simple and continuous relationship between those who wish to participate indefinitely in an Enterprise and those who wish to participate for a defined period of time.

Moreover, the infinitely divisible proportionate shares which constitute ‘Open’ Capital allow stakeholder interests to grow flexibly and organically with the growth of the Enterprise. In legal terms, the LLP agreement is essentially consensual and ‘pre-distributive’: it is demonstrably superior to prescriptive complex contractual relationships negotiated adversarially and subject to subsequent re-distributive legal action. Above all, the ‘Open’ Corporate Partnership is a Co-operative phenomenon which is capable, the author believes, of unleashing the power for good which the founding fathers of the Co-operative movement strove for in the 19<sup>th</sup> Century, only to become bogged down in the 20<sup>th</sup>.

So perhaps in the Co-operative Corporate Partnership – the unintended consequence of a 21<sup>st</sup> Century UK legislative initiative arguably implemented for the wrong reasons in the wrong way - we now have the means to create a truly Co-operative Society.

Behind it all is surely an idea so simple, so beautiful, that when we grasp it – in a decade, a century or a millennium – we will all say to each other, how could it have been otherwise? How could we have been so stupid for so long?

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Note (1) Page 5 <http://www.yesmagazine.org/23livingeconomy/korten.htm>)