Participant Guidance

Act in character throughout. Do not worry if you do not understand everything - the role play itself will help you clarify what you may not understand on first reading. Experienced role play and FairShares experts will brief you before the role play begins.

About You

You are a founder member of Future Energy Ltd, which is currently structured as a partnership with each founder having 1 vote.

During the role play, at least three people (75% of founding partners) need to agree a change in the constitution of the partnership and authorise incorporation as a new legal entity. All partners currently agree that their preferred option is a solidarity co-operative that will ensure a high level of reinvestment, inclusive employment and stronger customer relations. This is expressed through the way the surpluses will be shared:

- £1m of surplus is converted to co-operative capital (an indivisible collective reserve) to fund Future Energy's development plans.
- The remainder is paid out as follows: Employee members (35%), Customer Members (35%) and Investor Members (30%).

All founders would receive a share of the 70% of surplus paid out to employee members and customer members - all founders are customers and will become employee-directors on the conversion to Future Energy Ltd. One founder who provided seed funding will receive the 30% of surplus allocated to Investor Members until additional Investor Members are secured.

About the Decision You Have to Make

The Evolutesix consultant has obtained two legal templates from the FairShares Association – one accepted by the Financial Conduct Authority as a *bone fide* co-operative society and the other accepted by Companies House as a legal model for companies. The consultant has compared the template and tested both of them using the FairShares Rules Generator (**https://fairsharesrules.org**). Their advice to you is as follows.

Both legal templates will support the creation of an enterprise with founder, employee, customer and investor members. In both cases, the enterprise can pay out surpluses in excess of £1m per annum using the percentages proposed. However, there are some restrictions in co-operative societies that restrict weighted voting during special resolutions and restrict returns payable to investor members.

1) In the co-operative society template, ordinary resolutions can be passed on a show of hands, or through a poll (with weighted voting). **However, weighted voting cannot be applied to special resolutions.** In practice, this means that whenever there is a special resolution, customer members would be able to outvote founder, labour and investor members easily. Whilst there are provisions for a multi-stakeholder audit committee to approve resolutions before they go to a General Meeting, once a proposal is approved by the audit committee, there is no mechanism to prevent a single stakeholder dominating the vote in General Meeting.
2) The audit committee is a creative solution to the problem, but it would leave the co-operative vulnerable to capture by an elite, risking demutualisation similar to building societies in the 1980s/1990s, and undermining solidarity between employees and customers. It also compromises the general solidarity co-operative principle that the power of each interest group should be balanced with the others to enhance democratic member control.
3) Under both Company and Co-operative Society Law there are no restrictions (other than the level of surplus) on dividend payments made employee and customer members. After setting aside £1m surplus for future investment activities, 35% of the remainder can be paid to employees and 35% paid to customers. However, Co-operative Society Law requires a cap on 'interest' payable to Investor Members. Even if there is sufficient surplus to pay more, no more than 10% of the capital holding of each member can be paid out each year as interest. This will be sufficient to attract some social investors, but not all. It would probably exclude many impact investors who want to make capital gains on their investments in addition to interest.

There are, however, some advantages to incorporating as a co-operative society. In both legal templates, the combined voting power of labour and customer members must be greater than the combined voting power of founders and investors. This can be enforced by both the sponsor and the regulator of a co-operative society **without having to make any further changes to the model constitution**. If incorporating as a company, changes to 'entrench' specific clauses will be needed to prevent (consumer) members' reversing the protections for founder, labour and investor members in the future. In short, the democratic integrity of the co-operative could be challenged under Company Law if some clauses are not entrenched because there is no statutory protection. Working out how to entrench protections effectively may require further legal advice which raises costs.

There is a further disadvantage incorporating as a co-operative company, particularly if Future Energy wishes to work with co-operative enterprises at home and abroad. A substantial proportion of people active in the co-operative movement may not accept a co-operative company as a co-operative. This issue exists in the UK, but does not preclude recognition and acceptance by the leading trade body. Internationally, there is a lower level of acceptance that a company can be a co-operative (except in New Zealand where the concept of a co-operative company is established by law). Elsewhere, only a registered co-operative society is likely to be regarded as co-operative. This matters to the extent that Future Energy wishes to brand itself as a co-operative in international work.

Some of the marketing disadvantages of incorporating as a company are offset by a governance advantage. Under Company Law, the co-operative can apply weighted voting during special resolutions. In practice, this means that the voting power of consumers and investors (both likely to be more numerous than founders and employees) can be capped so they cannot outvote founders and/or employees. It is deeply ironic, but true for the UK, that solidarity co-operative principles can be protected under Company Law more easily than under Co-operative Law.

Once final difference that is noteworthy is that Investor members are 'non-voting' under Co-operative Law. If choosing Company Law, investor members can have (capped) voting powers. Company Law is likely to be more attractive to social investors, and less attractive to government funders. Co-operative Law is likely be more attractive to government funders, and less attractive to social investors (except the few that preferentially invest in co-operative and mutual enterprises).

The debate amongst founders of Future Energy

The proposal is that Future Energy incorporates as Future Energy Ltd. Three founders need to agree which legal model to use for incorporation and pass a resolution to authorise it.

You vote as an individual, not as a group. You are free to refine the proposal or suggest a different proposal (e.g. a Limited Liability Partnership or Charitable Association).

About the proposed shareholder groups in the new constitution:

Founders: There were four founders of Future Energy (three scientists who did PhDs together and a former-GP who became a social entrepreneur). They formed Future Energy as a partnership supported by a £250k seed fund from the social entrepreneur. S/he wants a financial return on this within five years. All founders want to *provide low cost / free energy to as many people as possible*.

Employees – founders propose that newly recruited staff become members after 1 year. As members, employees will share in the surplus, elect Directors and be able to vote in General Meetings.

Customers – founders propose that domestic customers become members if they buy a maintenance plan. They will share in the surplus, elect Director and be able to vote in General Meetings.

Investors – founders propose an investment community of social and impact investors sympathetic to sustainable development. The offer to them is 0% return for 2 years, then 5-8% returns from Year 3.