



Democratic public ownership for the 21st century

April 2018

the co-operative party

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Ownership Matters: Democratic Public Ownership for the 21st Century

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Foreword



Public ownership is now a mainstream political position. The majority of the population support public ownership of the railways, and key utilities like water.

The privatisation models of the late 80s and early 90s are coming apart at the seams and are increasingly exposed as a failure even in their own terms. No popular ownership revolution was achieved. Effective markets that would drive innovation and competition in the consumer interest have not been created. Regulators have failed to prevent privately owned business doing what privately owned businesses are designed to do – putting the interests of their shareholders above the interests of their customers or communities.

The time has come to go beyond asking whether public ownership in key areas is the right; and instead to make the case for the how and the what of public ownership in the 21st century. Making a positive contribution to that thinking is the purpose of this pamphlet.

We know that ownership matters. The Co-operative Party was formed to champion the idea that we will only achieve a fairer society when power and wealth are shared through collective ownership.

We have always been a party of public ownership. During the 1940s Co-operative MPs served in the Labour Government that built and reformed our great publicly owned institutions including the NHS. However, we have always believed that in order to achieve the fullest possible benefits from public ownership we need to be more radical than simply vesting authority and control in the hands of a few in Whitehall. Instead, we need democratic forms of public ownership that put power in the hands of the many. That give real voice, in the running of services and in critical decisions about issues like investment priorities and executive remuneration, to those who rely on them and who work within them.

This document makes that case for new, democratic forms of public ownership for our railways, energy sector and water industry. There is no one size fits all, and the models proposed here reflect that. These have become extremely complex industries and fundamental reform demands some complex and detailed solutions.

We believe that democratic, publicly owned services in these three areas will be better services, delivering better value for money for consumers and the public purse. We believe that accountable public ownership provides the most effective bulwark against future ideologically driven attempts to reprivatise these parts of our critical infrastructure; creating a stable, long-term approach these sectors so desperately need. And most importantly, we believe that these changes will play a part in creating a fairer economy that works in the common good.

Claire

Claire McCarthy
General Secretary

Introduction

Ownership matters. Who owns a business dictates in whose interest it is run, who has a say when decisions are made, and who benefits from its success.

Britain's public transport and utilities are owned by investors and operate for profit. Since privatisation and its "Tell Sid" promise of a share-owning economy, where Sid and any other ordinary citizen could buy their slice of British Gas, ownership of public utilities and transport has become increasingly concentrated in the hands of a few.

Many companies are no longer listed on the stock exchange and have no small or individual investors left at all. They are bought and sold on global markets by overseas companies, sovereign wealth funds, private equity firms and international hedge funds. Those few companies left on the stock exchange are still dominated by larger and private investors.

And a curious feature of Britain's private system is that large parts of it are once again government-run. State-owned corporations from other countries, for example, account for 25% of the UK's energy sector, and a whopping 68% of the UK's nuclear power.¹ And one in two of the 1.7bn passenger journeys made in the UK each year will be on trains belonging to firms which are ultimately owned by overseas governments.²

“It is savagely ironic that the Tories say they don't believe in state control, yet are perfectly happy to allow Britain's train companies to be run by state-owned railways – as long as it's another state!”

Mick Whelan,

General Secretary of the train drivers' union Aslef

As ownership narrows at the top, further away from the customers and employees, it is no surprise that their voice becomes diluted. When Thames Water pumped billions of litres of raw sewage into public waterways in 2013, rather than being sacked the Chief Executive got a pay rise.³ And when Virgin Trains and Stagecoach mismanaged the East Coast line, they were simultaneously awarded an extension on the West Coast line.

This debate goes beyond a basic argument about profits – it's a question of governance and accountability. For these basic services to properly operate in the interests of their customers, employees and communities, those customers, employees and communities need a say and a stake in how they are run.

The Co-operative Party believes the full potential of public ownership can only be achieved through the use of democratic, accountable and inclusive models.

This approach puts decision-making closer to the people affected by those decisions, giving billpayers and employees a democratic voice. When workers have a say in how their workplace is run and a stake in its success, productivity goes up. When consumers participate, they can ensure the services they rely on are invested in properly and run in everybody's interests. Decision-making is transparent, and decision-makers are accountable for the decisions they make in all our interests.

The Party's approach to public ownership today is based on the co-operative principles laid down more than 150 years ago. The earliest co-operative

societies were publicly owned - by the ordinary men and women who shopped or worked in them. These co-operative societies were a grassroots response to an unfair and exploitative system.

The co-operative movement is, by its nature, a grassroots self-help movement – a way for people to challenge the status quo and take practical action to improve society from the bottom-up. Co-operative values and principles, however, have wider application to the way society is organised, and are a useful lens through which to view national policy debates too.

The Co-operative Party seeks to create an economy where power and wealth are shared. Just as political institutions are measured by the extent to which they give the ordinary citizen the fullest opportunity of exercising political power, public ownership must be judged by the test of whether it gives economic suffrage to ordinary citizens too. Public utilities and transport redesigned using co-operative values and principles would democratise key aspects of our economy.

The future of the UK's energy, water and railways are part of an emerging public discussion about public ownership and "taking back control". The Labour Party manifesto in 2017's General Election pledged to bring key industries such as water, energy networks and rail franchises into public ownership. It was the latest and most ambitious rejection of our old fashioned and unaccountable privatised system.

This paper is a contribution to the discussion on public ownership, providing a co-operative voice within the wider debate. Democratic public ownership means customers and passengers having a say in way utilities and transport are run. It means improving productivity by giving employees a stake in their place of work. And importantly it means an irreversible shift to publicly owned rail, energy and water industries, protecting them from underinvestment or reprivatisation through democratic ownership and voice.

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The case for democratic public ownership

Monopolies don't make good markets

Support for public ownership in industries like energy and water has come and gone over the years, but the truth is that monopolies simply do not lend themselves to competition. When gas lighting first came to London, rival gas companies went as far as sending their workers into the fray to fight for exclusive pipe-laying rights on London's streets.

At the Battle for Bow Bridge, two hundred workers from one gas company were sent to construct barricades to ensure exclusive access to one of the few bridges over the River Lea, while workers from a rival gas company stormed those barricades to rip up the recently laid pipes.¹

As local authorities got involved, concessions would be granted to lay pipes and disturb roads in exchange for street lighting – giving monopoly power and high profits to the first comer. Other companies barely got a look in. By 1850, London had 14 gas companies, and in the race to gain competitive advantage, “quality suffered, often with lethal consequences.”²

Although today's industry has little in common with those original gas companies, and certainly doesn't descend into fistfights over pipelaying rights, their practices are still at times unedifying. In the 1980s, complex regulatory systems were designed to mimic the competition of markets, in order to prevent companies from exploiting their new monopoly positions. Ofwat and Ofgem were created with the requirement to apply complicated formulas like RPI-X, designed to reward innovation, customer service and efficiency savings.

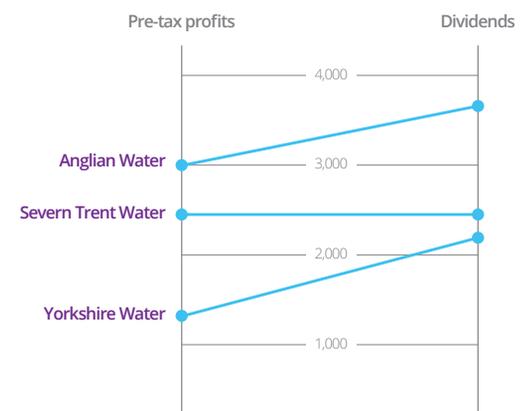
While these have been modified and honed over the years, the fact remains that customers have no option but to pay their bills to and buy tickets from single profit-making monopoly providers, or where choice does exist, broken markets often render their right to choose meaningless.

In rail, this lack of competition for franchises sees the same big companies running railways, regardless of their performance. Passengers endure poor services and rising ticket prices, and staff are overworked because the structure of the franchise agreement deliberately understaffs services.

In many water companies, profits leaving the system as shareholder dividends frequently exceed the organisations' pre-tax profits, while customer bills have risen by about 40% above inflation since 1989.³ Energy customers are

Some water companies pay more in dividends than they earn in profits

Cumulative figures 2007-2016 (£m)



Source: Bliss and Hall © FT

likewise quick to see rising prices when wholesale prices go up, but rarely see a drop in their bills when the reverse occurs.

Regulators, meanwhile, are left with a fundamental contradiction in duty, between the requirement to protect the customer from monopolistic behaviour, and their overarching responsibility to ensure companies running vital infrastructure have the money they need to keep the taps running and the lights on. In many “markets” the regulator can only intervene after a market abuse has taken place – usually in the form of a fine which is ultimately paid by customers via their bills.

The system also suffers from information asymmetry, where regulators rely on the utility itself for the information they need to determine prices. On the one hand, when prices are reviewed, companies are expected to put forward the best value business plans they can.

But they are incentivised to further outperform them, which provides a perverse incentive to omit some innovations and efficiencies from their original business plans. A regulator that is not in receipt of the full facts is not able to make a fair assessment or properly steward the industry.

The privatised system doesn't work for consumers or employees

The idea that the status quo is delivering the best outcomes for anyone except private shareholders is a minority view. There is growing consensus that action is needed to curb excess profits and deliver a better deal for billpayers.

A recent YouGov poll⁴ showed that 65% of the public want to re-nationalise Royal Mail, 60% railways, 59% water and 53% energy. The Labour Party manifesto in 2017 made bold promises to meet these demands, with a pledge to bring energy, water, rail and Royal Mail back into public ownership.

Broken utility and transport markets aren't a new political debate. Labour promised an energy price cap in the 2015 General Election, a call then taken up by the Conservative Party in 2017's election. The Conservative Government's own Cost of Energy Review⁵ undertaken by established industry economist Prof Dieter Helm CBE recommends public ownership of some of the functions of the privately owned National Grid – although this suggestion has to date been ignored.

Academics and think tanks from across the political spectrum find much common ground too. Prof Dieter Helm CBE concludes in a 2009 paper that, regarding privatisation of energy, “the results have been far from satisfactory. The balance sheets are widely exhausted, yet the investment needs have, if anything, got bigger.”⁶ Similarly, the Centre for Policy Studies, the organisation set up by Margaret Thatcher and Sir Keith Joseph, acknowledges that “yes, there are issues in many of the industries that Labour plans to nationalise, particularly in the energy and water sectors.”⁷

These assessments echo Labour's analysis that “many basic goods and services have been taken out of democratic control through privatisation. This has often led to higher prices and poorer quality, as prices are raised to pay out dividends.”⁸

Participation, accountability and economic democracy

The Co-operative Party believes that public utilities and transport should be run in the public interest for the long term. Distant and difficult to understand regulatory processes do not empower the consumer to challenge mismanagement, give employees a voice in their workplaces or communities the ability to decide how profits are redistributed.

The Co-operative Party has always believed that political democracy has to be supplemented by economic democracy. Therefore, in rail and utility markets characterised by monopolistic structures, we should pursue opportunities to convert them into democratic public ownership, accountable to their stakeholders. Changing the

way they are owned and governed would ensure that their interests are aligned with those of the public - their members - rather than being in competition with them.

Decision-making on how our railways and utilities are run are too distant from the communities they serve. Co-operative approaches ensure that profits are reinvested, and give communities and customers control over the infrastructure they rely on.

In 1950, the Party noted that “nationalisation changes ownership but does not by itself change administrative tone or advance the cause of industrial democracy.”⁹ Similarly today, the Party believes that without inviting a higher degree of participation in decision-making, new publicly owned structures, whilst preventing profit leakage, will not achieve the full benefits that truly democratic models offer.

In practice, this means organising utilities and rail in order to ensure democratic structures promote participation in decision-making and where surpluses are reinvested in the system or returned to billpayers as a ‘people’s dividend’.

Productivity gains

Organisations in which employees have a real influence, in particular where this is matched by an ownership stake, are more productive than where this is not the case. In these organisations workers are happier, better remunerated and more productive.¹⁰

This can be seen, for example, in the performance of co-owned companies. The Employee Ownership Index collated by Field Fisher Solicitors compares the share price performance of companies that are more than 10% owned by employees or employee trusts with the performance of FTSE Companies. Since 1992 the EOI has outperformed the FTSE by an average of 10% a year.¹¹ In cash terms, an investment of £100 in the EOI in 2003 would have been worth £754 in 2014. The same investment in the FTSE would have been worth just £280.¹²

The German University ‘Georg-August-Universität Göttingen’ study of Siemens collected data on a uniform employee ownership scheme set across its 60 countries of operation and 270,000 employees over a 5-year period, and demonstrated the strong correlation between ownership, employee retention, and individual and organisational productivity and satisfaction.¹³

The case has been strengthened by the development of a new Economic Democracy Index¹⁴, which includes measures on workers’ rights, ownership and representation. The team behind the new index have found a clear correlation between economic democracy and productivity.

Protection from underinvestment or privatisation

Democratic public ownership provides a ‘buffer’ against a future unsympathetic government. Even a glance at the history of many British industries shows that just as a government which champions public ownership can transform parts of our industry for the better; a government intent on privatisation can reverse any gains made and cause deep damage.

A lack of government investment can cause serious harm to the services and infrastructure we rely on. It isn’t only private businesses, as seen in water, which fail to invest in infrastructure and services. The Post Office’s services, for example, are being decimated by austerity whilst in public ownership.

Democratic public ownership can provide a protection against this. By virtue of the collective strength of the customers, workers and communities having a powerful and meaningful voice, their interests cannot be side-lined so easily in the future.

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Models of public ownership

Public ownership can assume a great variety of forms. The water, energy and transport sectors are wide ranging in scale, scope, complexity and function.

When considering models of public ownership, this variation should be reflected. No one approach will suit all elements of these industries, and any reorganisation should take into account the needs and circumstances of particular functions and sectors.

In 1952 the Co-operative Party called for a diversity in social ownership on the basis that “there is no one road along which all social forces must be obliged to travel”. While the world has moved on considerably since the fifties, this principle rings true today.

While we champion democratic, locally accountable mutual structures, we also acknowledge that for some parts of industry, the best outcomes for consumers and workers will be achieved through national government ownership or management – although in these cases it remains important to ensure participatory and accountable structures.

Public ownership can take three main forms:

- mutual ownership and management by workers and/or consumers;
- ownership and management by the national government, or;
- municipal ownership and management.

This chapter explores these options, and sets out broad principles for when each would be appropriate. It also sets out the checks and balances needed to ensure that, even when mutual forms are not the most appropriate, services remain accountable.

A distant Whitehall department cannot give consumers and workers a true voice and stake – co-operative values and principles must be applied in every instance to ensure everyone benefits from public ownership.

Co-operative values

Co-operatives are based on the values of:

- Self-help
- Self-responsibility
- Democracy
- Equality
- Equity
- Solidarity.

In the tradition of their founders, co-operative members believe in the ethical values of honesty, openness, social responsibility and caring for others.

Co-operative Principles

The co-operative principles are guidelines by which co-operatives put their values into practice.

1. Voluntary and Open Membership
2. Democratic Member Control
3. Member Economic Participation
4. Autonomy and Independence
5. Education, Training and Information
6. Co-operation among Co-operatives
7. Concern for Community

Co-operative ownership

As set out in the previous chapter, ownership and participation in decision-making by workers and consumers creates accountable, democratic structures which show concern for the community and act in the common good. This approach would have, at its heart, the co-operative values and principles.

Instead of profits being siphoned off for private shareholder dividends, they are either reinvested in the service or shared fairly between members of the co-operative as a 'people's dividend'. Workplaces are more productive when employees have a say and a stake, and organisations are more responsive to community needs when they have the chance to participate in decision-making.

And importantly, given the experience of past governments, co-operative models of ownership and management act as a buffer against reprivatisation and underinvestment.

Other forms of public ownership

A co-operative model means ownership and democratic oversight by members – be they workers, consumers, stakeholders or a combination. The benefits of a co-operative's success are shared, through dividends, lower costs or other benefits as defined by the members, or reinvested in the enterprise.

However, where a mutual structure is not the appropriate approach, ownership at a national or municipal government level will be the preferred approach.

National government controlled

Ownership by the national government may be the most appropriate approach in industries or parts of industries which are natural monopolies where the following criteria apply –

Circumstances in which national control may be appropriate

In extractive industries which are reliant on the efficient exploitation of finite natural resources which the whole country should benefit from. These sectors may also require the balancing of interests from one generation to another, and consideration of issues such as protecting the environment which may require decisions to be made which don't result in economic dividend locally

Example: oil exploration and extraction

For common industries where there is both:

1. uniformity and universal demand, and;
2. the optimum way of meeting this demand is across a large area of operation thanks to the technology or physical infrastructure.

Example: broadband and mobile phone infrastructure

Where such high investment is required to operate the industry that only the state is capable of achieving

Example: a nuclear power station

Where the industry has a demonstrably indirect relationship with consumers or local communities.

This may include sectors providing a service which is a number of steps removed from the end customer, or where it has a national footprint so no direct relationship with any single community.

Example: National Grid

When an industry is owned and run by national or devolved government, the following principles should be considered when designing its form and operation:

- Accountable structures which enable employees, consumers and communities to play an active role in how the industry operates and which ensure transparent decision-making
- Full opportunity for Parliament to scrutinise performance
- Structures should enable long-term decisions and investment to be made

Municipal enterprise

Municipal enterprise meets many of the criteria for improved accountability – town halls’ proximity to the people they represent does move decision making closer to the communities impacted and regular elections ensure democratic oversight.

However, there is the risk in a municipally run utility that the individual loses direct contact with the service in question. The municipality is responsible for such a plurality of services that the ability to hold the utility to account and to participate actively in decision-making risks being diluted.

Or, as a historic Co-operative Party pamphlet, “State and Municipal Trading” explains, the contrast between co-operative and state or municipal trading is that “under a system of State or municipal trading there is the very grave danger of the individual losing contact altogether in any direct sense, and feeling that the whole of the responsibility is in the hands of some remote body referred to as ‘the Government’, either central or local.”²

Therefore, municipal enterprise is the most appropriate approach in industries or parts of industries where the following criteria apply:

- Where the optimum area of operation is local and aligns with the boundaries of a single municipal authority or a coherent group of municipal authorities, and;
- Where municipal ownership and operation does not prevent the successful operation of co-operative enterprises (it should either complement co-operative provision, deliver something in partnership with co-operatives or fill a gap where there is no co-operative provision), and;
- Where municipal ownership does not disadvantage neighbouring areas – for example a municipal enterprise operating within just the town or city council boundaries would exclude rural areas and communities which depend on the infrastructure and services within the town and be unable to provide those services themselves as their own municipal enterprise;
- Or, it could be a consortium, for example self-supply of a product of service (eg office furniture, catering) through a co-operative whose members are/ include municipal authorities and other public-sector bodies.

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Water

The UK is the only country in the world to have fully privatised its water and sewerage systems. Not only did Thatcher's Government put the management of the water networks into private hands, but they sold off the physical assets too. The result is a system which is expensive, unaccountable and unfair, where the consumer voice is secondary to the interests of distant investors.

Meanwhile, water companies have become a desirable global financial commodity, bought and sold by big banks, international infrastructure investors, pensions and sovereign wealth funds. Their capital contribution to maintaining and upgrading infrastructure comes with a massive price tag – since privatisation, £1.8bn has been paid in dividends to shareholders and investors, while consumer bills have continued to rise.¹ From 1989 to 2015, there has been a 40% real term rise in household bills.² This has disproportionately impacted lower income households, as shown in an National Audit Office report from 2015 which stated that:

“In 2013, water bills represented 2.3% of average household expenditure, ranging from 5.3% for the 10% of households with the lowest incomes, to 1.1% for the 10% of households with the highest incomes. Water bills should be seen in the context of increased spending on other services, such as energy, placing further pressure on affordability.”³

A tale of two companies – Thames Water and Welsh Water

In 2013, Thames Water received the biggest regulatory fine for river pollution in UK corporate history after failing to maintain key equipment⁴.

At the time, Thames Water was owned by a complicated string of holding companies and offshore businesses, all ultimately owned by Macquarie Bank. Over the 11 years that Macquarie controlled Thames Water, the Australian bank received returns of between 15.5 and 19 per cent annually according to an analysis by the BBC⁵. Research by the Financial Times⁶ suggests that between 2006 and 2016, Macquarie and its fellow investors paid themselves £1.6bn in dividends, while Thames Water was loaded with £10.6bn of debt and ran up a pension deficit of £260m. Research by the Open University suggests that investors took more in dividends from Thames Water than it raised in post-tax profits between 2007 and 2012⁷.

Dividends, debt and the pension deficit weren't the only things to increase in this period – customer bills and numbers of complaints went up too. The only things to go down over this period were customer satisfaction, which is now ranked at 22 out of 23 water companies on the Consumer Council for Water's league table⁸, and Thames Water's credit rating, which is the worst in the industry according to Standards & Poors. Also low is Thames Water's tax bill – they regularly paid no

corporation tax on their £1.8bn turnover⁹, and parts of their company structure are based in tax havens like the Cayman Islands.

“A mound of leveraged debt appears to have been used to benefit investors at the expense of households and their rising water bills.”

John Allen and Michael Pryke, Open University

Customer bills have, in part, increased as the cost of financing the Thames Tideway tunnel through London was added. Although the complex regulatory system at the point of privatisation was intended to shift risk from bill payers to private businesses, the £4.2bn “super sewer” sees a dividend for investors from day one, but is paid for by Thames Water’s 15m customers¹⁰. However, should the project fall through, it isn’t those investors who will have to pay up, but the UK taxpayer who is the ultimate insurer for the project¹¹.

By contrast, Welsh Water, as a company limited by guarantee rather than shares, has no shareholders. In 2000, Glas Cymru, its current not-for-profit owner, was created as a “people’s bid” to take over Welsh Water, based on a belief that water is a public commodity, not a private enterprise.

The not-for-profit structure sought to save money and reduce bills through:

- not paying dividends to shareholders,
- an ownership model which meant it always operates in the interests of its customers,
- and through changing the way they raise finance to reduce the cost of credit.

Instead of issuing shares, the founders instead financed the £1.9 billion purchase with the largest ever UK sterling bond issue, making Welsh Water the first privatised water company to switch from equity financing to bond financing.

Glas Cymru is governed by members drawn from across the supply area and with a range of backgrounds, skills and experiences. They’re selected by an independent member selection panel which is required to maintain a diverse membership reflective of the range of customers and other stakeholders’ interests. There is an AGM to appoint the directors and auditors and to challenge the company on remuneration and other issues.

Welsh Water now have the strongest credit ratings in the water industry, reducing their financing costs and enabling them to spend money on improving infrastructure and services, or reducing customer bills. Customer bills have steadily reduced, and they have so far returned around £180 million to customers in the form of “customer dividends”. In addition, they have provided over £10 million of support for vulnerable and low-income customers through social tariffs (reduced tariffs for customers struggling to pay) and an assistance fund.

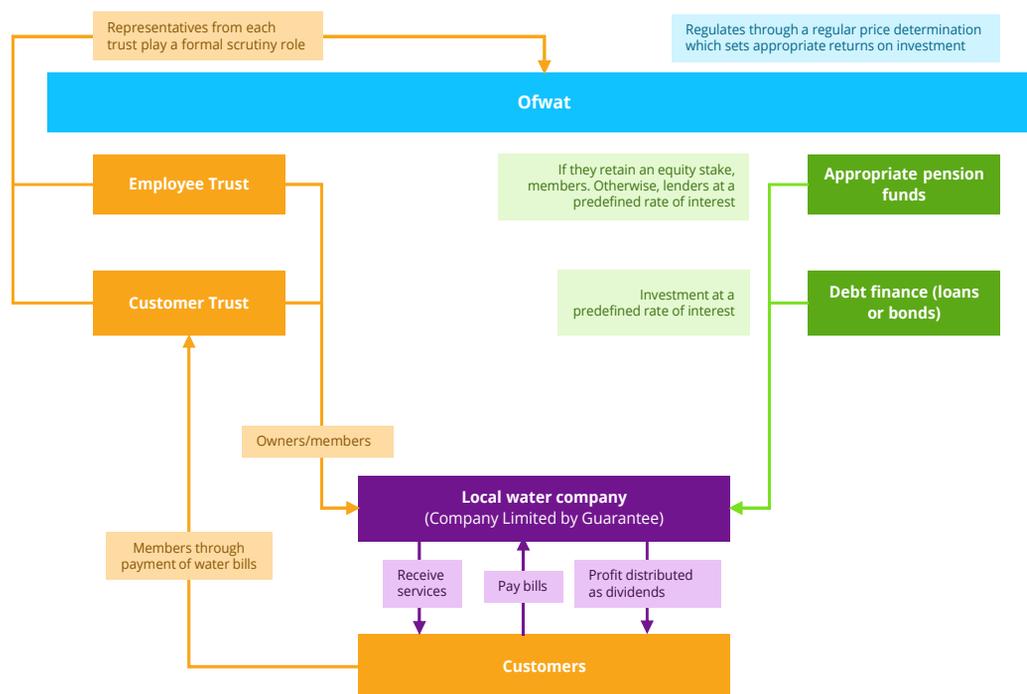
An overview of these proposals

A democratic, publicly owned water industry would be organised regionally, along existing water basin boundaries. Instead of being owned by distant shareholders, private companies and overseas governments, it would be owned by its customers and employees.

This transition would be achieved by changing water companies from being private businesses limited by shareholders into organisations limited by guarantee – a similar corporate form to Welsh Water. However, our proposals go further than the Welsh Water model and drawing on lessons from New Zealand’s energy grids, which are majority owned by consumer trusts.

Our model ensures democratic public ownership and decision-making through a consumer trust and an employee trust in every region. For each water company, these two trusts would be run along mutual lines – where every customer has

Proposed structure for a democratic and publicly owned water sector



equal membership of a regional Consumer Trust, and every employee of that water company has equal membership of an Employee Trust.

Every member would have an equal say and vote, and participation would be encouraged and enabled so that their voice can be heard both at company level - by voting for board members, having their say on remuneration, agreeing the company's audit, and choosing how profits are invested or redistributed as customer dividends, employee profit sharing and support for vulnerable customers - and nationally through a scrutiny role at Ofwat.

Why this form of public ownership?

While public ownership in water could take many forms, these proposals put forward a mutual approach, building on what works in Wales, and learning some of the lessons from public ownership before privatisation - ensuring the modern water system is well resourced, accountable and efficient.

The water industry is in need of significant and ongoing investment. Supporters of privatisation point to the underinvestment in water infrastructure before their sale in 1989, and the sums of money put into the system since entering into private ownership.

However, there is no form of public ownership which prevents investment - the lack of investment was not a consequence of public ownership but of political decision. Investment post-privatisation has been as a result of state intervention in the 'market' through the new regulator, Ofwat, and their regular price reviews.

On the other hand, the debt was wiped from the books of water companies just before privatisation, and under private ownership this has rocketed disproportionately relative to investment.

The scale of investment required, however, does not meet our test for national government ownership and management. Unlike a large power

station, for example, water has a predictable and steady income from customer bills, which cover the scale and cost of investment.

Furthermore, water companies have a direct relationship with their customers and a key role in their local communities – on issues from flooding to farming, their priorities should reflect local and regional needs. And while water is the same ‘product’, whether it comes out of a tap in Northumberland or Watford, in Northumberland there is an abundance of water meaning a focus on flood prevention and environmental management, while in Watford there are regular water shortages thanks to low groundwater, so the water company may have different priorities such as reducing leakage or managing hosepipe bans.

Any centralised form of ownership risks weakening the link between water companies and their communities, potentially removing the important role of customers, workers and communities in setting these priorities.

But the benefit of regional companies owned and managed by their workers and customers go beyond the practical considerations of investment and customer relationship. While the next Labour & Co-operative Government will have public ownership at its heart, there is no guarantee that future governments will seek the same approach. Organisations owned by their customers and employees, where they have equal voice and vote, are irreversibly publicly owned. Britain's utilities have been through many iterations, according to the ideological drivers of the government of the day.

Democratic public ownership of the type proposed would put an end to this and lock in the stakeholder interests necessary to argue for public ownership in the long term. Ownership by and in the interests of consumers and workers means they can consistently ensure sustainable investment and stewardship for the future.

The transition to democratic public ownership

First steps

Reform to the water industry in England should begin with the creation of a Consumer and an Employee Water Trust in every water company area.

Eventually, these democratic bodies will become the decision-makers and guarantors of the new not-for-profit water companies. Until then, they should play a significant new role in influencing water companies and water policy. Water companies, through licence conditions or other mechanisms, could be required to give them a formal role in board appointments and scrutiny.

Ofwat governance can be strengthened from day one too. Early improvements to Ofwat would not only make an immediate difference, they also help to build trust in the institution which will carry forward the transition to democratic public ownership.

Currently Ofwat have several formal engagements with investors, but none with customers and no requirement to work with them. Reforms to Ofwat and the way water is regulated should ensure the customer is no longer overlooked in favour of investor interests, and create greater public accountability. The new employee and consumer trusts should also have a role in scrutiny and decision-making at Ofwat by appointing a scrutiny panel which reviews the operations of the regulator and plays a role in board appointments.

This should be accompanied by an end to the short-termism which characterises the industry today, and which attracts those investors who exploit the system for a quick profit while failing to maintain key infrastructure. A new Duty of Resilience should be considered which would require Ofwat and the water companies to look further ahead than the next five-year price review cycle.

This new duty would include a mechanism to ensure fair treatment of responsible, long-term investors like pension funds, and a curb on the excesses of those private investors after a quick return. This could take the form of a “fair treatment of fair investors” principle for future price reviews, which ensures a fair long-term return for responsible investors who ensure the industry is efficient and value-for-money. This would provide the right incentives for patient investors whose long-term interests align with those of the sector, while preventing the under-investment from those less scrupulous, less patient and more expensive private investors.

Tax avoidance can be cracked down on early in the process too. Many investors are registered in tax havens – Ofwat should work with HMRC and financial regulators to tighten the rules on tax arrangements for companies wishing to invest in UK public utilities.

Medium and longer-term steps for a full democratic public ownership

Once Ofwat has been strengthened and new consumer and employee trusts formed, it is possible to take the next steps to create democratic, not-for-profit water companies. The Co-operative Party suggests three main areas of focus – changing the way the industry is financed, changing the corporate form of companies so that they are accountable and not-for-profit, and introducing robust mechanisms for customer and employee participation.

✓ Financing

Building on the reforms to financing detailed above which disincentivise the investors after a quick profit and prevent tax avoidance, further limits on the shareholder profit leaving the system should be put into place. Price determinations are currently based on a weighted average of the cost of equity and the cost of debt, plus investors’ expected UK tax burdens. Ofwat should, over a sustained period, reduce the cost of equity in its calculations while maintaining the fair treatment of

investor principle for the interest on debt finance. This is echoed by Financial Times economist Martin Wolf, who said as long ago as 2008,

“Owners of the assets should be allowed no more than a debt return – equivalent to the return on a safe long-term bond. Regulators should, meanwhile, ensure that there are adequate returns on a safe long-term bond... The present system is intolerable. It must change as soon as possible”.¹²

This would gradually discourage expensive equity investment and steer water companies towards the lower cost debt market, while retaining those responsible investors like the pension funds whose interests are aligned with that of the sector and whose investment helps to ensure a modern, resilient water infrastructure.

Over the longer term, as equity investors seek to sell, the consumer and employee trusts can then use bond issues to buy their stakes in the business. These would need to be underwritten by a “buffer”, or internal equity reserves to borrow against. This could be achieved through government guarantee on loans/ debt to ensure that any large unexpected investment needs will be met, and that should anything go awry the lenders are in a first loss position. This government guarantee could be replaced over time through the accumulation of non-distributed reserves/ retained profit by the trusts.

✓ Corporate form

The Welsh Water model uses a company limited by guarantee. The benefits of this are that instead of shareholders, it is owned and run by its guarantors. Building on the Welsh Water model, this approach proposes that these guarantors should eventually be the consumer and employee trusts, of which all customers and workers would be members.

Consumer and employee trusts buying stakes in their water company when they come up for sale is a good start, but on its own will take too long for ownership to transition to a public, not-for-profit democratic system.

However, as the ownership of water companies changes, legislation can be passed to embed the not-for-profit principle in the licence conditions for all water companies through amending the Water Industry Act 1991, where it specifies that “a water supply licence shall not be granted to a company unless - (a) it is a limited company; and (b) it is not a relevant undertaker” so that a limited by guarantee company, as used by Welsh Water is required. The guarantors of the Company would be the employee and consumer trusts.

To protect their not-for-profit status, the laws surrounding corporate governance should be amended to strengthen the governance of companies limited by guarantee so that they are protected from takeover or transformation into a for-profit company through an asset lock, similar to the American model of a public benefit corporation.

✓ Participation and accountability

The consumer and employee trusts would ensure customers and workers have an active role. Trust membership would enable members to vote for board members, agree the company's audit, director remuneration, company governance, and how profits are invested in infrastructure or distributed as consumer-dividends and employee profit sharing. Water companies should have internal structures designed to actively ensure and increase employee and customer democratic participation, and the strength of this should be assessed by Ofwat during the price review.

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Energy

When the energy sector was privatised, Britain was promised the chance to become a nation of 'Sids', with an offer in every ad break to buy shares in a newly privatised British Gas.

However, even on day one of British Gas' privatisation, it should have been clear that this vision would not be realised. Although millions signed up for the new shares, many of these new shareholders "staggered" their share issues, selling them on at the end of the first day's trading for a decent profit.

The ensuing years saw mergers and reorganisations in the industry which resulted in a new energy hegemony – centralised, unaccountable decision making shifted from a government department to six, privately owned energy companies. Vertically integrated, these companies control the entire value chain from power station to customer.

The promised benefits of competition – driving down prices and increasing innovation and efficiency – are yet to materialise. The nature of the sector means customers tend to be "sticky" as the incentives to switch are outweighed by the perceived hassle and time it takes, all for an identical product at a similar price. Dissatisfaction with the sector, ranked towards the bottom of all UK industries by the Institute of Customer Service, has not spurred customers into shopping around because of a lack of awareness of choice, low expectations of the likely outcome of engaging in the market, and a lack of ability or access to information to assess the choices on offer.²

In supply, this has meant that at least a third of customers remain with the incumbent regional supplier they were assigned when the industry was originally privatised. For customers on prepaid meters, who tend to be lower income or more vulnerable households, this figure jumps to 79%.³

A Competition and Markets Authority investigation into the industry in 2016 estimated that customers are overpaying for energy by £1.2bn every year.⁴ These customers pay the price when bills go up in response to rising wholesale costs, but are slow to come down when wholesale costs reduce.

In generation, new companies were supposed to bring innovation and efficiencies, competing with each other to build new, cheaper and cleaner power stations. However, as an Oxera report published in May 2013 exploring the Thatcher Government's legacy explains, "reliance on private capital had some less attractive consequences. Projects are now deliverable only if they make commercial returns, and the government is less able to make companies deliver schemes on public policy grounds. If it still owned the electricity generation industry, it would not be having to wait for the board of EDF to secure the next generation of nuclear power stations."⁵

Instead, a focus on what was good for the country – rather than the profits of the 'Big Six' energy companies – would make it easier to meet the UK's policy goals such as keeping bills affordable and decarbonising our energy supply.

The infrastructure that transports electricity and gas around the country was sold off too. This is a two-tiered system – a national transmission system which is the network of high-pressure gas pipes and high-voltage electricity cables that send power around the whole country, and the local distribution networks which take the electricity and gas from the national transmission grid and transport it into homes and businesses.

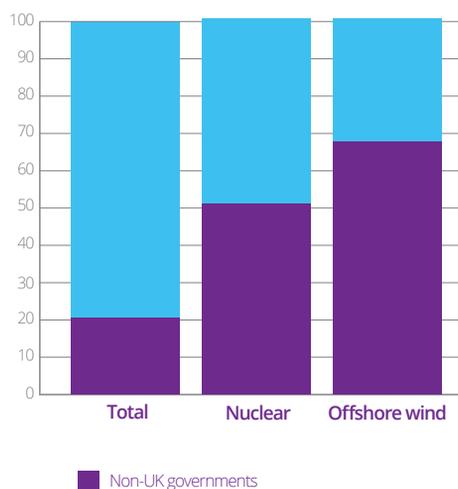
The National Grid is now a private company which also owns assets across America. In May 2017, the company reported a surge in operating profits, up 14%. Earning per share rose 16% to 73p.⁶ The UK's 14 electricity distribution grids are owned by six different groups. Gas distribution is owned by just four companies⁷. Each grid has a monopoly on distribution of electricity or gas in their areas.

Complicated regulation after privatisation has enabled financial engineering and a wave of takeovers and mergers. Cheap debt has allowed money to come out of the system through "dividends, special dividends and share buybacks"⁸ leading Citizens Advice to conclude that energy networks have made £7.5bn in "unjustified profit" over an eight-year period⁹.

Privatisation, above anything else, promised less state involvement in industry. Ironic, then, that the UK's energy supply now relies on state-owned companies. The governments of Denmark, France, Ireland, Finland, German and Sweden all profit from British energy, through state-owned companies Dong, EDF, Engie, ESB, Fortum, REW and Vattenfall. Other countries are represented too – through their sovereign wealth funds and state-owned investors.

Nowhere in recent times was this more controversial than the involvement of Chinese-controlled

Public ownership of UK electricity generating sector by non-UK national and regional governments, 2011/12



China General Nuclear and CNNC taking equity stakes in UK nuclear generation¹⁰. Prof. Andrew Cumbers makes the case that Chinese, French, Norwegian and Russian governments – through their state-owned corporations – “have collectively far more control over UK strategic energy interests than any British political actor”.¹¹

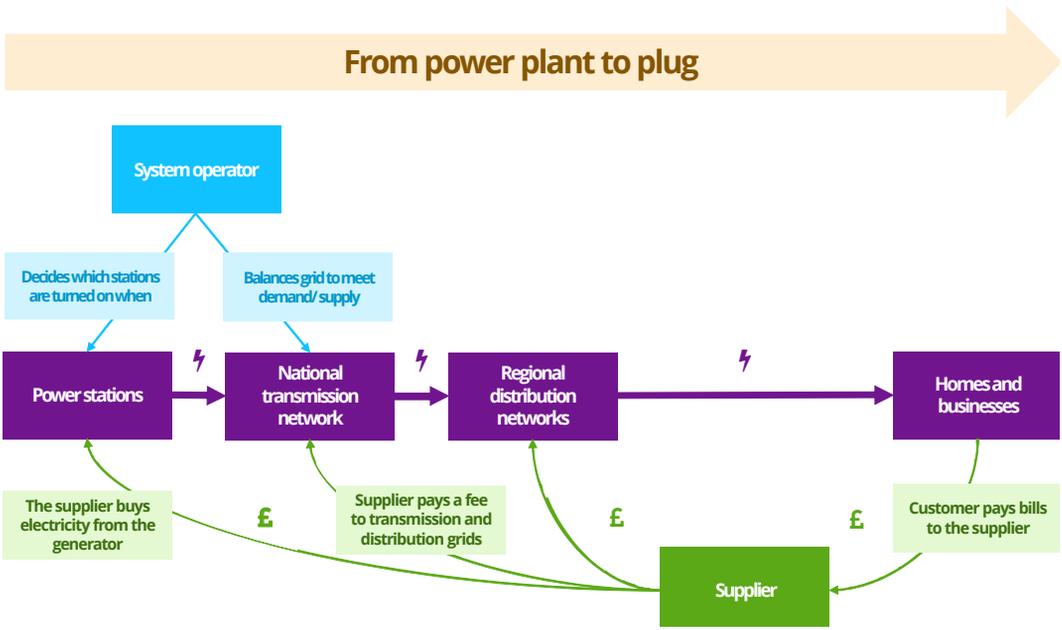
A quick guide to the current structure of the UK's energy system

The energy sector is complex in terms of the flow of electricity, gas and profit around the system.

In short, electricity is generated in power stations, wind farms and other renewable sources, which are wired up to the national transmission network. This is like the sector's motorway, sending electricity around the country at high voltage. It goes into regional distribution networks which reduce the voltage and wire the electricity into homes and businesses. The flow and balance of this is managed by the system operator.

However, the financial flows are different. The customer chooses a supply company and pays them for their electricity. The supplier buys electricity wholesale from generators, and pays a flat fee per customer to the national transmission and regional distribution grids. This fee forms part of customers' final energy bill at a rate decided by Ofgem during regular business planning and price review cycles.

Gas is similar - most gas is extracted from underground reserves or imported before being sent around the country in a national high pressure transmission grid, and locally in lower pressure distribution grid. The cost of this is also included in customers' bills, as regulated by Ofgem.



Ownership of regional distribution grids as of 2017

Gas network	Owner(s)
SGN	SSE (33.3%, UK), Borealis Infrastructure (25%, Canada), OTTP, (25%, Canada), Abu Dhabi Investment Authority (17.7%, Abu Dhabi)
Northern Gas Networks	Cheung Kong Group (Hong Kong), Power Asset Holdings Limited (Hong Kong) and SAS Trustee Corporation (Australian Pension Fund) (percentage splits unknown)
Cadent	39% National Grid (UK), 61% is a consortium led by Macquarie, an Australian investment bank. The deal is also backed by China Investment Corporation (CIC) and Qatar Investment Authority, along with fund managers including Hermes and Allianz
Wales and West Utilities	Cheung Kong Group (100%, Hong Kong)

Electricity network	Owner(s)
SSEPD	SSE (100%)
SP Energy Networks	Scottish Power (100%, Iberdrola, Spain)
Northern Ireland Electricity Networks	ESB Group (95% State Owned)
Electricity Northwest	Consortium of funds controlled by the Commonwealth Bank of Australia and IIF International Holding GP Limited which is a constituent of the Infrastructure Investments Fund (percentages not available)
Northern Powergrid	Berkshire Hathaway Energy (100%, US)
WPD	PPL Corporation (100% US)
UKPN	Cheung Kong Group (40% Hong Kong), Power Asset Holdings Limited (40% Hong Kong) and Li Ka Shing Foundation (20%)

Overview of proposals

The Co-operative Party proposes creating a new Energy Security Board, which would be a public body to oversee the whole energy system and ensure long-term decisions about investment and operation are made in the public interest. This would be accountable through a new advisory board made up of customers, workers and stakeholders.

A new publicly owned Power Generation Company would sit below the new Board, which would develop, own and operate new power generation, buy back strategically important existing power stations, and cap profits of any left in private ownership. It would also be responsible for supporting the growth of community, co-operative and municipal energy generation.

Energy supply would change from a Big-Six-dominated market to one where customers have a genuine choice between community, municipal and co-operative suppliers, or can club together to collectively purchase their energy directly from a newly transparent wholesale market.

The grids, meanwhile, would no longer be private companies exploiting national and regional monopolies. The national transmission grid would be a publicly owned company under the Energy Security Board, with workers on its board to ensure they have a voice and a stake. Regional distribution grids, on the other hand, would be owned by consumer and employee trusts in a democratic structure.

A new Energy Security Board to keep the lights on

A new Energy Security Board should be created, which would be responsible for developing a long-term strategy for keeping the lights on and meeting high level policy outcomes such as decarbonisation and affordability.

The Board would develop a long-term strategy looking, say, twenty years ahead, with the Department for Business, Energy and Industrial

Strategy (BEIS) and, every five years, would submit an energy security programme setting out investment requirements to meet its long-term strategy, which would include –

- maintaining existing power generation and developing new power generation as required;
- supporting the growth of community, co-operative and municipal energy generation;
- overseeing management of and ensuring investment in the electricity and gas transmission network;
- setting out and ensuring the delivery of universal service obligations;
- and investing in development of new technologies and innovations to transition the UK to a more sustainable and affordable energy system.

This investment could be provided by a combination of reinvestment of existing capital earned through generating and selling power into the grid and through direct investment by the central Government. Because this investment would be based on public policy considerations rather than market forces, the capacity market and other existing investment mechanisms would require review and reform to reflect this, and to enable community and co-operative renewable generation to flourish.

The Energy Security Board would also take on the role of system operator – currently a responsibility of National Grid. This ensures supply and demand are balanced and, as generation becomes more decentralised, ensures flexibility and fair prices for all participants.

The board would oversee the new public bodies tasked with running the different elements of the energy sector, and would be held to account by the Department for Business, Energy and Industrial Strategy, and by Parliament through select committee scrutiny and ministerial questions. Additionally, the Energy Security Board would have a two-tier governance structure, with an advisory board made up of customers, workers and key

stakeholders tasked with oversight, executive appointments and remuneration, and long-term strategic direction.

Generation

Since privatisation, energy generation in the UK has changed beyond recognition. The big coal, oil and gas plants of the Central Electricity Generating Board of the 1980s no longer dominate. Increasingly, ageing power stations are being phased out and replaced by the thousands of renewable power schemes, from big offshore windfarms to smaller-scale community solar generation.

The Co-operative Party has long championed a transition to distributed, renewable energy – because our continuing reliance on fossil fuels places a dangerous burden on our environment, and also because community energy schemes widen ownership, giving people a say and a stake in where their energy comes from.

In bringing energy generation into public ownership, this variation in where our energy comes from needs to shape our approach.

✓ **Public ownership of large scale power generation**

Large scale, centralised energy generation relies on finite natural resources to operate. The nature of the technology means that the optimum way for them to operate is at significant scale and to build new large-scale power stations, such as the new nuclear plant at Hinkley Point, require huge investment. Power stations do not directly supply homes – power goes into the grid, through the local distribution networks and is sold by consumer-facing supply companies – so the relationship with the customer is indirect.

Deciding how much electricity a large power station should generate cannot be a profit-driven decision – to transition to a modern, low-carbon energy system, these power stations increasingly need to be phased out. Their value during the

transition is simply to turn off when the wind blows and the sun shines, enabling our energy to come from renewable sources as much as possible, but on hand for backup power on days when the weather isn't generating enough for Britain's energy needs. Therefore, the decisions made may not result in economic dividend and will require the balancing of diverse interests.

These proposals suggest therefore that large scale power generation should be developed, owned and operated by or on behalf of the state. A new publicly owned Power Generation Company should be created with responsibility for developing, owning and managing the operation of large scale power generation - accountable to the new Energy Security Board and its independent advisory board of customers, workers and stakeholders.

All new power stations would be built and owned by the Power Generation Company. Existing power stations would require a more nuanced approach to balance the cost of bringing them back into public ownership within their lifespan - it may not be of value to 'buy back' power stations which will soon be taken offline anyway. All power stations can be made immediately more accountable regardless of lifespan, through a new requirement to have workers on their boards.

For power stations with a long lifespan, new powers to buy strategic assets from their ultimate UK holding company using government bonds should be created so that where it is deemed appropriate and of strategic value these power stations can be brought into the ownership and management of the new public body responsible for power generation.

Many large fossil fuel and nuclear power stations are due for decommissioning within the next two decades. As it currently stands, all of Britain's unabated coal must cease generation by 2025 and all existing nuclear power stations are due to be decommissioned between 2023 (Hinkley Point B and Hunterston) and 2035 (Sizewell). The value in 'buying back' these power stations, therefore, is limited.

A more proportional approach may be to amend the generation licence conditions to include a

clause which defines and limits excess profits leaving the system and prevents asset stripping, so that the remaining private companies cannot exploit the system.

Should the Energy Security Board decide that it is necessary to extend the life of some older power stations, the licence condition could be renegotiated to ensure maximum public benefit, and the Power Generation Company would retain the right of last resort to acquire the ultimate UK holding company's stake in the plant if these negotiations are not fruitful, so that it could be run in full public ownership.

✓ **A new generation of community, co-operative and municipal renewables**

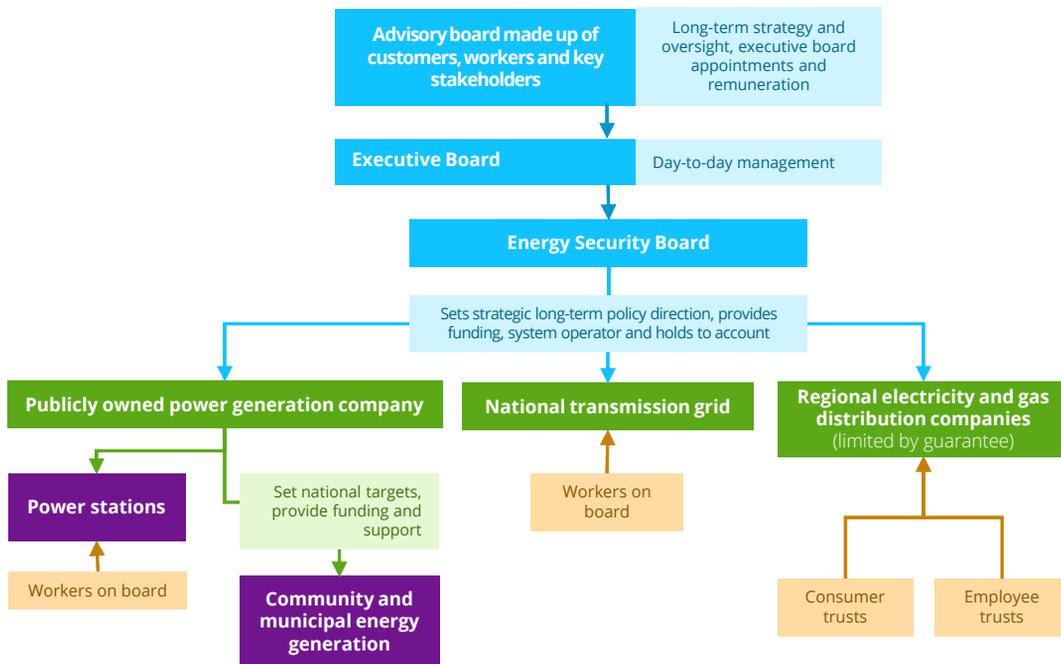
In the arena of decentralised energy generation, however, the co-operative and community sector has proven itself able to meet the challenge of delivering renewable energy schemes for the benefit of the community. For generation below a

certain size, there is no case for centralised ownership and management – local energy schemes have a direct relationship with their communities and have demonstrated that the investment required is not a barrier to delivering new projects. Similarly, many innovative local councils have developed renewable energy projects in their areas which benefit their residents.

Policies which support and enable a greater number and larger scale of community, co-operative and municipal energy projects to start-up and succeed is a more appropriate solution to public ownership in this sector.

As the UK's energy transition to a greener, more decentralised system continues, this sector will produce a greater and greater proportion of the UK's energy mix. It would also play a pivotal role in addressing fuel poverty, harnessing local leadership, and providing training and jobs for local

Proposed structure for a democratic and publicly owned energy sector



residents. Community ownership, in whichever form, ensures communities have a voice and a stake in the UK's energy mix.

By offering economic benefits, with returns remaining in the locality to be reinvested in energy efficiency or for other social impact, community energy ensures that the benefits of local energy generation remain in the locality. This is of vital importance to many local economies in the UK - it has been shown, for example, that for somewhere like Cornwall the value of energy services leaving the county dwarfs the income received from tourism.

Furthermore, consumer, local government, community and employee ownership models have been shown to offer behavioural benefits, as people who are more involved in where their energy comes from think about their energy use.

The community-energy sector has grown rapidly over the last decade. In England and Wales, it is currently made up of 222 organisations, with a collective 30,000 members and generating enough electricity to power 85,500 homes.¹² This growth shows communities' eagerness to be part of an energy transformation in the UK. However, growth of the sector has slowed across the UK as government support has been withdrawn, such as Feed-in Tariffs, Social Investment Tax Relief, and Enterprise Investment Scheme support.

There are a number of steps which would enable the sector to continue to grow:

1. The Energy Security Board should be responsible for developing and creating the incentives to deliver an ambitious long-term plan for the growth of the community energy sector. High-level 20-year targets should be set, with interim milestones to enable local, regional and national government to implement the necessary policies and procedures. These targets should address both a percentage of the nation's energy supply to be generated from community owned renewable energy projects and a percentage of the required CO2

reductions to be achieved via community owned renewable energy projects.

2. Community energy generation targets should be mandatory and matched with the appropriate funding. This should be in the form of a national community-owned renewable energy fund, administered at a local level. This should include section 106 and Community Infrastructure Levy (CIL) payments, as well as government grant and loans to provide:
 - c. Seed funding and start-up loans for both community energy organisations and the intermediary development organisations that support the sector
 - d. Bridging loans of £100,000 to £3 million for medium scale community owned energy projects

This could be supplemented by local or regional impact investment vehicles, created by local or regional government to pool energy opportunities for the long-term patient investor. As well as contributing their own patient capital, local and regional government could market opportunities to their partnered anchor institutions and more widely. Organisations interested in impact investing could include development finance institutions, private wealth managers, commercial banks, pension funds, investment funds, other co-operatives, private companies, and community development finance institutions (CDFIs).

Additionally, there should be a new Community-Feed-in Tariff and Community-Renewable-Heat-Incentive which ensure tariff uplifts for energy projects which achieve social and environmental returns.

5. Communities should be able to invest in locally owned energy projects with confidence and should benefit fully from its success. A new regulatory body for the community owned energy sector should be established, which oversees share offers. Tax relief that was previously available to investors in community owned renewable

energy projects such as the Enterprise Investment Scheme and Social Investment Tax Relief should be reinstated and extended to enable communities to invest with confidence and benefit fully from the success of their scheme.

6. A new statutory responsibility for local government and the new publicly owned water, energy and rail organisations, and other public bodies like the NHS, to make appropriate assets available for the community to develop renewable schemes. This could range from the roof space on housing estates and libraries for installing solar power, to the land around sewage treatment plants being offered to communities wanting to build wind turbines.

Community owned energy can take a number of corporate forms – this diversity should be embraced but some principles should underpin all schemes if future growth in the sector is to truly democratise the sector.

Projects, whether community or municipal, should be defined by their social and environmental benefits, and be rooted in their local community through some form of membership model which gives members a financial stake and a democratic say in how the project is run. How surplus income is spent should be a transparent decision which members can be involved in, and it should be either shared in the community as dividends or reinvested in the project or achieving its social and environmental aims. Community and municipal energy schemes should be asset locked so they cannot be turned into profit maximising private companies.

Fair energy trading

A lack of transparency and liquidity in the wholesale market makes it impossible to see if the price rises passed onto consumers are fair. It is part of the problem behind suppliers passing on similar price rises at the same time as each other to consumers, and also part of the reason that new entrants find the market challenging - they cannot benchmark prices to sell energy generated or buy energy at a fair price to supply to consumers.

✓ Transparent trading pool

Currently, big vertically integrated companies can sell energy to themselves at an unknown price or profit. Self-supply, where big vertically integrated companies sell their own energy to themselves, risks profits being masked in complicated corporate structures – while profits reported by suppliers may be in the single figures, it doesn't mean significant profits aren't made elsewhere.

The advantage that this gives the large companies, as well as the inability of customers or government to hold them to account, is a key problem with our existing energy system. This practice of self-supply means there is poor liquidity which acts as a barrier to new entrants and limited pressure to pass savings onto customers.

Transparent wholesale markets and an open exchange similar to the Nord Pool¹³ would improve liquidity, ensure transparent prices and create a level playing field for co-operative and municipal energy generation and supply companies.

✓ End vertical integration

At least while the new organisation and ownership of energy transitions into being, there will remain some private companies operating in both supply and generation, albeit with a diminished role. Given their current dominance of the energy markets, these remaining companies are likely to include the 'Big Six' – those six large companies which own and operate the largest portion of power generation and energy supply into homes.

To ensure a fair and transparent system from day one, supply and generation licences should be amended so that vertical integration (that is, owning the entire value chain from power station to plug socket) is no longer possible for profit-maximising businesses. The Electricity Act 1989 enforces the separation of some activities, such as distribution and both generation or supply, in section 6(2) and (2A). Similarly, an interconnector licensee cannot hold a generation, transmission, distribution or supply licence.¹⁴ Section 6 (2) and (2A) should be added to so that the same private organisation cannot be the holder of both a generation and supply licence. This should

be written in such a way to avoid the 'Big Six' simply 'spinning off' and using parent or holding companies to evade the intent of the policy, while enabling community and co-operative enterprises the flexibility to own both generation and supply.

Publicly owned transmission grids

Currently, the National Grid performs two vital roles – as infrastructure owner and manager of the electricity and gas transmission systems, which are the network of high-pressure gas pipes and high-voltage electricity cables which send power around the country, and as system operator, ensuring the right amount of power is being generated at any one time to meet demand.

These are the energy "motorways", transmitting large quantities of electricity and gas over long distances. This equates to approximately 7,200 km of overhead line, 1,500 km of underground cable, 342 electricity substations, 7,660 km of high pressure pipe and 628 above ground gas installations¹⁵. In Scotland, gas transmission is provided by the National Grid, but electricity transmission is split into two sections and managed by SP Energy Networks and Scottish and Southern Energy.

There is complete uniformity of demand for these services and neither interacts directly with the customer – the electricity and gas are piped into regional distribution networks which reduce the volume/ voltage and supply it into people's homes. Currently, the transmission and distribution costs are passed onto consumers via a charge on their energy bill. Last year, this accounted for 28% of a typical household bill¹⁶.

This charge is calculated using a complex regulatory formula, applied every seven years through a price review process led by Ofgem, the energy regulator. National Grid and the electricity and gas networks submit business plans detailing the capital and revenue required to maintain and replace infrastructure to meet the required standards. Factors such as innovation and customer service are factored in, and the networks are given a

price they're allowed to charge customers. If they manage to provide the service at lower cost, the savings are paid in dividends to shareholders.

This creates perverse incentives – network companies would benefit from providing higher costs at their price review in order to get a better regulatory settlement, and then to provide the actual service at a lower cost for greater profit. The regulator is left playing catch up, and only has the companies' own accounts to rely on for accurate information.

Meanwhile the billpayer is left paying a flat rate, regardless of income, for a universal service. General taxation which is progressive – meaning those on lower incomes pay a lower burden while those who earn a lot contribute more – would be a more efficient and progressive way to fund the transmission network.

This paper proposes the creation of a new publicly owned Transmission Company. This could be overseen by the Energy Security Board and its advisory board made up of customers, workers and other stakeholders. This is not a controversial proposal – the Conservative Government's own energy review conducted by Prof. Dieter Helm proposed that elements of National Grid move into public ownership – although the Government rejected the proposals and permitted it to remain in private ownership.

Implementing an accountable transmission grid is complicated by the fact that currently the company that owns National Grid also owns a number of unregulated and overseas assets, and that Scottish and Southern and Scottish Power are vertically integrated energy companies, involved in generation, transmission, distribution, supply and even telecoms.

The new grid company would only be seeking to take on the regulated transmission assets and system operator functions within the UK.

✓ Bring the system operator role into public ownership

The system operator balances the grid from day-to-day and makes decisions about the public interest and national strategic objectives. Its decisions need to balance competing interests and align with public policy rather than profit motives. They should span long timeframes and present a long-term vision of the infrastructure that Britain needs, while remaining publicly accountable, so this role should sit at the heart of the Energy Security Board.

Ofgem already consulted on creating a separate licence for a system operator, so that it is no longer part of the transmission licence. This would specify that National Grid Group board members could not also sit on the system operator board, and that cross-subsidy would be prevented through ring-fences. These changes were possible under the existing Electricity Act 1989 (Transfer of Licences) but don't go far enough as under those proposals the system operator remains within a profit-making entity.

Primary legislation would need to be amended to remove the ability for the private sector to own this function. It should be moved into the Energy Security Board, which is a publicly owned body, and which is accountable to its stakeholder advisory board, BEIS and Parliament.

✓ Public ownership and operation of grid assets

The physical assets – their ownership and operation, not just the strategic management of them – needs to be addressed too.

This could be achieved through passing new legislation which sets out a new, publicly owned structure for the UK's electricity and gas transmission networks, and setting out compensation for the existing National Grid shareholders.

This would require the compulsory transfer of shares from the current, private companies

and shareholders, to the new publicly owned Transmission Company.

The level of compensation would be based on their regulated asset value (RAV) and considerations of public benefit, as per the precedent set by the ECHR that “legitimate objectives in the ‘public interest’, such as those pursued in measures of economic reform or measures designed to achieve greater social justice, may call for less than reimbursement of the full market value.”¹⁷ The level of compensation would clearly be developed in negotiation with the company and its shareholders.

The new Transmission Company would sit under the Energy Security Board, accountable to its advisory board made up of customers, workers and other stakeholders. For day-to-day accountability, there should be customers and workers on the board of the Transmission Company too.

Regional Distribution Grids

Distribution networks for gas and electricity are, much like water, organised along regional lines. They take power from the national grid and send it into homes and businesses, and are responsible for managing infrastructure and ensuring local security of supply.

Unlike water, though, their relationship with the customer is indirect – consumers currently buy their energy from a supplier, who pays the local grid a fee per customer. This fee is included in the customer's energy bill.

Nonetheless, this paper proposes a mutual structure. Despite no direct customer relationship with billpayers, network costs make up a significant portion of final bills. Furthermore, electricity and gas networks have an important role to play in communities in preventing and fixing local blackouts, supporting vulnerable local residents, minimising disruption when maintaining local infrastructure, and as significant local employers.

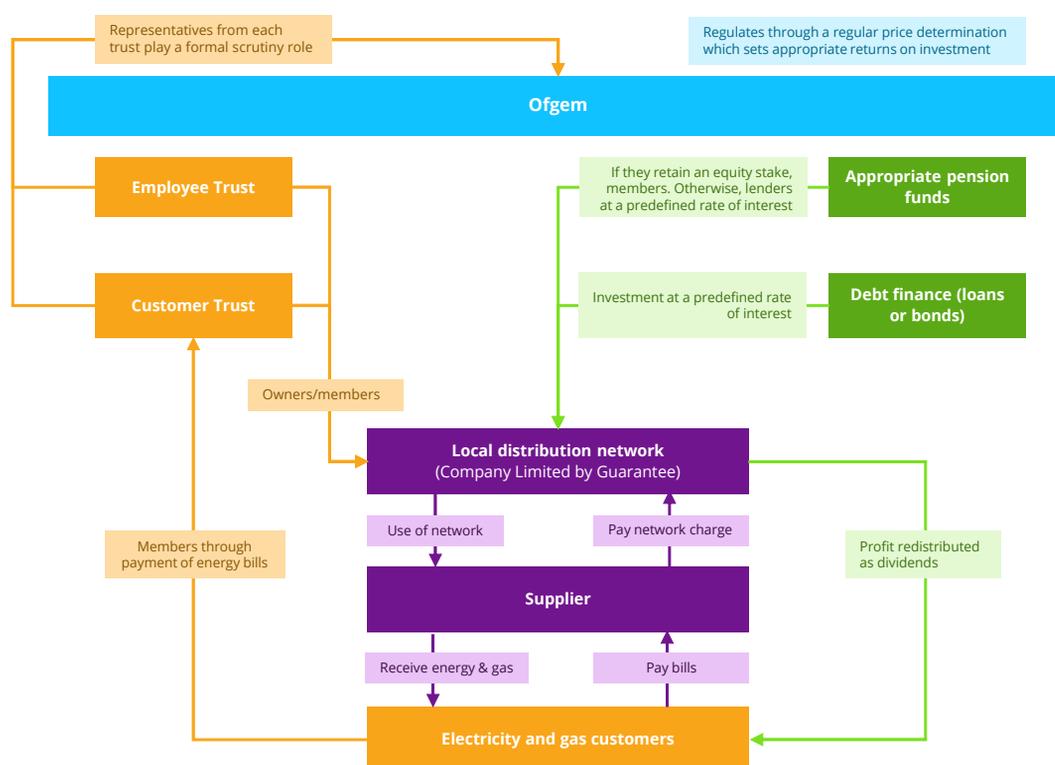
Their current geography is logical in terms of the balance between being locally accountable and large enough to secure investment and economies of scale – but by being regional it exceeds the bounds of any local authority. Therefore, while the local authority voice is very important, particularly on issues like looking after vulnerable residents and preventing disruption when the road is dug up to maintain pipes or wires, we suggest a similar model to our proposals for water rather than municipal companies.

A mutual approach, much like in water, would ensure local and regional priorities are at the heart of how the service is run through local membership of billpayers and employees. Local authorities could also have a voice in the new publicly owned structures. Profits would be

reinvested in improving the infrastructure, or spent to support programmes tackling fuel poverty or protecting the environment.

This would see a Consumer Trust and Employee Trust in each distribution area. These would be run along mutual lines, so that every customer has equal membership by virtue of paying their bills, and every employee of the distribution company has equal membership. These trusts would be the guarantors of new public companies limited by guarantee – accountable to the trusts rather than distant shareholders. The trusts would give all members an equal say and vote on board appointments, remuneration, audit and reinvestment or redistribution of profits.

Proposed structure for democratic and publicly owned electricity and gas distribution networks



Case study – consumer co-operatives in New Zealand

When Electric Power Boards were commercialised in New Zealand, all consumers served by the board at the time of restructure were deemed to own them. As a result, a large number of consumer- or community-trust owned companies were established such as Vector, and other co-operative models such as Electricity Ashburton (EA) Networks.

EA Networks is co-operatively owned – of over 30,000,000 shares, 28,000,000 are owned by the district council and the remainder are owned by customers, each of whom holds 100 shares. Consumer shareholders can elect executive committee members on a one member one vote basis. Vector are 75.1% owned by a consumer trust which provides the company with two of its seven board members, and all consumers receive dividends – in 2009 each received USD 203. Vector is financed through a mixture of debt and equity.

The transition to democratic public ownership

First steps

Ofgem has lost the trust of the industry and consumers – it has failed to curb excessive profits or exploitative behaviour of big energy companies, and the way it regulates the national and regional grids is overcomplicated and ineffective. While, eventually, in a publicly owned system, the role of an independent regulator will be drastically altered, in the interim period while reforms are ongoing, it is important that this is a robust and trusted body, both by consumers who need confidence that they are getting a fair deal, and by investors and industry players, as their engagement will make for a smoother transition and ensure continued long-term investment in British infrastructure and manufacturing. Initial reforms to Ofgem should therefore include mechanisms which ensure the customer is no longer overlooked in favour of investor interests, and create greater public accountability.

This should be accompanied by an end to the short-termism which characterises investment in the industry today, and which attracts those investors who exploit the system for a quick profit while failing to maintain key infrastructure. As with water, a new Duty of Resilience would require Ofgem and the distribution companies to look further ahead than the next price review cycle.

In the same way as set out in the proposals for water, this new duty would include a “fair treatment of fair investors” principle for future price reviews to ensure the interests of investors are appropriately aligned with those of customers and the industry. Those investors who use tax havens would be tackled through Ofgem working with HMRC and financial regulators to tighten the rules.

And importantly, reform to electricity and gas distribution in England should begin with the creation of a Consumer and an Employee Water Trust in every distribution area, not dissimilar to the trusts described in New Zealand distribution networks. Eventually, these democratic bodies will become the decision-makers and guarantors of the new not-for-profit distribution companies. Until then, they should play a significant new role in influencing distribution companies and energy policy. Distribution companies, through licence conditions or other mechanisms, could be required to give them a formal role in board appointments and scrutiny and the trusts would have a formal role in improving Ofgem.

Medium and longer-term steps towards democratic public ownership

As with water, there are further steps needed to transition fully to the new model. The Co-operative Party suggests three main areas of focus – changing the way the industry is financed, changing the corporate form of companies so that they are

accountable and not-for-profit, and introducing robust mechanisms for customer and employee participation.

✓ **Financing**

Over the longer term, further limits on the shareholder profit leaving the system should be put into place. The way price determinations are made should be changed so that the cost of equity in calculations is reduced while maintaining the fair treatment of investor principle for the interest on debt finance. This would encourage companies to access the lower cost debt market and discourage expensive equity investors after bigger profits.

As equity investors seek to sell, the consumer and employee trusts can then use bond issues to buy their stakes in the business. As with the trusts in the new water industry, these would need to be underwritten by a "buffer", or internal equity reserves to borrow against. This could be achieved through government guarantee on loans/ debt to ensure that any large unexpected investment needs will be met, and that should anything go awry the lenders are in a first loss position. This government guarantee could be replaced over time through the accumulation of non-distributed reserves/ retained profit by the trusts.

✓ **Corporate form**

As with Welsh Water, and the proposals in this paper for a new democratic, publicly owned water industry, the model proposes a company limited by guarantee as the most appropriate corporate form. This means distribution companies would be owned and run by its guarantors, the consumer and employee trusts, rather than distant shareholders.

As the new trusts begin buying stakes in distribution companies and the ownership gradually changes, legislation can be passed to embed the not-for-profit principle in the licence conditions for all distribution companies.

Through a collective modification procedure or amendment of section 7 of the Electricity

Act 1989, standard licence conditions could be changed to define the appropriate corporate form for distribution companies to be company limited by guarantee, as used by Welsh Water. The guarantors of the Company would be the employee and consumer trusts.

As referenced in the water section of this publication, the laws surrounding corporate governance should be amended to protect their not-for-profit status, ensuring they are not at risk of takeover or transformation into a for-profit company. This could be done by creating an asset lock, similar to the American model of a public benefit corporation.

✓ **Participation and accountability**

The consumer and employee trusts would give customers and workers an active role - the board should include employee- and customer-directors, and trust membership would enable members to vote for board members, agree the company's audit, director remuneration, company governance, and how profits are invested or distributed as consumer-dividends and employee profit sharing. Democracy should be facilitated through internal structures which support and enable active participation.

In this way, distribution companies will become genuinely accountable to their local communities and employees. Decisions will be made by and close to the customers they impact and employees will have a meaningful stake in their workplace.

Supply

Energy supply, unlike the rest of the energy sector, does not rely on monopoly infrastructure. Currently, to supply electricity a company requires little more than a supply licence and a website. In theory, consumers can shop around for the best tariff for them – whether it is the cheapest, the greenest, or the smartest. While the product is the same whichever a consumer picks – the electricity and gas coming through the wires and pipes into their home all comes from the same grid regardless of their supplier – the energy supplier can choose which generators they purchase from, how far in advance they buy, the extent to

which they hedge price increases or decreases, and the amount they spend on customer care and back office functions.

All of these variations dictate how much a tariff costs, and the intention behind privatisation was to create competition between suppliers to deliver better and better value in order to win customers. However, in practice this has simply not been the case. Despite low levels of satisfaction, 62% of customers cannot recall ever having switched¹⁸ and an Ofgem investigation into the market showed that among the big players in the industry there is at best weak competition, if not tacit co-ordination. They point to significant similarity between products, the fact that price rises are announced at the same time as each other, and are of the same magnitude, that domestic supply margins have converged, and all major suppliers increase prices more quickly and fully when costs increase than they reduce them when costs fall.¹⁹

Despite an increase in small, new, independent players in the market over the last decade, over 80% of the domestic market share sits with just six large suppliers²⁰.

Clearly, the market for electricity and gas has broken. Competition has failed to deliver the value for money that was promised. However, because it is not a natural monopoly and there is not uniformity in demand, these proposals don't suggest existing large energy companies be brought into central government or regional ownership. For national or local government to "buy back" the energy suppliers, it would be an unnecessarily costly exercise and might not deliver the best outcomes for consumers.

Instead, we suggest ways to transition to a system where co-operative, community and municipal energy suppliers can flourish, and where the big businesses can no longer extract a profit for their shareholders through unfair increases to consumer bills.

End the dominance of the 'Big Six'

The energy supply market should become more diverse, with co-operative, community and municipal suppliers supplying affordable energy in a fair and transparent way. To achieve this, there first needs to be a level playing field.

Some of the main problems with the market as it currently operates are:

- The incumbents' advantage – As spelt out in Ofgem's submission to the recent Competition and Markets Authority, "The six incumbent suppliers... inherited a stock of consumers; a large proportion of who have never engaged in the energy market or have only had limited interaction with it. The incumbents continue to hold a disproportionate share of these customers to this day."²¹
- Lack of transparency in price – vertical integration, whereby the six biggest suppliers are also the six biggest generators, means companies 'self-supply', or buy their own energy without putting it on the open market. It's impossible for consumers to see if the prices passed on to them is fair and difficult for other suppliers to get a look in.
- Tacit collusion – when one 'Big Six' energy supplier puts up prices, it's likely that others will all announce a similar price rise within a few days. The Competition and Markets Authority did not find evidence of explicit collusion but suggests that there is possible tacit co-ordination reflected in the timing and size of price announcements, and that across the board prices tend to rise faster when costs rise than they reduce when costs fall. Ofgem spells out the impact this has: "Although tacit coordination is not a breach of competition law, it reduces competition and worsens outcomes for consumers."²²
- Growing margins – the average profits for the 'Big Six' have increased from just 0.89% in 2009 when Ofgem began collecting figures, to 4.48% in 2016.²³ These

profits are rising in both the retail and the generating arms of the companies, and at the same time as price rises are announced. However, there is no evidence to suggest that rising margins is accompanied by rising efficiency or quality in service – which could be a sign of a failure of competition.

A policy response to address these problems with the market and barriers to entry could include:

✓ **Break up the 'Big Six'**

To create a fairer, transparent system which enable new entrants to challenge the incumbents, it should no longer be possible for private companies to hold both a supply and generation licence.

As referenced previously, the Electricity Act 1989 already enforces the separation of some activities, such as distribution and both generation or supply, in section 6(2) and (2A). Similarly, an interconnector licensee cannot hold a generation, transmission, distribution or supply licence.²⁴ This should be expanded on to prevent the holder of a supply licence also holding a generation licence, written in such a way to avoid the 'Big Six' simply spinning off separate companies under the same ultimate parent company.

✓ **Cap on profit margins**

When Ofgem referred the industry for a full competition investigation in 2014, they questioned "the suppliers' contentions that five percent is a fair retail margin"²⁵ and admits that they have not defined what an appropriate profit margin would be. This was recently highlighted by the Financial Times, who point out that "what makes Britain's regime different from the one for private US utilities, for instance, is that these returns are not capped."²⁶

For big, profit-maximising energy suppliers, we suggest that the regulator and government, in conversation with consumers, do define an appropriate profit margin. This should inform a new regulatory regime which places a limit on returns for shareholders. Community, co-

operative, and social enterprise energy suppliers would be exempt, because their accountable structures mean prices and returns are either returned to members, or reinvested in the service or community.

✓ **End the incumbency advantage**

When an energy supplier goes bust, Ofgem have a "safety net" whereby they hold a competitive process to identify a new supplier, without involvement of the customers effected, and transfers them in bulk to the winning supplier. They use metrics around cost and customer service to make the decision. Customers are then free to switch or stay with their new supplier.

The incumbency advantage of large energy suppliers is such that they supply the majority of customers, few of whom actively switch. Currently, if they exploit this dominant position by overcharging, failing to resolve complaints or mis-selling, for example, the regulator can issue a fine. Instead, the ability to extend Ofgem's "safety net" to encompass other market failings, rather than just insolvency. If a supplier is so unfit in their ability to deliver a service that they deserve a fine of tens of millions of pounds, then the customers affected deserve to be protected – a new mechanism for Ofgem to switch groups of customers to new suppliers through a competitive process should be explored.

✓ **Switch up the market**

When a customer's fixed tariff deal comes to an end, they are currently automatically rolled over onto a standard tariff. While Ofgem recently changed the rules on this so that they can be put onto another fixed term tariff rather than the more expensive standard variable tariff, this requires no active participation of the customer. This means many customers don't shop around for their next deal and default to their existing supplier.

We suggest a system in which all tariffs are fixed term – so that they come up for renewal at the end of the contract and the customer is in a position to make a choice. Many are fixed term,

but standard variable tariffs, for example, are not. A customer may choose to remain with their existing supplier, but they would be required to actively confirm that they wish to do so. Rather than automatically rolling over, this change would prompt a comparison much like customers do for insurance policies.

Enable the development of co-operative and community energy suppliers

The original co-operative and mutual societies were created as a way for ordinary people to come together to provide mutual self-help for their members. The Co-operative Party believes that this is equally true today – by existing to provide a service for their members rather than generate profits for external shareholders, co-operative and mutual enterprises are the key to creating an economy that puts people before profit.

Energy suppliers which are owned and run by their customers or communities offer a solution in a sector in which for too long their voices haven't been heard. Co-operative models more than fill the energy accountability deficit which has seen price rises every winter and record fines issued to the big energy suppliers for overcharging²⁷, inaccurate bills, mis-selling²⁸ and “chaotic” customer service²⁹.

Once the imbalances in the market have been rectified, through reducing the dominance and incumbency advantage of the ‘Big Six’, co-operative and community energy supply can be enabled with a combination of:

✓ Simplifying the licencing and regulation

Ofgem’s Licence Lite was intended to make the regulatory system simpler for smaller-scale schemes but hasn't seen much success since it was introduced in 2009. This should be reviewed and amended so that it fits the needs of community schemes.

In addition, some community energy schemes which generate renewable energy would like to be able to directly supply their members and

wider community. This would enable them to tackle fuel poverty, for example, and would open new markets and income for their community energy scheme to grow or expand.

Currently, the complications of the licencing and regulation system mean this is too onerous for community schemes. While we propose earlier in this document the amendment to licences which says no single entity can hold both a supply and generation licence, there could be scope for a more flexible and easily navigable approach for community and co-operative schemes. This should also include development of a service for communities to self-supply.

✓ Enabling collective brokering

There has been a growing trend in collective switching, with schemes like the Big Switch enabling customers to come together to negotiate a better deal for their energy. For example, a collective switching scheme launched by a local co-operative Community Energy Direct and Which? Helped over 600 households across Yorkshire change their energy supplier, saving an average of £173 per household.³⁰

Department for Energy and Climate Change research into collective switching schemes and oil buying groups suggested that they have the potential for improving competition in the market and providing assistance for the least well off to secure a better deal on their energy. Furthermore, the active participation in the energy market meant greater awareness of switching and better understanding of the processes involved.³¹

However, currently, collective switching only really enables customers to swap between energy supply companies – it does not give consumers the ability to buy their energy directly from the wholesale market. Currently, this is a fairly difficult and opaque task and few consumers have the inclination to do so – but by cutting out the middleman, there would be scope to reduce costs and create a more responsive system in which consumers have a voice and a role.

The proposed new transparent energy trading pool would make this wholesale purchase easier, as prices would be transparent. Support could

be given to develop the role of a “collective broker” – this could be co-operatives, community organisations, charities or social enterprises which operate on behalf of a group of customers to purchase energy directly.

✓ **Funding and support for new co-operative and community suppliers**

For new co-operatives and innovative community suppliers to begin operating in a scalable and sustainable way, the appropriate funding should be available. This could be administered in a similar way to community energy generation, with government grants and loans available for seed funding and bridging loans.

Support should be provided in the form of tailored advice in navigating the regulatory environment. The government could develop or support the development of shared back office functions, such as the IT systems required to access energy trading, smart meter data and other industry codes and processes.

✓ **Municipal energy supply**

Providing they do not crowd out co-operative and community suppliers from the market, there is an important role for town halls in supplying affordable energy to their residents or local businesses, as well as working with other local authorities, public bodies or anchor institutions to create energy consortia to self-supply. Baltimore Metropolitan Council did this³², for example, through their Baltimore Regional Co-operative Purchasing scheme.

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Passenger Rail

There is a palpable sense that change to the ownership and structure of the industry is required. Recent surveys and opinion polling show a clear majority for the running the railways in public control. YouGov surveys suggest that support for public ownership of railways is at 60%,¹ while the Legatum Institute puts this as high as 76%.²

This is not simply nostalgia for the days of British Rail. Rather it shows that the country believes we should have more say in the way in which the industry is run, as shown by polling conducted by Co-operatives UK which revealed 85% of respondents wanted “more say”.³

Passenger satisfaction has been in steady decline since the National Rail Passenger Satisfaction Survey began in Spring 2011. Every year, over 50,000 passengers are consulted on a variety of metrics, from choice of cafes and shops available and cleanliness, to meatier issues like reliability and value for money.

For the most recent survey, in Autumn 2017, overall satisfaction remained at 81%⁴, fallen from a high of 85% in Autumn 2012. However, this masks a deeper unease with the way our railways are run. Looking more closely at the figures reveals that on many routes, passengers are unhappy with levels of overcrowding, reliability and how the company deals with delays. And more importantly, not even fifty percent of passengers believe that what they get for their ticket prices is value for money.

The debate on the rail industry tends to focus on the private provision of passenger services and the publicly-owned Network Rail. This chapter will therefore focus on these two aspects of the industry as they are the areas that a new Government is most likely to change, and because they are the parts of the industry where co-operative and mutual values, principles and models have most to offer.

Other issues remain important too – including the operation and ownership of the rolling stock companies, rail freight, station ownership and management, support for community rail, and the development of open access ventures such as Go-op.⁵

The Co-operative Party proposes a wholesale change of the rail industry. This publication supports the continued public ownership of infrastructure management (currently Network Rail) and looks to provide models and governance for the integration of the infrastructure management and the creation of new publicly-controlled rail passenger services. Public control which involves the passenger, employee and local authority will bring service decisions closer to the people who work or travel on our trains.

A short history of rail passenger privatisation

Since the much-vaunted Victorian age of rail the ownership of track and train has moved between public and private. Early railways were left to the entrepreneurs who built over 7,000 miles of rail track in England and Scotland by 1852⁶.

Among this confusion and enthusiasm, ideas of public ownership were already creeping into public policy debate, with the Prime Minister William Gladstone toying with nationalisation as early as the 1840s. In the First World War, railways were brought under state control, but in 1921 nationalisation was rejected in favour of four large regulated companies.

It wasn't until the 1945 Labour Government that complete nationalisation was back on the table, and the 1947 Transport Act created British Railways (which later became British Rail), a state-owned company that operated most of the rail transport in Britain. However, by the 1990s private enterprise was back in fashion, and the Railways Act 1993 broke up and sold off the operations of the British Rail Board.

Louise Butcher of the House of Commons Library eloquently summed up the process of rail passenger privatisation post-British Rail (BR) and described thus:

'Once the Railways Act 1993 was implemented in April 1994, the passenger railway was restructured so that domestic passenger train services could be offered to the private sector to run on a franchised basis.'

'British Rail (BR) reorganised its passenger services into 25 different train operating units. These units were gradually incorporated as subsidiaries of BR and run as separate 'shadow' businesses. They paid access charges for the use of track and infrastructure, and rentals for stations and rolling stock, on the same basis as the franchisees have since the introduction of franchising 'proper'.'

'Each operated under its own licence (granted by the Rail Regulator), its railway safety case (approved by the Health and Safety Executive) and a track access agreement with Railtrack (approved by the Regulator). A wide range of station and depot access agreements (also approved by the Regulator), property leases and other contracts were also required by each train operating business. Each of the 25 train operating companies (TOCs) was then offered for sale as a separate franchise. Private sector companies, management/employee buy-outs and, if the Franchising Director agreed (in practice he never did), BR could bid for the franchises through a bidding process overseen by the Director. The successful bidder acquired the TOC outright for a fixed number of years.'

'The first franchises, South West Trains and Great Western, were awarded in December 1995 and the first privatised services started operating in February 1996. The last franchise to be agreed was ScotRail, which started operating in private hands in April 1997. For the first franchises the Franchising Director produced a Passenger Service Requirement (PSR) setting out the minimum service levels for train services, based on the timetable then being operated by BR. Each PSR was specific to the franchise. The Franchising Director had the responsibility for monitoring the TOCs' performance. If TOCs did not deliver the proper timetable, the Franchising Director could impose penalties or, as a last resort, terminate the Franchise Agreement.'

'The Franchising Director's functions were laid down in section 5 of the 1993 Act – he was responsible for securing the provision of railway passenger services by entering into Franchise Agreements, with franchisees being selected through a competitive tendering process. Train companies bid for franchises on the basis of the amount of funding they would require – or the premium they would be prepared to pay – in order to run these services. The winner was the company seeking the lowest subsidy or offering the highest premium. Under the Transport Act 2000 the Strategic Rail Authority (SRA) inherited all the functions, property, rights, and liabilities of the Franchising Director.'

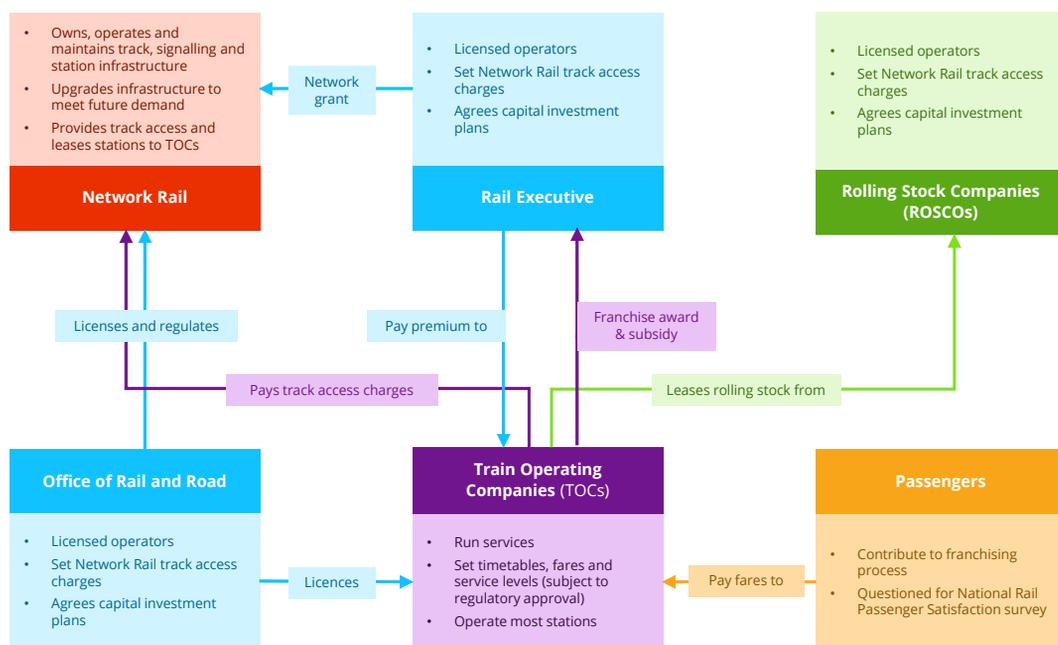
*'Under the Railways Act 2005, the functions relating to Franchise Agreements for England transferred from the SRA to the Secretary of State for Transport, responsibility for the Scottish franchise transferred to the Scottish Government, and the Welsh Government was granted a direct role for local and regional passenger rail services in Wales.'*⁷

The current industry structure

The public policy debate about railways is distorted by the industry's complex structure and funding arrangements. Not only does it make the issues harder to debate without significant level of understanding, when something goes wrong or passengers, politicians or employees complain, it is too easy for each body in the industry to point fingers at each other. The difficulty in pinning down the cause of the problems creates a vacuum of public accountability.

The Campaign for Better Transport in their report 'Guide to rail franchising', have produced a usable graphic showing the structure of the industry⁸. Because it is a guide specifically to passenger franchising, it leaves out arrangements around the delivery of rail freight and other aspects of the industry such as Community Rail. However, given this publication focuses on the Government's role, Network Rail and the Train Operating Companies (TOCs), it provides a useful outline.

Current structure of the UK passenger rail industry



This diagram not only demonstrates the complexity but also the dearth of public and employee involvement and say in an industry largely paid for by us.

In recent years the Government has changed its position on Network Rail. Since the collapse of Railtrack in the early 2000s, it remains a public entity – as a company limited by guarantee. Today, the Government takes a more hands on role within the governance and specifies Network Rail spending through the publication of the High-Level Output Statement (HLOS).

This recent change in terms of governance on the board of Network Rail came along with the disbanding of 'Network Rail Members'. The Members of Network Rail were the nominal voice of the tax payer. As a board appointed group of members of the public and industry stakeholders, they formed a second-tier board and scrutinised the executive board.

Whilst the operation of the 'Members' was not perfect it had the potential to play an important role in the accountability of the Network Rail. It is a retrograde step to have disbanded them - rather

than reform the role and structure, which could have provided an important counterbalance to the decisions made by senior executives.

The ability of employees and passengers to exercise accountability within train operating companies is extremely limited. In the case of employees, there was just one UK train operating company with an employee director – a post which at the time of writing this position was unfilled.

Passenger Focus is the statutory voice of the passenger in the industry. It has statutory role in franchise consultations and provides valuable research. As will be outlined later in the chapter, Passenger Focus should be retained within a new industry structure - but should be much strengthened to ensure more pro-active scrutiny and governance functions. It is clear that there is a thirst for greater passenger accountability as evidenced by the success of campaigning groups such as the Association of British Commuters.

Who owns Britain's railways?

Part of the UK's rail industry is already in public ownership. Infrastructure, including track, large stations and its associated land is owned and operated through a company limited by guarantee, Network Rail. Network Rail is funded through direct public subsidy in the form of a grant.

When the industry was privatised, the existing rolling stock (the trains themselves) was sold to the new operators or three new ROSCOs. These ROSCOs are not subject to the same close regulation that other parts of the rail industry are, and perhaps as a result they make significant profits. According to the RMT, they enjoy a profit margin of 16.7%, accounting for 2p in every pound spent on a ticket.⁹

These trains are leased to individual train operating companies (TOCs) at a price point established by the Department for Transport (DfT) through the franchise specification process. This transaction

is underwritten by a government guarantee. The TOCs are awarded franchises and public subsidy to run services on particular routes.

There has been a well-worn line that the UK Government is happy with public ownership of the passenger railways as long as it is not the British public, this view seems to be borne out with a glance through the current ownership of the rail franchises. Our railways are operated by German, Dutch, Japanese, Spanish, Italian and Chinese state railways running franchises. This is supplemented by a small number being owned and run by UK registered private companies such as Virgin Trains, Stagecoach and First Group. It is usual that the foreign public sector owned operators reinvest profits made in other countries they operate in straight back in to their own network.

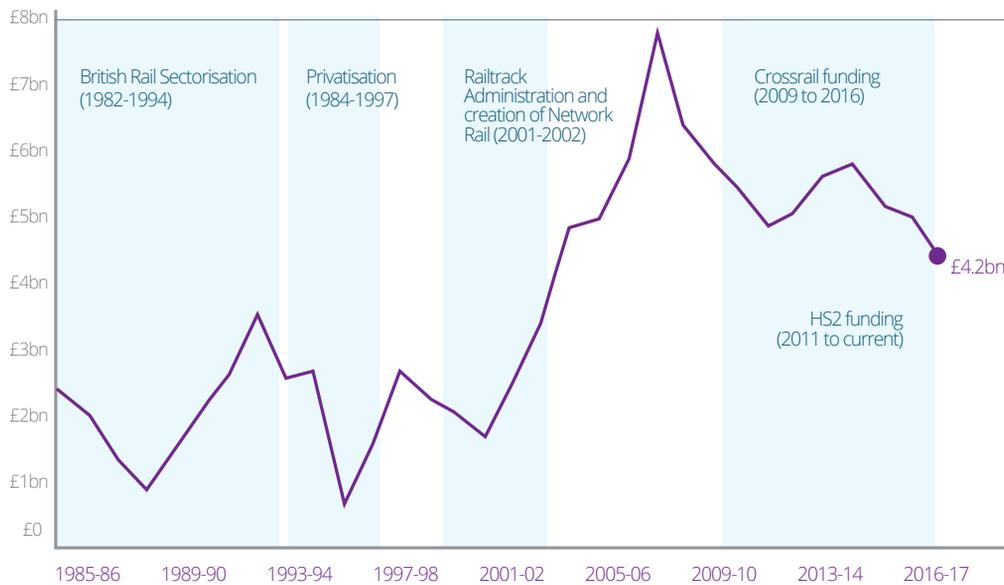
There are also a small number of open operators of passenger rail services which provide a small number of routes outside of the rail franchises (agreed to by Network Rail and DfT). These operators have traditionally been independently owned however they are increasingly owned by the big transport Groups including First Group and DB. Rail freight companies are privately owned and receive a small amount of Government subsidy.

How are Britain's railways funded?

The reality borne out of twenty years of privatisation has been the lesson that the only two real methods of funding the rail industry are the tax payer and the fare payer. Private investment in the industry has been minimal.

Latest statistics from the rail regulator, the Office of Rail and Road (ORR), show something shy of £7bn has been invested in the UK's railways by private companies over ten years¹⁰. The overwhelming amount of this investment is rolling stock companies buy rolling stock to lease to TOCs. But even this investment is underwritten by government guarantees through franchising agreements. Compare this to the £9.7bn of rail funding from passenger fares and the £3.4bn from government funding in 2016-17 alone, as

UK passenger rail, total public subsidy 1985-2017



The supporters of the privatised industry will point towards the fact that passenger TOCs taken as a group actually return a net profit to the Treasury. This figure fluctuates year on year as a result of the changing requirements outlined within individual franchise agreements. The figure is reached cumulatively, and many franchises have no premium going back to the government.

More fundamentally, this supposed net income is little more than a trick of accounting. As detailed in the 'The Great Train Robbery Report'¹³, the TOCs can only make profits because of the Network Rail direct grant. This means that on paper there is less direct subsidy for TOCs, allowing the Treasury to keep many of the costs of rail off the public balance sheets and creating an illusion of profitability among the TOCs.

In truth, rather than giving TOCs a direct grant, this subsidy is delivered through the system of track access charges levied by Network Rail. This works by the government giving Network Rail a grant, which is applied to lowering the track access charges paid by the TOCs.

This artificially lowers the cost of operating the route, so that the TOCs "have been paying less in charges even as they use the infrastructure more"¹⁴ at the taxpayer's expense. Therefore, the apparent net income is in fact a return to the taxpayer of a small percentage of subsidy that the taxpayer gave them, indirectly, in the first place. The cumulative cost of the privatised railways structure has been estimated at £1.2 billion per year – of which £0.7 billion is paid out in profits to these publicly subsidised TOCs.¹⁵

A failure of competition

Rail privatisation was promoted in the early 1990s with promises of a better, cheaper service for rail users requiring less subsidy by tax payers. Private rail companies would bring in capital and their business expertise which would transform the

sector's performance. The competition for franchises would allow for increased innovation and performance which would benefit the passenger.

Through the 20 years of franchising the Department for Transport has undergone at least three large iterations. The franchises offered by the Rail Executive within the Department for Transport are now more akin to the concession model used by Merseytravel and TfL. There is also now a score for social value which would be delivered within a successful bid.

However, the problems of franchising have only increased. Even the Centre for Policy Studies recent report 'The Cost of Nationalisation' accepts there is a fundamental failure of rail competition. Their solution was to dig the hole deeper by seeking to allow 'on track competition' a move which would further fragment services and weaken accountability.

In their 2016/17 report on Rail Passenger Franchising, the Public Accounts Committee laid the sorry state of rail franchising bare:

'Franchising delivers the most benefits to passengers where there is robust competition between bidders to operate services. The direct award dependency of the Department and recent fall in market interest demonstrates that genuine competition has been restricted to a limited number of franchises.'¹⁶

Franchising costs have not lessened, and genuine competition is at an all-time low with fewer and fewer companies competing for franchises. The above excerpt from the PAC report makes reference to a practice the Department for Transport has increasingly relied upon which serves only to prop up the ailing market. The awarding of contracts with the absence of any nominal franchise competition is now commonplace. The Department for Transport's 'franchise schedule' shows at least six of the franchises are currently in or have planned 'direct awards'.¹⁷

Whilst as ever the precise financial details within the direct contract awards are shrouded in commercial confidentiality, the criteria of the direct awards the Government uses is usually based on the belief there would be little or no market for the open franchise competition. The features of a direct award contracts are yet more reduction levels of private sector investment and returns and more risk placed on the Government and tax payer.

Proposals for a democratic passenger railway

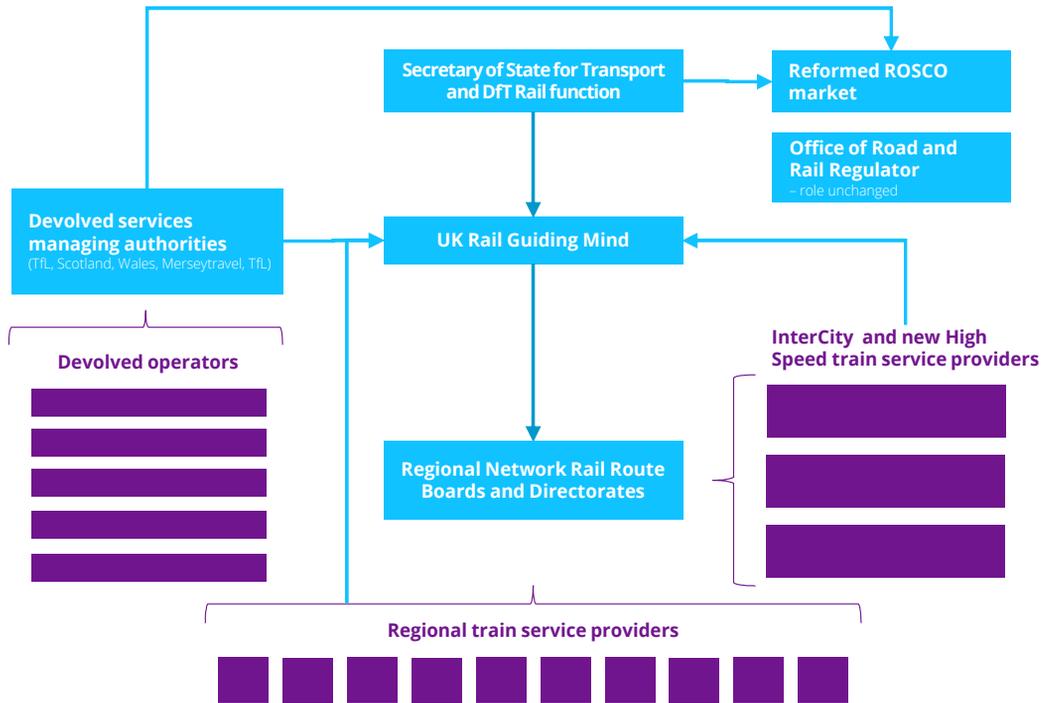
The complicated system, lack of passenger or employee voice, and failed market means there is a serious accountability deficit at the heart of our railways. When passengers, staff or politicians highlight problems, the difficulty in understanding the current arrangements and the ease with which companies within it can lay the blame elsewhere obscures our ability to track how public funds from taxes and fares are spent, or challenge when the system is abused.

As set out in a TSSA and Common Weal report¹⁸, whatever the precise nature of the newly reformed delivery mechanism the inclusion and adherence to co-operative values and principles would be all important – clearly a view the Co-operative Party shares.

The industry and network does not need to suffer in this way. A bold new approach to rail services and infrastructure management which benefits from public control strengthened with passenger and employee voice is achievable.

A repeal of Section 25 of the Railways Act 1993¹⁹ opens up the exciting prospect of setting up rail services which are publicly owned. The proposed model combines national, regional and sub regional control, and the associated accountability, along with new methods to increase passenger and employee say within service delivery.

Proposed structure for a democratic and publicly owned passenger rail industry



This new structure would be characterised by:

- The continued involvement and ultimate responsibility of the Secretary of State for Transport and some current rail functions of the Department for Transport.
- The continued involvement and management of devolved railways (Scotland, Wales, TfL, TfN and Merseytravel).
- The continued public ownership of Network Rail assets along with a new strengthened regional and route infrastructure management structure.
- The continued role of the independent regulator and functions currently carried out by the Office of Road and Rail.
- The establishment of a new 'Guiding Mind' which is accountable to the Secretary of State for Transport. Its governance would include current elements of Network Rail, new passenger and freight operators,

employees, industry stakeholders and Local Authority elements.

- The establishment a series of new mutual train operating companies which have strong fare payer, relevant local authority and employee elements within their governance and our professionally managed. Given the nature of intercity operators it will be desirable to generate a different not for profit model.
- A new strengthened and more accountable passenger rail voice which builds upon the work of Passenger Focus.

✓ A democratic 'Guiding Mind' for the railways

Rail assets, such as track and land, and Network Rail's borrowing powers should be transferred into a new Guiding Mind, which would play a strategic role in developing investment and expenditure plans alongside the Secretary of State and the DfT. It would be the ultimate planning authority and would take an active role in management

of the infrastructure along with monitoring and supervisory functions of the operators outside of the devolved system.

The Guiding Mind would be supplemented by a series of regional infrastructure boards who would work closely with operators and provide project management and delivery of infrastructure maintenance and renewal. The regional infrastructure boards would be a strengthening of the current route directorates within Network Rail. The new regional boards would be accountable to the new Guiding Mind, but would provide more regional focus and expertise in terms of maintenance and renewal of infrastructure.

This proposal would create a structure that is easier for regional operators to work with to plan works and required improvements. These boards would not receive ownership of the national assets but rather deliver specialist regional support and project management of infrastructure schemes and maintenance. They would also be well placed to forge new working relationships and partnerships with local authorities within their region.

Most importantly, though, the new Guiding Mind would have passenger and employee voice at its heart. A strengthened passenger voice would hold it accountable alongside the rail regulator, the ORR. Passengers and employees would have a clear role in decision-making through a mixed stakeholder board which would have a say on issues from remuneration and executive appointments to longer term strategic priorities and scrutiny of performance.

Roles for employee representation including trade unions would benefit the supervisory board along with other industry stakeholders such as the rail freight industry and local authority representation.

✓ Passenger voice

A properly funded, open and independent passenger voice organisation can build upon the work that Passenger Focus already provides.

Over recent years, the cuts to Passenger Focus and the extension to its remit to include Emotorists,

along with its closeness to industry, has not helped the organisation to date make its mark in debates about the performance and future of the industry. The work it does carry out, though is useful, and this must not be lost within a new organisation. Rather, with more of a campaign focus and grassroots membership, it could play a hugely beneficial role within a new industry focus.

✓ Regional decision-making

Devolved governments and regional authority structures play an important role in the current rail debate. Their ability to take decisions over services should continue.

In previous franchise rounds Local Authorities were 'co-signatories' on franchise contracts a practice halted early within the Coalition Government's period of office - a decision which angered many.

Both the Scottish and Welsh Governments have extensive specification and management powers over the ScotRail and Welsh and Borders franchises. It is notable that in the case of the Scottish Government, they have the ability not to be bound by the 1993 Railways Act, allowing them to bring the service back in house. The Welsh Government, Merseytravel and Transport for London, who also specify and manage services, do not have this ability.

In more recent years Transport for the North (a collection of northern local authorities) have enjoyed increased management of both the Northern and Trans Pennine franchises with a view to becoming the sole managers in years to come.

This devolution is welcome as it allows decisions affecting services in areas and communities to be taken closer to them. There is a clear ambition by local and regional authorities to be further involved in the management of their services, as evidenced by the London Mayor and Transport for London's pressure to be allowed to manage further elements of commuter rail services serving the capital and the development of Transport for the North.

It is clear that the devolution of rail decision making can and does make a significant impact within

the rail network. It will only benefit local transport planning and integration within a newly publicly accountable rail industry. It will therefore be for the ultimate decision makers in the devolved administrations to decide how best to deliver their services. Clearly it will be hoped that these decision makers bring them back to deliver on a not-for-profit status.

✓ **Accountable train operating services**

For the remaining routes outside of devolved structures, these plans propose that the next Labour & Co-operative Government would act to withdraw new franchise opportunities from the existing train operating companies as the contracts expire – at zero cost. Instead, regional franchises and intercity routes would be operated by new, publicly owned, accountable Train Service Providers (TSPs) with strong farepayer, local authority and employee voice within their governance, and regulated by the ORR.

It is possible that some franchisees, as in the past, will fail to meet their current over-optimistic franchise financial targets and so will wish to hand back those franchises before term. This will increase the speed of transition.

The Co-operative Party believes that these new accountable TSPs should have a mixed stakeholder model of governance. The important stakeholders, including passengers, employees and local authorities, would provide governance and strategic direction to a professional management team.

In more regionally based rail services, there is a strong case for local authority involvement. In comparison, the intercity operators on long distance routes such as the West Coast Mainline, East Coast Mainline and Great Western Railway cover the length and breadth of the country taking in many different local authorities. For intercity routes, combined authorities may be the appropriate stakeholders.

The board structure should be two-tier. The TSP would contain a professional management body with a mixed stakeholder scrutiny board above it. This scrutiny board would consist of passengers, community rail partnerships, the business

community and individuals nominated by the relevant local, devolved or regional government.

Passengers and employees should have a significant proportion of seats on the Scrutiny Board so that their voice is at the heart of decision-making. This could be done through a membership model - a passenger who can demonstrate regular usage of the service either by a season ticket or regular trips (for example, 20 per year or more) becomes a 'member' of the TSP. The passenger representation could then be drawn from this membership base through self-application and a ballot of members at train stations and online. Similarly, employee representatives could be organised democratically, with additional and meaningful roles for the sector's unions.

The Scrutiny Board should have clear functions, including formal responsibility for:

- Selecting and appointing the Chair and Non-Executive Directors through a nominations committee
- Approving the appointment of the Chief Executive
- Being involved in the development of an annual strategic plan produced by Directly Operated Rail
- And would have the powers to dismiss the chair and non-executive directors, and determine the board's wage and bonus structure through its remuneration committee.

And lastly, any model for a TSP must ensure that it has at its heart wider community involvement, engagement, community reinvestment, development of community rail partnerships (often charities or mutuals) and local infrastructure development. These are vital if the wider potential social benefit of rail services is to be realised in a new publicly controlled system.

Under these proposals, the Management Board would remain responsible for the day-to-day management of the organisation. The Scrutiny Board would meet every two months with further contact between the two boards encouraged at other points. This would be supplemented by wider passenger members meetings carried out twice a year with an AGM.

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