

This chapter was originally Chapter 28 in the second edition of Equity & Trusts, which was published in 2001. My intention in writing this essay as part of a textbook on trusts law was to include within the trusts law canon elements of the law of unincorporated associations (otherwise a staple of trusts law courses in relation to certainty of objects) relating to co-operative societies and friendly societies which are separately regulated and which arise (now) under separate legislative codes. Part of the interest, for me, in considering these topics was to expand the basis on which property law is commonly understood to arise. So, in relation to co-operatives for example, it is evident that property can be owned by a group of people without any individual within that group having separate, severable rights. Akin to the concepts of joint tenancy, survivorship and unity of interest in land law, it is possible for someone to be a co-owner of property but to own nothing one's self individually. If you like, this is the perfect communist model of property: together we own everything, separately we own nothing.

CO-OPERATIVES, FRIENDLY SOCIETIES AND TRUSTS

28.1 INTRODUCTION

28.1.1 The overlap between co-operatives and trusts

At the time of writing, no other book on equity and trusts considers co-operatives and friendly societies as part of the general discussion of the better-established topics: although all of those books do consider unincorporated associations and their interaction with express trusts.¹ Co-operatives and friendly societies have traditionally been forms of unincorporated associations. The inclusion of a separate discussion of these entities in this book is for two reasons. First, these entities occupy a middle ground somewhere between ordinary companies and private trusts: and therefore they give us a different perspective on the manner in which property might be held and used for the benefit of a group of people otherwise than as beneficiaries or as shareholders. Whereas the ordinary company began life as a partnership holding property on trust for the members of the company in pursuit of their common objectives, the societies considered in this chapter constitute a similar arrangement aimed primarily at personal welfare as opposed to commercial activities. Unlike trusts, the societies considered in this chapter have frequently been defined by statute as being forms of body corporate – albeit not ordinary companies organised under the Companies Act 1985.

Second, these entities tie in closely with the focus in this part of the book on trusts being used for welfare purposes. Co-operative entities enable private individuals to band together and share property for common purposes: typically for their common welfare as a geographic community. The provision of welfare through private sector (as opposed to public sector) entities constitutes a politically-contested drift in states in which the role of the welfare state is being steadily reduced. As such, co-operatives offer a means of providing for communal welfare in a style which pre-dates the welfare state and therefore offer an important interaction with charities and pension funds as considered in this Part 8 [Welfare-uses of trusts, including charities] of the book. As mentioned at the very beginning of this Part 8, it is true to say that most family trusts were created historically for the provision of welfare for wealthy families pure and simple and therefore there is a similar underlying common purpose between the histories of trusts and of co-operatives.

¹ As discussed in chapter 4.

There are interesting parallels to be drawn between the rights of beneficiaries and trustees which will mark one possible future for the ordinary private trust being used for the provision of welfare services. One particularly important theme in that regard is the likelihood of the introduction of a statutory regulator to oversee such activities as opposed to reliance solely on the law of trusts to protect beneficiaries. Once a form of collective endeavour becomes sufficiently socially significant (like pensions funds, unit trusts or charities) there is usually a call for a formal regulatory structure to oversee the sector rather than relying on individuals benefiting from the service to protect their own interests through litigation. All of the societies considered in this chapter have great potential significance in the future of financial services in the United Kingdom for private individuals on low incomes, as well as constituting a particularly significant part of the social history of these islands since the Industrial Revolution.

Three entities are considered in this chapter. First, the co-operative: or, to give that entity its technical name, the 'industrial and provident society'. Second, the credit union – which is a form of industrial and provident society organised under a subtly different statutory code. Both of these forms of industrial and provident society are bodies corporate which are receptacles for property subscribed by their members for the purposes of the society. Those members will frequently, but not always, be entitled to take some benefit from the society's property. Third, the friendly society which can be organised as either a corporate body or as an unincorporated association. The friendly society is organised under a distinct statutory code and, in recognition of its role as a resurgently important provider of financial services to the public, is [now] regulated by the Financial Services Authority. The genesis of all three forms of entity (of which the friendly society is the oldest lawful structure) was as a means of providing benefits for their working class membership, typically in the form of insurance against those members being unable to work through injury, illness or otherwise. As such there is a clear parallel between the personal welfare objectives of these entities and a private discretionary trust created by individuals to pay income to those beneficiaries who become eligible at any time. There are close parallels between this activity and both pension funds and insurance companies.

28.1.2 The social history of communal undertakings

The societies considered in this chapter were formed originally as communal undertakings of working people at a time when it was illegal to belong to such organisations because it was feared that they were seditious. In consequence, their legalisation in the late 19th century demonstrates both a determination to control these entities by providing in legislation for the form which they could take and a utilitarian acceptance of the fact that it would be for the benefit of the public purse if working people provided for insurance against their own frailty rather than rely on others to care for them.

Civil unrest in the 19th century

One of the extraordinary facts of English history is the fact that its polity remained comparatively untouched by the tide of revolution which swept Europe in 1848.² English social history does demonstrate, though, the level of unrest which was caused by the industrial revolution and a fear that England would succumb to the kind of insurrectionary, revolutionary change which had swept Europe. This had very important ramifications for English law because it ingrained in the ruling classes of the time a fear of the 'mob' which stretched not simply to a criminalisation of public demonstrations and even homelessness (in the Vagrancy Acts) but also a criminalisation of membership of associations of working people formed to protect the economic interests of their members. These associations were formed at the time of the division of the population between the new industrial towns and the remaining agricultural communities which brought with them extreme levels of poverty for the working class.

The principal legacy of the French Revolution on English political life was a paranoid fear of working class insurrection. Beyond a rapid-fire response to actual violence on the streets was an anticipation of sedition if the working class were allowed to form active associations. Therefore, while the ability of the working classes to form merely social associations came to be tolerated eventually, the criminal law still outlawed trades unions and any combination of working persons which caused a 'restraint of trade'. Judicial interpretation of the legislation during this period tended to restrict the operation of these associations even further. The line at which co-operatives were not tolerated was roughly the point at which groups of workers sought to restrict the availability of their labour, the possibility of non-members carrying out a particular trade under the closed shop and labourers seeking to control the conditions of their employment. It is interesting that the legal professions were permitted to set up precisely such associations in the 1850s with the creation, effectively, of closed shops for barristers, solicitors and attorneys.

² Hobsbawn, 1975.

One common theme among the historians of 19th century England is the change in the social conditions of 'the people' between the end of the Napoleonic wars in 1815 and the 1870s with the expansion of the British Empire through the industrial revolution.³ Legal enfranchisement of the emergent working class in a very large part of the new social compact emerging in the Britain at this time as the working mass acquired rights under contract law against their masters but still suffered under the law of tort if they struck and caused those same masters financial loss.

The co-operative movements – beyond property rights

These early co-operatives were rudimentary associations of serf labourers or workers in shared occupations pooling resources. The aims of these co-operatives were very different from the other trust structures considered thus far in this book. From the perspective of the contract/property divide in legal theory, these were organisations which were typically syndicalist or collectivist: in which the property rights of individuals were surrendered to the use of the collective. Only comity between individuals controlled the use of that property. Today such 'comity' would be explicable in terms of contract – however, at the time any such associations were illegal combinations and therefore could only have constituted void contracts even if their participants had been legally competent to create contracts. Even discussing property rights and contract in this context is inaccurate because these people simply did not have legal rights: they were non-persons as far as the law was concerned. They were the disenfranchised mass of the emergent English working class.

As EP Thompson explains the development of the working class it is important to look beyond the development of different categories of working people (differences between those living in the towns and those in the countryside, differences between the labouring classes and domestic servants) and to see this social development as explicable in terms of an homogenous class developing common life experiences and political goals.⁴ One of the most significant forms of suffrage for the emergent working class was legal enfranchisement through employment contracts and private property rights. The granting of these rights gave the working classes the ability to provide for their own personal welfare and to plan for their own security.

28.2 INDUSTRIAL AND PROVIDENT SOCIETIES

28.2.1 The nature of industrial and provident societies

An industrial and provident society (a 'society') is the legal form taken by a co-operative – that is, a collective entity which expresses the common personality of its individual members and which works for common goals identified by that membership. An industrial and provident society is a body corporate, as considered below, meaning that the society can own its property. It would be possible to organise a co-operative entity as a trust such that the property was held on trust for the membership subject to the rules of the society – this would require the settlors to take care not to create an invalid purpose trust as considered in chapter 4. Alternatively such co-operatives could also be structured as partnerships (if they were to carry on business activities under s 1 of the Partnership Act 1892), or as unincorporated associations (also considered in chapter 4), or as an ordinary company (under the Companies Act 1985). This chapter will concentrate on the co-operative organised as an industrial and provident society – their Victorian format.⁵

The 'industrial and provident societies' were first partnerships between the members authorised originally under Statute 4&5 Will 4 c 40 which established the friendly societies, considered below. The first Industrial and Provident Societies Act was passed in 1852 which recognised these societies as an entity distinct from partnerships or unincorporated associations. It was not under the Industrial and Provident Societies Act 1862 that such societies attracted corporate form and limited liability – notably before ordinary companies were accepted as being distinct legal persons by the common law. The statutory codes for such societies is now contained in the consolidating Industrial and Provident Societies Act 1965 (IPSA 1965) and the Industrial and Provident Societies Act 1978 (IPSA 1978).

³ See eg EP Thompson, 1963; Hobsbawn, 1975; Woodward, 1962.

⁴ Thompson, 1963.

⁵ For the purposes of this chapter, the industrial and provident society will be taken to be the expression of the co-operative, being the form which such entities usually take in practice. An industrial and provident society takes deposits from its members to aim to fulfil the purposes identified in the society's objectives.

In line with the regulation of such societies, a society can either be registered (and thus acquire the tax and other benefits allocated to such societies) or can remain unregistered and be treated as either a trust, unincorporated association or partnership – all of which are beyond the scope of this discussion. The benefits are an advantageous tax regime, distinct legal personality as corporations, and exemption from liability as deposit-taking institutions to comply with the onerous banking and insurance regulation and legislation.

A registered industrial and provident society specifically is organised as a corporation with limited liability,⁶ having operated as either a partnership or an unincorporated association before 1862. Industrial and provident societies are not companies under the terms of the Companies Act 1985,⁷ although it is possible under the legislation for a society to convert itself into a company. The corporate status and limited liability accorded to industrial and provident societies are acquired on registration.⁸ Societies are sued in their own name and have title in their own property.⁹

It is a requirement under the legislation that a society have a minimum of seven members.¹⁰ That requirement ensures that the society is not simply a small, private trust but rather a comparatively large association of persons. Demonstrating the antiquity of the model, that was also the precise requirement under s 3 of the Joint Stock Companies Act 1856 (since repealed) for the number of members in a joint stock company.

28.2.2 Obligatory principles for co-operative status

IPSA 1965 requires that industrial and provident societies be organised on co-operative principles or that they carry on business ‘for the benefit of the community’. The principle requirement for registration as a co-operative is that ‘the society is a *bona fide* co-operative society’.¹³ In deciding whether or not a society is indeed a ‘*bona fide* co-operative society’ s (3) IPSA 1965 provides that:

... the expression ‘co-operative society’ does not include a society which carries on, or intends to carry on, business with the object of making profits mainly for the payment of interest, dividends or bonuses on money invested or deposited with, or lent to, the society or any other person.

Significantly, any business conducted by the society cannot be carried on for shareholder profit, as with an ordinary company. Rather, any business activity must be for the purposes of the society.

The industrial and provident society is organised so as to achieve collective goals on the basis of communal democracy. Co-operatives might be created to fulfil one of a number of purposes, for example: housing co-operatives (such as housing associations organised under the Housing Act 1985), consumer co-operatives, agricultural co-operatives, and workers’ co-operatives. The older co-operative societies, which typically carry on activities as production, retail, insurance or loan businesses are organised as industrial and provident societies. They are consumer-oriented in that it is the customers of the society who make up the membership who have voting and dividend rights. The newer or larger societies use the form of the company limited by shares.¹⁴ In the 1970s the workers’ co-operative came to prominence due to high unemployment in the late 1970s and ability for those made redundant to use their of statutory redundancy payments to invest in new ventures under Industrial Common Ownership Act 1976.

That there is an obligation to follow co-operative activities, it is worth considering what is meant by the term ‘co-operative’. Snaith’s *The Law on Co-operatives*¹⁵ identifies six central features of a co-operative: democratic control of the society by its membership; limited interest in the capital by the members (as opposed to shareholders in a company); distribution of surplus assets for the purposes of the society under its own rules; open membership; a commitment to the education of its members either generally or in relation to the use of their own property; and a federalising tendency to act together with other co-operatives.

⁶ Industrial and Provident Societies Act (IPSA) 1965, s 3.

⁷ *Re Devon and Somerset Farmers Ltd* [1993] BCC 410.

⁸ IPSA 1965, s 3.

⁹ *Drym Fabricators Ltd v Johnson* [1981] ICR 274.

¹⁰ IPSA 1965, s 2(1)(a).

¹³ *Ibid.*

¹⁴ *Scottish Co-operative Wholesale Society Ltd v Meyer* [1959] AC 324.

¹⁵ Snaith, 1984.

The idea of democratic control is particularly interesting. While English property law tends to focus on rights in identified property, the co-operative personifies a very different attitude. Co-operatives derive from a tradition which pre-dates the acquisition of property rights by the working classes. Co-operatives evolved at a time when working people acquired no legal rights against their masters, in the way that Coke explained the old law of 'master and servant'. The syndicalist and collectivist traditions emerged at a time when the members of the collective themselves as serfs were literally the property of a land lord under the master-servant relationship. There was no legal understanding of individual rights for such people. In its place there was an understanding that the members were bound by their compact formed by the constitution of their association and entitled to the common wealth established by their collective labour and savings. There were no property rights as commonly understood by English law to be enforced. Rather there were the shared values of the collective which directed and compelled use of the property.

28.2.3 Alternatively – business carried on for the benefit of the community

An alternative means of constituting a co-operative is by demonstrating to the regulator of industrial and provident societies that there are general, special reasons why the entity should be an industrial and provident society rather than an ordinary company. Section 1(1)(b) IPSA 1965 provides:

- (b) that, in view of the fact that the business of the society is being, or is intended to be, conducted for the benefit of the community, there are special reasons why the society should be registered under this Act rather than as a company under the Companies Act 1985.

Therefore, the entity must be able to demonstrate that its activities are for the 'benefit of the community'. What precisely is meant by the expression 'benefit of the community' is not defined in the legislation. It is suggested that there is no need to construe this expression as narrowly as is done in the law of charities (see perhaps *Ministry of Health v Simpson*¹⁶) because the overriding policy requirement that there be an intention to create a *bona fide* charity is not a prerequisite of the creation of an industrial and provident society.¹⁷

28.2.4 The rights of the members in relation to the assets of the society

Significantly the registered rules of a society bind both the society and all of its members, giving a contractual flavour to their relationship.¹⁸ Members can be either individuals, other societies or companies.¹⁹ The binding nature of these rules is stated to be as though each members had signed those rules in person.²⁰ Amendments to the rules are only binding on an individual members if that member's consent in writing had been obtained prior to the change.²¹

Importantly, the member of a society does not acquire proprietary rights against the assets held by the society. Section 22 IPSA 1965 provides that:-

All moneys payable to a registered society by a member thereof shall be a debt due from that member to the society and shall be recoverable as such in the county court ...

Therefore, the right of a member of a society is that of an ordinary debtor. However, a member of an industrial and provident society makes a deposit which 'shall be recoverable'.²² The deposit made by the member requires a transfer of property to the society in return for which the member acquires a stake in the co-operative undertaking of the society. Notably, that stake is not a proprietary stake in legal terms – rather it is a 'social investor's stake' in the benevolent activities of the co-operative. It is the society itself which holds title in all deposits made with it. Therefore, the rights of the members are entirely in the personal nexus established by the contract (in the form of the society's rules) between the member and the society and the (statutory) debt generated by that relationship to recover the deposit made.

¹⁶ [1951] AC 251.

¹⁷ For a more comprehensive discussion of the nature of co-operative activity see Hudson, 2000.

¹⁸ IPSA 1965, s 14(1).

¹⁹ *Ibid*, s 19.

²⁰ *Ibid*, s 14(1).

²¹ *Ibid*.

²² *Gwendolen Freehold Land Society v Wicks* [1904] 2 KB 622; [1904-07] All ER Rep 564.

By contradistinction, the society has a lien over the shares of any member for a debt owed by that member to the society. In situations where members take loans from the society or otherwise acquire personal obligations to the society, the society will acquire proprietary rights against the member's assets. This lien forms a species of mortgage between the society and the member.²³

Disputes between the society or its officers and any of its members can be restricted to any dispute resolution procedure specified in the society's rules.²⁴ This may be an attractive option to the drafters of those rules to prevent comparatively small societies from wasting too much of their funds on litigation when issues could be solved, for example, by arbitration. Therefore, the contractual nature of membership of an industrial and provident society is emphasised once again.

28.3 CREDIT UNIONS

28.3.1 The nature of the credit union

Credit unions are a form of industrial and provident society organised under the Credit Unions Act (CUA) 1979 which take deposits from their members and make small loans to those same members typically in situations in which those members are not able to acquire financial services from high street banks. An entity is only entitled to represent itself as a 'credit union' if it is organised as an industrial and provident society.³⁵ It is possible for other entities to carry on effectively the same activities as a *de jure* credit union, whether as a company, an unincorporated association or possibly even as a form of partnership, but they do not acquire the legal and tax advantages of being a credit union under the 1979 Act.

Credit unions have been advocated as a means of providing financial services to those parts of the community which do are unable to obtain banking and other facilities.³⁶ They are typically local initiatives which are required by the 1979 Act to have a link with the community which they serve. Credit unions pool resources drawn from local communities in the form of deposits (or subscriptions) made by those members so that the credit union can make loans to those same members. The subscriptions made by members will typically be small. The depositor may receive a low rate of interest in return for the subscription although the principal aim of the union is to provide a pool of capital for local people.

The credit union is identified as such by the presence of five key factors: an objective of the promotion of thrift amongst its members, statutorily prescribed numbers of members, a common bond with a local community or other restrictive category of persons, prescribed rules, and compulsory insurance. The number of members of a credit union shall not exceed a specified number.³⁷ At present that number is fixed at 5,000. There is also a maximum limit imposed upon the interest in the shares of a credit union which one person is capable of holding, this limit being currently fixed at £5,000.³⁸

23 *Everitt v Automatic Weighing Machine Co* [1892] 3 Ch 506; (1892) 62 LJ Ch 241.

24 IPSA 1965, s 60.

35 CUA 1979, s 3.

36 HM Treasury, *Access to Financial Services*, November 1999.

37 CUA 1979, s 6(2), (3).

38 Credit Unions Order 1989, SI 1989/2423.

28.3.2 Objects of a credit union

The unique nature of the credit union is as a community-based initiative for people to pool money and make loans to members out of those common funds. The statutorily provided 'objects' of a credit union are provided in s 1(2) CUA 1979:

- (a) the promotion of thrift among the members of the society by the accumulation of their savings;
- (b) the creation of sources of credit for the benefit of members of the society at a fair and reasonable rate of interest;
- (c) the use and control of the members' savings for their mutual benefit; and
- (d) the training and education of the members in their wise use of money and in the management of their financial affairs.

It is to be noted that these are defined as being the 'objects' of the credit union and not merely common principles or standards to be borne in mind: rather, these are the corporate and constitutional objectives of any entity which attracts the sobriquet 'credit union'.

The core principle of the 'promotion of thrift' is particularly vague. The term 'thrift' has a dictionary definition of 'prudent use of money and goods: sensible and cautious management of money and goods in order to waste as little as possible and obtain maximum value'.³⁹ The *Oxford English Dictionary* definition stresses 'saving ways, sparing expenditure'. As a core statement of the principal feature of a credit union it is obscure, as a statement of the investment obligations of a credit union it would be particularly vague. What it does appear to suggest is that the credit union should be risk-averse in the use of its funds. Typically a credit union must focus on making loans to its membership rather than making financial market investments. The subsequent conditions for acceptance as a credit union suggest that the union exists to provide a source of credit for members who, effectively in parentheses, would not otherwise be able to acquire credit from high street financial institutions. This is achieved through the application of savings for the mutual benefit of the membership.

The final objective is perhaps the least significant of the three offering a collateral objective of educating the membership as to the 'wise use' of their money 'in the management of their financial affairs'. While this is the least significant legal statement of the purpose of the credit union, it is the most revealing statement as to the underlying purpose and activity of the union. There is undoubtedly a significant element of social engineering at work in the construction of this statutory scheme. The word 'thrift' is echoed on the imprecation that there be 'education' of the membership as to the 'wise' use of their own money. This is an attempt to reach out to those who do not have the use of financial services both to offer them a self-help structure and also to have them taught how to take care of themselves. There is a deeply utilitarian purpose at work here with the grand, classic sweep of the Victorian age of empire.

28.3.3 Requirement of a 'common bond'

It is a requirement that there be a common bond between the members of the credit union (and in turn between the credit union and the communal impact of its activities). Therefore, the CUA 1979 provides for what are described as *appropriate* 'qualifications to admission to membership':

- (a) Following a particular occupation;
- (b) residing in a particular locality;⁴⁰
- (c) being employed in a particular locality;
- (d) being employed by a particular employer;
- (e) being a member of a bona fide organisation or being otherwise associated with other members of the society for a purpose other than that of forming a society to be registered as a credit union;

and such other qualifications as are for the time being approved by the appropriate registrar.⁴¹

³⁹ *Encarta World Dictionary*, 1999.

⁴⁰ *R v St Leonard's, Shoreditch, Inhabitants* (1865) LR 1 QB 463; *R v Glossop Union* (1866) LR 1 QB 227; *Levenue v IRC* [1928] AC 217.

⁴¹ CUA 1979, s 1(4).

Therefore, credit unions have a broader definition of the communities than simply the geographic areas which they serve. That the membership resides in a particular locality is, however, one of the possibilities. The employment-based credit unions are likely to become less important as occupational pension schemes become more prevalent and with the introduction of a minimum wage. Therefore, it is likely that credit unions will continue to be most important in relation to initiatives in small, geographic communities.

28.3.4 Rights of members

As with an ordinary industrial and provident society, the members of a credit union do not own the assets of the union. Rather, the members acquire shares in the union in proportion to the size of their deposit. All shares are required to be denominated as £1.⁴² Those shares can be fully paid or paid for by periodical payments but are not allotted until fully paid up in cash.⁴³ Significantly, shares in a credit union are not transferable, unlike shares in a public company by the member during his lifetime⁴⁴ although they may be transferred on death.⁴⁵ Therefore the rights accorded by the share are restricted, thus locking the investor's return on investment into her rights under the rules of the credit union against that credit union.

28.3.5 Borrowing and lending powers

Credit unions are only permitted to accept deposits from shareholders for the allotment of shares⁴⁶ but are otherwise precluded from taking deposits by the criminal law.⁴⁷ The term 'deposit' is defined as being any amount of money taken on the basis that it will be repaid (whether with or without interest) other than in relation to the provision of services by the credit union.⁴⁸ A credit union is entitled to borrow money up to one-half of its total paid up share capital.⁴⁹

Loans may be made by the credit union to members for 'provident or productive purposes' on such terms as the rules of the society provide but not for more than five years and not at a rate of interest of more than 1% per month.⁵⁰ The amount of the loan must not be more than £2,000 in excess of that member's paid up shareholding in the society. The credit union is only entitled to invest its surplus funds in the manner specified by the Registrar.⁵¹ The term 'surplus funds' is defined as constituting any funds from time-to-time 'not immediately required for its purposes'.⁵² The expression 'funds' would seem to include money and not, for example, any land or similar assets held by the credit union from time to time. In general terms excess funds are to be held in a current account with an authorised bank.⁵³ Clearly, the policy is to ensure that credit unions keep their assets in only the most basic of investment activities.

42 *Ibid*, s 7(1).

43 *Ibid*.

44 *Ibid*, s 7(2).

45 *Ibid*, s 7(3).

46 *Ibid*, s 8(1).

47 *Ibid*, s 8(4).

48 *Ibid*, s 8(2).

49 *Ibid*, s 10(1).

50 *Ibid*, s 11.

51 *Ibid*, s 13(1).

52 *Ibid*, s 13(4).

53 *Ibid*, s 13(2).

28.3.6 Distribution of profits

The means of distributing profits is decided by the 'credit union in general meeting'⁵⁴ and not simply by the management of the union as with an ordinary company. In this context, 'profits' means profits after payments of debts, taxation and depreciation of assets: hereafter 'distributable profits'.⁵⁵ There is an obligation to maintain 10% of the profit from any year as a general reserve.⁵⁶ It is that remaining 90% of the distributable profits which is allocated by the credit union in general meeting. Distributable profits are to be applied in the payment of dividends⁵⁷ - which differs significantly from an ordinary co-operative in which assets are not paid out to members but are rather applied for the benevolent purposes of the society. Otherwise distributable profits in credit unions may be applied for two further purposes: in rebate of interest on loans made to members,⁵⁸ or for 'social, cultural or charitable purposes'.⁵⁹ One part of the society's funds which are typically ring-fenced are deposits taken from people too young to be members: those contributions are held on trust by the society.⁶⁰

Where organised as an industrial and provident society and registered under CUA 1979, the credit union is a corporation capable of taking title in property attributed to it. Therefore, the officers of the credit union stand in the same relationship to the union's property as the directors of an industrial and provident society occupy in relation to the property attributed to such a society.

28.4 FRIENDLY SOCIETIES

28.4.1 A phenomenon of great historical importance

Friendly societies were the first form of lawful structure permitted for working class people to form a common bond for their mutual welfare under English law. Other activities, such as trade union membership, would remain prohibited by criminal penalty and would subsequently be discouraged by potential civil liability even after its legislative decriminalisation in 1874. At the beginning of the 21st century, renewed focus on personal welfare provision through friendly societies perhaps signals a return to that forms of Victorian utilitarianism which encouraged the working classes to seek out self-help initiatives such as membership of friendly societies. The late modern friendly society is marketed in the general marketplace for financial services as a means of making prudent financial investment by means of insurance policy, rather than as a co-operative working class activity. Indeed, the benevolent aspect of friendly societies has receded and is no longer a pre-requisite in the legislation governing the creation of such entities. It is only the industrial and provident societies which are *required* by law to operate along co-operative lines or for the benefit of the community. Friendly societies are permitted to have benevolent purposes in their constitution but are no longer obliged to act in that way.

54 *Ibid*, s 14(3).

55 *Ibid*, s 14(1).

56 *Ibid*, s 14(2).

57 *Ibid*, s 14(3)(a).

58 *Ibid*, s 14(3)(b).

59 *Ibid*, s 14(3)(c).

60 *Ibid*, s 14(7).

28.4.2 The legal fundamentals of friendly societies

Legal structure – incorporated and unincorporated associations

This chapter considers two forms of investment entity: the corporate and the unincorporated friendly society. Friendly societies organised under the Friendly Societies Act 1974 (FSA 1974) had no legal personality: they were typically unincorporated associations although their property was vested in trustees on behalf of the societies and their members.⁶¹ As considered below, the Friendly Societies Act 1992 (FSA 1992) has generated two-tiers of such society: the incorporated and the unincorporated. Significantly, no new friendly societies can be organised and registered on the unincorporated FSA 1974 basis after the enactment of the FSA 1992.⁶² Friendly societies of the FSA 1974 variety are usually organised as unincorporated associations (which is focus of the first section of this chapter). A discussion of incorporated societies and the new regulatory regime introduced by FSA 1992 follows. While older societies were merely associations, friendly societies organised as unincorporated associations are now empowered to convert themselves into corporations.⁶³ The general law of trusts as it relates to that on unincorporated associations was considered in detail in chapter 4.

The new regime – incorporated societies

Before 1992, friendly societies were not permitted to organise themselves as companies. Therefore, the structure generally adopted for the purposes of achieving registration was to create a trust and have the property used for the purposes of the society vested in the trustees of the society.⁶⁴ This structure is still used by most friendly societies created before 1974 but still in existence after 1992. The FSA 1992 permitted the creation of incorporated friendly societies. The effect of Part II of FSA 1992 is to create a two-tier system of friendly societies as mentioned above. The new structure applied to friendly societies whether created under the FSA 1974 structure or under the FSA 1992 structure. This new legal status is available both to societies registered under the 1992 Act and also existing societies registered under the 1974 legislation.

Comparison with other community-based investment structures

Industrial and provident societies, including credit unions, which otherwise resemble friendly societies in many ways, are accurately described as being ‘entities’ because they are legal persons in the form of corporations. Friendly societies and industrial and provident societies formerly shared a common legal heritage and today occupy roughly similar financial services market positions. The changes introduced by the FSA 1992 have meant that friendly societies have been able to organise as companies and to offer a range of financial products in a different way than hitherto. That sector has seen a rise in activity as a result of this change to their structure marketing products to private investors with the advantages of tax-free investments.

Typically, friendly societies have as one of their aims some benevolent purpose. The kinds of purpose which frequently fall within this ambit as those to provide for life, endowment or sickness insurance up to a specified limit; or to establish workmen’s clubs for social, educational or recreational purposes; or to promote other benevolent activities, such as old people’s homes and so on. However, the introduction of incorporated societies in the FSA 1992 has downgraded the importance of those benevolent purposes to an optional extra which *may* form a part of the society’s objects.⁶⁵ In relation to industrial and provident societies there remains an obligation that the entity be organised on the basis of co-operative objects.⁶⁶ Therefore, friendly societies have begun to shift towards more straightforward financial services for members and policyholders which do not require a common link as they would have done in the original 18th century friendly societies. The social investment function has begun to wane in favour of the marketing of modern financial investment. The introduction of the new regulatory body (the Friendly Societies Commission) is part of this strengthening of the importance of this sector in the provision of ordinary financial services. That body has since been absorbed into the Financial Services Authority.⁶⁷ This is in stark contrast to the co-operative purposes which are a pre-requisite of registration as an industrial and provident society or as a credit union considered above.

61 FSA 1974, s 54.

62 *Ibid*, s 93(1).

63 *Ibid*, s 91.

64 *Ibid*, s 54.

65 *Ibid*, s 10.

66 *Ibid*, s 1.

67 Financial Services and Markets Act 2000, s 334.

28.4.3 The advantages of registration

To qualify for the advantages of registration as a friendly society, that society must register with the Registrar of Friendly Societies. The office of Registrar is a function which had previously generally devolved to the Securities and Investment Board (SIB) but has subsequently passed to the Financial Services Authority. The statutory code governing friendly societies is contained in a series of statutes stretching from the FSA 1974 to the FSA 1992. The FSA 1974 was a consolidating statute which drew together a range of legislation from the Friendly Societies Acts 1896 up to the 1971 Act. The Friendly Societies Act 1981 and the Friendly Societies Act 1984 effect minor amendments to the main statute of 1974. The FSA 1992 effects further, more significant changes.

It is important to note that, while this discussion will confine itself to friendly societies properly so-called, the Friendly Societies Acts cover six classes of entity: friendly societies, benevolent societies, cattle insurance societies, working men's clubs, old people's homes societies and specially authorised societies. It is the operation of the friendly societies as investment entities and in the 21st century as well-marketed financial institutions which are the concern of this section.

28.4.4 Unincorporated friendly societies

In seeking to define these societies it is difficult to do better than to adopt the definition provided in the pre-1992 edition of *Halsbury's Statutes*⁶⁸ in which unincorporated friendly societies were defined as being:

... mutual insurance associations in which members subscribe for provident benefits for themselves and their families, and may be unregistered or registered.

This reflects the genesis of the friendly societies as associations of working men and women from particular geographic areas, typically working in similar trades, organising one with another so as to insure one another against injury, ill-health and so forth. The aims of those societies was to provide 'provident benefits'. The word 'provident' has a dictionary definition of 'preparing for future needs'. The form of preparation was on a social and mutual basis. In the 21st century the slow disappearance of mutual building societies into banks has allowed friendly societies to provide mutual investment opportunities which otherwise do not exist. This form of society is now on the wane since the prohibition in FSA 1992 on any new societies being created and registered in this unincorporated format;⁶⁹ although new branches of pre-existing unincorporated societies can be registered.⁷⁰

The relationship between the members and the society

In general terms a friendly society the relationship of the member of an unincorporated friendly society and the society itself is governed by the law of contract.⁷¹ It should be remembered though that FSA 1974 requires an express trust be created.⁷² Each society is required to have at least one trustee and each branch is also required to have at least one trustee.⁷³ The society itself does not have legal personality and therefore it will be the trustees who will enter into contractual relations with the members *ex officio*. The right of the member during the life of the society will therefore be as a beneficiary under a trust with vested proprietary rights.⁷⁴

⁶⁸ *Halsbury's Statutes*, 1986, vol 19, p 2.

⁶⁹ FSA 1992, s 93(1).

⁷⁰ FSA 1974, ss 12, 15A, 16.

⁷¹ *Re Bucks Constabulary Widows and Orphans Fund Friendly Society (No 2)* [1979] 1 WLR 936.

⁷² FSA 1974, s 24(1).

⁷³ *Re Pilkington Brothers Ltd Workmen's Pension Fund* [1953] 2 All ER 816, [1953] 1 WLR 1084; *Oldham Our Lady's Sick and Burial Society v Taylor* (1887) 3 TLR 472, CA.

⁷⁴ FSA 1974, s 54(1); *Leahy v Attorney-General* [1959] 2 WLR 722.

The nature of the property law relationships between the participants is not as easy as the ordinary law of trusts would suggest. Significantly in relation to friendly societies, the liabilities of the trustees to make investments are restricted. Under the ordinary law of trusts the trustee is required to make the best possible investment return⁷⁵ and to make good any losses personally whether or not fault can be demonstrated.⁷⁶ The trustee of a friendly society, however, 'shall not be liable to make good any deficiencies in the funds of the society or branch, but each trustee shall be liable only for sums of money actually received by him on account of the society or branch'.⁷⁷ Therefore, the liability of the trustee is limited to stewardship of money actually received and not to getting the money in.⁷⁸ However, the statute does remove liability for 'any deficiencies in the funds of the society': which would seem to include investment⁷⁹ and other losses.⁸⁰ While the precise ambit of this provision is unclear, it does appear to constitute an express abrogation of the ordinary principles of the law of trusts. There are also provisions as to the responsibilities of trustees to make available 'proper books of account'⁸¹ and audited materials.⁸²

Furthermore, s 54(1) FSA 1974 provides that:

All property belonging to a registered society shall vest in the trustees for the time being of the society, for the use and benefit of the society and the members thereof and all persons claiming through the members according to the rules of the society.

The class of beneficiaries appears to include the society as well as the members. As is apparent from s 54(1) the rights of beneficiaries are not restricted to the members themselves as beneficiaries but also to any person who can claim through a member 'according to the rules of the society'.⁸³ Therefore, the contractual basis of the rules supplements the ordinary trusts law analysis by allowing for equitable interests to arise not simply on the basis of contribution but also on the basis of express inclusion of other person within the class of beneficiaries. While there is nothing remarkable in saying that a settlor or group of settlors can decide to benefit persons other than the settlors themselves as beneficiaries, it does constitute an extra dimension to the understanding in the ordinary law that the analysis of such societies be based on principles of contract (in the form of the rules of the society) rather than simply on the basis of the allocation of rights in the law of trusts on a basis proportionate to the size of the claimant's contribution.

During the life of the individual's membership it will be the parties' contractual agreement which will govern each person's obligation; after the termination of the society or of the agreement it will similarly be the rules of contract which will govern distribution of assets. The judicial approach to such societies has been to define them as associations based on contract.⁸⁴ Therefore, if this analysis were correct, the member would lose all property rights in money contributed by way of premium payment to the society. The amount of any premium payable would be fixed by the contract between the members. This is the approach which the caselaw has clearly adopted – as considered below in relation to winding up. This aspect of the law relating to unincorporated associations is not straightforward: the reader is referred to the more detailed consideration of unincorporated associations at the end of this chapter.

⁷⁵ *Cowan v Scargill* [1985] Ch 270.

⁷⁶ *Re Massingberd* (1890) 63 LT 296.

⁷⁷ FSA 1974, s 46.

⁷⁸ *Yeates v Roberts* (1855) 7 De GM & G 227, (1855) 3 Eq Rep 830; *Davies v Griffiths* (1853) 1 WR 402.

⁷⁹ FSA 1974, s 46.

⁸⁰ *Cox v James* (1882) Diprose & Gammon 282; *Holmes v Taylor* (1889) Diprose & Gammon, and all trustees are bound: *Avery v Andrews* (1882) 51 LJ Ch 414.

⁸¹ FSA 1974, s 29(1).

⁸² *Ibid*, ss 29–45, as amended and repealed by FSA 1992.

⁸³ FSA 1974, s 54(1).

⁸⁴ *Re Bucks Constabulary Widows and Orphans Fund Friendly Society (No 2)* [1979] 1 WLR 936.

Winding up

Significantly, as emerges from that more detailed discussion later, a member of a mere association does not have any right in any identifiable property attributed to the association on resulting trust principles or otherwise.⁸⁵ Rather, it is the rules of the society, constituting the contract between the members, which is decisive of the issue of the rights of members to the property attributed to the society.⁸⁶ The picture is complicated in relation to friendly societies by the presence of a trustee holding the property both for the society and the members. It is suggested that because both the society and the members are expressed in s 54(1) FSA 1974 as being beneficiaries, that any distribution of funds would be required to be made in accordance with the rules of the society in the same way as if those rules were contained in a trust document. In the absence of any specific provision in the rules dealing with the distribution of the funds of the society, any surplus assets will be distributed among the members then existing in equal parts.⁸⁷ This distribution among the membership as a matter of contract operates to the exclusion of any claim by the Crown as *bona vacantia*.⁸⁸

It is suggested that this modern approach based on the law of contract accords with trusts law thinking and is not merely a displacement of the rules of property with rules based on contract. In the leading House of Lords decision in *Westdeutsche Landesbank v Islington*,⁸⁹ Lord Browne-Wilkinson expressed the view that once money had been transferred on the intention that it was being transferred outright, then title in that property passed to the recipient even if the contract is subsequently held to have been void. In that case it was said that the law of trusts could only be applicable if the recipient had knowledge of some factor affecting the transaction which affected her conscience sufficiently *before the time of the transfer* to require the recipient to hold that money on trust. So, with an unincorporated association, transfer of money by way of premium from a member to the officers of the society under contract does not permit the payer to assert any proprietary rights in relation to any money paid on the winding up of the society. Rather, rights to receive any amount of money or other property would be based on a personal claim arising under contract (that is, under the terms of an association's rules). It would only be if, for example, the officers of the society knew that the society was about to be wound up in such a way that the member would not receive any benefit for the premium paid in the impending winding up that it would be possible for the member to argue that the officers knew of a factor affecting their consciences which entitled that member to have her payment treated as being held on trust and not transferred outright to the association.

28.4.5 Incorporated friendly societies

As considered previously, FSA 1992 introduced a corporate form of friendly society. The process of converting an unincorporated society and the statutory regulation of corporate societies is considered in the following sections.

The process and effect of incorporation

The process of incorporation is set out in s 5 FSA 1992. The society must have objects which comply with those set out in the legislation⁹⁰ whether the provision of annuities, accident or sickness insurance, to provide for funeral expenses or for general benevolent purposes.⁹¹ The society is incorporated from the moment of its registration with the Registrar of Friendly Societies.⁹² A particular regime for the creation and regulation of subsidiaries of friendly societies is contained in the FSA 1992.⁹³

85 *Re Amalgamated Society of Railway Servants, Addison v Pilcher* [1910] 2 Ch 547.

86 *Re Bucks Constabulary Widows and Orphans Fund Friendly Society (No 2)* [1979] 1 WLR 936.

87 *Ibid.*

88 *Ibid.*

89 [1996] AC 669.

90 FSA 1992, s 5(2)(a).

91 *Ibid*, Sched 2.

92 *Ibid*, s 5(3).

93 *Ibid*, s 54.

Subject to what is said below about the powers of the society, the management of the society is to be carried out by a committee of management.⁹⁴ It is also required that there be a chief executive and a secretary appointed to act for the society.⁹⁵ A friendly society has likewise to publish half-yearly statements relating to its finances.⁹⁶ The regime for disqualification of directors relating to ordinary companies is expressly adopted, with some modifications, to apply members of the management committee and other officers of incorporated friendly societies.⁹⁷ There are express, statutory criteria of prudent management imposed on the committee of management, below.

Purposes and powers of an incorporated friendly society

The purposes and objects of the society are those contained in its memorandum.⁹⁸ The categories of purpose which are permissible for registered friendly societies are those set out in Sched 2 to FSA 1992.⁹⁹ The society is also deemed to have any powers incidental to its main objects.¹⁰⁰ The society can adopt benevolent purposes beyond those in Sch 2 to FSA 1992.¹⁰¹ However, as noted above, the reduction of the benevolent activities to an optional extra is a change in the fundamental nature of friendly societies which are now more straightforwardly directed at insurance business.¹⁰² Within the carrying on of insurance business,¹⁰³ the society will also be permitted to make a broad range of investments ranging from acquiring interests in land to investing in securities (provided that is within the terms of the society's constitution).¹⁰⁴

The memorandum then becomes binding on the society, its officers and its members or anyone claiming on behalf of its members.¹⁰⁵ This is not quite the corollary of the rules of the unincorporated society considered above. Any rules of the incorporated society are similarly binding on the members, the society and its officers.¹⁰⁶ Significantly the *ultra vires* rule does not apply to incorporated societies whether as to restriction in the society's memorandum on the powers of the society¹⁰⁷ or in the society's rules imposing a restriction on the committee of management.¹⁰⁸ Having been enacted after the changes effected in ordinary company law by the Companies Act 1989 in removing the *ultra vires* rule in that context, FSA 1992 removes that possible defence in avoiding transactions in relation to incorporated friendly societies. The members nevertheless retain the right to bring actions restricting the activities of the committee of management if those actions are outwith the powers of the society.¹⁰⁹

Winding up and dissolution of incorporated friendly societies

If the society is dissolved, the members entitled to participate in the distribution of assets are prima facie the persons who are members at the date of dissolution.¹¹⁰ However, this common law principle pre-dates FSA 1992.¹¹¹

94 *Ibid*, s 27.

95 *Ibid*, s 28.

96 Companies Act 1985, s 720.

97 Company Directors Disqualification Act 1986, s 22B.

98 FSA 1992, s 7(1).

99 *Ibid*, s 5(2).

100 *Ibid*, s 7(4).

101 *Ibid*, s 10.

102 In general terms a society will be precluded from carrying on commercial business other than insurance business: FSA 1992, s 38.

103 Including group insurance business: FSA 1992, s 11.

104 FSA 1992, s 14.

105 *Ibid*, s 8(1).

106 *Ibid*, s 9(1).

107 *Ibid*, s 8(2)–(5).

108 *Ibid*, s 9(2)–(5).

109 *Ibid*, s 9(6).

110 *Re William Denley and Sons Ltd Sick and Benevolent Fund* [1971] 1 WLR 973.

111 In general terms, the rules for winding up ordinary companies is imported into the law relating to incorporated friendly societies.