

Working with Stakeholders



Nominet Independent Governance Review

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Nominet - Independent Governance Review

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Since 2001, Mutuo has worked to promote new mutuals. This has led to renewed growth in the mutual sector, with public sector mutuals established in health, housing and education and new community based businesses ranging from football to childcare.

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- Campaigning for a better understanding of the benefits of mutual businesses
- Conducting and publishing policy research on issues of importance to the mutual sector
- Developing innovative new mutual businesses for the delivery of public services
- Delivering specialist consultancy services to mutuals
- Providing a Public affairs service for mutual businesses

Mutuo is proud to have the support of its Patrons in this work: Rt. Hon. Gordon Brown MP, Rt. Hon. Lord Naseby and Professor Ian Hargreaves.

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Introduction

Nominet operates at the heart of e-commerce in the UK, running the register of .uk domain names. As such, it is relied upon for the safe, stable and secure management of the .uk Internet name space.

Nominet is a company limited by guarantee, whose members largely comprise organisations from the UK Internet commercial community. It is run as a private “not-for-profit” organisation, without the direct involvement of Government.

Questions have been raised recently about the adequacy of its governance arrangements, and whether they appropriately reflect the interests of parties outside the current membership.

BERR letter

These questions came to a head in September 2008 in a meeting with the Department for Business, Enterprise & Regulatory Reform. This was followed by a letter to the Chairman of Nominet, dated 15th October 2008 from David Hendon, Director Business Relations 2 of BERR. This letter raised the following questions:

- How far do Nominet’s constitution and board structure follow accepted best practice in terms of corporate governance as set out in the combined code?
- How effectively does the company ensure that the directors of the company reflect the wider stakeholder interest?
- In particular, how does Nominet ensure the continued development and evolution of industry self regulation in order to protect wider stakeholder interests?
- What arguments would you employ to convince my Ministers that the present relationship between Government and the company is appropriate in ensuring that public policy objectives in relation to the management of the domain name system and the standing of the UK in the internet community are understood and taken into account?
- Are there any actions that either the company or the Government – individually or together – might take in the short term to address any of the concerns identified in relation to the above questions?

In response, Nominet announced in November 2008 that it had appointed Professor Bob Garratt to lead an independent review of the current corporate governance structure, to be benchmarked against established best practice governance standards.

This Report by Mutuo has been commissioned by Nominet to assist Professor Garratt's review by examining the current and potential future engagement of its stakeholders in the corporate governance of the organisation.

This Report

This Report by Mutuo comprises four Parts.

Part 1 comprises a Discussion Guide, introducing Nominet and its governance, and setting out the issues which arise from the governance.

Part 2 comprises the findings of a stakeholder consultation exercise, conducted by Mutuo's partner organisation Stratosphere Research. It is based on in-depth qualitative research among stakeholders

Part 3 comprises a Comparative Study in which other organisations are considered with a view to examining how they address the issues which Nominet faces.

Part 4 comprises recommendations put forward by Mutuo, based upon the previous three Parts, and the response to the questions posed by BERR.

Limitations

Of necessity, this report has been carried out in a short time-scale. It is mainly based upon information and documentation provided by Nominet, or which are publicly available.

The qualitative research was undertaken in accordance with market research protocol. It is unique to this project and was completed through eight focus groups and 21 individual interviews with stakeholders.

A small number of additional interviews have been carried out with external parties.

About Nominet**1. What Nominet does**

The principal activity of Nominet is the registration and maintenance of .uk domain names. It also runs the technology for Internet traffic which locates a computer on the Internet that is hosting the web site or email system. These activities entail the provision of support, and the operation of a dispute resolution system in connection with the domain names it registers and maintains.

Nominet provides the central registry for internet domain names in the .uk country code Top Level Domain (ccTLD). In this capacity, Nominet is the Top Level Domain operator for the .uk ccTLD. Nominet maintains a registry, or database, containing details of the following Second Level Domains (SLDs): .co.uk, .me.uk, .org.uk, .plc.uk, .ltd.uk, .net.uk and .sch.uk. In addition, Nominet bears overall responsibility for the remaining SLDs in the .uk ccTLD for which day to day maintenance is delegated to third parties.

Nominet's activities are a component part of the global Domain Name System (DNS) which was developed in the early days of the Internet. The DNS provides for the Internet a mapping function between a domain name and its corresponding numeric Internet protocol (IP) address for the computer which hosts that domain name. In order to manage the growing number of domain names being registered, each TLD and ccTLD required its own manager.

The DNS is also an operational look-up mechanism whereby Internet users (via software packages such as Internet browsers or email tools) may enter a domain name as part of a Universal Resource Locator on the world wide web or as part of a complete email address and have it automatically translated into the IP address currently associated with that domain name. Nominet effectively provides the mechanism for the routing of all Internet traffic for .uk domain names.

Background, and authority of Nominet to do what it does

The origins of the Internet lie in a network commissioned in 1969 by the US Department of Defence (DoD) to aid communication among defence contractors, university researchers and the DoD itself. The UK Ministry of Defence (MoD) and the UK research community were also involved at an early stage. Within the UK, there were several academic and defence initiatives for interconnecting computers. Within the UK, Professor Peter Kirstein of University College London was selected initially by the MoD and university users to manage the .uk ccTLD.

The system of organising internet names around the world was originally established and managed by the late Dr Jonathan Postel of the University of

Southern California. He entered into a central database a “Name” relating to each country which signified the person with authority to manage and maintain the domain name space for that country. He did not actively appoint Names, but entered them into his database on the request of the internet community in the relevant country.

In the early 1990s with the growth of the Internet and the increasing commercial use of the network, Professor Kirstein handed over the management of the .uk ccTLD to Dr Willie Black, who was the head of the team operating the extensive Joint Academic Network (JANET) in the UK. The transfer of the management of the .uk ccTLD was approved by the 4 or 5 commercial Internet companies which had then been recently formed in the UK, by the MoD and by the academic and research community who were using the Internet at that time.

In 1994 Dr Willie Black was appointed program director of the United Kingdom Education and Research Networking Association (UKERNA), a “not-for-profit” company which was formed to take over the running of the JANET.

By delegation from the designated manager (Professor Kirstein and then Dr Willie Black), the actual operation of the nameservers for the .uk ccTLD and the process of registration prior to 1996 was carried out by several Internet Service Providers (ISPs) as a voluntary contribution to the infrastructure required for the use of the Internet. None of those organisations received payment for their services nor were any formal contracts in place.

By mid-1995, the exponential growth in knowledge and use of the Internet around the world resulted in a significant increase in numbers of ISPs seeking to register names for companies who wanted to have their names and trademarks made visible on the Internet, as well as for individuals. In response to this and growing pressure to review the voluntary mechanism, a series of consultations was undertaken with the Internet industry in the UK as to how to reshape the domain name registration process within the UK. The outcome was the formation of Nominet to which the responsibility for management of the .uk ccTLD was transferred. This was done by formally announcing it to the local Internet community, and arranging for Internet Assigned Numbers Authority (IANA) to record the change. In early 1996, Dr Willie Black left UKERNA to become Executive Chairman of Nominet.

While there is no global governing body of the Internet, IANA was the body originally responsible for the overall coordination and management of the DNS, including registering designated managers for all top-level domains (such as .uk). The name IANA described a function more than an entity, as it was not formally organised or constituted. In essence, IANA functioned as a contractor of the US Government.

Nominet's authority to administer the .uk domain and host the .uk ccTLD root nameservers has been registered with IANA since 1 August 1996. In 1998, in response to a US Government White Paper, private “not-for-profit” corporation

was created by the Internet community to manage the DNS: the Internet Corporation for Assigned Names and Numbers (ICANN).

As the organisation responsible for the .uk namespace, Nominet is involved in a number of ways with the wider global Internet community.

- It participates in the technical community, for example through the development of Internet standards through the Internet Engineering Task Force, and through RIPE (the European IP Address Registry).
- It has regular contact with its opposite numbers in other nation states, both via ICANN and through CENTR, the Council of European National Top Level Domain Registries.
- It has regular contact with ICANN and many ICANN stakeholders and participants, and its Chief Executive is a member of the council of the country code names supporting organisation (ccNSO) within ICANN. Nominet itself is a member of this organisation.
- It plays an active role in the Internet Governance Forum, and is recognised by HM Government as contributing to a strong UK input into the Forum.

Statutory position

There is no direct grant of authority by the Government to Nominet to carry out its functions. As already explained, it acquired the function by a different route. However, that does not mean that legislation does not impinge upon the carrying out of its activities.

Under the Communications Act 2003, the Office of Communications (OFCOM) has certain functions including in relation to “telephone numbers”. Under Statutory Instrument 2003 number 3281 Telephone Number Exclusion (Domain Names and Internet Addresses) Order 2003, any number which is used as an Internet domain name, Internet address or an address or identifier incorporating either an internet domain name or an internet address, including an email address, is excluded from treatment as a telephone number for the purposes of the relevant parts of the Communications Act 2003.

Currently therefore, responsibility for the registry function and its associated activities (such as dispute resolution) have not been made subject to regulation, and remain the responsibility of Nominet.

The nature of what Nominet does, and how it is described

In its most recent report and accounts (2007), Nominet states that it provides “a public service for the .uk namespace on behalf of the UK Internet community”. What does this mean?

As explained above, the origin of the allocation of responsibility for the management of the domain name space for countries goes back to the 1990s. The functions and responsibilities of designated managers of top level domains were set out in the document entitled "Domain Name System Structure and Delegation" written by the late Dr Jonathan Postel in March 1994. The document is very widely known to Internet administrators by its serial number "RFC 1591". The status of this document is that it provides information, and does not specify an Internet standard of any kind. However, it is regarded as an authoritative statement of the basis on which the Domain Name System was established.

A number of extracts from RFC 1591 are relevant here.

The major concern in selecting a designated manager for a domain is that it be able to carry out the necessary responsibilities, and have the ability to do an equitable, just, honest, and competent job.

1) *The key requirement is that for each domain there be a designated manager for supervising that domain's name space. In the case of top-level domains that are country codes this means that there is a manager that supervises the domain names and operates the domain name system in that country.*

2) *These designated authorities are trustees for the delegated domain, and have a duty to serve the community.*

The designated manager is the trustee of the top-level domain for the both the nation, in the case of a country code, and the global Internet community.

This makes it clear that the designated manager is carrying out its role for the benefit of the global Internet community, who are dependent upon the competent and efficient operation of the Domain Name System, and for the benefit of the nation to whom that country code belongs. The role is a kind of "public service", in the sense that both the country concerned and the global Internet community need the service in order for the Internet to function for their mutual benefit.

As explained, the background of the development of the Internet, was as a mechanism for aiding communication and sharing information. Those involved both in the US and the UK treated the function which Nominet subsequently took over as something to be done on a voluntary or non-exploitative basis. It was not something to be done for private advantage or profit, but for the good of all. (It is fair to point out that some TLDs are operated on a commercial for profit basis, such as .com.)

This premise was enshrined in the Principles and Guidelines for the Delegation and Administration of Country Code Top Level Domains presented by the Governmental Advisory Committee in April 2005. This stated (as a principle) that ultimate public policy authority over the relevant ccTLD rests with the

relevant government or public authority, and that how this authority is exercised is determined by applicable law. By way of guideline, it stated that the relevant government or public authority was strongly encouraged to ensure that the ccTLD is being administered in the public interest, within the framework of its national public policy and relevant laws and regulations.

At the time when Nominet was established, advice was sought from the Department of Trade and Industry (DTI, now BERR) which suggested that Nominet should follow a number of guiding principles, the first of which was that it should be cost, not profit orientated. This advice was followed, effectively continuing the ethos of those who had been responsible for the function before. This subject will be considered further in Chapter 3.

Nominet therefore operates as a provider of a public service for the benefit of Internet users. Its business and funding model is predicated on this, as will be described next.

Summary

- **Nominet is the registry for .uk domain names, and provides associated technology and services relating to this function**
- **It derives its authority to discharge its function from**
 - **the de facto transfer of the registration function (with industry consensus) from those who had done it before**
 - **its registration with ICANN (previously IANA) as the body to host the .uk root nameserver**
 - **the fact that its activities have not been made subject to regulation or direction by Government.**
- **It operates as a provider of a public service for the benefit of the Internet community**

2. How Nominet is owned and funded

Nominet is a company limited by guarantee (without a share capital) whose members are liable to commit up to £10 each if required to do so on a winding up.

As is consistent with an organisation delivering services for the public benefit, its members have no entitlement to receive any benefit from its trade, either by way of distribution of trading profits, or by way of capital distribution on a solvent winding-up. In such event, any capital surplus is to be given or transferred to another institution or institutions having similar objects to those of Nominet, or if none can be found, to one or more charities with particular objects.

In relation to members, the Articles of Association specify as follows:

The Membership shall be made up of the subscribers to the Memorandum and Articles of Association, the members of the Board; and Internet service providers, connectivity resellers, web suppliers and other individuals or organisations with an interest in the operation of the .UK domain, who or which apply for admission, are admitted by the Board, and pay a subscription. (Article 2)

To date, the Board has not rejected any application for membership. In practice, because of the charging arrangements which are described below, membership is primarily of interest to those with a commercial interest in the value of domain names and in the rights connected with such domain names.

Since at least the early 1990s it has been recognised that the buying and selling of domain names is capable of being a lucrative commercial activity. There are two main aspects to this. First, there is an obvious value in owning the domain name (followed by .co.uk) equivalent to your own name or that of your business. Originally, some justification or entitlement was required before a registrant would be issued with a domain name, but since 1995 the registration of domain names has been on a first come, first served basis. There is therefore a potential value in a domain name limited only by what an interested party is willing to pay for it.

Second, as a result of the way that Internet advertising functions (“pay per click”) there is a value based upon the volume of internet traffic visiting the website associated with a domain name. Where that website hosts advertisements, the owner can generate income every time a user accesses another website via the advertisement.

A domain name can be registered direct with Nominet, at a cost of £80. This buys the right to the domain name for a period of two years, at the end of which it can be renewed. However, the need for other technical services to support the registration to enable the registrant to make use of a web-site and email facilities makes it generally unattractive to register direct with Nominet.

(Recently direct registrations are approximately 6 per month, compared with an average of approximately 140,000 per month.) It is more convenient for potential registrants to go to a third party supplier who can sell them a domain name, together with such other support as they may wish to acquire. Those commercial enterprises which are engaged in this line of activity can reduce the cost of registering a domain name by becoming a member of Nominet. Membership of Nominet brings the cost down from £80 per domain name to £5 per name. The cost of membership is a joining fee of £400, and an annual subscription of £100.

These pricing arrangements and the cost of membership result in the membership substantially comprising those individuals or organisations for whom the buying, selling and ownership of domain names are of commercial interest.

There are currently approximately 3000 members. Whilst they comprise a wide variety of interests, the following constitute the most significant:

- Internet Service Providers
- Web-hosting organisations
- Brand-protection organisations
- “Domainers” who buy and sell domain names
- Web-site designers
- Systems interpreters

Business and funding model

In its 2007 annual report and accounts, Nominet describes itself as a “private, not-for-profit company”. This is reflected in its standard term contract with registrants, in the “Fees and payment” section of which it states:

6 We are a not-for-profit organisation so our fees (see our website) reflect the cost of work we do. To make sure that every person who registers a domain name pays their fair share of the costs of running the central registry, we:

6.1 may make a charge for any of the services we provide under this contract, as long as (where only we can provide the service) we believe the fee is set at a not-for-profit cost-recovery level only;

6.2 ...

Since Nominet has no share capital, and its Memorandum and Articles of Association prohibit all distributions to members, the “capital” in its accounts consists of retained reserves – accumulated surpluses resulting from its trading. These are described in its accounts (under conventional accounting standards) as “Profit and loss account”, which at 30th September 2007 stood at £15,483,000. The note to the accounts states that these funds are retained for the continuation of the ongoing operations and for contingencies.

There are currently in excess of 7 million registered domain names, and the number continues to grow reasonably steadily. The annual growth rate at the

end of September 2008 was 13.6%, down on the previous year's rate of 17%. Nominet receives payment for two years in advance, in relation to every registered domain name. In the year to September 07, the renewal rate was 70%. The business underpinning Nominet's income is therefore relatively stable. According to the statistics published by Nominet, globally domain name registrations have grown significantly over the last 5 years (from under 50 million in December 2002 to over 174 million in September 2008).

Nominet has no need to raise any share capital on the basis of its current business and funding model. The balance sheet as at 30th September 2007 included tangible fixed assets of £11,367m, investments of £11.462m, and net current assets of £9.881m including cash at bank of £10.343m. In 2007 it moved into new premises on Oxford Science Park. I has been able to invest significantly in appropriate infrastructure and system scaling and robustness.

Nominet has recently set up a charitable foundation to which it has made a gift of £5m.

Summary

- **Nominet is owned by its members, which mainly comprise commercial organisations with an interest in buying, selling or owning domain names**
- **It derives its income from fees for the registration of domain names**
- **It trades on the basis of seeking to cover costs, not maximising profit**
- **It has a stable business, and a strong financial position**

3. The current governance arrangements

Members

As already stated, admission to membership of Nominet requires completion of an application, payment of a subscription, and admission by the Board (Article 2). Failure to pay the subscription for more than a month after payment becomes due results in the automatic loss of membership (Article 3.5).

The Members of Nominet have the usual roles in a company limited by guarantee, namely to attend and vote (by proxy if they are an individual and so choose – Article 20) at general meetings of the company (Articles 4, 8 and 19); and to approve or appoint certain members of the board (Article 26). Unusually, a resolution proposed at any general meeting has to be approved (except where the Companies Act or the Articles prescribe a different majority) by a two-thirds majority of the votes cast, rather than by the more usual simple majority (Article 13).

In relation to voting, there are the usual provisions for voting on a show of hands unless a poll is demanded or required. On a show of hands, every Member has one vote. Article 19 provides that subscriptions and poll voting rights will be related to the Member's relative commercial involvement in the .uk domain name service, and are to be set by means of bye-laws established in accordance with Article 52.1. Under bye-laws established under Article 52.1, 25% of the total votes are distributed equally amongst the membership, and 75% of the votes are distributed in relation to the number of paid-for domain names on the register linked to individual Members. There are also provisions to put a cap on the size of any Member's voting strength.

With 75% of votes on a poll or in any election being distributed on the basis of the number of domain names registered, this gives significant advantage to members with large numbers of paid-for names. By way of illustration, when the voting formula was applied on a recent vote, the members with the lowest number of votes had 692 votes; those with the highest had tens or even hundreds of thousands of votes, one having nearly 1.4 million votes. The effect of this is that a significant majority of the votes rest with the top 24 members, should they all vote. These voting arrangements, when taken with the registration and membership charges which discourage ordinary Internet users from membership, effectively result in the membership being dominated by those with a commercial interest in the buying, selling and ownership of domain names.

Under Article 19A, the power to change the level of Membership subscriptions or registration fees is effectively reserved to the Members. This provision requires the Board to consult with the Members before making any such change, and it further requires that the consultation is to take place by an electronic ballot, which must require votes for and against each proposed change. The Board is only authorised to implement a change if **at least 75% of the votes cast in the ballot are in favour of the proposed change.**

Effectively, the members retain the power to determine the company's selling price.

In relation to Members' involvement in the appointment of directors, Article 26 provides that the Board shall include four "Non-Executive Directors approved by the Membership". Under this provision, the four non-executive positions are filled by elections conducted using transferable votes, and the weighted voting mechanism referred to above.

Board

Article 26 just mentioned provides as follows:

The Board shall consist of two Executive Directors, of whom one shall be the Managing Director of the Company, and (subject to Article 32), four Non-Executive Directors approved by the Membership ("the appointed Members"). The Managing Director shall be the Chairman of the Board.

Currently, there is a Chief Executive (Lesley Cowley), and a non-executive Chairman appointed by the Board. It is understood that the provisions contained in Article 26 reflected the desired arrangements when Nominet came into existence and Dr Willie Black left UKERNA to become Managing Director and Chairman of Nominet. He was replaced by Lesley Cowley as Chief Executive in 2002. When he subsequently ceased to be Chairman, a decision was taken to recruit an external non-executive Chairman (Bob Gilbert), and the Articles of Association have not been amended to reflect this (proposed amendments have been rejected by the members).

Article 37, as is normal in a company, delegates responsibility for running the company to the Board. It provides:

The Board shall have control over all the affairs and property of the Company, and may exercise all such powers as the Company thinks fit, except as otherwise provided by the Memorandum of Association of the Company and these Articles. In the exercise of its powers, the Board will have regard to any regulations made by the Members (such regulations not to invalidate any prior acts of the Board which would have been valid if the regulations had not been made).

Policy Advisory Body

Aside from the formal governance arrangements contained within the Articles of Association, there is a Policy Advisory Body. This was set up in March 1999, and has its own rules and Code of Conduct. According to its rules, it "represents the interests of the different stakeholders in the .uk Top Level Domain" (Rule 3.1). It operates in addition to the existing executive staff, Board and membership (3.2). It "will develop proposals for policies and rules (as opposed to operational matters), for consideration by the stakeholders

and/or the Board, and consult with interested parties where appropriate. The PAB may discuss matters of its own motion, or matters suggested to it by the Board, membership or public” (3.3). “The decisions of the PAB are not binding on the Board, but the Board will seriously consider them” (3.4).

The PAB comprises up to two non-executive members of the Board, appointed by the Board; eight members elected by the membership; and up to eight appointed persons from organisations (currently CBI, BERR, All Party Parliamentary Communications Group, the Information Commissioner’s Office, the Institute of Trade Mark Attorneys, and the Federation of Small Businesses).

The ccTLD of any country is a legitimate matter of interest or concern for its government. This is clearly recognised in the Principles and Guidelines for the Delegation and Administration of Country Code Top Level Domains presented by the Governmental Advisory Committee in April 2005. The successful operation of registry services and the maintenance of stability in the management of its national domain name-space are matters of national commercial and economic interest. A government also has a legitimate interest for reasons of security of its citizens (especially young people), crime prevention and the maintenance of law and order.

In some jurisdictions, government is directly involved in the management of the domain name. Other than membership of the PAB via a BERR representative, the UK government has no direct involvement in the governance of Nominet. Furthermore, as evidenced most recently by the BERR letter of October 2008, subject to addressing the current concerns about Nominet’s governance, the government is not seeking to change this.

Summary

- **Nominet is a membership-based organisation.**
- **As a result of its voting arrangements and the registration and membership charges, the membership is dominated by those with a commercial interest in the buying, selling and ownership of domain names.**
- **The Board of Nominet has control over all of its affairs and property**
- **A significant qualification to this is that the Members, as well as exercising traditional rights of membership, have to approve any change to membership subscriptions or registration fees**
- **The Board comprises a Chief Executive, a non-executive chairman, and four non-executive directors elected by the members**
- **There is a Policy Advisory Board, containing members and representatives of other important stakeholders**

- **The state has a legitimate interest in the ccTLD; however in the UK, the government has no direct involvement in its management or governance.**

What is corporate governance, and what is its aim?

1. Meaning of corporate governance

“Corporate governance” is concerned with how a corporate entity is organised and controlled.

A corporate entity, such as a company or a mutual society, is an artificial legal person – that is to say, it has no physical existence (unlike human persons), but the law pretends it exists and treats it as if it was a real person. What does this mean?

Every person who is recognised in our legal system is able to own property, enter into contracts, sue and be sued. As individuals, we have legal “rights”, and we can enforce those rights in a court of law because the law recognises us as persons.

The law also recognises corporate or artificial persons. Even though Tesco and Microsoft do not actually exist in the physical world, they and other corporations can go to court to enforce their rights in just the same way as human persons.

However, being an artificial person, a corporation can only act through human agents – people, or groups of people. The constitution of a corporate entity (amongst other things) basically describes those groups of people – who they are (directors, members, shareholders etc.), how you become one of them, and what their roles and responsibilities are. This is necessary so that those involved on the inside of the corporate entity know what their role is; and so that those on the outside know who do deal on behalf of the corporation (who has authority) for particular purposes.

All of this is written down in the constitution (Memorandum and Articles of Association, in the case of a company), and the constitution is the legal document which everyone can rely upon as describing how the corporation works, or how the corporation is governed. In addition to the constitution, different types of corporate entities develop ideas of good or best practice which supplement or go beyond what is written into constitutions. The Combined Code for companies listed on the Stock Exchange; the NHS Foundation Trust Code of Governance for NHS Foundation Trusts, and the Corporate Governance Code of Best Practice for Consumer Cooperative Societies are all examples of this.

2. Separation of ownership and control

At the heart of most corporate entities (including companies, whether limited by shares or by guarantee) is a separation of ownership (by members or shareholders) from control (by those in charge of running the business). In a simple corporation, the founders (members or shareholders) provide in the constitution for responsibility for running the business to be delegated to a smaller group of people, usually referred to as the board of directors. The directors are usually responsible for running the business on behalf of the members.¹ They are rather like trustees of the corporation's assets, and they are required by law to report back to the members every year explaining how they have used the assets (directors' report and accounts). We would say that the directors **have to account**, or are **accountable** to the members.

The board of directors and the members are the two main groups of people (or "organs") involved in the governance of a corporate entity.² Depending on the nature and size of the corporation, there may be other organs which have to be provided for within the constitution.

Most of the powers of a corporation are usually delegated to the board of directors, and the members generally have a limited role to play in governance. In a company where the members are (often passive) investors, their role is usually confined to appointing/electing and removing directors, approving any change to the constitution of the corporate entity, and appointing independent accountants (auditors) whose job is to assure the members that those in charge are telling the truth in their report on the finances of the business. In member-based corporations where members have a role other than as investors, they may play a greater role in the business than traditional investor shareholders, based upon a greater interest and wider relationship with the corporation.

Corporate governance comprises what **all** of the organs of the corporate entity do, not just what the board of directors does. When designing or reviewing corporate governance, it is therefore important to consider **the whole of corporate governance**, not just part of it. Changing part without considering the whole can result in unforeseen consequences, and destabilisation of the very organisation itself.

3. Purpose of a constitution and corporate governance

Corporations are formed or come into existence for a purpose. Companies limited by shares are formed by their promoters to generate a financial return for investors through some form of trade. People form mutual societies as a means of working together to provide a service for themselves and future members. This is effectively the "corporate purpose", or the reason why the corporation exists.

¹ See, for example, Table A article 70 for a private company limited by shares.

² In strict legal terms, it is the **members meeting** which is the organ of the corporation, rather than members individually.

Essentially, corporations are created to own or “hold” some kind of business, in order to deliver the corporate purpose. They are vehicles to hold and run the business, so that the founders and subsequent owners can secure the corporate purpose without being exposed to personal liability if something goes wrong. By creating a separate (artificial) legal person, the founders protect or insulate themselves³ against the commercial risks carried by the business. This is the concept of “limited liability”. It is **the corporation** and not the founders or owners, which owns the assets, enters into contracts, and carries on the trade, and it is therefore **the corporation** which carries the risks.

If the function of the corporate entity is to be the vehicle to hold a business, then the job of the constitution and the corporate governance arrangements is to make that vehicle as effective as possible. The aim is to ensure, as far as possible, that the intention of the founders and the subsequent owners (the corporate purpose) is achieved, through operating a successful business.

Governance arrangements and the constitution are therefore a **means to an end**. The objective is to deliver the corporate purpose by providing a vehicle to run a business.

4. Effective corporate governance

If corporate governance arrangements are to be effective, then they need to meet the needs of the business. This means fulfilling two basic requirements. The first is that responsibility for the business is in the hands of people who have the necessary skills and experience – basically are **competent** to carry out the job assigned to them and competent to operate in the particular commercial environment and cope with the challenges involved. Ensuring competence normally requires **the selection and appointment** of properly qualified people to run the business.

The second requirement is that the people running the business are located within the corporate structure in such a way that ensures that they are appropriately accountable to the owners of the business. This includes such things as the size and composition of the board, the composition and terms of reference of committees/sub-committees of the Board, the power of the owners to appoint and remove the board/managers, and the power of the owners to play an appropriate part (through elected representatives or otherwise) in strategic planning and decision-making for the business.

Overly complex or bureaucratic arrangements, which impede effective and timely decision-making, will make the business less effective. On the other hand, arrangements which do not sufficiently control decision-making expose the organisation to risk, and deviation from its purpose. The governance

³ Except in rare situations where people deliberately use a corporate entity to hide from commercial risks, in which case the law generally does not allow the protection of limited liability to be effective.

arrangements therefore have to achieve a balance, and represent a compromise or settlement between ownership and control.

In finding out the needs of the business, it is necessary to listen to those responsible for the day to day management of the business. They are in the best position to describe or set out the needs of the business. However, it is not **their business**, and they must reach a settlement with those to whom the business belongs. Managers are merely the servants of those who delegated authority to them, and ultimately their job is deliver the objectives of the founders or owners for time being. It is for the owners to be clear about their objectives and the corporate purpose, so that the managers know what they are supposed to be doing.

5. Driving the business

One of the features of **effective governance** is that it does not just provide a corporate vehicle for holding a business; it should actually drive the business forwards, by containing its own mechanism of tension to push the business to be more efficient and successful. This is best explained by example.

The company limited by shares is the most used corporate vehicle in the UK and many other jurisdictions. One of the reasons for this is that it is very effective. Its corporate purpose is to generate a return for investor-shareholders. In a company, the directors know that their job is to maximise shareholder value – to drive the business to be as profitable as possible. If they fail to do so, the shareholders will put pressure on them, and ultimately replace them if they are ineffective (i.e. enforcing **accountability**). In other words, the company contains **tension** within its governance arrangements, and it is this tension which is the mechanism to drive its own efficiency and success. In the design of a company, the corporate purpose, the interests of those for whose benefit the company trades (shareholders) and the power exercisable by shareholders are all in alignment, so that the governance is effective. Consequentially, the model is “self-adjusting” and does not normally need any external agent to ensure that it sticks to or delivers its corporate purpose.⁴ The shareholders will make sure that it does, and the law will back them up.

In many companies limited by guarantee (but not Nominet), by contrast, there is no comparable mechanism to drive efficiency and success. Commonly, the directors are the members of the company. This means that there is **no accountability** within the corporate entity, nobody driving the directors to perform well, or better. The model nevertheless works in some contexts, e.g. charities which wish to incorporate; but here there is an **external** agent to ensure that the corporation sticks to its corporate purpose – the Charity Commission.

⁴ The shareholders fulfil this role. In the event of misbehaviour by directors, the courts will come to the assistance of the shareholders and enforce the corporate purpose.

As a company limited by guarantee but with a substantial membership, on the face of it Nominet appears to contain the mechanism to drive the business to be more successful and efficient. However, it needs to be considered whether the overall design of the governance is effective – that is to say, whether there is alignment between the corporate purpose, the interests of the members and the power exercisable by members.

These issues will be examined in the following chapters.

Summary

- **Corporate governance comprises what *all* of the organs of the corporate entity do, not just what the board of directors does.**
- **Corporate governance is a means to an end: delivering the vision of the founders of the corporate entity (the corporate purpose), by providing a vehicle to run a business, and limit the liability of the owners.**
- **The overarching aim of corporate governance is to establish arrangements which meet the needs of the business by**
 - **Ensuring that those responsible for running the business have the necessary skills and experience to do the job in the particular commercial environment**
 - **Providing a framework of accountability to those for whose benefit the business is run**
- **Effective governance is based upon achieving an alignment between corporate purpose, the interests of those for whom the business is run, and their power.**

Purpose and ownership

1. Meaning of corporate purpose

As previously explained, the “corporate purpose” is the reason why the corporation exists. A company limited by shares exists in order to generate a financial return to its investors. A mutual society exists in order to provide goods and services to its members. The new NHS Foundation Trusts exist in order to provide services (health) to the public.

Broadly speaking, corporations exist either for a private, or for a public purpose.

A company limited by shares (whether it is a private or a public limited company – “public” in that context just means that it can offer its shares for sale to the public) exists for a **private purpose**: namely to trade for the private benefit of its shareholders.

Corporations which exist for a **public purpose** carry on their business for the benefit of the public. Examples include:

- NHS Foundation Trusts, whose principal purpose is to provide health services to the public;
- Charitable corporations, which essentially exist in order to serve the common good;
- Community benefit societies, which are a type of mutual society which are legally required to trade for the benefit of the community, and prohibited from distributing any trading or capital surplus to members.

The corporate purpose is important, because it both defines what the organisation is seeking to achieve, and it sets the context for defining the legal duties of those in charge of the business – usually the directors. Broadly, the directors of a corporation are obliged to follow that purpose in carrying out their duties.

The directors of a company limited by shares would be acting in breach of duty and could be restrained by shareholders if they simply planned to give away money to charity, or use profits for the public good – unless they were doing so in the best interests of the company (i.e. to improve the company’s profitability); or were specifically authorised by the shareholders to do so.

The directors of a community benefit society would be acting in breach of their duty if they sought to offer special benefits to members, which were not available to other members of the community.

It should be noted that certain legal forms – such as the company limited by guarantee, which is the one used by Nominet – can be used for **either a public or a private purpose**. Many charities (i.e. public purpose corporations) are registered as companies limited by guarantee, though this may change with the introduction of a new bespoke corporate vehicle for charities called “charitable incorporated organisations”. The company limited by guarantee can be used for a private purpose as well, such as private clubs or associations which wish to have the benefit of incorporated status in order to limit the liability of the members.

In other words, although companies limited by shares exist for a private purpose, companies limited by guarantee may exist for a private or a public purpose.

2. Nominet’s corporate purpose

What is Nominet’s corporate purpose? It is not explicitly stated in its Memorandum and Articles of Association, but the following extracts from its objects clause suggest from its **intended activities** that it has a public purpose:

3.1 to act as the Network Information Centre for the United Kingdom ...

3.3.2 [to] maintain registers of domain names ...

3.3.4 [to] provide facilities for searching the registers ...

Certain activities in the objects clause are listed under the heading “Public benefit, consultancy educational and other services to improve technology, law and governance”.⁵ These include:

...to fund, promote, or undertake research and development into any area of knowledge, technical development ...or human endeavour, that relates to an area of expertise of the Company or which may be used to further the Company’s objects;

to provide, develop and promote training, education and understanding of ITI, ITR, and the Internet, information technology, computing, dispute resolution and related areas (such as Internet law);

Notwithstanding that these **activities** suggest that Nominet has a public purpose, it has to be recognised that **corporate purpose cannot exclusively be determined by what the corporation does**. This can only be established by looking at **why it carries out those activities** – is it for a

⁵ It should be noted that clause 3.14.1 of the Memorandum specifies that the headings shall be ignored for the purposes of interpretation – i.e. they are not strictly part of the legal document.

public or a private purpose? It is entirely possible to carry on public purpose activities (carrying on research, operating a public register, delivering public healthcare), but for a private commercial purpose. Indeed the objects clause (clause 3) specifically states that the objects “shall be carried out on a commercial basis”. However, it seems reasonably clear from the full wording that what this means is that the objects shall be carried out on a commercial basis, not on a charitable or voluntary one. In the early days of the allocation of domain names before Nominet was formed, time and expertise were given on a voluntary basis, but this was not to continue under Nominet’s regime.

The **purpose** for which Nominet exists is made abundantly clear by clause 6 of the Memorandum. This provides that all of the income and capital of the Company are to be used solely towards the promotion of its objects, and that no part of the income or capital shall be paid or transferred to the members, whether directly or indirectly. The clause goes on to provide that nothing should stop the payment of reasonable and proper remuneration to officers, employees or members in return for any services provided to the Company, or reasonable payments for any other normal activity a company is likely to enter into (borrowing money, renting property etc.).

Clause 6 is backed up by Clause 9, which makes provision for what happens on a solvent winding-up of the Company – namely transfer of any capital surplus to another institution with similar objects, or to a charity or other institution existing in order to conduct research for the public benefit into electronic networking and/or related disciplines and subject areas. All of these provisions have been “entrenched” in the Memorandum, that is to say, there is a provision (clause 4) which says that they cannot be changed unless 90% of the votes cast at a meeting are in favour of the change.

It seems clear, therefore, that Nominet exists for a public purpose, in order to provide a service for the common good, or public benefit, and not for a private purpose. The constitution strives to prevent any private benefit being derived by members.

3. “Not-for-profit”

The phrase “not-for-profit” is commonly used in relation to organisations which are not owned by investor shareholders. It is used by Nominet in its annual report and accounts, in its contractual documentation already referred to (see Chapter 1, paragraph 2.10) and on its website. Some comment is needed in the context of discussing corporate purpose. Whilst the phrase is very commonly used in the UK (in the US “non-profit” is often used), it can be a misleading phrase and is not always helpful.

Any corporation which does not make a surplus or profit (the amount by which income exceeds expenditure) will make a loss. A corporation which consistently makes losses will eventually consume its assets and become insolvent. **Every corporation, therefore, whatever its corporate purpose, must strive to make a profit.** Otherwise, it will not survive, it will be unable

to deliver its corporate purpose and the directors might thereby find themselves in breach of duty.

The phrase “not-for-profit” is used to distinguish an organisation from the vast majority of other businesses which are owned by investors. As already explained, a company limited by shares exists for a private purpose, namely to generate a return for its shareholders. In other words, not only must it be profitable in order to survive and to continue to deliver its corporate purpose (just like any other trading corporation), but ***its very corporate purpose is to generate a profit***. That is why it is in business.

People therefore commonly use the phrase “not-for-profit” in order to say that their organisation is not one of those corporations whose very corporate purpose is to make profits for its owners. The phrase can be misleading because as explained, every corporation (including “not-for-profit” organisations) do strive to make a profit in order to survive. The true sense in which it is “not-for-profit” is that its reason for existence, unlike investor-owned companies, is not to generate a financial return for investors. And so consequently it does not distribute its trading profit or capital surplus to its owners.

It is also an unhelpful phrase, because it only says something about what the organisation ***is not***, rather than what it ***is***; and because it can be taken to imply that there is something “uncommercial” about the organisation.

In relation to Nominet, not only is it commercial and profitable, but it has accumulated reserves (profits) of more than £15 million. Making those profits was not what it set out to do, and they are not currently needed for the business, hence the establishment of the Nominet Charitable Foundation to fund education, research and development initiatives.

Nominet’s aim is set out in the standard terms and conditions (already referred to) contained in its contract with registrants. Under the heading “Fees and payment” it states:

6 We are a not-for-profit organisation so our fees (see our website) reflect the cost of work we do. To make sure that every person who registers a domain name pays their fair share of the costs of running the central registry, we:

6.1 may make a charge for any of the services we provide under this contract, as long as (where only we can provide the service) we believe the fee is set at a not-for-profit cost-recovery level only;

6.2 ...

It is clear from this wording that Nominet trades on the basis of trying to charge the appropriate amount to cover the cost of what it does. Or to put it another way, it does not intend (nor does it strive) to charge an amount which an investor-owned company might charge in the same circumstances in order to generate the best possible return for those investors.

This is a similar approach to the traditional co-operative one, in which the business (village shops originally) strove to bring basic goods and provisions to customers at a fair price, without exploitation. They had to strike a price in order to sell the goods to customers, but they would not know until the end of the trading period whether they had charged the right price. The origin of the traditional co-operative dividend was that if the society had made a surplus (profit) at the year end, it provided the mechanism by which it reimbursed customers, in proportion to what they had spent at the shop, for (effectively) having charged too much.

So Nominet, like the traditional mutual organisations, needs to be commercial and fiscally prudent, to ensure that it generates a surplus year on year in order that it survives and can continue to provide its services; but its fundamental purpose is not to generate profits: it is to provide the service.

4. Ownership

The owners of a corporate entity are the grass-roots members or shareholders. In many corporate entities, a member can sell their stake in the business, or ownership, by selling their shares. Also, in such corporations all of the shareholders together can decide to sell all of the shares in the business, so that the whole business is taken over by a new owner.

In some corporations, the member **cannot** sell their membership, nor can the members collectively sell the business to a new owner. All they can do is resign their membership and take no further part in the activities of the corporation. This is the case with Nominet and its membership (save that membership can be transferred on mergers, incorporation etc.). The members cannot realise any value by disposing of their membership, nor would this be consistent with an organisation which was trading for a public purpose. However, the members are still the owners of the corporation, in the sense that nobody else owns it; it is for the members (and nobody else) to decide whether or not to wind it up, or to change its constitution.

It is important who the owners of a corporation are. Ownership confers certain (usually limited) rights in relation to running the business and determining its future. The shareholders of a private limited company do not want unknown third parties or competitors to become part-owners of their business, and so it is common for the constitution of a private company to contain provisions enabling the current shareholders to retain control, and setting certain barriers to sale of shares to external third parties. Except in special and limited circumstances, a company whose shares are traded on the Stock Exchange cannot prevent external third parties, or a competitor from buying shares. Subject to rules and regulations (including the Takeover Code), a third party can acquire a controlling stake and take over ownership and control of the company.

It is important who the owners are, because at the end of the day it is the owners who seek to ensure delivery of the corporate purpose, by using their

rights of ownership to make sure that those in positions of responsibility deliver that purpose. If they do not, as in the case of directors of a public limited company who fail to deliver the profitability which the members/shareholders expect, then the members can remove them from office and replace them with people more likely to achieve what they want.

In relation to organisations carrying on business or operating for a public purpose, there are essentially two forms of ownership. One option, which could be labelled the “trustee model”, provides for ownership to be ***in the hands of trustees or some surrogate for the public*** for whose benefit the business operates. State-owned businesses are the obvious illustration of this where government itself (central, regional or local) is the owner of the service on behalf of citizens. Charitable organisations are another illustration, where selected individuals are entrusted with “ownership” in order to ensure that the organisation achieves its objectives. In this approach, the “owner” does not own the corporation for their own benefit, but ***on behalf of the public***, for whose benefit the business is conducted. To protect the public interest and create some form of accountability, the owner is therefore required by the law (public accountability, judicial review, charity law etc.) to behave in an appropriate way which ensures that the business is run in the public interest, not in the private interest of the owner.

The other approach is for the ownership to be ***in the hands of the public themselves***. In this approach, which could be labelled the “open membership model”, membership is open to anybody (subject perhaps to some qualification, such as where they live), so that individual members of the public can join, become involved, and speak for and act as owners themselves rather than having somebody else do it for them. In this model, the management are directly accountable to the public themselves for running the service. This is the approach of the traditional mutual organisations (co-operative societies, building societies etc.). It is also the approach adopted by the NHS Foundation Trusts, which pioneer a new form of “public ownership” through the new legal entity which they use, known as a “public benefit corporation”.

The open membership model invariably relies upon a small minority of those entitled to become members actually doing so. However the ***availability of membership*** to all should they choose to exercise it, and the willingness of many people to rely on those who have the time and inclination to join and become involved can result in a responsive form of ownership, which is closer to its customer base than alternative approaches. Its success as a form of ownership really depends upon the extent to which members become actively involved, and put pressure on those responsible for running the business to do so better. This in turn depends upon the organisation being willing to invest in membership, and support member development with human and financial resources

Both the trustee model and the open membership model have their advantages and disadvantages. In the public sector where for several decades state-ownership has been in decline because the state is looking to

move away from the ownership of provision, the state-as-trustee model is therefore diminishing. It remains strong in the charitable sector. The open membership model is more in keeping with contemporary aspirations of engagement, accountability, and openness, and is currently evolving quite rapidly. It is doing so, drawing expressly on the historical models of traditional co-operative and mutual societies.

5. Ownership of Nominet

How does Nominet compare with these different approaches? It purports to have an open membership. As mentioned in Chapter 1, under its Articles of Association, membership of Nominet is open to “Internet service providers, connectivity resellers, web suppliers and other individuals and organisations with an interest in the operation of the .uk domain name”. Admission to membership is subject only to Board approval and payment of a subscription. On the face of it, any person or organisation with an interest could therefore become a member.

In reality however, Nominet’s membership almost entirely comprises those organisations with a commercial interest in the buying, selling and ownership of domain names. The structure of Nominet’s charging arrangements for domain name registrations and for membership subscriptions are relevant here. There is a clear financial incentive to become a member in order to gain the discounted registration fees from which members benefit. However, the membership subscription is £100 per annum (with a £400 joining fee) work strongly against the encouragement of wide public membership. At that cost, it is unlikely that any individual or organisation would become a member unless there was a commercial benefit in doing so.

Furthermore, the voting arrangements for Members (based on the number of domain names registered) act as a disincentive for membership. An individual or organisation might well consider that with these arrangements, their voice (and the voices of others in a similar position) would not be heard, and that the organisation would be dominated by a particular interest group.

The result of these charging and voting arrangements is that Nominet’s membership is its immediate customer base – i.e. those who register the most domain names – rather than a representative body of the public or of Internet users. In other words, Nominet is owned not by the general public or Internet users. Rather, it is owned by its private commercial customers.

Was this intentional? In the early days before Nominet’s existence, as has already been explained commercial organisations were assisting in this function for the public benefit, and indeed without remuneration. Such organisations will doubtless have been amongst the original members of Nominet. However, when Nominet was established with an open membership, whilst members may actually have chosen to behave in a particular way, there is nothing in the constitution of a company which **imposes duties** on a member to act in a particular way, or in accordance with any particular principles or duties.

Furthermore, there is no external requirement from any other source compelling members of Nominet to behave in a particular way. Consequently, the members are free to act in their own interest, as is normal for members of a company.

The result of these arrangements overall is that Nominet is established on the open membership basis described above, but in such a way that broad representative membership is discouraged by the membership fees and charging arrangements. As a result, rather than being owned and controlled by a broad cross-section of interests which together might secure the public interest, it is controlled by a limited group of organisations which have a private commercial interest in the buying, selling and owning of domain names.

Summary

- **Corporate purpose defines why a trading organisation exists, what it is striving to achieve, and what are the duties of those responsible for running it.**
- **Nominet exists in order to provide a public service, for the benefit of the public.**
- **Nominet needs to be profitable in order to be able to continue to provide its service. It does not provide a service in order to generate a profit.**
- **Broadly, there are two forms of ownership for providers of public services:**
 - **The trustee model**
 - **The open membership model**
- **Nominet adopts the open membership model.**
- **However, as a result of its charging and voting arrangements, it is predominantly owned and controlled by its private commercial customers.**

Issues of governance for Nominet

1. Introduction

This chapter will conclude Part 1 of the Governance Review by setting out, in the light of the previous three chapters, a number of irregularities or problems which exist concerning the ownership and governance of Nominet.

Before describing these irregularities, it is important to make a general point. Some organisations function satisfactorily ***in spite of their ownership and governance arrangements***. If the right individuals are in place, with the right motivation, and cause the organisation to deliver exactly what all the key parties desire, then the formal governance arrangements are of less significance. However, such situations are uncommon, they are vulnerable over time to change of personality, and may at any stage struggle to cope with crises, whether of an internal or external nature.

The situation which Nominet finds itself in is that, as illustrated by recent events (e.g. dispute with and resignation of a director, thinly-veiled threats of intervention by Government) the organisation is not functioning satisfactorily. It is appropriate in such circumstances to carry out a governance review, and a decision has been taken to do so. When conducting such a review, it is important to bring out into the open ***all of the serious irregularities or problems*** which appear from a review of the constitutional documents and other relevant evidence. Which of those problems need to be addressed, and the manner in which they are addressed are separate questions, requiring careful consideration and debate in the light of stakeholder analysis, comparison with other organisations and other expert advice. At this stage, the aim is simply to expose the obvious constitutional irregularities.

The following are the main issues to be considered.

Ownership

Nominet exists to provide a public service. However, based on this there is a mismatch with its ownership arrangements, whereby it is owned by its private commercial customers. There is therefore no effective mechanism for ensuring that the management is accountable for delivering services in the public interest.

There is no effective mechanism for developing membership which is representative of wider interests.

Determining charges

Currently under the Articles, the members of Nominet set the subscriptions and registration fees. Setting prices for selling to third parties is properly a board responsibility.

Board structure

There are flaws in the structure of the Board:

- It is dominated by individuals from and elected by its private customer members.
- Under its Articles, it does not have any independent non-executive directors to provide a counterbalance to the executive directors.
- Currently it has a non-executive Chairman, but under its Articles, the requirement is for an executive chairman (managing director).

Other participants

There is no formal role for other participants in the governance. Although there is a Policy Advisory Board which affords some opportunity, this is not formally recognised in the constitution, nor does it have any formal constitutional role.

Although Nominet's activities are excepted from regulation by Statutory Instrument and it is carrying out a public function, there is no recognition in its formal constitution:-

- that it has a formal public responsibility and duties;
- of any formal role for or link with the State or any agency of the State.

Other constitutional matters

There are a number of anomalies or gaps in the constitution, including (not in order of priority):

- The size of majority required to change the constitution;
- The mechanism for removing members of Nominet;
- The quorum for board meetings;
- Conflict of interest at Board level;
- Appointment of Chairman and CE.

There are a number of other areas which could be considered for change or improvement, such as:

- postal voting rather than proxies;
- removal of board members;
- the role of the secretary;

Each of these matters will now be explained in further detail.

2. Ownership

Nominet exists to provide a public service. If the service is indeed to be delivered **for the benefit of the public**, then for the reasons already explained, it would be expected that the ownership arrangements (i.e. who membership is open to, how they are designed to ensure that they are representative of the public), and the Board governance arrangements (see below), would be designed to ensure that the organisation did indeed deliver a service for the benefit of the public.

The current ownership arrangements, as already pointed out, effectively result in a membership comprising those with a private commercial interest in the buying, selling and owning domain names. Whilst such persons comprise an important and significant interest group, they do not represent wider public interests. As well as dominating the membership, the current members control the voting rights, because votes are substantially based on the domain names registered in relation to each registrar.

The charging arrangements and current membership structure provide no incentive to, and actually actively discourage wider representation from the vast range of users of the Internet. Nominet's activities and the way it undertakes them are of potential interest to a wide range of user-groups including such obvious ones as: private individuals, general commercial organisations, academia (education and research), public sector, voluntary and charitable sector, government (central, regional and local).

The ownership of a corporation is of fundamental significance, because the corporation is dependent upon the owners to secure delivery of the corporate purpose – that is the basic function of the owners (compare the role of shareholders of a company limited by shares, or members of a mutual society). In other words, it is important that there is alignment between the corporate purpose, who the owners are, and how the down-stream governance is designed. Without such alignment, there is no effective basis within the organisation to make those with executive responsibility accountable for delivering the corporate purpose.

That alignment does not exist in Nominet's case. It would be expected that, given its public purpose, its ownership would be designed to deliver that purpose. Unless Nominet is to adopt the trustee model of ownership, then

membership of Nominet needs to be realistically open and available to, and actively encouraged amongst a wider population, which together will drive such a public purpose.

That is not to say that those with a private commercial interest in buying, selling and owning domain names do not comprise one of the significant user-groups – clearly they do. They should be appropriately represented, and may even have a particular role to play in certain aspects of the governance. However, it appears to be inappropriate that they should dominate the membership, and, through their voting rights and the current threshold required to change the constitution, be in a position to control the structural development of the company.

3. Determining charges

Currently under the Articles, the members of Nominet set the subscriptions and registration fees. Determining the price at which a business sells its services is a key function of those entrusted with the management of the business. It is not uncommon in federal bodies or trade associations for the general membership to approve the annual subscriptions, but that is because such organisations primarily exist in order to serve their members, and predominantly their trade is with their members. It is therefore sensible in such organisations that the membership should collectively decide what funds they want their organisation to have.

This is not the case with Nominet, which exists to serve the public: it is not a federal body, or trade association. Whilst there may be a substantial overlap between its membership and those with whom it trades directly, that is a function of the field in which it is carrying on business, and the chosen method of operation. In reality, Nominet's customers are **registrants not registrars**. Every registrant has a contract with Nominet, and these are the customers to whom Nominet is actually providing its services. It is more convenient (and significantly cheaper) for those customers (registrants) to deal with Nominet through an intermediary or agent (registrar). But those intermediaries have no legal or moral mandate, nor are they able to speak for or represent those registrants.

Setting prices (registration fees) for selling to customers is properly a board responsibility. Where a board (as in this case) is charged with responsibility for managing the affairs of the company, this requires board control over pricing. Such a function, as with other important responsibilities, has to be carried out in accordance with the legal duties of directors. This ensures that the board remains legally and properly accountable for the decisions it makes in relation to pricing.

Where pricing is reserved in the constitution (as here) to the membership, not only does this partially undermine the Board's control over the affairs of the company. It also places this important decision ***in the hands of those who neither owe any legal duty in making the decision, nor are accountable***

to anybody else for making that decision. It therefore means that there is nothing to stop them **making that decision entirely in their own interests.**

Whether or not pricing decisions have, to date, been made in the public interest or not (no comment is being made on that), for the future it is important that such decisions are made and seen to be made in the appropriate forum, by persons operating under a legal duty to make those decisions properly in the public interest. This is necessary both for the direct public interest in making good decisions about pricing, and the indirect need for the organisation to be credible to third parties, including Government.

Finally in relation to changing registration fees and Membership subscriptions, these can only be changed if at least seventy-five per cent of the votes cast in a ballot are in favour of the proposed change. The requirement for such a high majority, rather than just a simple majority, will tend to result in preservation of the status quo, rather than adaptation.

4. Board Structure

As mentioned above, it is important that the ownership of a corporation is in alignment with the corporate purpose. It is equally important that the governance, in terms of those responsible for managing or overseeing the management of the corporation, is similarly in alignment. What does this mean in practice?

As explained in Chapter 2, if governance is to be effective, it has to meet the needs of the business, which includes two basic requirements. The first is that responsibility for the business is in the hands of people who have the necessary skills and experience – are **competent** to do the job. The second requirement is that the people running the business are located within the corporate structure in such a way that ensures that they are **appropriately accountable** to the owners of the business to ensure that it delivers its corporate purpose..

Competence is usually secured by selecting and appointing individuals to carry out specific executive roles. In substantial organisations, it is also common to recruit and appoint non-executive directors, who have specific commercial experience and expertise for that role. Their role is to be independent of the executive, to be objective, and to challenge the executive in the performance of their duties. A board of a substantial organisation therefore normally comprises professional executives and professional non-executives in order to **secure the competence** to meet the needs of the business.

In membership organisations such as mutual societies, in order to secure **appropriate accountability** of the board, it is normal to provide for specific representation of members at the highest level of decision making. Elected representatives commonly have the right to appoint or remove appointed professional board members, to play a part in determining future plans and strategy, and broadly to use their position to ensure that the organisation

delivers its corporate purpose. ***It is not normal for such elected representatives to be part of the decision-making body responsible for running the business – i.e. to be on the board.***⁶ There are two basic reasons for that.

- First, because of the very process of election, competence (to act as a director of a substantial corporation) cannot be guaranteed. Open elections are designed to secure “representativeness”, not competence. Competence is secured by the appointed part of the governance.
- Second, because elected representatives (by definition) have a direct interest in issues regularly discussed by the body. In other words, they have a systemic conflict of interest. They cannot therefore stand back from everyday decision-making and act, and be seen to act, as independent objective decision-makers.

Elected representatives are not there to make the everyday business decisions. Theirs is a different function, namely to watch over the professionals appointed to run the day to day business; to make sure that they do so in a way that is most likely to deliver the corporate objective, and to play a part in setting the business plans and strategies that the professional management are hired to deliver.

Nominet’s Board is charged by the Articles of Association with having control over all the affairs and property of the Company. Such a job requires the professional competence of appointed executives, and the detached oversight of professional non-executives. The Board currently only has one professional executive on the Board. It has one person (the chairman) who would probably fulfil the description of a professional non-executive, though according to the Articles of Association, the chairman is actually required to be an executive (the managing director).

The majority of the Board (the remaining four individuals) comprise elected representatives of members. For the reasons already given, it is generally inappropriate that elected representatives of members should serve on the main decision-making body with professional executives, let alone comprise a majority. In a membership based organisation, it is clearly appropriate to have elected representatives of members within the governance so that the membership thereby remains in overall control of the organisation, not the executives: but the arrangements need to be such that basic competence to run the business is not compromised.

A particular problem exists if the Chief Executive were to cease to hold office: article 36 provides that in that event, until a replacement was appointed the remaining members of the Board ***would continue to have all of the powers***

⁶ This is discussed further in Part 3. Building societies are one exception to this general point, in that they have a unitary board containing executives and elected non-executives. However, it is not a process of open election for non-executives. Also building societies are subject to supervision and regulation by the Financial Services Authority.

granted to the Board. This means that the Company could be under the control of individuals none of whom (necessarily) had the relevant competence to run the business.

5. Other participants

The primary mechanism for participation in the affairs of a corporation is through membership. It is common (as will be explored in Part 2) to make additional provision in a constitution for significant stakeholders for whom membership is not an appropriate mechanism of participation, to be able to play a part in the formal governance in other ways.

The formal constitution of Nominet (Memorandum and Articles of Association) makes no provision for other stakeholders to play a formal part in the governance. Furthermore, as pointed out, the membership itself is not representative of the wide spectrum of users who regularly use and rely upon the Internet. Broadly, it is dominated by those with a private commercial interest in the buying, selling and owning domain names.

Nominet does make provision for some participation by stakeholders in its affairs via the Policy Advisory Body. However, this body is not referred to in the constitution, and at least in theory it could be ignored by the Board. It would be logical for the body (such as the PAB) representing members in the governance to have a more substantial role, so that it can play a greater part in the overall governance.

The composition of the Policy Advisory Body is itself dominated by members (ten out of eighteen). Furthermore, the rules governing the PAB appear to be subject to the approval of the Board (which is dominated by members of Nominet). These arrangements are not conducive to allowing other voices and constituencies to be heard.

There is one particular omission in this context, and this concerns the role of the state. The activities of Nominet are not currently subject to OFCOM's regulatory remit. In relation to its existing activities, OFCOM has express and clear duties to further the interests of citizens and consumers. Not only are no such duties articulated or contained in the constitution of Nominet, but Nominet uses a legal form which imposes no obligation to carry on its activities for the public benefit (unlike legal forms such as the community benefit society). There is no formal grant of authority by the State or any organ of the state giving Nominet the rights and responsibilities in relation to the public asset comprised in the .uk namespace. Other than through extreme action (such as nationalisation of Nominet), neither the state nor any other party on behalf of the public interest in the UK has any power to force Nominet to act for the public good, or to terminate Nominet's role if it fails to reform.

This in itself would not be a problem, if the ownership of Nominet was broadly representative of those having a legitimate interest in its affairs, and it was

basically designed to act in the public interest. However where this it not the case, this poses a problem for the state.

This problem is recognised in BERR's letter of 15th October 2008. The state has a legitimate interest in the proper guardianship of the public asset (e.g. national economic interest, law enforcement, security). Where the ownership and governance arrangements are not working satisfactorily in what it perceives to be the public interest, something has to be done. The letter seems to imply that there are two options. The first is to deal with "unresolved concerns about how Nominet's structure and constitution addressed its responsibility to stakeholders other than its Membership". Failing this, the alternative option is to ensure that the "relationship between Government and the company is appropriate". This might be taken to refer to other situations where a body is licensed by the state to carry out a particular function in the public interest.

6. Other constitutional matters

The size of majority required for resolutions

Under clause 4 of the Memorandum of Association, no changes can be made to certain provisions in the constitution unless 90% of the votes cast are in favour of the resolution. Whilst it may be appropriate to protect some of the provisions in this way (such as clauses 5, 6 and 9), it seems inappropriate to require such a high threshold to change the objects rule. Such a threshold is generally difficult to achieve, and it is almost at the level used **to prevent change** to a constitution.

In relation to other members' resolutions, article 13 provides that a resolution is approved if at least two-thirds of the votes cast are in favour, unless the Act or the Articles make alternative provision. The normal threshold for an ordinary resolution is a simple majority. Once again, including the higher threshold will tend to make change or evolution more difficult to achieve. This is suggestive of a certain nervousness at the time of establishing Nominet.

The mechanism for removing members of Nominet

It is important in the constitution of a membership based organisation to include effective provisions to enable members who are acting in a way calculated or likely to be damaging to the organisation to be removed from membership. Otherwise, membership can be abused, and the organisation harmed.

Grounds for removal from membership are usually limited to what is needed to prevent damage to the organisation. Subject to the need for proving that the grounds apply, removal should proceed without impediment. Currently article 3.6 requires a resolution of at least 90% of the votes cast at a Members' meeting. A Members' meeting is an inappropriate forum to make such a decision as it is likely to be influenced by factors other than merely establishing the necessary grounds. Furthermore, the high threshold required

is likely to make removal very difficult, even if a member is damaging the company.

The quorum for board meetings

The quorum for board meetings is four, irrespective of who those individuals are. This means that it would be possible for a meeting of the board to proceed without the Chief Executive or Chairman present. Given the composition of the Board, this is inappropriate, save obviously in special situations (for example, where the Board is considering the Chief Executive's performance, or contract).

Conflict of interest at Board

There are no provisions in the Articles of Association addressing conflict of interest. This is of particular concern, given the composition of the Board referred to above. In addition, absence of provisions in the Articles mean that any director having an interest has to disclose it for approval not just to the rest of the board, but to the members in general meeting, which is clearly impractical. Failure to do so puts individual directors at personal risk. The new statutory duty to avoid conflicts of interest (section 175 (1) Companies Act 2006) raises issues which also need to be considered.

Appointment of Chairman and CE

There would appear to be no specific provision covering the appointment of the two executive directors (one of whom is required to be the Chairman and Managing Director). It is assumed that the remaining board members make the appointment

7. Other areas for consideration

Postal voting rather than proxies

In a membership based organisation, postal voting is often considered to be a preferable alternative to proxies, ensuring that members who cannot attend but do not wish to appoint a proxy can nevertheless vote.

Removal of board members

It is common to provide that elected members of a representative body can be removed by the remaining members of the body if they commit a serious breach of an agreed code of conduct.

The role of the secretary

The role of secretary is more significant in a corporation whose governance includes a significant elected element. This is because elected representatives can be at a disadvantage compared to employed executives in terms of their knowledge of the business and affairs of the organisation.

Additional governance provisions are a good idea, and the secretary usually plays an important part.

PART 2 – STAKEHOLDER CONSULTATION

Background and Explanations.

As part of the overall Nominet governance review, Mutuo’s qualitative research partner, Stratosphere, was tasked with conducting in-depth qualitative research among stakeholders.

A discussion guide was developed with input from the Nominet team and formed the basis for the interviews and group discussions that were conducted (Appendix).

All of the qualitative research was conducted in accordance with market research protocol; in particular, respondents were informed that their views would be presented anonymously in the reporting process.

In the report that follows, direct quotations from respondents are in quotation marks and *italics*, and they are attributed to their stakeholder group.

1. Methodology and Sample

The research consisted of a series of focus groups and individual interviews. The latter were partly conducted face-to-face and partly on the telephone.

Macro-Category	Micro-Category	Focus Groups	Individual Interviews	Total People
Users	Brand owners. Super-users. Representatives of industry		3	3
Industry	Top 25 Registrars		5	5
	Normal registrars	1	2	4
	Secondary market (“domainers”)	1	3	5
	DRS Experts	1	0	4
	Brand protection specialists	1	0	6
	Elected PAB members	1	1	4
Influencers	Safety and children’s charities	2		5
Staff	Staff at Nominet	1	8	11
Totals		8	21	47

2. Summary and Conclusions

- Levels of knowledge of Nominet varied according to how central it was considered to people's lives and livelihoods. For some respondents, such as secondary marketers, it was of central importance and thus a subject of close interest. For others it was relatively less important, but important nonetheless.
- In terms of strengths, Nominet was highly regarded for its technical excellence and customer service excellence. It was also seen to be a key "beacon" for the UK Internet industry internationally.
- In terms of weaknesses, some members felt that Nominet was inflexible on issues such as pricing and duration of domain holding.
- A more general weakness was identified as governance, with both specific problems and an element of notoriety resulting from these.
- The key purpose of Nominet was consistently identified as managing the .uk registry space. However, it was also associated with being a major guardian of the Internet in the UK and globally. There was also a view that the role of Nominet had to some extent changed and with the potential to change further; in particular, by embracing new opportunities such as ENUMs.
- There were divergent views about whether this was the right course of action. While senior staff, experts and representatives of industry thought this was the right direction for Nominet as it helped UK plc, there was resistance among some secondary marketers and registrars who felt it should focus on its core, established role of managing the .uk domain space.
- A background theme was that the Internet had changed dramatically since the creation of Nominet, and would change again. Essentially it had become bigger, more mainstream and fundamentally more important.
- A key issue identified was that the governance model of Nominet had not evolved in line with its de facto changed mission and potential new opportunities, with the changed nature of the Internet, and with the fact that the Internet and therefore Nominet is now a "critical piece of the whole Internet in the UK".
- That is, when Nominet was created, the membership based model served to represent the key stakeholders at that time. Now, key stakeholders are identified as being much wider than in the past – including members, staff, registrants, general public/end-users, Government, and the broader Internet community.

- Within this, many identified the most important stakeholder group as the end-users/general public. As non-members their interests are not believed to be represented.
- At the same time, it is believed that one particular group, the secondary market, is over-represented in relation to its relevance as a stakeholder group. This is because they have a high propensity to vote and seek office in elections.
- From the point of view of the secondary marketers, the problem is not so much with themselves, as they actively take part; the problem is that other people do not engage in the process.
- From the point of view of other people, because Nominet is relatively less important, they are less inclined to engage in the election process (or may not be members at all).
- There is clearly a very strong atmosphere of mistrust currently between Nominet staff and the secondary market. There is also mistrust on the part of other informed stakeholders about the secondary market. Views seem to be extremely bitter and entrenched on the part of the secondary marketers especially, with suspiciousness a particular issue.
- Many of the other groups felt that the governance model of Nominet lent itself to “capture” by groups with vested interests, and that though this was always a possibility it had to some extent actually happened in the last two years, and that this was what had caused the problems associated with the organisation.
- Other governance issues identified in the research were the lack of clarity of the chairman’s role (discussed by secondary marketers but also by users and registrars), and the lack of appropriate skills, vision and experience among Board members.
- There was also a strong view from many (registrars, users, experts) that the membership model led to problems around decision making (e.g. on pricing or pursuing new opportunities) due to the need to consult or even gain 75% voting support before proceeding.
- In terms of self-regulation, almost all supported this ideal for Nominet and the Internet in general. It was felt that regulation from Government or active involvement/ownership would be unsuitable as there was not the necessary expertise and that it would result in greater bureaucracy and slower progress when, in the landscape of the fast changing Internet, speed was essential.

- However, it was also understood by many that Government intervention might be needed to resolve the governance problems at Nominet if it was unable to do so itself.
- It was also generally agreed that changes were needed to resolve the problems, and that this would entail changes to the governance model.
- Key objectives, as identified in this research consultation exercise, of any changes would be to:
 1. Re-balance the Board to provide greater representation of the interests of all stakeholder groups.
 - Downweighting or removing sectional interests especially secondary marketers.
 - Representation of the interest of wider stakeholders beyond members.
 2. Increase the specific skill-sets and experience on the Board.
 3. Provide greater strategic vision to help take the company forward.
 4. Increase the effectiveness and speed of decision making.
 5. Provide clarity and accountability around the roles of the Chief Executive and Chairman, including the issue of remuneration.
- The stakeholders we interviewed also put forward specific suggestions as to how these objectives might be met, whilst often making the point that they were not experts in this field themselves. Ideas included:
 1. Appointing more independent directors with broader skill-sets and greater visions. People with experience of wider industry.
 2. Enlarging the Board.
 3. Introducing higher threshold for membership (membership fees, insurances, other qualifications/requirements).
 4. Introducing new consultation or voting methods to encourage greater participation.

3. Main Findings

a. Familiarity with Nominet

All of the sample we interviewed were familiar to some extent with Nominet. However, there were wide variations in exactly how much they knew. Some respondents were extremely well informed: for example, brand protection and DRS experts, PAB members, staff, secondary marketers, and most larger registrars. Other respondents were less familiar with the precise details: examples included safety and security experts, some registrars, and some representatives of industry.

The key issues in terms of levels of familiarity were not so much with what Nominet does as with how it is structured. In particular, whilst everyone we interviewed could provide a definition of the purpose of Nominet, there were variations in how much they knew about issues such as board composition, elections, ownership, and the membership basis of the organisation.

The reasons why some respondents knew more about Nominet than others are essentially to do with perceived self-interest in the context of other activities/concerns in their lives.

Thus, for a secondary marketer whose main business model may consist of creating, buying and selling domain names, interaction with Nominet may be of critical importance and regarded as worth spending time on.

For a security/safety expert with many concerns, the precise workings of Nominet may be perceived as relatively less important.

b. Attitudes towards Nominet: Perceived Strengths

Nominet was renowned for its technical excellence. In particular, respondents noted that as far as they could recall, there had never been major downtime/outages linked to the performance of Nominet.

There was also praise for its involvement in creating technical standards generally and sharing the results with the wider Internet community.

Nominet staff were seen as responsive to requests for help. They could be accessed easily for example on the telephone and were seen as very helpful and good at resolving problems quickly.

“I like dealing with them. I feel very comfortable with them. I imagine it’s quite a laid back place” (Secondary market)

Among respondents such as safety/security, brand protection/DRS experts and industry representatives, there was a sense that Nominet looked to the wider interest and this was positively regarded. This was manifested for

example in giving support and awards for best practice on the Internet and in helping with safety/security issues.

*“We’ve always found Nominet extremely willing to seek and give advice even where life might have been easier if they hadn’t spoken to us”
(Safety/Security)*

Related to this, it was generally felt that Nominet was good at representing the UK at international forums. (N.B. There was some dissent about the desirability of this – discussed in the section on Purpose below).

c. Attitudes towards Nominet: Perceived Weaknesses

Among some members (secondary marketers and some registrars) there was a feeling that Nominet was inflexible. This related in particular to pricing and duration of registrations. For example, some larger registrars felt that they should by virtue of being key customers and thus providers of income to Nominet, be offered more flexible arrangements.

There was a feeling among some that whilst the Internet had changed dramatically in the last decade or so, Nominet had not changed accordingly.

This was linked to a more general area of perceived weakness - that of governance. We will look at this in more detail later in this report but two key themes emerged:

- Problems/dangers associated with the membership model, at least as currently structured.
- Potentially damaging publicity surrounding the organisation as a result of internal conflict.

“They have got a bit of a reputation as a bunch of ferrets fighting in a sack” (Safety/security)

*“Good to present a good image of the UK, like the BBC and the Queen. The trouble in the last eighteen months has been quite damaging”
(Secondary marketer)*

“I don’t want Nominet embroiled in problems like last year. I want them to get away from all this nonsense. All far too emotional” (Registrar)

d. Purpose of Nominet

When asked what Nominet was or what it did, or what its purpose was, almost everyone began with a simple and clear definition based on managing the registry for the .uk Internet space.

This was seen as the core of what Nominet had been involved with since its inception.

However, two other areas also emerged.

The first was that Nominet was seen as one of the major guardians, or perhaps even *the* major guardian, of the Internet in the UK and representing the UK in wider forums.

The second was that Nominet was believed to be looking at other, new opportunities. Examples were running other countries' registries and ENUMs.

An area of debate emerged in terms of whether it was right for Nominet to move beyond its core purpose in these ways.

For some respondents, there was strong support for Nominet's wider role as a "beacon" for the Internet. It was felt that some form of organisation needed to assume this role and that Nominet was both well placed and had done the right thing in doing so.

"It's now become a critical piece of the whole Internet in the UK" (User)

However, some of the secondary marketers felt that this was not what Nominet was for, and that it resulted in the organisation looking beyond the interests of the members, such as themselves.

A similar polarity existed in relation to new opportunities. We found that for example senior staff and some representatives of industry thought that Nominet should pursue ENUMs for example, as they were important to "UK plc".

Again, there was resistance to this among some members including registrars and secondary marketers who felt that it was another indication of Nominet moving beyond the interests of the members such as themselves.

"I get the feeling they want to take it further. We want them to stay focussed, and not get too far away from managing the domain space" (Registrar)

e. Changing Landscape

A theme that emerged was that the Internet landscape had changed a lot over the years, that more changes would come about, and that the pace of such changes would be fast.

A key point was simply that the Internet in general has become much bigger, more important and more mainstream than when Nominet was created in the 1990s.

Whereas at that time it was of importance mainly to an involved, interested minority, mainly from technical backgrounds, now it effectively touches the lives of everyone in the UK.

“I think they did a good job but the landscape has changed and they are ill equipped to deal with it.” (PAB)

f. Ownership of Nominet

There was uncertainty about who owned Nominet.

Some respondents (e.g. PAB members, staff, some secondary marketers and domainers) were able to give the legal basis of the company. That is, Nominet was a ‘Not For Profit limited company.’

Others were less certain and felt that it was nearer to, or perhaps actually, a quasi non-governmental organisation.

Whilst many members felt that as a membership based organisation, they could be seen as the owners, there was also knowledge that they were not shareowners and thus if for example Nominet were sold then they might not benefit.

“Nobody really owns it. I would imagine that if it was wound up it would go to the members. But we’re not shareholders. But .co.uk belongs to the country. Nominet could be replaced.” (Secondary market)

Most revealingly, although the question asked was about who owned Nominet, the answers often quickly moved towards a discussion of who Nominet served and thus in whose interests it should be owned.

“Difficult. The country owns it. It’s a national asset. Although actually it’s a not for profit company owned by its members.” (Registrar)

g. Profit Levels

One aspect of Nominet that appeared to have become somewhat controversial was the level of profits and the donation of some of the profits to a charity foundation.

It was clearly a cause of resentment with members, including registrars and secondary marketers.

Particular grievances were that:

- It was felt that the profits had been accrued due to the monopolistic nature of Nominet’s position in the market and also by the hard work of

the contributing members who had to work hard to achieve sales of registrations.

- Nominet could have or perhaps should consider sharing the profits with the members (although some also felt that this would be a very difficult task as the money should perhaps go to registrants rather than the members themselves).
- Nominet had not consulted widely on setting up the foundation or on which charities for example should benefit.

There was also a definite sense that it was the question of the money that had soured relations between Nominet and some members (both secondary marketers and registrars) and contributed to the atmosphere of mistrust.

The importance of accountability and transparency in relation to the money was seen as particularly important:

“Nominet is very wealthy so you need accountability so it does not become a gravy train” (Brand Protection)

h. Elections and engagement

One key issue is the extent to which members or other stakeholders are currently willing to get involved in elections or other forms of engagement.

We asked some of the member stakeholders whether they had considered standing for office themselves or putting forward colleagues.

The registrars said that although there might be some value in this, they were very busy running their own businesses and could not justify the time commitment entailed.

Indeed, we did interview one large registrar who did not fully understand the fact that voting occurred, and thus had not exercised his company's right to vote.

“Membership should be a cross-section of all. But it's just people who joined to get low cost domain names” (Staff)

“For some individuals it's a hobby which becomes a major part of their life. You need some degree of accountability but perhaps they should be drawn from well-established institutions who are trusted rather than votes where 1% of the membership take part.” (Safety/security)

“I wouldn't say we have a formal relationship. We're happy that it's running well and to let them get on with it. You stick to your knitting” (User)

“It’s a small minority who tend to be active and a small minority who tend to vote. A lot of members I speak to only want to register. They don’t have any interest in any more contact. Only a few are engaged”.
(Staff)

“If everyone voted it would be awesome. The problem is some groups are over-represented – the domainers. It’s not their fault. It’s Nominet’s responsibility to get others to vote. Domainers at least are voting”
(Secondary market).

i. Atmosphere of Mistrust

It was very clear that relations between Nominet and one of its constituent member groups are currently very low, and that this is a significant source of controversy. There is a high degree of tension between the senior staff at Nominet and the secondary market.

Although there were differences of opinions among the secondary marketers, on a number of key points they tended to concur.

At the same time, it should be pointed out that senior staff were not treated as a separate stakeholder group for our interviews. Yet, we are aware of strong differences of perception between senior staff and the views of secondary marketers as expressed to us.

We should therefore emphasise that the points that follow are perceptions we encountered among the secondary marketers interviewed in this review; they do not represent the equally valid viewpoints of the authors or of other stakeholder groups:

1. Secondary marketers felt that Nominet pigeonholes them as domainers when they may often have multi-faceted business interests on the Internet and beyond. For example, also acting as registrars, web development activities, and selling advertising.
2. Secondary marketers felt that Nominet asks members to get involved in voting and standing for elections but is felt to object to the fact that secondary marketers do precisely this.
3. Secondary marketers believed that Nominet sees and presents the secondary marketers as an organised “cabal” whereas they themselves believe that in fact they only have loose ties of interest and often disagree among themselves.
4. Secondary marketers believed that Nominet put company efforts behind rallying votes against candidates seen as representing secondary market interests.

5. Secondary marketers were suspicious of the motivations of senior staff at Nominet and there are fears that they may be acting from self-interest rather than putting members' interests first.
6. Secondary marketers believed that there is suppression of dissent within Nominet. They felt that Nominet resorts too readily to litigation to prevent dissenting views being heard.
7. Secondary marketers saw this as exemplified by legal action taken against a Board member. There was among secondary marketers a suspicion that the departure of a senior executive was similar in nature.
8. Secondary marketers believed that there was insufficient accountability and transparency at the top of Nominet. In particular, lack of clarity about the status of the chairman and his role in remuneration matters.
9. Some secondary marketers linked this to the specific issue about the long term investment plan and the view of secondary marketers that it had not been made open until "discovered".

In the words of secondary marketers themselves:

*"Domainers are seen as the enemy but they are just entrepreneurs."
(Secondary market)*

"They'll do law suits left, right and centre to hush things up. It's getting a little Stalinesque". (Secondary market)

We also found some evidence of the Nominet staff feeling the strain of the relationship with the secondary marketers.

"Having to pander to a bunch of lunatics" (Staff)

"The trouble is, they think what will the stakeholders think rather than what's best for Nominet, and that's made the company very risk averse." (Staff)

"There's a conflict of interest with members who have other drivers than the benefit of .co.uk in mind. They have their own business model and you end up with a small interest group trying to run something and that skews it. It's not even that broad because most members don't even engage. It's just those who shout the loudest". (Staff)

However, concerns about the role of the secondary marketers were not limited to staff.

"We've had some problems of late. No problems two years ago. It's not perfect at the moment. There is a need to put the house in order to protect us. A bunch of people whose only interest is sales of domains

tried to use it for their own purposes against the public interest and against ours". (Registrar)

There was then considerable mistrust of the secondary marketers beyond the Nominet staff. They were defended by some as simply being entrepreneurs. However, others felt that they acted out of self-interest and that their activities actively harmed businesses and thus the country's interests overall.

j. Identification of Stakeholders

When asked who Nominet served, or who its stakeholder groups were, a wide range were identified.

These were:

- Members
- Staff
- Registrants
- Wider public/end-users
- Government
- Internet community e.g. ISPs.

These groups were seen as being in a complex relationship of roles and interests.

Some distinctions were drawn:

- Some groups were "paying" stakeholders – that is, members.
- Some groups were stakeholders but without being aware of the fact - the vast majority of registrants and the general public/end-users.

We explored which were regarded as being the most important stakeholder groups. There was some reluctance to decide upon a most important stakeholder group. This was because:

- All stakeholders have a stake and therefore it was seen as hard or wrong to privilege one group at the expense of others.
- It depended what was meant by "important." Registrars for example pointed out that they were most important in terms of making money for Nominet.

Having said this, ultimately most respondents did make a choice in answer to this question.

Essentially, many registrars tended to see themselves as the most important stakeholder group. This was related to the financial contribution made to Nominet by their businesses.

Overall, though, most other respondents if they chose a most important group tended to opt for the general public/end-users. It was the faith of the end-users in the integrity of the Internet that allowed registrants to conduct business and that allowed other groups such as registrars, staff, and experts to facilitate the process.

Government was also often linked to the end-users as representing their interests in the political process.

k. Protecting Wider Stakeholders' Interests

A key perceived problem with Nominet is that the governance model based on membership is believed to lead to potential and actual under-representation of the wider stakeholder interest.

It was felt by many respondents that the model may well have been appropriate when Nominet was set up, as at that time the Internet was only of real interest to the technical community who were involved in creating it. Thus, a model based on the involvement of members with voting rights by its nature would have involved most of the people affected by the Internet.

However, with the changed landscape of the Internet and in particular the fact that it touches everyone's lives, there were strong views that the model had now out-lived its purposes, at least as currently constructed.

Thus, we have seen that the most widely acknowledged most important stakeholder group, the end-users or general public, are seen as being left out of the governance structure:

- Whilst the Internet is important to them, they also have many other concerns/interests.
- They do not in general know of Nominet's existence.
- They would not have the interest to become members. Nor would they want to pay the membership fees.
- Therefore they do not take part in the election process.

At the same time, some stakeholder groups were seen as over-represented due to the membership structure and the patchy nature of voting.

That is, because Nominet is membership based, elections to the Board result in members being elected. Because voting levels are low, the result is believed to be higher levels of voting among some groups, especially secondary marketers.

An allied issue is that because involvement in or with Nominet is of critical importance to some groups, again especially secondary marketers, they are also regarded as having a higher interest in standing for elections (to PAB or Main Board).

There was discussion about the concept of “capture” in the research sessions. For example, the experts and registrars discussed this. There was a belief that this had always been a possibility given the structure of Nominet. However, it was felt that this had actually happened with the number of secondary marketers being elected to key positions.

Secondary marketers were believed to have become more powerful in recent years partly because they were believed to account for a larger share of .uk domains than previously.

The idea of “capture” was associated with the potential for pushing through or preventing policies or decisions in line with specific or vested interests even though this might conflict with the interests of the wider stakeholder groups.

It is interesting to note the comment of one user who was not familiar with the structure of the organisation:

“As long as they remain impartial, it’s fine” (User)

However, from the point of view of many other respondents, Nominet was open to or perhaps actually had been captured by specific interests and that this was holding back the company. Its impartiality, in other words, could not be guaranteed.

I. Attitudes Towards the Governance Structure

Governance was seen as a key weakness of Nominet by most of the stakeholders we interviewed.

Particular issues that emerged were:

- Imbalance of interest.
- Openness to capture by sectional interests.
- Lack of representation of wider stakeholder interests.
- Low levels of voting in elections.

- Lack of clarity about the role of the chairman (discussed mainly by secondary marketers but also by users and registrars).
- Lack of appropriate skills, experience and vision among Board members based on the elected model.
- Role and responsibility had outgrown the structure

“Not the right model now. It’s grown beyond that. It’s time for change. Well intentioned though it was at the time...with the current structure you can’t guarantee you’ll get people on the Board with any vision....Lucky dip” (User)

“I think they are just responding to market conditions. They were set up with a certain structure which was fine and worked well. But as the Internet evolved, the structure served less well. They responded by trying to improve service and best practice but in my opinion if they want to manage the Internet effectively they are going to have to change the structure (PAB)

“My major criticism of Nominet...is that it is too much run by its members and not sufficiently open to the views of the wider community. It’s not a criticism given the constitution, it’s just that I don’t like the constitution” (DRS Expert).

“The trouble is you hear from the people who shout the loudest and they are not always representative of the wider stakeholder community. Invariably they have hidden interests and agendas” (DRS Expert)

“Something that is so obvious to me working on the frontline, the members won’t push through, because the members can’t see the benefits to the community as a whole...it’s the stagnation it causes” (Staff)

“Nominet has stuck doggedly to the membership principle because they believe it confers legitimacy and breadth of representation. It does in theory but not in practice.” (Brand Protection)

“It’s a collective benign dictatorship under increasing lobbying from domainers who are a blight on the industry” (Registrar)

There was some familiarity with previous attempts to change the structure. Several respondents believed that it was the manner in which the ideas were presented, or the general sense of mistrust, that prevented ratification, as fundamentally the ideas themselves may have been sound:

“Extra directors – they wanted to add two outside elections. It was a good idea but there was a fear they’d appoint their cronies”. (Secondary marketer)

“Tried to make too many changes at once and forgot they were dealing with a cricket club mentality” (Registrar)

m. Decision Making Process (including Pricing)

We asked the respondents who in their opinion was best placed to make key decisions on strategy and other matters for Nominet.

Most respondents felt that issues such as pricing, major strategic decisions and the appointment of key executives below main Board level should be the responsibility of the Board.

The caveats to this were that:

- The Board as currently established was seen as inappropriate due to its perceived lack of specific skills, levels of mistrust (secondary marketers and some registrars), lack of representation of wider stakeholders.
- There is a value in consulting the members, but not perhaps on the current voting basis - their views should be taken into account but not necessarily be decisive.

However, there was a minority, consisting of secondary marketers and some registrars, who felt that the membership should decide on key issues.

It was felt by many that the current governance structure slows down decision making or prevents correct decisions being taken.

“Integral to any business is a good governance structure. Me, I think the Board is quite constrained in what it can do. You can’t please Peter and Paul. Everything has to go to consultation with the members. Like pricing. It’s exceptionally tough to get anything through. You need to plan ahead, anticipate changes, and that’s difficult when it takes six to twelve months to get even a small change” (Staff)

“They are desperately keen to show that they are opening themselves up to the entire community...it lays them open to elements that are fairly hostile and because they have so much independence and integrity it means they give platforms to people with all sorts of axes” (DRS Expert)

n. Self-Regulation

The feedback we received from the research was that self-regulation by the industry and by Nominet was generally seen as a good thing.

The Internet in the UK had grown in a largely self-regulated way, and Nominet had developed accordingly within this.

“I think Nominet’s approach is entirely sensible. Self-regulation is fine for those who want to regulate themselves. Our job is to police the Internet, but they have a legal and moral responsibility to assist us. I think it’s a good regime and they do listen to us. The problem is, if the industry self-regulates efficiently it’ll do the minimum. But if the Government gets involved it’ll be a sledgehammer to crack a nut.”
(Safety/security)

“As far as the secondary market is concerned we have a vested interest to self-regulate. You have to be responsible for your own actions” (Secondary market)

“I think it’s been pretty good, just recent problems. I don’t see how it could change. I don’t think the Government getting involved would make it better”. (Secondary market).

However, there were some dissenting views on this or points on which respondents wanted distinctions to be drawn.

“In the past, it worked well. As time has gone on and Nominet gets devoured by the domainers, less and less well.” (Registrar)

For example, within the safety and security stakeholders, whilst there was a view that self-regulation was fine when dealing with reputable organisations or people it was felt that less reputable people or outright criminals could take advantage of this situation. Therefore, intervention by the authorities, whether termed regulation or not, was sometimes necessary.

“What counts is what works. If the industry can satisfy that they are doing a good job and it’s working fine. But there are a number of areas where it is fraying at the edges.....but who would want Government involvement or civil service involvement unless absolutely necessary?”
(Safety/security)

There was very little appetite among the people we interviewed for more government intervention, for example. The reasons for this were that:

- It was believed that Government did not have the expertise to run a company with Nominet’s responsibilities.
- Government involvement would make Nominet more bureaucratic, more difficult to deal with and slower.
- The Internet landscape could change very quickly and Governmental processes inevitably meant that it would not be able to keep up with the

pace of change needed. (*“The Internet landscape changes every six months or so. Government can’t keep up” - Registrar*)

- In other countries, Government involvement or outright ownership/control was not believed to have produced better managed registries.

However, it was understood by many that if Nominet did not sort out its governance problems, then Government might have to intervene.

Indeed, among larger users a view was expressed that given the importance of Nominet to themselves but also to the UK Internet overall, then if Nominet did not address the issues, major users might be forced to take the issue to Government directly.

The fact that BERR had written a letter to Nominet was fairly well known. It was regarded as a sign of Governmental concern.

A minority (mainly secondary marketers) felt that the letter was in a sense a bluff, a way of helping Nominet forced changes through against the will of members for fear of greater consequences in the form of Government intervention or even total control.

More people however took the letter as a serious sign of the fact that Nominet’s problems were in the public eye, and that this was another reason why change was vital (and welcome).

o. Knowledge of and Attitudes Towards Nom-Steer

Members and staff were familiar with nom-steer. It has a highly controversial reputation.

Nom-steer had its defenders who made points in its favour:

- It was generally agreed that it is useful to have feedback from members and that some form of forum is therefore needed. It was felt that nom-steer to some extent fulfilled this purpose.
- It was a channel of communication and potentially added to the democratic nature of a membership based organisation.
- It was in-house and so could be observed and acted upon if needed.
- It sometimes provided a useful way of highlighting technical issues.

However, many people were horrified at nom-steer and the nature of the debates and comments. Particular points were:

- The hurtful, personal or aggressive nature of comments. It was interesting to note staff's perception that individuals could be perfectly reasonable in conversation but unfair and even spiteful when making contributions to nom-steer.
- Some staff were clearly deeply upset by comments (and without a way of making their own feelings known).
- The very limited number of people who contribute – regarded as the same small number of people who have contributed for many years.
- Petty, irrelevant and low level nature of issues discussed.
- Intimidatory atmosphere characterised by attacks on incorrect protocol and “flaming”
- Time commitment – it was felt that the points under discussion could lead to protracted debates which deterred many (e.g. busy registrars) from taking part.

The net outcome of all of these points is that whatever value a forum for debate could have, nom-steer seems to fall a long way short in the views of most people we interviewed.

As an example of the shortcomings, we interviewed one respondent in the secondary market who said that he often wrote contributions but never posted them for fear of the comments that he would receive back.

“They don’t even agree with each other. They are petty and pathetic and they bicker about everything.” (Staff)

“Sometimes scary, sometimes amusing, sometimes boring....sometimes a bit upsetting for the staff” (Staff)

“I get pretty frustrated with it. But is it ever a good thing to stop people speaking their minds? But it needs moderation” (User)

“You get noisy people, but you live with it. At least you know what people are thinking. I’d therefore leave it in place and wouldn’t have it moderated because some people would see this as censorship” (contributor to Nom-steer)

“I love it. It’s a soap opera. A great mechanism to view their airs (sic). I know it often gets slated and people say stupid things, but we let ourselves down by not responding” (Staff)

p. Knowledge of and Attitudes Towards Policy Advisory Board (PAB)

The existence of PAB was well known among most respondents. The general feeling from the research was that PAB was originally a good idea but that in practice it was somewhat ineffectual. That is, the idea of having a body of advisors that could help the company and the main Board with their experience was seen as potentially a good idea. However, it was felt that there were four particular issues with PAB:

- Not enough of the right kind of people, with the right levels of experience were elected.
- There was a feeling that people stood for self-interest rather than for the good of Nominet.
- Discussions were seen as extremely detailed, perhaps overly so, and quasi-legalistic.
- It was believed to be very time consuming which served to put off people who might otherwise have thought of standing.

“It needs a lot of time and I don’t think it has much teeth” (Secondary market)

“One of the problems.... is that it is very navel gazing” (Safety/security)

“PAB elections? We should really put someone on, but we’re very successful, too busy selling and making their profits” (Registrar)

“We are running large business and don’t see the payback. For us what they talk about at those meetings is irrelevant to our customer base. It’s always about paragraphs” (Registrar)

There was also a sense that PAB was a little cliquey:

“It’s who knows who” (User)

q. Suggestions For Changes To Governance

Because of the problems of the last year, the structural potential for further problems and the need to prevent them in the future, there was a clear and overwhelming appetite for change among the people we interviewed. Although different groups or individuals thought about the problem in different ways, they were in accord that there must be change for the good of Nominet and its stakeholders.

In discussing suggestions for potential changes to the governance of Nominet, we should firstly look at the objectives of change – what respondents hoped change would achieve.

The key objectives that need to be met by any changes were as follows:

1. Re-balance the Board to provide greater representation of the interests of all stakeholder groups.
 - a. Downweighting or removing sectional interests especially secondary marketers.
 - b. Representation of the interest of wider stakeholders beyond members.
2. Increase the specific skill-sets and experience on the Board
3. Provide greater strategic vision to help take the company forward.
4. Increase the effectiveness and speed of decision making
5. Provide clarity and accountability around the roles of the Chief Executive and Chairman, including the issue of remuneration.

Whilst many respondents were keen to stress that it was not within their ability to suggest specific changes to governance, others without necessarily being completely specific were able to put forward ideas for consideration. These included:

5. Appointing more independent directors with broader skill-sets and greater visions. People with experience of wider industry.
6. Enlarging the Board.
7. Introducing higher threshold for membership (membership fees, insurances, other qualifications).
8. Introducing new consultation or voting methods to encourage greater participation.
9. Undertaking a full review of Nomsteer and the PAB to ensure that such organs contribute positively to Nominet

“You need the right skills on the Board and they need to be appointed rather than just elected. And they need the right knowledge to forge the future. The Board needs other parties to help shape the decisions. The representation of business bodies is too narrow at the moment.....you need a balanced Board which has the power to drive the business forward.” (Staff)

Appendix: Discussion Guide

Explain purpose of interview/group. In outline, part of a review to look at the governance of Nominet. Explain that their views will be treated anonymously and that no names will be mentioned in our reporting. Explain need to tape/note the session.

Either ask individual about him/herself or get group to introduce themselves.

Explore how much connection with or knowledge they have of Nominet.

So what is Nominet? How would you describe it? What is its main purpose?

Explore positive and negatives: what is good and what is bad about Nominet?

Who would you say owns Nominet? Explore.

Who would you say it serves?

How does it compare to other types of business or organizations? Is it better or worse, same or different? If so in what ways?

Thinking about the governance structure of Nominet, how familiar with it are you?

How would you describe/categorise it?

How appropriate do you see it for an organization with Nominet's responsibilities?

What are Nominet's stakeholder groups? Explore

What would you say is their role within Nominet?

How appropriate is their role?

Which do you think are the most important stakeholders?

What makes you say that?

How clear would you say your own role is in relation to Nominet (Are members clear about their own role in Nominet?)

What is the purpose of your stakeholder group?

Who do you or your stakeholder group serve?

How appropriate would you say that role is?

If there was a decision about pricing issues that needed to be made, to what extent do you feel you would be able to influence or inform the process? Explore.

Which stakeholders are best qualified to decide:

- Business strategy and planning.
- major business decisions (e.g. pricing)
- Appointment and removal of key executives.
- The role of the secretary.
- Membership matters.

How much accountability would you say there is within the structure?

How well do you think Nominet's self regulation protects....

- Children?
- Business?
- Government?
- Consumers?
-

To what extent do you agree with the following statements...

- As long as the Internet industry is perceived to be regulating itself effectively there is no need for government to take over the role.
- I believe the UK Internet industry acts responsibly towards its customers
- I have no reason to doubt the Internet industry's competence to self regulate
- I believe the Internet industry as a whole has a proven track record of self-regulation

Explain that Nominet have been asked some questions by the government:

- How effectively does the company ensure that the directors of the company reflect the wider stakeholder interest?
- In particular, how does Nominet ensure the continued development and industry self regulation in order to protect wider stakeholder interests.

How do they you feel that Nominet meets these points from the government? What ought to be done?

Thinking about the future, what would you say should be done in terms of governance?

What are the key issues?

What should be done?

Any other points you wish to make?

Staff (can be asked of all but especially staff):

Have you heard of or had dealings with nom-steer? How do you feel about it?

Have you heard of PAB (Policy Advisory Board)? How do you feel about it?

Thank you.

PART 2 – STAKEHOLDER CONSULTATION

‘Trust and confidence in the Internet’ – the Government View

This note is based on an interview with David Hendon, Director, Business Relations in the Enterprise and Business Group at BERR and has been supplemented by extracts from his speech to the Nominet registrar conference, 19 November 2008.

On Nominet generally

Nominet has made a positive impact on the Internet community. It has a standing internationally that is almost without parallel. It is demonstrating to UK stakeholders that it can identify activities where it can promote best practice in the industry to the benefit of all stakeholders.

The challenge now is to ensure that the governance of the company allows it to maintain and develop its leadership role in relation to the Internet industry.

‘I hope that this is not seen as a power struggle but as an opportunity for all stakeholders to reconsider what they want out of the company in terms of the core business and the wider promotion of the UK Internet industry. I hope that we can build on Nominet’s strengths and look forward to creating a firm foundation for an even greater positive impact going forward.’

Nominet provides a public service

Nominet is the registry for .uk domain names, and its purpose is to make them available to all people.

Currently a member based private organisation, Nominet was started in a mutual sense with a public good element, operating for a public purpose.

It can be considered to be a type of public service because if members stopped providing the service, Government would have to act to continue the function.

But an issue for us in Government is that we put a huge amount of effort into understanding the vulnerabilities of the national systems that define life in the UK – finance, energy, water, transport, communications and so on. It is hard to find another example like the DNS where such a vital aspect of the critical national infrastructure is left in the hands of a private company which is unlicensed and unregulated.

I am well aware that the company seriously take the fact that the process of resolving domain names is part of the national infrastructure.

'We regard the effective management of the domain name system and that the company has a wider responsibility to the society in which it operates.'

However, Government is not concerned at all about the particular ownership of Nominet.

It is felt that Nominet should be in the private sector, and Government would rather it was not in public ownership. But it must be run efficiently and not in the interests of a small number of stakeholders who have a business interest in it and who can exploit it.

Comments on Nominet's governance structure

Nominet was established by a group of people running a business in the interest of the wider internet community.

But at the beginning, no one had any idea how important Nominet's role would be to the UK – in fact it is a critical part of infrastructure.

'There seems to be an ongoing process of gradual capture/infiltration of the governance structure by those whose business is to trade domain names. These particular stakeholders appear to want to reduce the already low registration fee so they can register more names with the same amount of capital. This would serve none but their own interests.'

Should the capture of Nominet by such an interest group be complete, Ministers would be incredulous that something as important as Nominet governs itself without external regulation or checks and balances.

BERR recognises that recent internal divisions mean that Nominet is not currently in a good place. It fears that these changes are not in the public interest and that the wider public interest activities of Nominet are under threat.

If everything was proceeding smoothly with no conflict, then there would be no need for the current Government scrutiny – it is the current events in Nominet that have prompted greater BERR scrutiny.

The company has to show that it is run in a way that will guarantee that that all stakeholder interests are taken into account.

This is a key point: whom should Nominet serve? Its members' interests – essentially that of the domain name supply chain? Or those of the wider community that depend on domain names: the "consumers"?

Diversity in the boardroom is an important feature of good governance. Running the .uk domain should not be seen as the petty fiefdom of a clique of

members, and the dominant membership voice on the Board raises immediate concerns about how effective the Board can be in ensuring that Nominet fulfils its public-service mandate, rather than serving the interests of the few.

Recent press coverage of the battles in the boardroom appear to me to support my concern, that there is a lack of understanding of this wider role among some of the Board members.

'I was surprised there seems to be some sort of accepted wisdom emerging that the result of my letter will be that the Government will put someone on the Board of the Nominet. This is certainly not what I am thinking.'

On Domaining

Domaining is a legal business but I am sceptical about the value it brings to the industry or the country as a whole. The whole activity seems predestined to push at the boundaries of what is acceptable in acquiring domain names that will be of legitimate interest to a body or private individual.

It seems patently obvious to me that Nominet should be taking a strong position as the regulator of such activity and if that regulation is dominated by practitioners of domaining, then I think we have a serious problem. This is a clear example of my concerns about whether Nominet's governance model is adequate. But I hope – sincerely – that the review will identify how best the company should reflect the interests of all parties.

Although there are currently no government plans to limit the business of domaining, if there were a new or regulated structure, Government could formalise the arbitration process that is voluntarily available.

'If Nominet were to respond to a Government consultation to ban domainers, what would their response be, and who would influence it?'

In the end, I will be suggesting to Ministers that we want the domain name system in the UK to work for ordinary Internet users and not be tilted towards the interests of a small set of people who seek to make money by buying, sitting on and subsequently selling domain names.

Registry price setting

Nominet's Board must be able to decide on pricing – although there are issues when there is a monopoly and public interest must be considered.

'Is there an acceptable framework for setting policies that impact on the rights and interests of the customers of this supply chain?'

While reducing prices is generally a “good thing”, I have concerns when the people and organisations making the decision stand to benefit significantly from the decision.

While this might benefit individual business models, has there been serious thought given to the wider impact that this might have on the end user?

On Government intervention/regulation

Nominet operates as it does by virtue of the fact that it has been allowed to by the UK Government. This is not the case in other countries.

‘Although many Internet users think the Government should keep out of the Internet, I suggest to you that most ordinary people who just use the Internet like they use the banking system or the trains think that the Government should make sure it all works properly for them and that bad things get stopped from happening.’

The company is more than simply a registry for .uk but also a regulator – in the sense of self-regulation – for the domain name activity in the UK.

No-one expects domain name companies to act as a police force but if there is something that can be done to minimise the availability of domain names to criminals, then you should be looking to do it. As we have found in relation to closing down access to child abuse images, there comes a time when Society can expect business to stand up and be counted.

Continued attacks on the dispute resolution service – a mechanism put in place to protect rights holders from abusive practices in the industry, and in itself a pretty limited effort to show the industry cares about consumer protection – reflect badly on the industry self-governance model.

My sincere hope is that any problems can be resolved by the company for the company. The evidence for that will be in how the company responds to the independent review of its corporate governance.

If there is a real problem in the company meeting its wider obligations to all of its members and its stakeholders, taking into account the wider consumer interests then we may have to take action.

If the ‘domainer’ balance on board meant that the system was loaded in their favour, there would be a need for some Government action.

Traditionally Government has not been bothered about a direct governance role in Nominet or any other service provider. For example, it works with fully private operators – such as BT, where there is no governance role for BERR, but there is an Independent Regulator responsible to Parliament in the shape of OFCOM.

Even if BERR were to take a governance role in Nominet, it would inevitably be a minority stake and probably of little effect.

The State cannot just sit back and let Nominet drift. If forced to do anything, BERR would most be likely to licence Nominet's operations, and take powers to regulate the business.

Achieving primary legislation is easy enough. There would need to be a short domain name bill which would define a licence. OFCOM would then be responsible for managing the licence.

There are well known discussions about a potential new Communications Bill – which the Government is likely to be brought forward before long. This would be an opportunity to take action.

Alternatively, the Government could set up an entirely new registry and tell ICANN that it was the legitimate body.

These options would however be a painful and time consuming process for all and it is preferable that Nominet reforms itself to continue its current role, but in the public interest.

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– the Government View**

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‘Although many Internet users think the Government should keep out of the Internet, I suggest to you that most ordinary people who just use the Internet like they use the banking system or the trains think that the Government should make sure it all works properly for them and that bad things get stopped from happening.’

The company is more than simply a registry for .uk but also a regulator – in the sense of self-regulation – for the domain name activity in the UK.

No-one expects domain name companies to act as a police force but if there is something that can be done to minimise the availability of domain names to criminals, then you should be looking to do it. As we have found in relation to closing down access to child abuse images, there comes a time when Society can expect business to stand up and be counted.

Continued attacks on the dispute resolution service – a mechanism put in place to protect rights holders from abusive practices in the industry, and in itself a pretty limited effort to show the industry cares about consumer protection – reflect badly on the industry self-governance model.

My sincere hope is that any problems can be resolved by the company for the company. The evidence for that will be in how the company responds to the independent review of its corporate governance.

If there is a real problem in the company meeting its wider obligations to all of its members and its stakeholders, taking into account the wider consumer interests then we may have to take action.

If the ‘domainer’ balance on board meant that the system was loaded in their favour, there would be a need for some Government action.

Traditionally Government has not been bothered about a direct governance role in Nominet or any other service provider. For example, it works with fully private operators – such as BT, where there is no governance role for BERR, but there is an Independent Regulator responsible to Parliament in the shape of OFCOM.

Even if BERR were to take a governance role in Nominet, it would inevitably be a minority stake and probably of little effect.

The State cannot just sit back and let Nominet drift. If forced to do anything, BERR would most be likely to licence Nominet's operations, and take powers to regulate the business.

Achieving primary legislation is easy enough. There would need to be a short domain name bill which would define a licence. OFCOM would then be responsible for managing the licence.

There are well known discussions about a potential new Communications Bill – which the Government is likely to be brought forward before long. This would be an opportunity to take action.

Alternatively, the Government could set up an entirely new registry and tell ICANN that it was the legitimate body.

These options would however be a painful and time consuming process for all and it is preferable that Nominet reforms itself to continue its current role, but in the public interest.

Introduction and explanation of selected comparisons**1. Introduction**

Undertaking a comparative study of Nominet's ownership and governance structure requires at the outset the identification of organisations with which it can usefully be compared. At a superficial level, the most obvious source of comparison is likely to be the equivalent organisations in other jurisdictions. Such a comparison will be made, but the way in which other jurisdictions deal with the issues will self-evidently reflect their own commercial and corporate traditions and culture. In addition, these equivalent organisations are of approximately equivalent age (i.e. not very old), and they are similarly dealing with a rapidly evolving field of operation. They are therefore unlikely to reflect a significantly more mature stage of development.

Another approach is to look for organisations undertaking a similar role in the UK. Needless to say, it is not easy to find such organisations. Responsibility for the .uk namespace is hard to compare with responsibility for other public assets, which are usually physical assets (e.g. railway track or reservoirs) rather than intellectual property; or are effectively controlled by government (the register of companies). Nevertheless, some comparison will be made in this field, as it sheds some useful light on issues.

It seems that perhaps the most helpful comparators are to be found by looking at organisations which have some similarities in relation to their form of ownership, and corporate purpose. This needs to be explained.

Ownership and stakeholder participation

At present, Nominet is neither owned by the state, nor by private investors. It sits in that area which, in UK terms is neither the public, nor the private sector. The state (judging by the BERR letter of October 2008) is not particularly attracted to the idea of taking the function into public ownership, apparently seeing merit in what it refers to as the "self-regulatory approach". Certainly Nominet itself, judging by the way it holds itself out, does not seem to be seeking to become an agency of the state. Neither is there any suggestion, emanating from Nominet, its members or government that it should be owned by investors and operated on a profit-generating basis. It is therefore assumed that relevant comparisons should be with organisations which are neither state (publicly) owned, nor investor (privately) owned.

However, as appears from Part 1, its current ownership (dominated by organisations for whom the buying, selling and ownership of domain names are of commercial interest) is not consistent with its public purpose. Not only does it appear from an objective analysis of the organisation, its functions and purpose that the ownership arrangements need to be reconsidered, but it also seems reasonably clear from the BERR letter of October 2008 that unless

they **are reconsidered**, there will be some form of intervention by Government.

An obvious option is to broaden the ownership/membership to include other interests or “stakeholders”, and possibly that other mechanisms should be considered within the constitution for participation by certain stakeholders, other than through membership. Comparisons will therefore be made with organisations which provide for wider participation in the ownership and governance.

Corporate purpose

Nominet exists and carries on business for a public purpose – to provide services for the public benefit. It does so on the basis of full cost recovery. It is not dependant upon state subsidy; nor is it trading in order to generate a financial return to the state or its owners. It needs to be commercial in outlook and fiscally prudent in order to be able to carry on serving the public interest on a long-term basis. Comparisons will therefore be made with organisations which are similarly independent of Government, trading on a commercial basis, but delivering a service in the public, rather than a private interest.

2. Comparisons

On this basis, the following organisations have been chosen as comparisons:

- Homerton University Hospital NHS Foundation Trust
- The Co-operative Group
- Salford Community Leisure
- Network Rail and
- Canadian Internet Registration Authority (CIRA)

A brief introduction to each organisation is set out below, and the reason for their selection is explained and summarised in each case. The individual comparisons are set out at the end of this Chapter.

3. Homerton University Hospital NHS Foundation Trust

NHS Foundation Trusts were created by legislation in 2003, and there are over 100 of them in existence. Originally planned for hospital (or acute) trusts, they now include specialist, mental health, and care trusts. They are a new type of corporation (a “public benefit corporation”), expressly modelled on traditional mutual and co-operative societies, which are at arms length from the state: unlike NHS Trusts which are owned by the state, they cannot be told what to do by the Secretary of State. Their turn-over ranges between about £10m and £600m. They trade, by entering into contracts with commissioners (Primary Care Trusts) under which they provide services for patients. The contracts are legally enforceable, and it is the job of each NHS Foundation Trust to ensure that it can meet legal its obligations. Ultimately, it can become insolvent and fail.

The key information about Homerton is as follows:

- Principal business – Homerton is the local hospital for Hackney, providing hospital services to the local population, and general and specialist care across East London, the City and beyond.
- Annual turn-over – its turn-over in the year to March 08 was £159m
- Number of employees – over 2,200
- Number of members – there were 6,143 in March 08

It has been selected because:

- **It exists for a public purpose**
- **The state has an interest in what it does, and is part of the corporate context, but does not own or control it.**
- **It trades, and so has to be commercial in outlook and fiscally prudent in order to be able to carry on serving the public interest on a long-term basis.**
- **It is owned by the community, via a membership which includes customers (public, patients, and carers) and staff.**
- **It has a representative form of governance, which includes provision for a number of other relevant key stakeholders, and a professional board of directors (executive and non-executive).**

4. Co-operative Group

The Co-operative Group is the UK's largest co-operative society. It used to be the Co-operative Wholesale Society, and as the name implies, was the federal body, owned by the primary retail societies which manufactured or purchased goods on their behalf. In recent years, through mergers with a number of primary societies, it has itself become predominantly a primary society. It still continues to have a federal role, and it hosts the buying on behalf of the movement through Co-operative Retail Trading Group which has separate governance. It also owns CIS (Co-operative Insurance Services) and the Co-operative Bank.

The key information about Co-operative Group is as follows:

- Principal business – it trades in food retail, financial services, pharmacy, travel, funerals and motors. It trades throughout the UK (including some businesses in Northern Ireland). The bulk of its trade is with its individual members. However it operates a bulk

purchasing service on behalf of other societies in relation to both the food retail business and travel.

- Annual revenue in the year to January 08 – £6.5 billion
- Number of employees – approximately 81,000 people
- Number of members – approximately 3,000,000
- Current key developments – it is in the process of acquiring the retailing group Somerfield, and merging with Britannia Building Society.

It has been selected because:

- **Although it does not exist for the same sort of public purpose as the other organisations considered, it exists in order to provide a service, not to generate profits for investors (it does not have any).**
- **It trades in a range of sectors, and has to be commercial in outlook and fiscally prudent in order to be able to carry on serving the public interest on a long-term basis.**
- **It is owned by its members, comprising its customers and staff.**
- **It has a representative form of governance, which includes provision for individual as well as corporate members, for whom it provides “federal services”. It has professional executive management, and is in the process of introducing a limited number of professional non-executives.**

5. Salford Community Leisure

Salford Community Leisure is the entity created when Salford City Council transferred its leisure services department out of Council ownership and control. It was established as a community benefit society, a type of mutual society, increasingly being used for public services when owned by the community. It operates sports centres, swimming pools, fitness centres and community centres. Its income is derived from turn-stile revenue (43%) and from the Council on an output-based contract (44%).

The key information about SCL is as follows:

- Principal business – The principal activity of the Society during the period was the provision of a range of diverse sports and physical activities within the city of Salford which include sports centres, swimming pools, specialist sports facilities, sports development and sports events.

- Annual income –in the year to March 08 was £8.5m
- Number of employees – 550
- Number of members – 260 approx

It has been selected because:

- **It exists for a public purpose**
- **The state (local authority) has an interest in what it does, and has a function within the governance, but does not own and control it.**
- **It trades, and so has to be commercial in outlook and fiscally prudent in order to be able to carry on serving the public interest on a long-term basis.**
- **It is owned by the community, via a membership which includes local community (local residents, and users) and staff.**
- **It has a representative form of governance, which includes provision for a number of other relevant key stakeholders, including local government. It has professional executive management.**

6. Network Rail

Network Rail, through its ownership of Network Rail Infrastructure Limited, is the holder of a network licence, and owns and operates the national railway network. It was established as a membership based organisation (company limited by guarantee) following the failure of Railtrack PLC and took over responsibility in 2002. Its business is now mainly funded by debt. For some time there have been concerns about its ownership structure, claims of a democratic deficit, and problems of accountability. A recent report by KPMG for the Office of Rail Regulation reveals some interesting questions.

The key information about Network Rail is as follows:

- Principal business – Running, maintaining and developing Britain’s tracks, signalling system, rail bridges, tunnels, level crossings, viaducts and 18 key stations.
- Annual income –in the year to March 08 was £5,960 million
- Number of employees – 33,500
- Number of members – 102

It has been selected because:

- **It exists for a public purpose**
- **It trades, and so has to be commercial in outlook and fiscally prudent in order to be able to carry on serving the public interest on a long-term basis.**
- **The state (Department of Transport) has an interest in what it does, and has a function within the governance, but does not own and control it.**
- **It has a membership, from industry and the public.**
- **It has professional executive and non-executive board, with a form of accountability to the membership**

7. Canadian Internet Registration Authority (CIRA)

CIRA took over responsibility for the ccTLD in 2000. Until then, it had been under the control of the University of British Columbia since inception in 1987, and managed for the University by John Demco. CIRA was established as a not for profit Canadian corporation, with a membership comprising registrants.

The key information about CIRA is as follows:

- Principal business – The operation of the dot-ca Internet country code Top Level Domain (ccTLD) as a key public resource for all Canadians in an innovative, open, and efficient manner. Over 1 million .ca domains have been registered. CIRA may carry out other Internet related activities for the Canadian community in a similar manner.
- Annual income – total revenues in the year to March 08 was \$Canadian 9.3 million
- Number of employees – 46
- Number of members – 15,400

It has been selected because:

- **It exists for a public purpose and is carrying out a similar function**
- **The state has an interest in what it does, and has a function within the governance, but does not own and control it.**

- **It trades, and so has to be commercial in outlook and fiscally prudent in order to be able to carry on serving the public interest on a long-term basis.**
- **It is owned by the Canadian internet community, via a membership comprising registrants of domain names.**
- **It has a representative form of governance, which includes a board of directors who are mainly elected democratically, and professional management.**

COMPARATIVE STUDY

Compared features	Homerton University Hospital NHS Foundation Trust
Corporate purpose	The principle purpose of an NHS Foundation Trust is to provide NHS services. It may do other things incidental to that. It therefore exists for a public purpose.
<p>Ownership Who: extent to which they are representative; constituencies; membership strategy; preventing capture</p> <p>What: role within the corporation, and limits; function in relation to purpose; how they drive the organisation</p> <p>How: what motivates them, relationship to the business; their role in driving the organisation</p>	<p>Who – The owners of an NHS Foundation Trust are its members, which come from the following constituencies (in the case of Homerton): public constituencies which are defined geographically and open to anybody living within the area concerned, and a staff constituency. At 31st March 2008, there were 6,143 members, comprising 4,701 from public constituencies, and 1,447 from the staff constituency. The trust is legally obliged to take steps to ensure that its membership is representative of those entitled to become members. This is intended to ensure that the membership is not self-selecting, and that sections of the community which might not otherwise be appropriately represented are targeted to encourage participation. This is achieved through a membership strategy. These arrangements result in a broadly representative membership (gender, age, ethnic and social mix), measured against census data.</p> <p>Capture is not generally an issue, as open membership and the strategic drive for representative membership makes it unlikely that any single group could acquire sufficient influence.</p> <p>What – Membership entitles people to <i>information</i>, <i>voice</i> (through access to and ability to speak at meetings, and contact with their elected representatives), and <i>representation</i> (through direct elections). Members elect their representatives to the board of governors, can stand for election, and have such other rights as the constitution gives them. Generally this includes attending and voting at members meetings. Homerton seeks: to increase the number of active, informed members; to engage the local community through community visits to a wide range of groups and stakeholders; to ensure members receive appropriate communications; and to ensure that it is accountable for its performance to its members. See http://www.homerton.nhs.uk/uploaded_files/About_the_Trust/annual_report_07_08.pdf for further information.</p> <p>How – People generally become members because of an interest in “their hospital”, or in health generally, whether as a patient, carer, relative of a patient, or in some work or professional capacity. There are no commercial membership benefits, and membership has no impact on the care received by a patient. It creates an additional relationship, if an individual chooses to use it. Tax-payers fund the NHS, and NHS funds and membership of an NHS Foundation Trust provides an opportunity to have some say in the local spending of those</p>

	funds.
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Through their elected representatives, and through their opportunities to attend and speak at members meetings, individual members have the opportunity to have their voice heard and influence affairs.

<p><u>Board of Directors</u> Who: the make-up of those in charge; getting competent and efficient management</p> <p>What: extent of role in terms of day to day business, future planning and strategy and how constrained; corporate leadership and disinterested decision-making</p> <p>How: duties they owe, how they are accountable</p>	<p>Who – The board of an NHS Foundation Trust comprises executive and non-executive directors. Executive directors on the board must include a chief executive, finance director, and two directors with medical experience. Non-executive directors include the chairman, and must have an overall majority. Non-executive directors are required to be independent (a code of governance elaborates on this), there are strict rules about how to deal with conflicts of interest, and they generally are brought in because they have significant commercial or other relevant experience. They are typically remunerated in the [£10,000 - £15,000] range. Broadly, the non-executives, including the chairman, are appointed and can be removed by the board of governors (see below); and executive directors are appointed and can be removed by the non-executive directors. Homerton has 5 executive directors, and 6 non-executive directors including the chair.</p> <p>What – Broadly, the board of directors is responsible for running the business. The only formal restraint on their powers is that in drawing up the forward plans, they are required to have regard to the views of the board of governors. This, taken with the Governors’ power to remove non-executive directors, means that in practice, the board of directors works with (and cannot simply ignore) the board of governors. The board of governors, which is mainly elected, is designed (as explained below) to be the directors’ link to members and the community. The directors, by contrast are all appointed, based on their personal skills and suitability for the role. The directors therefore do not owe any allegiance to any particular interest group, and can therefore make professional and disinterested decisions, in the best interests of the Foundation Trust.</p> <p>How – All directors, both executive and non-executive, owe the traditional duties of directors, namely honesty and good faith, a duty to act at all times in the best interest of the Foundation Trust, and a duty of care. All directors are on fixed terms, and subject to reappointment under specified procedures. The board of directors is also required to make an annual report to the board of governors and present it at a public meeting, in much the same way as a company reports to its shareholders. In some trusts, the directors also present some information to members meetings. Directors cannot be removed by members – only as set out above.</p>
<p><u>Representative body (Board of Governors)</u> Who: composition of representative body, and how they get on</p>	<p>Who – The board of governors is the representative part of an NHS Foundation Trust. It must have a majority elected by public and patient constituencies, and a minority comprising: elected representatives of staff, and appointed representatives of a local authority and a primary care trust. It may have additional governors</p>

<p>What: powers it has, in relation to Board, forward planning, strategy etc.; “melting pot”</p> <p>How: the way in which they drive efficiency and accountability, and keep pressure on Board</p>	<p>appointed by partnership organisations which it must name in its constitution. Homerton has 14 elected public governors, 6 elected staff governors, 2 appointed by a primary care trust, one appointed by a local authority, one appointed by each of three partnership organisations which are: the Corporation of London, City University, and Queen Mary College of the University of London.</p> <p>What – The board of governors of an NHS Foundation Trust appoints and removes the non-executive directors including the chairman, it approves their remuneration and allowances, it appoints and may remove the auditor, it receives the annual report and accounts, and it provides its views to the board of directors when they are preparing the forward plans. These are the formal statutory functions. In practice, it is effectively the “melting pot” in which the views of all the relevant interested parties or stakeholders can be taken into account and balanced. Its composition is designed to be representative and reflective of its local community insofar as is relevant to the services it provides. This means that where significant future issues need to be decided by the board of directors, the board of governors can be a debating chamber and sounding board for making those decisions. It effectively acts as a two-way link between the board of directors, and the members in their different constituencies/local community the trust serves.</p> <p>How – The board of governors has the formal, statutory mechanisms referred to above to influence the board and drive the organisation forward, and it also has the regular informal contact with non-executive and executive directors, through which it can influence affairs. There is a constant process of communication, feed-back, and review, through which the two boards relate to each other. The power to remove non-executive directors is the ultimate weapon in the hands of the governors, but which they would not want to use save in extreme circumstances, as frivolous use of it might affect the trust’s continuing operation as an NHS Foundation Trust (see below).</p>
<p>State’s role Nature of State’s interest</p> <p>Relationship with the state</p>	<p>Nature of State’s interest – The Secretary of State for Health has a statutory duty to provide a health service (the NHS). NHS Trusts and NHS Foundation Trusts discharge this responsibility on behalf of the Secretary of State.</p> <p>Relationship with the state – An NHS Foundation Trust is independent of the State. An NHS Trust can only become an NHS Foundation Trust if (a) the Secretary of State supports the application, and (b) if the independent regulator (Monitor) will accept the trust as sufficiently competent and well-organised. Monitor acts as the regulator, and can exercise normal regulatory powers (removing officers, telling the trust to do or not to do things</p>

<p>State role in constitution and governance</p>	<p>etc.) if he thinks that the trust is in breach of its statutory “authorisation”. Monitor is appointed by and accountable to Parliament, and broadly his role is to ensure that NHS Foundation Trusts remain solvent and able to carry out their legal responsibilities. The Secretary of State has no power to tell an NHS Foundation Trust what to do, and how to operate – whereas he can with an NHS Trust. Having said that, the Department of Health sets standards nationally which must be complied with, it is responsible for the commissioning framework within which NHS Foundation Trusts win business, and the pricing for services carried out by NHS Foundation Trusts is also determined centrally, not by individual trusts. Subject to that, an NHS Trust is independent of the State.</p> <p>State role in constitution and governance – The State has no role in the constitution, and no power to interfere in the governance of an NHS Foundation Trust. The regulator can only do so if a trust is in breach of its authorisation. The only residual power of the Secretary of State is in the event of the insolvency of an NHS Foundation Trust, in which case the Secretary of State would have access to the assets needed to continue to deliver the relevant health services.</p>
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<p>How: what motivates them, relationship to the business; their role in driving the organisation</p>	<p>How – Individuals join the society usually as a result of trading with it. Members are entitled to receive a dividend on their trade with the society. The membership proposition seeks to attract members through the opportunity to share in the society’s financial success (dividend), supporting local communities (substantial funds are regularly disbursed by local committees), and changing the world (the society is active in campaigning on a variety of issues concerning social justice). The society strongly promotes its “values and principles”, and through that seeks to attract active members.</p> <p>Corporate members join in order to become entitled to a dividend on their trade with the society, to be part of the co-operative retail family, and to have their say in the running of the Group’s activities, which invariably impinge on their own services.</p>
<p>Board Who: the make-up of those in charge; getting competent and efficient management</p> <p>What: extent of role in terms of day to day business, future planning and strategy and how constrained; corporate leadership and disinterested decision-making</p> <p>How: duties they owe, how they are accountable</p>	<p>Who – The board of the society comprises 20 democratically elected individuals, 15 elected by local area committee members from amongst the members of their regional board, and 5 elected by the corporate members. These elected individuals appoint an executive team, to whom the running of the day to day business is delegated in the constitution. Competence and efficient management are ensured by the appointment of professional executives and managers, and professional non-executives.</p> <p>What – The board does not run the day to day business. It decides the vision and strategy of the society and its businesses in discussion with those responsible for running them. It appoints the executive team, and then it oversees the executives in the implementation of those strategies. Day to day decisions are therefore made by professional executives. Strategic decisions have to be taken by the board</p> <p>How – The board owes the usual legal duties, subject to the fact that it is democratically elected, and not in charge of running the day to day business. The executives (professionals, appointed for their skills and appropriately remunerated to reflect the responsibility they carry) are the ones making the professional management decisions, and providing advice and recommendations to the board about strategic issues and forward plans.</p> <p>The board is accountable to the membership via the democratic structures. With the executives, it reports twice yearly at members meetings, which are attended by delegations from each region and from corporate members.</p>

<p><u>Executive</u> Who: the make-up of those in charge; getting competent and efficient management</p> <p>What: extent of role in terms of day to day business, future planning and strategy and how constrained; corporate leadership and disinterested decision-making</p> <p>How: duties they owe, how they are accountable</p>	<p>Who – The chief executive, other executives and secretary are appointed and can be removed by the board. There are three “subsidiary boards” appointed by the board, which comprise executives, independent non-executives and elected board members.</p> <p>What – The executives are responsible for running the business. The subsidiary boards are responsible for overseeing those parts of the business allocated to them. Future planning and strategy has to be approved by the board.</p> <p>How – Executives and subsidiary boards owe legal duties much like company directors responsible for running a business. The delegation of day to day management to executives ensures that commercial decision-making is not undertaken by elected representatives, who may owe allegiance to a particular geographical constituency. Executives are accountable to the elected representatives of members through serving on the subsidiary boards, and attendance at board meetings.</p>
<p><u>Representative body</u> Who: composition of representative body, and how they get on</p> <p>What: powers it has, in relation to Board, forward planning, strategy etc.; “melting pot”</p> <p>How: the way in which</p>	<p>Who – As already mentioned, as well as the board, the society has regional boards and area committees. It also has Values and Principles Committees at regional and central level.</p> <p>What – Regional boards receive and monitor trading information; they approve certain management decisions such as certain capital expenditure matters and the closure of core trading units in the Region; and they make recommendations to the Board; they also have various democratic functions. Area committees represent Individual Members and promote their participation within the Society; they are local champions, within the society, of those trading with the Society; and they promote Co-operative Values and Principles amongst individual members and the local community.</p>

<p>they drive efficiency and accountability, and keep pressure on Board</p>	<p>How – They do this ultimately through elections, but most of the time by direct contact and dialogue.</p>
<p>State's role Nature of State's interest Relationship with the state State role in constitution and governance</p>	<p>Nature of State's interest – The state has no role or interest in the society's affairs.</p> <p>Relationship with the state – The society has no legal relationship with any organ of the state (other than through regulated activities such as financial services, and normal commercial relationships).</p> <p>State role in constitution and governance – None.</p>

COMPARATIVE STUDY

Compared features	Salford Community Leisure Limited
Corporate purpose	The society's purpose is to trade for the benefit of the community. It enables the community to promote the well-being of its people through healthy recreation and physical activity. It is effectively a provider of public services. http://www.salford.gov.uk/council/corporate/directorates/socialservices/scl.htm
<p><u>Ownership</u> Who: extent to which they are representative; constituencies; membership strategy; preventing capture</p> <p>What: role within the corporation, and limits; function in relation to purpose; how they drive the organisation</p> <p>How: what motivates them, relationship to the business; their role in driving the organisation</p>	<p>Who – Membership is open to anybody over 16 who uses the society's facilities or is interested in sport and leisure (community members) or works for the society (employee members). There are approximately 165 community members and 100 staff members. Capture of the organisation is prevented by the balance of the board which includes representatives through other democratic processes (see below), and membership comprising both users and staff.</p> <p>What – Members can attend members meetings, receive information about SCL, vote in the election of Board Members, seek nomination for serving on the Board, and take part in the other member activities which SCL provides. Each year, there is an annual members' meeting, at which the Board reports on what happened in the latest financial year, presents the forward plans for future years, and at which the results of elections are announced. Additionally, there are occasional special members meetings, to make major decisions about SCL in areas such as making changes to the constitution.</p> <p>How – Sport and leisure are significant in relation to both personal health and well-being, and community. There are significant overlaps with education, healthcare, community safety, and local business. The society's governance and ownership structure are intended to reflect this, and to provide opportunities for participation, for a wide variety of motives, in an area which has significant levels of poverty and deprivation. Motivation is diverse, commonly relating to an individual's life-experience, job, personal health, or leisure activities. SCL has over 40,000 registered users, and has contact with large numbers of young people, through numerous clubs and associations using its facilities. Membership (and board) representation for staff makes them more motivated to ensure that the organisation performs successfully.</p>
<p><u>Board</u> Who: the make-up of those in charge; getting</p>	<p>Who – The board comprises: four community members, of which one is the chair Salford District Sports Council, and three are elected; three employee members elected by employee members; three are members of the local</p>

<p>competent and efficient management</p> <p>What: extent of role in terms of day to day business, future planning and strategy and how constrained; corporate leadership and disinterested decision-making</p> <p>How: duties they owe, how they are accountable</p>	<p>authority's Community Committees, elected by those serving on the Community Committees; two representatives of Salford City Council, including at least one elected member; four persons representing business, health, education and community safety appointed by Salford Partnership; and not more than two co-opted persons (currently a representative of Sport England, and a lawyer specialising in mental health and psychological injury). The Chief Executive is not a member of the Board, but heads a separate management team.</p> <p>What – The board develops and approves the policies, strategies and objectives to be pursued by the Society, and monitors the Chief Executive in pursuing them. The board appoints and removes the Chief Executive and secretary and fixes the terms and conditions of their appointment. Executive responsibility for management of the business is delegated in the rules to the Chief Executive, who is appointed on the basis of professional skills and qualifications to discharge the responsibilities of the role. The board is effectively the “melting pot” in which the views of all the relevant interested parties or stakeholders can be taken into account and balanced. Its composition is designed to be representative and reflective of the local community.</p> <p>How – The board owes the usual legal duties, subject to the fact that it is democratically elected/representative, and not in charge of running the day to day business. The Chief Executive and management team (professionals, appointed for their skills and appropriately remunerated to reflect the responsibility they carry) are the ones making the professional management decisions, and providing advice and recommendations to the board about strategic issues and forward plans.</p> <p>The board is accountable to the membership via elections and the annual meeting, at which the Chief Executive also makes presentation to the members. The Chief Executive is accountable to the board through attendance at all board meetings.</p>
<p>Representative body</p> <p>Who: composition of representative body, and how they get on</p> <p>What: powers it has, in relation to Board, forward</p>	<p>Who – Like the retail co-operative society model, the board is the representative body and ultimately responsible for the society's affairs, but with day-to-day responsibility for running the business delegated to a professional executive which is separate from and does not sit on the board. Unlike the retail co-operative society model, the board of SCL is broadly representative of a wide variety of interest (as described above). In this sense, it is more akin to the board of governors of an NHS Foundation Trust. However, it has significantly more power than the latter.</p> <p>What – As described above.</p>

<p>planning, strategy etc.; “melting pot”</p> <p>How: the way in which they drive efficiency and accountability, and keep pressure on Board</p>	<p>How – As described above.</p>
<p>State’s role</p> <p>Nature of State’s interest</p> <p>Relationship with the state</p> <p>State role in constitution and governance</p>	<p>Nature of State’s interest – The local authority has a legitimate interest in the society’s affairs. SCL was created when the former leisure services department of Salford City Council was “externalised” into direct community ownership via SCL in 2003. The local authority has a continuing interest through its powers and responsibilities in relation to leisure and well-being, as well as through its education responsibilities.</p> <p>Relationship with the state – SCL continues to provide substantial services to Salford City Council on output based contracts (about 44% of its revenues). The Council has two appointed representatives on the board. It has proved to be very successful having both a contractual and constitutional relationship with the Council. It means that the Council’s voice can be heard both as both a major customer but also through other areas of activity where sport and leisure play a significant role.</p> <p>State (local authority) role in constitution and governance – The Council has two representatives on the board. In addition, there are provisions requiring the Council’s consent to change certain limited provisions in the rules – mainly the corporate purpose, objects and powers, and the Council’s representation on the board.</p>

COMPARATIVE STUDY

Compared features	Network Rail Limited
Corporate purpose	<p>The memorandum of association contains detailed provisions in the objects clause for the ownership and operation of a railway network services and stations services, but does not expressly describe the purpose of the organisation. However, clauses 4, 5 and 6 make it clear that no private benefit can accrue to members from the company's trade, and that all resources are to be expended on the objects. Payments to director, officer and third parties must be on a "reasonable and proper basis. From this, it is included that the business is to be conducted for a public purpose.</p> <p>Unlike other corporations covered by these studies, Network Rail is substantially funded by debt funding – of over £20 billion.</p>
<p>Ownership</p> <p>Who: extent to which they are representative; constituencies; membership strategy; preventing capture</p> <p>What: role within the corporation, and limits; function in relation to purpose; how they drive the organisation</p> <p>How: what motivates them, relationship to the business; their role in</p>	<p>Who – Network Rail has industry members, public members and a special member who are selected and appointed in accordance with the policy and procedures set out in the membership policy document. The board reviews and may amend this document. An independent panel, which is appointed by the board, supervises the process for selection and appointment. Members identified through the prescribed process are appointed by the board. Currently there are 26 industry members, 75 public members, and one special member (the Department for Transport). Industry membership (in short) is open to certain categories of licensed operators of services, and preferred bidders for franchises for passenger transport services. Public membership is open to organisations or individuals who are recommended for membership by the membership selection panel. The board also has the power to remove members, but in limited circumstances broadly relating to misbehaviour.</p> <p>The extent to which the members are representative is a function of the procedures and policies established by the board.</p> <p>What – The board is accountable to the members as if they were shareholders, and this is achieved by members receiving regular reports on the business, attending meetings, and approving the appointments and reappointments of directors and auditors. They can also remove directors. Certain transactions with related parties (directors, former directors, connected persons etc.) have to be approved by members.</p> <p>How – Given that the members are selected and appointed, this gives rise to a difficult issue for Network Rail. KPMG were commissioned to carry out a review of membership aspects of its governance. The review revealed</p>

driving the organisation	significant questions about the members, namely: in whose interests should Network Rail members act? How should members be organised? Should members be incentivised to fulfil their role, and if so, how? How should members be selected? What information do members require?
<p>Board Who: the make-up of those in charge; getting competent and efficient management</p> <p>What: extent of role in terms of day to day business, future planning and strategy and how constrained; corporate leadership and disinterested decision-making</p> <p>How: duties they owe, how they are accountable</p>	<p>Who – The Board currently comprises six executive directors, and eight non-executive directors. The Department for Transport has the right to appoint one non-executive director. The licence requires that the board of the licence-holder shall always contain a majority of non-executive directors.</p> <p>What – The board has the normal powers of a board of a company to manage the business and affairs of the company.</p> <p>How – The duties owed by the directors are those normally owed by directors of a company. The articles of association contain extensive provisions concerning conflict of interest, and disclosure of interest. The directors are accountable in the traditional way for a company, namely reporting to the members who appoint/reappoint and have the power to remove them.</p>
<p>Representative body Who: composition of representative body, and how they get on</p> <p>What: powers it has, in relation to Board, forward planning, strategy etc.; “melting pot”</p> <p>How: the way in which</p>	<p>Who – The members are the representative body within Network Rail. However, since there are 102 members, they cannot operate as a representative body in the way as other organisations reviewed.</p> <p>What – No substantial powers other than those referred to above.</p> <p>How – See comments above under Ownership, and what motivates members.</p>

<p>they drive efficiency and accountability, and keep pressure on Board</p>	
<p><u>State's role</u> Nature of State's interest</p> <p>Relationship with the state</p> <p>State role in constitution and governance</p>	<p>Nature of State's interest – Railways form a significant part of a public transport system. From 1948 the railways were under state ownership and control until privatised over the three year period 1994 to 1997. Although it is now in private (i.e. non-state) ownership, its debts are guaranteed by the Government, and it is publicly funded</p> <p>Relationship with the state – In March 1994, the Secretary of State for Transport granted a licence to Railtrack PLC to be the operator of the network. This was a 25 year licence. Since 2003, Network Rail Infrastructure Limited has been the holder of this licence, and its shares are all owned by Network Rail Limited. The Office of Rail Regulation (which is independent of Government) regulates the monopoly, and health and safety.</p> <p>State role in constitution and governance – The Department for Transport is a special member of the company, and within the articles of association has the power to block any changes to the articles which affect the rights of the special member. As special member the DfT has the power to appoint a non-executive director. Subject to any obligations of confidentiality agreed from time to time, this director is permitted under the articles to disclose information received as a director to the Department for Transport.</p>

COMPARATIVE STUDY

Compared features	Canadian Internet Registration Authority (CIRA)
Corporate purpose	<p>The letters patent recording the incorporation of CIRA specify that its objects are to act as the registry for the .ca Internet domain, to provide professional registry services etc.. Nothing express is state about the purpose (whether it is for private or public benefit). The letter patent provide that on a dissolution or winding up, any surplus assets shall be distributed to one or more organisation in Canada carrying on similar activities. This provision for disinterested distribution, together with the form of corporation subsequently contained in by-laws (membership-based, striving to be representative, one member one vote), suggest a public and not a private purpose. This is also consistent with the recitals in the umbrella agreement under which CIRA was designated as the registry.</p>
<p>Ownership Who: extent to which they are representative; constituencies; membership strategy; preventing capture What: role within the corporation, and limits; function in relation to purpose; how they drive the organisation How: what motivates them, relationship to the business; their role in driving the organisation</p>	<p>Who – Membership of CIRA is open to any authenticated registrant with a domain name. Following a membership enrolment drive in 07/08 (which was itself part of a programme of corporate governance reforms aimed, amongst other things, at securing an appropriate balance of representation among the board of directors), membership has increased to 15,400. They vote on a one member one vote basis at meetings and in elections.</p> <p>What – Members have the traditional role, of receiving information, attending and voting at members meetings (which can be held by electronic means), electing representatives and seeking election themselves. A 2/3 majority of members attending and voting at a meeting is required for amendments to the constitution. A similar majority resolution can remove a director from office.</p> <p>How – Registrants are the primary customers of an internet registration service. Although (as in the UK) registrants are more likely to register a domain name via a registrar, they are in practice the customers of the registration service. They therefore have an interest in the operation of the service.</p>
<p>Board Who: the make-up of those in charge; getting competent and efficient</p>	<p>Who – The board comprises 12 elected members, plus the President and CEO, a representative of Government, and another individual who sit on the board as ex officio, non-voting directors. The elected directors are elected annually, online. 9 of the 12 are elected by members from a slate of Nomination Committee candidates, and 3</p>

<p>management</p> <p>What: extent of role in terms of day to day business, future planning and strategy and how constrained; corporate leadership and disinterested decision-making</p> <p>How: duties they owe, how they are accountable</p>	<p>from a slate of members' candidates. The recent program of corporate governance reforms aimed, amongst other things at securing a representative board. The board appoints the Nomination Committee, and in doing so shall strive to ensure that its membership is at all times representative of the diverse constituencies, interest and make up of the Canadian population. One third of the committee is to comprise individuals who work for government, non-governmental organisations, not-for-profit and charitable organisations, educational institutions and other institutions of a public or quasi-public nature.</p> <p>Competence is ensured by the appointment of a professional chief executive officer in charge of running the business.</p> <p>What – Under the by-laws, the board manages the business and affairs of the corporation. The by-laws also expressly provide for the president, who is the chief executive officer for the corporation, to be responsible for the general and active management of the affairs of the corporation.</p> <p>How – The duties are comparable to the position for an English company. By a 2/3 resolution of members attending and voting at a meeting, a director can be removed from office.</p>
<p><u>Representative body</u></p> <p>Who: composition of representative body, and how they get on</p> <p>What: powers it has, in relation to Board, forward planning, strategy etc.; “melting pot”</p> <p>How: the way in which they drive efficiency and accountability, and keep</p>	<p>Who – There is no separate body – the board is effectively the representative body within the governance. The Nominations Committee is intended to be representative, presumably to make it more likely that the slate of candidates for the board will itself reflect a wider perspective.</p> <p>What – N/a</p> <p>How – N/a</p>

pressure on Board	
State's role	
Nature of State's interest	Nature of State's interest – Like any state, it has a commercial and economic interest in the competent operation of the registry function for the .ca name space. It also has a legitimate interest from a point of view of the security of its citizens (particularly young people), crime prevention and the maintenance of law and order.
Relationship with the state	Relationship with the state – Under an umbrella agreement in 2000, the Government designated CIRA to have responsibility for the .ca domain space. The Government has the power to terminate the arrangement in limited circumstances.
State role in constitution and governance	State role in constitution and governance – The Government has a representative on the board, who is ex officio and non-voting.

Making some comparisons, drawing some conclusions

1. Approach in making comparisons

In this chapter, the organisations identified will be used to make comparisons with Nominet in two basic areas:

- the way in which the ownership relates to the corporate purpose; and
- the way in which the professional management team is located within a democratically accountable framework.

The first area is basically concerned with the question: for an organisation carrying out this (i.e. Nominet's) particular public service, what are the most appropriate ownership and stakeholder engagement arrangements? The second area is basically concerned with the question: how do you combine competent professional management, in this particular instance, with effective representative governance?

These two questions are topical for any membership organisation which is striving to improve and be more successful at delivering its objective. They are also highly topical questions across the public sector with the continuing exploration and development of forms of ownership other than traditional investor ownership.

When existing membership organisations ask these questions, they are invariably unsettling for those already involved at any tier of the existing governance, whether as members, elected representatives, or appointed officers (the incumbents), because they raise the possibility of unknown change, which may affect them personally. In order that the process of asking the questions, answering them, and taking appropriate steps consequential on those answers should not be distorted by such concerns, a number of guidelines can be helpful.

First, it needs to be clear that the process is designed to establish (and must stick to pursuing) ***what is in the best interests of the organisation*** in terms of achieving its fundamental objective or purpose.

The second point is that if it turns out that any changes are appropriate, a practical and deliverable transition mechanism for achieving those changes needs to be worked out.

Finally, it is important to recognise that where individuals are personally affected by the process of change, it may be appropriate, both as a matter of fairness and as a matter of securing their support to implementing any

changes, that there should be a period of transition which gives them some temporary protection, and time to adapt to changed circumstances.

The last two points are therefore transition issues. The first one, however, is a permanent one. The starting point has to be clarity about the purpose for which the organization exists, and that was addressed in section 2 of Chapter 3, Part 1. It concluded that Nominet exists for a public purpose, in order to provide a public service, that that is what its founders intended; and that they also intended that the public purpose should not be changed. That is the basis upon which the comparative organisations will be examined.

2. Corporate purpose and ownership/membership – introduction to comparisons

Corporate purpose and ownership are closely inter-linked in the design of a corporation. For the operation of a corporation to be most effective, ownership needs to be in the hands of those who are pre-disposed towards enforcing the corporate purpose – that is to say, it is in their current personal interest to ensure that the organisation does what it is intended to do.

For example, the company limited by shares works so well because the corporate purpose is to generate a return for investors: investors are the owners; and because as investors their main objective is to maximise their return, they will tend to drive the company to deliver its corporate objective. Or putting it another way, there is **alignment between the corporate purpose and the interests of the owners** (see Chapter 2 Part 1).

The company limited by shares is an example of an organisation established to deliver a **private purpose**, namely a financial return for its private owners. Who would be the appropriate owners for an organisation established for a **public purpose**? This question was considered in part 4 (paragraphs 4.5 to 4.8) of Chapter 3, Part 1. The conclusion was that the two options for the ownership of an organisation operating for a public purpose are either a ***trustee or surrogate on behalf of the public***; or ***the public themselves***.

3. Making the comparisons – corporate purpose and ownership

To some extent, all of the organisations featured in the case-studies are involved in trading for some sort of public purpose, in the sense that they are not trading for a private purpose (which normally means the private purpose of generating a return for investors). They also all have a form of “public” membership (the membership rather than the trustee model), though this varies considerably. Whilst it is true to say that open membership models are historically very well established in the UK via the mutual sector, it is fair to say that such models are not well-known, nor well-understood nor yet well-established for the ownership of public assets in this country. In our national mindset, we are clear about state/public ownership, and private ownership involving the ownership of something which we can sell for money. We are not so familiar with open public ownership (by citizens) on a basis where

ownership cannot be sold. This area is currently undergoing significant change, as can be seen from the first and third example.

Homerton University Hospital NHS Foundation Trust

NHS Foundation Trusts are carrying out a public service which used to be carried out under the direct control of the state. They are an interesting development in that they illustrate a form of governance where the state no longer wants to be the provider itself (or to own the provider), but instead wishes the provider to be owned by local communities. However **the corporate purpose remains a public service one**, though the powers are widened to enable the body to trade (subject to quite a lot of limitations) to generate income to support the public purpose.

NHS Foundation Trusts are **owned by** their local community, in the sense that they have no investor-owners, and the state no longer owns and controls them. They are owned by their members. Every member has one vote. Membership is open to the public, patients and staff, and no financial commitment is involved in membership – it is free – and membership cannot be sold. However, **the sense of ownership** is not always strong amongst NHS Foundation Trusts. To a considerable extent, that sense of ownership by members is weak (1) because the form of governance is strictly prescribed by statute with members having fewer entrenched rights than normal, and (2) because local ownership sits uncomfortably within the commissioning and regulatory framework through which the duty of the Secretary of State for Health to provide a national health service is discharged. NHS Foundation Trusts are still relatively young (the oldest were only set up in 2004) and it is likely that this form of ownership – the public benefit corporation – will evolve further.

Homerton has been very successful in developing a representative membership, and using that to build stronger links with its local community. At present, the current NHS Foundation Trusts like Homerton illustrate a significant step forward from traditional state (or nationalised) ownership, towards local community ownership. The members, through the board of governors, are increasingly influential in the governance of the trust. It is to be assumed that as the sense of ownership strengthens, the membership will become more significant in driving the organisation. As tax-payers and users or potential users of the service (and staff), local people have a potential interest and incentive to take part.

By having the public, patients and staff as owners/members, NHS Foundation Trusts provide a mechanism for the interests of users, residents and staff to be heard and taken into account. The model illustrates an alignment between ownership (by the public) and corporate purpose (the public interest), and in the long term, subject to this not being undermined by other developments within the NHS, it is to be anticipated that as the sense of ownership strengthens, the role of local people in influencing the services and enforcing the public purpose will continue. Importantly, the ownership (and downstream

governance) arrangements make it unlikely that any one interest group will ever secure an inappropriate level of influence (capture).

Co-operative Group

The Co-operative Group is the case-study which probably seems furthest away from what we today think of as a “public purpose”. However, it has been included because its reason for existence, and indeed the reason for the existence of all of the traditional mutual organisations, was **to provide a service to people** within a community who would not otherwise have had access to that service. The underlying principle of the traditional mutual societies was that by combining their need for something and working together (co-operating), people within communities could create a sustainable business to meet their common need. In that sense the traditional mutuals had a **public purpose**, because their services and membership were open and available to all, and nobody derived a private benefit from them. These principles are enshrined in the so-called “Co-operative Principles”.

The mutual societies sought to trade on the basis that they just wanted to cover their costs (rather like Nominet). This required them to strike selling prices, and it was only at the end of the year that they could establish whether they had got it right. If they had a surplus, in a sense they had charged too much, and they therefore either needed to return it to members/ the community in the form of some minor public services (e.g. providing access to newspapers and books in the days before public libraries), or to repay to customers what they had overcharged. This is the origin of the “co-op divi” – a post facto price adjustment. Societies commonly have in their rules the power both to pay dividends to members and non-members in proportion to their trade. In practice, they tend only to pay dividends to members, to provide an incentive for joining.

The Co-operative Group, like other retail co-operative societies is owned by its members who are individual customers and staff, and corporate members. Members must own one £1 share, so there is no effective economic barrier to membership. Every member has one vote in elections. Within the Co-operative Group’s general meetings, voting is by regional delegation for individual members, and by corporate members, based in each case upon volume of trade.

In the early days of the co-operative movement (from the 1850s onwards), this form of ownership became extremely successful, and thousands of societies were established throughout the UK. This was in response to the need for ordinary people to have access to food at a fair price. By 1965, co-operative societies had a market-share of over 30%. In the latter half of the twentieth century, with the rapid growth of competition from privately-owned supermarkets, market share declined and had reached 5 % in 2005. It no longer made sense for a food retailer to be a membership based organisation; consequentially membership had declined, its influence over management was weakened, management itself struggled to find a meaning to trading as a

co-operative in the prevailing culture, and all efforts were concentrated on competing simply in order to survive.

This position has significantly changed in recent years, with the growth of interest in fairly traded goods, and concerns about the practices of investor-owned retailers. There is currently a resurgence of interest in businesses like the Co-operative Group and other mutual and co-operative organisations, which strive to be guided by values and principles. The membership of the Co-operative Group is growing, and its trading performance now compares favourably with competitors (it is currently acquiring Somerfield, and merging with Britannia Building Society). Members and their representatives are increasingly significant in the development of the business. Recently 100,000 members contributed to the development of a food ethical policy.

The Co-operative Group has a very substantial membership across the UK, numbering over three million. Members are grouped into regions, and areas within regions for democratic participation. The use of the internet and webcasting are becoming established to broaden members' participation in meetings. The Co-operative Group is therefore a further illustration of the alignment between corporate purpose and ownership, on the public ownership model.

It is openly recognised and understood in the co-operative movement that successful societies are dependent upon a broadly based and **active membership**. The Co-operative Group is probably at the forefront of those working hard and consciously at the development of this. Recent developments include a very up-front recognition of the corporate purpose in the Group's new rule-book as well as throughout its democratic governance arrangements.

Salford Community Leisure

Salford Community Leisure represents a form of governance which is becoming increasingly popular for public services. SCL is the community-owned body created to take over the former leisure services of Salford City Council. Its corporate purpose is to trade "for the benefit of the community", this terminology being derived from the fact that it is incorporated as a society for the benefit of the community, under Industrial and Provident Society Law (soon to be re-branded "Co-operative and Community Benefit Society Law"). In other words, it is trading for a public purpose, and providing services which were previously provided by a local authority.

The difference from its previous public-ownership is that the organisation is at arms-length from the local authority, being owned and controlled by local people (350 community and staff members). Members hold a nominal £1 share, so there is no economic barrier to membership. Every member has one vote.

Under local authority ownership, a service has to struggle for attention and funding amongst other competing demands, and the opportunity for optimising

the service for the public good can be lost. Through becoming directly owned by local people who are its users and staff, the organisation is much more focussed on **how that service** can meet the needs of local people, and can be immediately responsive to changing needs and new opportunities. This has had a significant impact on the organisation, its morale, the way it is treated within the local community, and within the region.

The ownership arrangements are in alignment with the corporate purpose of the organisation. This both helps to drive accountability, and provides credibility to the organisation as an independent body, enabling it to win opportunities which would not have been possible under its former ownership. The ownership arrangements give a legitimacy and grounding to the representative governance which controls the organisation.

Network Rail

Network Rail is the owner and operator of the railway network. It replaced a previous body (Railtrack PLC) which was owned by investors (equity shareholders). As a member owned organisation but with a closed membership, it is effectively in private rather than state ownership. However it owns and operates what is a monopoly activity for the benefit of the public. Its monopoly function (plus health and safety) are subject to regulation by the Office of Rail Regulation.

Network Rail is an interesting organisation to compare for a number of reasons. It is a company limited by guarantee, trading for a public purpose. It has 102 industry and public members (every member has one vote), and therefore appears to be owned by the public, but the current arrangements are not considered to be working satisfactorily. There are perceived weaknesses of governance and accountability, and KPMG were recently commissioned to carry out a review of membership aspects of its governance.

The review revealed significant questions amongst the members:

- in whose interests should Network Rail members act?
- how should members be organised?
- should members be incentivised to fulfil their role, and if so, how?
- how should members be selected?
- what information do members require?

Each question is itself revealing:

Question 1: because Network Rail's ownership model is neither the trustee model nor the public ownership model, the members do not know whether they are supposed to be acting in the public interest (i.e. as trustees) or their own interests (as owners). In the public ownership model, **it is assumed** that members will act in their own interest, or the interest of the group from which they come. This "self-interest" is moderated through the collective act of co-operating through the corporate entity, a balance of constituencies, and elected representatives sitting on a representative body where they owe **clear**

legal duties to act in a particular way. In the trustee model by contrast, other mechanisms are needed to cause the trustees do their job.

Question 2: the membership is too large (102) to act as a single body. However the confusion about role just mentioned creates a difficulty as to how they should operate.

Question 3: the incentive for members in the trustee model is a legal duty as trustee, and a commitment to public service. The incentive for participation in the public ownership model is self-interest (or the interest of the group from which the individual member comes). The idea of having to **create incentives** to drive the corporate purpose seems perverse. It would be more logical to address the issue by changing to an ownership model where **the owners already have the incentive** to drive the organisation.

Question 4: here is the nub of the problem. The basic principle of a corporation is that the many who own the organisation (the members) delegate to and appoint the few (the board). Where, as in this constitution, the board **select the members**, there is a logical conundrum: how can the board, to whom the members then delegate authority to run the corporation, **select** those members? The idea of delegation and accountability collapse in on themselves.

Question 5: without clarity about whether members are trustees or owners in their own right, it is difficult to specify what information the members need.

Although the membership structure of Network Rails strives to create an alignment of ownership and corporate purpose, by making the appointment of the members a function of the board, there is no real owner of the organisation – there is an **ownership deficit**. Consequently, there is nobody to exercise the rights of an owner – to drive the organisation to do what it is supposed to do, and no alignment is in practice achieved.

Canadian Internet Registration Authority

As the name implies CIRA parallel body to Nominet in Canada in relation to the .ca namespace. It took over this responsibility from the University of British Columbia. In 2005, CIRA began pursuing a program of corporate governance reforms to ensure that “fair and sound practices are embedded across the organization ...including appropriate balance of representation on the Board of Directors” (2005 – 2008 Strategic Plan). The program’s final phase was achieved in 07/08 with a new membership enrolment process and membership drive, resulting in 15,400 members.

Membership of CIRA is open to all authenticated registrants with a domain name. There is no fee for becoming a member. Every member has one vote.

These arrangements bring ownership and corporate into alignment on the public ownership model.

4. Drawing some conclusions in relation to corporate purpose and ownership

Getting the ownership right for the corporate purpose is fundamental to the long-term success of the organisation. Unless it is right, then ultimately there will be no proper mechanism for driving the organisation to deliver its corporate purpose, and a failure of accountability, which is addressed in more detail in the next section. “Accountability” needs to characterise the relationship which those entrusted with the running of the business (the managers) have with the owners of the business. Unless there is a genuine sense in which **the owners have entrusted responsibility to managers**, and unless the owners have a *real and existing incentive* to make the managers perform, then the accountability is unlikely to be effective, and the organisation has a weak driving mechanism.

This is illustrated by the current situation with Network Rail. An objective analysis of Network Rail’s basic governance arrangements might well conclude that since the board basically controls the selection and appointment of members, the ownership arrangements are artificial or cosmetic. Consequently, there is an ownership deficit, the members do not have a real incentive to make the organisation perform, and there is no real sense in which the members have entrusted management responsibility to the board. Consequently there is no effective basis for the board to be accountable; and as a result the governance is weak. This appears to be borne out by current concerns.

The NHS Foundation Trust model is a much more developed approach, but heavily prescribed in statute. The limited role of members (as contained in statute) is not conducive to the development of a strong sense of local ownership, and consequently it is to some extent down to the local implementation of the governance arrangements to determine how effectively the local community is “involved” and actually drives the organisation. Trusts like the Homerton are getting good results out of the model. The creation of constituencies of members so that at grass roots level, the organisation balances the interests of customers and staff, is of some interest.

The co-operative model, at least historically speaking, provides a more realistic sense of ownership. The rapid changes currently taking place in the cultural context (somewhat affected by climate change, the economic crisis, and the growing pressure for trade justice) are once more giving relevance to co-operative trading, and the developments in co-operative governance are reflecting this. Consequently the role of membership is becoming more significant to the business again, and the influence of members and their representatives on the management is also increasing. This is reflected in the Co-operative Group’s recent constitutional review.

The Co-operative Group divides its members into geographical constituencies. It does not divide them in relation to the nature of their interest in the society. In other words, customers and staff are all within the same constituency/ies. The democratic structures prevent employee capture

by setting limits on the level of employee representation, which is an alternative way of securing balance, but not by separating employees into a different constituency, the constitution fails to acknowledge the interest of employees in their own right.

Salford Community Leisure probably represents the most developed of the forms of member ownership. It has separate constituencies for community and staff members; the members clearly have greater constitutional authority than the members of a foundation trust, enabling a stronger sense of ownership to develop more quickly.

The members of CIRA are registrants, rather than registrars. Since registrants are, in reality, the main customers of a domain registry, this appears to be a good basis for securing alignment between corporate purpose and ownership. Having voting arrangements based on one member one vote would also appear to be a logical approach.

All of the organisations considered strive to align ownership with the corporate purpose. The extent to which the members feel that they own their organisation varies significantly. It has to be said that in the UK, we are not used to this form of ownership. Although it goes back to something traditional and well-established (traditional ideas of mutuality and co-operation), those traditions have substantially faded out of general public consciousness, and are in the process of being reintroduced or reawakened.

As will have been seen in the comparative organisations, ownership by members can (and ideally should) include more than just one interest group. It need not be limited to users or customers of the service; through the creation of constituencies of members, it can extend to others indirectly affected by the service (e.g. carers and local residents), and others directly involved (e.g. staff). It will also have been noted that whilst membership is usually the mechanism for an interest group to participate in the governance, some of the models provide for direct participation of specific and appropriate bodies via an appointed representative (e.g. local authority, primary care trust). This will be covered in the next section.

In most membership based organisations, the number of people who become members tends to be only a small proportion of those entitled to become members within a constituency. Many are not interested, do not have the time to get involved, or are content (i.e. not sufficiently discontent) to leave others to exercise membership rights. Open membership, and its availability without restriction **however much it is actually taken up**, plays an important part in governance, both from the point of view of members, non-members, and those in positions of responsibility. Open membership is, by definition, always available, and therefore something those in position of responsibility have to take into account at all times.

There are two important facts which flow from the tendency for relatively small numbers of people to respond to the opportunity to participate actively. The first is that the overall governance arrangements need to be designed in a

way which both prevents capture or distortion by one particular interest group, to the detriment of the wider public interest; and strives to ensure that an appropriate balance is achieved in the representative structures. This is necessary to make sure that the level of representation of each interest group strikes an appropriate balance given their legitimate interest in the organisation. An obvious example of this is staff – it is normally appropriate for staff to have some representation in such forms of governance, but it would be inappropriate for them to be able to dominate or control affairs.

The second point is that open membership will not work effectively without the operation of a **membership strategy**. If membership is simply made open and available to all, then the membership will, by definition, be self-selecting and is unlikely to be representative. The development of a membership strategy requires a basic mapping (age, gender, ethnic, socio-economic, etc.) of the potential membership community, and working out what membership recruitment strategies are needed to reach and appeal to those sections of the membership community likely to be under-represented. The membership strategy can then inform the allocation of resources within the member development budget, and usage of the relevant methods of communication likely to reach the target groups concerned. The recruitment and development of active members is currently an area of significant study and development.

Looking at Nominet in comparison with these examples, a number of points are striking.

- Only a limited section of those with an interest in its affairs are (and, because of the charging arrangements, are likely to be) members. A narrow membership does not create the alignment between ownership and purpose, making it less likely that the organisation will, in the long term, continue to operate in the public interest.
- It only has one constituency of members. There is no attempt to divide potential members by geography, or the nature of their interest in its affairs. This makes it more difficult to secure a broad range of representation (which is dealt with in the next section).
- There is no mechanism for staff to participate in membership.

Summary

- **The comparisons illustrate a range of options for a public ownership model**
- **Constituencies of members can be helpful**
- **Apart from Network Rail (whose ownership arrangements are currently under review) all of the organisations have open membership, with no economic barriers to membership**

- **A genuinely open membership provides the opportunity for aligning ownership with the corporate purpose of serving the public interest**

5. Combining professional competence and democratic accountability - introduction

In chapter 2, Part 1, it was explained that “governance” comprises what ***all of the organs of the corporation do***, and that includes the members or members’ meeting. In practice, within governance the members have a limited and occasional role. Most of the power within the organisation is delegated to a smaller group or groups of people. At this level, chapter 2 Part 1 concluded that:

- *The overarching aim of corporate governance is to establish arrangements which meet the needs of the business by*
- *Ensuring that those responsible for running the business have the necessary skills and experience to do the job in the particular commercial environment*
- *Providing a framework of accountability to those for whose benefit the business is run*

The basic challenge for a membership based, democratically organised body is ensuring that those in positions of responsibility are competent to run the business, and will do so in accordance with the corporate purpose. The problem with democracy is that it is designed to deliver “***representativeness***”, not ***competence***. An electoral process tends to produce those whom the electorate think are most likely to deliver what ***they*** want. Within a corporate structure, where those in charge carry strict legal duties to act in accordance with ***the best interests of the corporation***, this creates a problematic tension. Furthermore, where the corporation is substantial and needs to be managed by people with very specific skills, qualifications and experience, it is highly unlikely that people with the necessary competence will be produced by election.

The normal compromise, therefore, is to provide for the ***selection and appointment*** of individuals who have the right skills, qualifications and experience to run the business. This is intended, as far as possible, to ***ensure competence***, and thereby to minimise the risk to the organisation of something going wrong because the management were not up to the job.

If this compromise (of appointing the management) is not to undermine the whole point of having a membership based and democratically organised entity, two things are essential. The first is that the ***process of selection and appointment*** (and if necessary removal) of management is appropriate. The second is that the management are ***located within the organisation*** in such a way that (1) they are able to fulfil their potential to use their specialist skills,

and (2) that the organisation can ensure that their skills are used for the purpose for which the organisation exists.

Traditionally (such as in the retail co-operative movement), this has involved establishing arrangements involving the senior management (executives), and elected representatives of members. Such arrangements may be satisfactory for a relatively small or uncomplicated business. However, at some point in terms of growth in size and complexity, this relatively simple combination starts to become less effective. A point is reached where independent qualified non-executive directors are needed in order to keep the management in check, and to provide an effective counter-balance to them. Not only does this become difficult for elected directors, who may or may not have the necessary skills to carry out the function, but their vested interests as representatives of a particular interest group become hard to manage at board level. The emerging thinking on this will be illustrated.

6. Making the comparisons – professional competence and democratic accountability

All of the comparisons chosen secure executive competence through appointing a professionally qualified executive team to run the business. Different approaches are adopted in the various organisations as to whether independent professional non-executives are part of the arrangements, or not. The big differences are in the role of the democratically elected or representative individuals, and the comparative positions they have within the governance hierarchy.

Homerton University Hospital NHS Foundation Trust

As is the case with all NHS Foundation Trust, the Homerton has a board of directors comprising five executive and six non-executive directors. The chair is one of the non-executive directors. This design of board is similar to a PLC board, and reflects the underlying principles of the Combined Code. The board of directors is responsible for running the trust, including responsibility for overall strategy and the day to day delivery of the service. Broadly, the executive directors are appointed and can be removed by the non-executive directors. The non-executive directors are appointed by the board of governors (called the Council of Governors at the Homerton).

In no sense does the board of an NHS Foundation Trust strive to be representative of the membership or community it serves. The role of the board is to deliver competent management. Representativeness is the objective of the board of governors. This specifically strives to mirror the community of interested individuals and relevant local organisations.

Homerton's board of governors comprises 14 public governors, **elected** by and from the public members who live within the geographical constituencies; 6 staff governors **elected** by and from the staff members; 2 governors **appointed** by the Primary Care Trust; one governor **appointed** by the local authority; and three partnership governors **appointed** by each of the

Corporation of London, City University, and Queen Mary College of the University of London.

The board of governors has a number of specific statutory roles, including the appointment of non-executive directors, approving the appointment of the chief executive, appointing the auditor, receiving the annual accounts and auditor's report, and contributing to the forward planning of the trust's services. These statutory functions do not sufficiently describe the role, which really consists of being the link between those responsible for running the trust, and the members and membership community for whose benefit the trust exists to provide services. It is therefore a two-way role in terms of passing messages, views and information.

The board of governors is designed to reflect the local community, and the organisations which are most significant to the successful running of the trust. By bringing this particular combination and balance of people together in one room, and charging them with seeking to help the Homerton to be as successful as possible at achieving its corporate purpose, the board of governors provides a forum for collecting and synthesising the views and aspirations of the relevant parts of the community. The community and the membership of the trust are too big and numerous for the board of directors to interact with on any regular basis: the board of governors provides a carefully constructed group of people designed to reflect that community and membership for the board of directors to work with. It is important for the governors to work with the directors, particularly in the development of the trust's forward plans, as the directors have a statutory duty to have regard to the views of the board of governors. The directors ignore the governors at their peril, because of the governors' powers of appointment and removal of non-executive directors.

This is a highly developed, and relatively complex form of governance. Being a radical new departure in the health sector, it is taking some time for it to settle down. In particular, the role of governors was not well understood in the early days, but trusts such as Homerton have progressed significantly in making the arrangements work.

Co-operative Group

In general, the boards of the large retail co-operative societies are **entirely made up of democratically elected directors**. They are responsible for appointing a chief executive, determining strategy and policies with the executives, and then monitoring the executive in the implementation of those policies and strategy. **The executive management of the day to day business is delegated by the constitution to the executives**, effectively prohibiting elected directors from running the business themselves.

The Co-operative Group's structures are more complex than the average retail society in a number of respects.

Because it has corporate members as well as individual members, the corporate members have some representation on the board (five seats, usually held by chief executives of corporate members). This means that the board of directors includes some professional (rather than “lay”) board members, though in some cases the societies they are responsible for running are likely to be a fraction of the size. Following its recent constitutional review, the board is obliged to carry out a skills gap analysis of itself, and has the power to appoint up to three independent directors to fill gaps identified.

Because of the size and complexity of the Co-operative Group’s business, in its recent constitutional review it has decided to form three subsidiary boards to oversee different parts of the business. These boards are to comprise elected directors, independent appointed directors, and executives. In one part of the business (financial services) such arrangements have been in place for some time as they are required by the regulator.

There are lower tier democratic structures, which are necessary given the size and geographical spread of the society and its business. There are seven regional boards (from whom the society’s board members are elected), and each region is divided into a number of areas, each of which has an area committee. Regional boards have some limited decision-making powers in relation to the business in their region.

The recent developments in the governance of the Co-operative Group demonstrate a move from an entirely democratically elected board, to one which may include independent non-executive directors. This is not an easy step for the leading organisation within a movement which puts a high premium on democratic election. However it reflects a growing recognition that if powerful executive directors are to be sufficiently held in check, and if the society is to have the capacity at senior level to consider and make decisions about major strategic issues of large value and affecting many people, independent appointed directors may be needed. As an illustration of the issues facing the society, it is currently in the process of acquiring the retailer Somerfield, and merging with Britannia Building Society.

It remains the case that the chief executive and other members of the executive team are not members of the board – though they attend and report to board meetings. ***The executives are responsible for running the day-to-day business, not the board.*** The board has a more strategic role in relation to the business, which includes monitoring the management in their delivery of agreed strategies and objective, and ensuring that they follow co-operative values and principles in running the business.

Salford Community Leisure

Like the Co-operative Group, SCL’s chief executive attends board meetings, ***but is not a member of the board.*** There is a similar separation of day-to-day management and strategic control and responsibility.

The composition of the board of SCL has significant differences from the Co-operative Group's board. SCL's board comprises four ***elected*** community members representing users (one of whom is always the chair of the Salford District Sports Council); three ***elected*** members of staff; three ***elected*** representatives of the local council's community committees (representing local residents); two representatives ***appointed*** by Salford City Council; and four individuals ***appointed*** by the Salford Partnership to represent health, education, business and community safety.

There are no independent non-executive directors in the traditional sense, but there is the power for the board to ***co-opt*** up to two additional board members to fill any skills gaps. Currently there are two such individuals, one being a lawyer with particular relevant skills, and one being a representative from Sport England.

This model of governance is designed for an organisation of a smaller scale than the Co-operative Group or an NHS Foundation Trust. It comprises a substantial proportion (10/18) of elected representation to support the sense of community ownership, but makes significant provision for representation by other significant parties (6/18). It clearly differs from the board of governors of an NHS Foundation Trust, whose powers and responsibilities are significantly less, but that reflects a different governance design.

Network Rail

The board of directors of Network Rail, like those of NHS Foundation Trusts looks more like the board of a PLC. It currently comprises six executive directors and eight non-executive directors, one of whom is appointed by the Department for Transport.

When compared with the other organisations examined, Network Rail has no representative body, (other than the members), nor does it have any representation of its members on the board. Other than the statutory mechanism for the board to report annually to the members, and the power of the members to remove a director, there is no mechanism designed within the governance to enable interaction and accountability. There is a problem with the ownership of the corporation and it is unclear whether members are owners in their own right or as trustees. Consequently there is no clear mechanism of incentives for the members to drive the performance of the board of directors.

Canadian Internet Registration Authority

The board of CIRA comprises twelve elected directors, and three ex officio non-voting directors. The non-voting directors comprise the president/CEO, an individual appointed by the government, and another individual (who had responsibility for registrations for a number of years before CIRA took over the function from the University of British Columbia).

The governance arrangements reflect a slightly different corporate tradition from that in the UK, though the underlying principles are similar. The by-laws of CIRA provide that the board manages the business and affairs of the corporation. However it also provides that the president/CEO is responsible for the “general and active management of the affairs of the corporation”. This is similar to the separation of strategic responsibility and day-to-day control illustrated by the Co-operative Group and Salford Community Leisure.

The twelve elected directors come to the board by two different routes. Nine of them are elected by members from a slate of candidates put forward by a Nominations Committee, and the remaining three are elected by members from a slate of candidates from members. This enables the composition of the board to be tailored to include a broader spread of representation, but without dividing members into constituencies.

7. Drawing some conclusions in relation to professional competence and democratic accountability

Looking at Nominet beside these organisations, the following points stand out.

None of the organisations examined have a body, charged with responsibility for the day-to-day business, which is dominated by elected representatives. They all either delegate management responsibility for the business to a separate executive team (Co-operative Group, Salford Community Leisure, CIRA), or that responsibility is borne by an entirely professional board (Homerton, Network Rail). Even setting aside issues of conflict of interest, this is a basic principle of governance design: ensure that the body charged with responsibility has the competence needed to do the job.

Nominet’s current board comprises (according to the constitution) two executive directors (one of whom is to be managing director and chairman) and four directors elected by members. ***There is no provision in the constitution for any independent non-executive***, though currently Nominet has a chief executive who sits on the board, and a non-executive chairman.

Of the five organisations considered, of the four which have any form of representative governance beyond the membership (Homerton, Co-operative Group, Salford Community Leisure and CIRA) ***they all seek to achieve some form of a balance of interest in that representation.*** This provides a broad spread of interests for determining future strategy, choosing a chief executive, and overseeing management. Nominet has no equivalent arrangements.

Summary

- **The comparisons illustrate a range of options for how to combine professional competence and representative governance**

- **None of them combine the representative role with responsibility for running the day to day business**
- **Apart from Salford Community Leisure, they all include provision for independent professional directors**
- **All of the organisations which have a representative form of governance strive to achieve a balance of representation**

8. The role of the State

Finally, this chapter will look briefly at the involvement of the state in the five organisations considered.

Although NHS Foundation Trusts are theoretically independent of the state, there are a number of very significant mechanisms whereby their freedom is curtailed. They are subject to regulation by Monitor, which is a system designed to prevent them from failing financially (prudential borrowing code, prohibition on dealing with assets etc.). Their business is dependant on central funds via the NHS commissioning framework, through which their contracts with PCTs generate their income. They are dependent upon the Department of Health for the setting of prices for the services they provide. Having said all of that, they are free from interference by the state in the operation of their every day business. The state is represented on the board of governors via a local authority governor and Primary Care Trust governor, but otherwise the state has no role in the constitution.

Save in particular areas of trade which fall within statutory regulation (e.g. financial services), the state has no role at all in the governance of the Co-operative Group. Its business activities are not traditionally regarded as “public services”, though for the reasons explained, it is arguable that they are carried on in the public interest, rather than for a private purpose.

The state (local authority) retains some involvement in the governance of Salford Community Leisure. The council has two places on the board; and it has a veto over changes to certain limited clauses of the constitution, effectively to prevent the organisation ceasing to do what it was set up to do.

The state has some continuing involvement in the governance of Network Rail. The Department for Transport appoints a non-executive director. It is also a member of the corporation, with special powers to block any changes to the constitution which might affect its powers.

The government of Canada appoints one of the non-voting members of the board of CIRA.

How does this compare with Nominet? At present, its activities are not regulated. The Policy Advisory Board (which has no formal constitutional role) contains a representative from BERR, and the Information Commissioner’s Office.

The letter of 15th October 2008 from BERR is not overtly pressing for a direct governance role. Whilst it states that “many countries regarded their country code as a national asset, the management of which required direct involvement of Government”, it goes on to refer the “self-regulatory approach that the Government prefers”.

Although all of the comparisons considered, with the exception of the Co-operative Group, contain a directly appointed representative of the state, it is submitted that, provided the ownership and governance arrangements make appropriate arrangements to secure the public interest, there is no inherent reason why the constitution of Nominet should include provision for the appointment of a representative of Government.

Summary

- **With the exception of the Co-operative Group, all of the organisations considered include provision in their constitution for a representative of Government to be appointed**
- **Nominet currently makes no such provision**
- **BERR does not seem to be seeking direct representation within the governance of Nominet, and there is no inherent reason why it should be necessary**

PART 4 – RECOMMENDATIONS AND RESPONSES TO BERR QUESTIONS

1. Recommendations

Corporate purpose and ownership/membership

Recommendation 1: Clarify Nominet's purpose (public not private) and

- Express it clearly as a commitment in the constitution
- Consider whether company limited by guarantee is appropriate for the purpose

Recommendation 2: Detach commercial discount arrangements on multiple registrations from membership, to remove any financial barriers to wider membership. Give responsibility to the Board for determining charges for registration and membership.

Recommendation 3: Broaden membership –

- Introduce constituencies for membership, comprising at least (1) users and (2) staff
- Consider establishing further constituencies within users, e.g. (1) individual/personal (2) commercial (3) education (4) voluntary and charitable (5) public sector
- Whatever representative arrangements are introduced, introduce constitutional requirements for review from time to time to ensure that they reflect what is appropriate as use of the Internet develops
- Revise voting arrangements to achieve a fair balance across the membership
- Develop a membership strategy for the recruitment and development of active engaged members, and resource member development

Combining professional competence and democratic accountability

Recommendation 4: revise current board/management structure. Consider how to

- achieve competence and representativeness
- achieve a balance of interests between relevant constituencies of members/stakeholders
- bring in professional non-executive directors

- resolve chairman issue.

Look at three potential models for achieving this:

- Foundation trust model (like Homerton), with professional board of executives and non-executives (one of whom is chairman), and separate subordinate representative body including elected members and stakeholder representatives (if appropriate)
- Co-operative model (like Co-operative Group) with elected board (one of whom is chairman), and delegation of responsibility for running the day to day business to executive team (who are not board members); professional non-executives at one or other level
- Community benefit model (like Salford Community Leisure) with representative board, which could include stakeholders and professional non-executives (one of whom might be chairman), and responsibility for running the business delegated to executives.

Recommendation 5: consider composition and balance of representative element, to ensure inclusion of appropriate representation from relevant interest groups amongst interested persons – i.e. different constituencies of members, representatives from key stakeholders or other representative bodies. Whatever arrangements are arrived at, introduce constitutional requirements for review from time to time to ensure that those arrangements continue to be appropriate as use of the Internet develops.

Recommendation 6: on the basis of an express commitment to carrying on business in the public interest, and a representative membership/governance structure as above, **do not** include direct representation of Government.

Other issues

Recommendation 7: revise majority required for changing the constitution to more normal arrangements, but include more appropriate and effective arrangements for entrenching provisions which should not be changed (this will depend on which corporate form is used)

Recommendation 8: include revised arrangements for removal of members for misbehaviour/damaging the organisation

Recommendation 9: include provisions for appointment/removal of all relevant officers (chief executive, chair etc.)

Recommendation 10: include appropriate provisions at each level to address conflict of interest

Recommendation 11: consider whether postal/electronic voting should replace proxy arrangements

Recommendation 12: include provisions for self-regulation of representative body, with compulsory code of conduct, and power (of the body itself) to remove any who commit a serious breach of the code of conduct

Recommendation 13: consider role of secretary in the light of revised governance arrangements.

2. Responses to BERR questions

The questions contained in the letter of 15th October 2008 to Nominet from David Hendon of the Department for Business Enterprise and Regulatory Reform, and the responses based on this report, are set out in the table below.

Question	Response
How far do Nominet's constitution and board structure follow accepted practice in terms of corporate governance as set out in the combined code?	See Professor Garratt's report
How effectively does the company ensure that the directors of the company reflect the wider stakeholder interest?	Currently, it does not. Recommendation 4 addresses this, and requires the company to consider various options to deliver representativeness, whilst at the same time ensuring competence.
In particular, how does Nominet ensure the continued development and evolution of industry self regulation in order to protect the wider stakeholder interests?	Given that new policy issues and challenges constantly arise as the Internet and its use develop, there are two basic needs: (1) that Nominet continually reviews how it represents the interests of all relevant parties – this is covered in Recommendations 3 and 5; (2) that if, in carrying out reviews as proposed in Recommendations 3 and 5, further constitutional change is appropriate, then such change is possible, subject to appropriate consideration and due process – this is covered in Recommendation 7.

Question	Response
<p>What arguments would you employ to convince my Ministers that the present relationship between Government and the company is appropriate in ensuring that public policy objectives in relation to the management of the domain name system and the standing of the UK in the internet community are understood and taken into account?</p>	<p>The “present relationship” is one where the Government has no direct involvement in Nominet. The priority for Nominet now is to establish first-class ownership and governance arrangements to make it as likely as possible that management of the domain name system will be carried out to the highest standards in the public interest. Delivering this outcome, which the Recommendations aim to do, is an unassailable argument to use with Ministers that the “present relationship” (i.e. where the Government continues to have no direct involvement) is appropriate. By having a clear and express commitment to operate in the public interest, and new representative arrangements within the governance to drive Nominet to deliver this, Nominet will demonstrate that Government involvement is unnecessary and in fact, undesirable. Implementing the Recommendations and introducing first-class ownership and governance arrangements will also demonstrate that the standing of the UK in the Internet community is properly understood and taken into account</p>
<p>Are there any actions that either the company or Government – individually or together – might take in the short term to address any concerns identified in relation to the above questions?</p>	<p>Implementing the Recommendations will not be easy. They will need to be discussed by the current membership and other relevant parties, with a view to bringing forward detailed proposals for adoption by the members. A clear indication of the Government’s position in relation to the Recommendations and any such draft detailed proposals will be needed.</p>

Author biographies

Cliff Mills

As well as working as a consultant with Mutuo, Cliff Mills is a consultant at Cobbetts, solicitors in Manchester, Leeds and Birmingham. He is a leading expert in corporate governance and the law of mutual and co-operative organisations.

With a background acting for the large retail co-operative societies on mergers, constitutional and governance issues, with Mutuo he has argued the case for the development of new models of co-operative and mutual ownership for use across public services.

He led the team at Cobbetts which supported many of the first NHS foundation trusts on establishing their new governance structures, and he works extensively with their boards of directors and governors. He served on the Department of Health's External Reference Group on governance matters.

He has designed new models of ownership for providers of out of hours primary care services, and a variety of other areas including children's services (Sure Start), leisure services and social housing.

Peter Hunt

Peter has been Chief Executive of Mutuo since 2001, which he founded as the first cross mutual sector body to promote mutual governance to opinion formers and decision makers.

Peter has fourteen years' experience in the mutual sector, working with co-operatives, mutuals and employee owned businesses.

In 1999, he was a co-founder and secretary of Supporters Direct, the football supporters' initiative, which has gone on to establish over 100 supporters' trusts at professional football clubs.

In 2002 and 2003, he led the Parliamentary team which piloted three Private Members Bills through Parliament, updating Mutual Society law and encouraging democratic employee ownership. In 2007, he added the Building Societies (Funding) and Mutuals Societies (Transfers) Act to this tally.

Since 2004, he has worked closely on a number of public sector structural reforms, including NHS Foundation Trusts, advising both Government and Trust Boards on the adoption of new membership structures.

He recently led the Mutuo team in a major constitutional and governance review by the Co-operative Group.

Steve Williams

Steve is a highly experienced all round researcher and planner. He began his career at Millward Brown market research agency where he specialised in qualitative research and worked on a raft of blue chip clients.

From there he moved on to the advertising agency JWT (Manchester) where he eventually became Planning Director. His work there included running the Planning Department and over-seeing strategic development on all of the agency's clients as well as managing or advising on the research process.

Steve set up Stratosphere in 1999 working either on his own or with a select group of other highly experienced researchers as projects demand. Having been on the receiving end of many debriefs, Steve appreciates the importance of presenting results in a convincing and credible manner, encapsulating the flavours and drivers of the consumer world but always bringing this back to strong directions based on the needs of the client's business strategy.

Steve is a full member of the Market Research Society (MRS) and is a member of the Association for Qualitative Research (AQR)