MAYWEATHERS

Co-operative Business Structures

Disclaimer

This article constitutes a summary of the information of the subject matter covered. This information is of a general nature and is not intended to be nor should it be relied upon as legal or any other type of professional advice.

Co-operatives are one of the most under-utilised business structures in Australia. The purpose of this article is to identify the types of co-operatives, set out some of the key features of co-operatives and identify why people should consider, subject to the facts and circumstances of each proposed venture, using a co-operative business structure.

Co-operatives (**co-ops**) are people centred organisations that are owned, controlled and used by their members. A co-op's main purpose is to benefit its members. Co-ops have been defined by the International Co-operative Alliance (ICA) as:

> *"[A]n autonomous association of persons united voluntarily to meet their common economic, social and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise*".

Co-ops are based on the values of self-help, self-responsibility, democracy, equality, equity and solidarity. Their members place significant emphasis in the ethical values of honesty, openness, social responsibility and caring for others.

Co-ops are different from other business structures primarily because of their member ownership, member participation, democratic structure and the use of funds for mutual, rather than individual, benefit.

Types of Co-operatives

Co-ops can be established as either a trading co-operative or non-trading co-operative.

A trading co-op may distribute any surplus funds to its members and for this reason is subject to a disclosure regime under co-operatives legislation that generally does not apply to non-trading co-ops, other than in NSW.

A non-trading co-op will typically use surplus funds to support its activities. Funds are not distributed to members. As such, non-trading co-ops are more likely to be appropriate for a community organisation.

Key Features of a Co-operative Business Model

We set out below some of the key features of a co-op business model together with our observations.

Primary Purpose

Unique to any other business structure, co-ops exist for the benefit of their members and / or broader part of society as opposed to maximising profits for its shareholders.

Co-ops tend to pursue longer term sustainable objectives / projects.

Co-ops particularly suit community based projects and initiatives in that they provide a forum for communities to combine individual strength and value to achieve a viable and sustainable enterprise.

Structure

Co-ops can be established as either 'for profit' or 'not for profit'.

Organisational Ownership

Co-ops are owned by the users who benefit from membership as opposed to shareholders of a company who may not actually use the goods or services provided by the corporation.

Members of a co-op are assigned one vote each. This differs from a company where one vote is usually assigned to one share.

Shares in a co-op can only be acquired by active members. This differs from a company in that shares can be purchased by any person or organisation.

Members & Membership Issues

Co-ops must have a minimum of 5 members (either individual or corporate). This can be an advantage because greater number of members can translate to greater combination of skill sets, experience and expertise. This differs from a company where there is a minimum of one member.

Membership to a co-op is restricted to persons willing to commit to active membership. That being said, membership is open to any person or organisation. This differs from a company where there are no restrictions except in relation to foreign ownership or substantial shareholding requirements.

Members, other than director members, can be under 18 years of age (albeit these members cannot stand for office and do not have the right to vote).

Typically, memberships can be cancelled if members are not active. This does not exist in relation to companies.

Day-to-Day Management & Control

Co-ops are controlled democratically and are required to have a robust corporate governance model.

Directors are nominated and elected by members and have specific duties that are defined by the common law and statute. Any member 18 years or older may choose to nominate themselves as a director.

In broad terms, a director must:

- act in good faith.
- act with care and diligence.
- avoid conflicts of interest.
- avoid the unauthorised use of co-op property or information.
- avoid the taking of unauthorised benefits.
- act honestly.
- act within the powers granted to them.

A co-op's management structure is based on similar principles as those for a company. Generally, the board is responsible for managing the affairs of a co-op. However, legislation and in some cases the co-op's own rules require the board to defer certain important decisions to members at a general meeting. These include changes to the rules, acquiring or selling certain co-op assets, changing structure or winding up.

The boards' level of involvement in the day-to-day affairs varies from co-op to co-op.

Capital Structure

Share capital is derived from active members only.

Fundraising and Finance

Co-ops can borrow money either from members, financial institutions (i.e. loans and leases) and / or the public (i.e. debentures, bonds and co-op capital units (**CCUs**)).

Co-ops can only issue shares to members.

Co-ops can invest in new or existing projects.

Co-ops can issue securities (i.e. equity (shares) or debt (debentures, bonds or CCUs)).

There are no limits to how much can be raised through membership share offers.

Co-ops are in some cases entitled to ask its members to buy more shares or to lend the co-op money at an interest rate. It can do this without having to comply with the *Corporations Act 2001* (Cth).

Co-ops can also issue debt securities to the public, but once a co-op does this and the offer is outside the State, then it is covered by the Corporations Act.

Share Price

A co-op's share value is fixed at par value, although may in some cases be issued at a premium (there are restrictions on what the premium may be used for). There is no opportunity for capital gains. This differs from a company, in particular a listed company, where the value of shares fluctuates.

A member's share in a co-op is transferrable subject to the co-op's rules.

Shares may be repurchased (with limits) for par value or less.

Benefit of Distribution

A co-op's proportion of surplus can shared amongst members based on use of goods and services or through the declaration of a dividend (either franked or unfranked) on shares (trading co-ops only).

For non-trading co-ops surplus can be utilised to improve services to members (including rebates allowing goods or services to be provided more cheaply) or to improve / extend the co-op's activities. Non-trading co-ops may elect to donate part or all of a surplus to a charity. This differs from a company where dividends (franked or unfranked) are distributed to investors according to the class of share.

Liability

A co-op's liability is limited to unpaid amounts on shares and any other charges payable by members to the co-op in accordance with the co-op's rules.

Co-ops can sue and be sued.

Typically members / shareholders, directors, managers and employees have no individual responsibility for the debts of the co-op unless those debts arise from reckless, negligent or fraudulent conduct.

Financial Reporting

Co-ops must keep written financial records that correctly record and explain their transactions and financial position and performance and enable financial statements to be prepared and audited. The records must be retained for seven years and may be kept in any language, however an English translation must be available. The records may be kept in electronic form but a hardcopy must also be available.

Participating co-ops must lodge annual reports with the Registrar of Cooperatives in the jurisdiction of their original registration.

Co-ops carrying on business in another state or territory may decide where to keep its financial records.

If financial records are kept outside of the State of registration, sufficient information concerning those records must be kept in that State. The Registrar must be advised of the location of those records.

Participating co-ops may be required to produce specified financial information in another participating jurisdiction at the request of that Registrar and if so requested, the directions must be complied with.

There are different reporting requirements based on the size of a co-op.

While small co-ops have less financial reporting requirements than large co-ops, they must still comply with regulations.

Co-ops that issue securities to the public, regardless of size, will need to meet the reporting requirements of a large co-op.

Other Issues

Co-ops can join forces with other co-ops to share resources through association or through 'second tier' co-ops.

Co-ops generally require and provide ongoing co-op education programs for members. This perpetuates ongoing learning and development.

Is it the best structure for your business?

It is important to carefully consider whether the co-op model (distributing or non-distributing) is the right vehicle for what you plan to do. There are a number of other business structure options including partnerships, incorporated associations and limited liability companies which should be considered when deciding on a co-op structure, by way of comparison.

Co-op business structures are used for a number of reasons. Some of those reasons are set out below, to:

- to provide a service that is not available.
- to increase their power in the marketplace.
- to keep profits and control of a business within a community.
- to keep a community or business alive: See Mayweathers' blog on the BCCM website titled "Talking Turkey" dated 4 December 2014.

Overall, some of the benefits of a co-op business structure are:

- generally it is inexpensive to register a co-op.
- members can offer greater combination of skill sets, experience and expertise.
- all members and shareholders are expected to be active in the co-op.
- shareholders have an equal vote at a general meetings irrespective of their shareholding or involvement in the co-op.
- members (other than directors) can be under 18, though these members cannot stand for office and do not have the right to vote.
- shareholders, directors, managers and employees do not have responsibility for debts of the co-op unless those debts are caused recklessly, negligently or

fraudulently.

- a co-op is owned and controlled by its members, as opposed to its investors.
- co-ops can benefit from increased buying power.

If you require any further information on co-operative business structure or would like assistance in establishing one, please do not hesitate to contact us.

Dated: December 2014

André Adams | Partner

T: +61 2 8020 5721 | T: +61 8 7129 7051
M: 0403 161 505
E: andre.adams@mayweathers.com.au

John Zappia | Partner

T: +61 2 8020 5723 | T: +61 8 7129 7053
M: 0403 969 474
E: john.zappia@mayweathers.com.au

Steve Vrtkovski | Partner

T: +61 2 8020 5722 | T: +61 8 7129 7052
M: 0419 550 571
E: steve@vrtkovski@mayweathers.com.au

MAYWEATHERS

Sydney Level 9, City Mutual Building, 66 Hunter Street Sydney NSW 2000
T: +61 2 8020 5720 | F: +61 2 9012 0146

Adelaide Level 30, Westpac House, 91 King William Street Adelaide SA 5000
T: +61 8 7129 7050 | F: +61 8 7200 7660

mayweathers.com.au