

## **Co-operatives Legislation in Australia**

## Contents

Co-operatives Legislation in Australia.....	1
About this paper .....	3
Broad impacts of the Australian legislative environment .....	3
Australian co-operatives under the CNL.....	5
1. Interpretation of CNL.....	5
2. Formation requirements .....	5
3. Legal capacity.....	5
4. Governance .....	5
5. Co-operative types .....	6
6. Share capital .....	6
7. Membership and voting .....	7
8. Distributions.....	7
9. Rules .....	7
10. Disclosure requirements for issue of securities .....	8
11. Co-operative finance.....	8
12. Auditing and financial reporting.....	9
13. Mergers, acquisitions and takeovers.....	10

## About this paper

The purpose of this paper is to provide a simple summary of co-operative legislation in Australia. It is written to provide a resource for comparison with the *Co-operative and Community Benefit Society Act, 2014* in the United Kingdom.

It does not provide comment or direct comparison with legislation in the United Kingdom, rather it lists the key characteristics of Australian co-operatives legislation to allow general comparison with features of co-operatives under UK legislation.

As part of the description of Australian co-operatives legislation, the paper also provides some background to the federal legislative system in Australia those impacts on this body of law.

## Broad impacts of the Australian legislative environment

1. Australian law is complicated by the federal legal system. Co-operatives legislation<sup>1</sup> is made by each State; the Australian Federal Parliament makes company law<sup>2</sup>. Whilst State law is the primary regulatory regime for co-operatives, Australian company law has precedence over State law in respect of financial markets.
2. Since 1992 co-operatives legislation has borrowed drafting from company law on topics such as the nature of a co-operative as a separate legal entity with full civil powers as well as the corporate governance principles of board and members along with accountability through directors' duties and financial reporting.
3. An immediate difference between co-operatives laws in Australia is that they frequently refer to, adopt or apply aspects of company law. This has

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<sup>1</sup> The term 'co-operatives legislation' is used to generally describe legislation governing co-operatives in each State and Territory of Australia. Until 2014 each State and Territory had a Co-operatives Act. In March 2014 both New South Wales and Victoria passed uniform legislation referred to commonly as the Co-operatives National Law. This same legislation will commence in South Australia later in May 2015. There is a consistent statute in Western Australia.

<sup>2</sup> Prior to 2001, each State had a Companies Act. In 2001, States referred their power under the Australian Constitution to make laws about companies. The Federal Parliament passed the Corporations Act in 2001 and established a single corporate regulator for companies and the financial market, the Australian Securities and Investments Commission – ASIC.

more than a statutory interpretation impact.<sup>3</sup> It means that professional advisers see shares and other securities through a 'company law lens'. There is no strong professional co-operative sector, and until the Business Council of Co-operatives & Mutuals was formed, most regulatory advice or information came from the regulators.

4. The development of specific co-operatives legislation in Australia began in the 1920s as a result of policies to aid rural and community development. The legislation was particularly patronising and even in 2015 bears remnants of this policy. The regulator, the Registrar of Co-operatives (in each State) has extensive investigative powers and there are a number of instances whereby approval is required where it is not really consistent with the principle of autonomy and independence for a co-operative, and certainly creates a heavier regulatory role than exists for companies.
5. Co-operatives legislation differs from State to State. The regulatory differences are not significant, but they tend to contribute to additional compliance costs where a co-operative wishes to conduct regular business across a State border. I note there are differences between Scotland and England in the UK legislation; however, these differences are within the one piece of legislation.
6. Until 2014, there were 8 different co-operative statutes, one for each of the Australian jurisdictions.  
A co-operative wishing to conduct regular business in more than one State was required to register as a foreign co-operative in those other States. In 2014, as a result of an inter-government agreement, States agreed to pass a uniform law, the Co-operatives National Law (CNL) and to remove the requirements for separate registration.

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<sup>3</sup> A simple comparison: The Co-operatives National Law has 624 sections and 4 Schedules. The Co-operative and Community Benefit Societies Act, 2014 (UK) has 155 sections and 7 Schedules.

## Australian co-operatives under the CNL

Australia is moving slowly towards adoption of the CNL<sup>4</sup>. This is a code that will remove significant jurisdictional differences in co-operatives legislation, but will continue to be regulated by each State Registrar.

The following description of the legal characteristics of co-operatives is based on the CNL.

### 1. Interpretation of CNL

- Legislation incorporates co-operative principles; interpretation of legislation is to favour the principles.

### 2. Formation requirements

- Minimum of 5 members
- A co-operative group requires a minimum of two co-operatives
- Pre approval of rules by Registrar
- Pre approval of disclosure statement if co-op has a share capital<sup>5</sup>
- Formation meeting only occurs after approval

### 3. Legal capacity

- Full legal capacity as for any corporation
- Can issue shares (if it has a share capital) and debt securities
- Can issue special securities called a co-operative capital unit (CCU) that can be traded on a stock exchange

### 4. Governance

- Board + members
- Must have at least 3 directors

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<sup>4</sup> The CNL commenced in New South Wales and Victoria in 2014. Western Australia passed a version of the CNL in 2010. South Australia will commence the CNL in late May 2015.

<sup>5</sup> Whether a disclosure statement is required for a non-distributing co-operative with a share capital is a policy matter. There is no published policy by Registrars, generally a disclosure statement will be required if the level of commitment required of members (either as share buy-in, or other requirements) is significant.

- Directors must be elected; the legislation does not provide for appointment of directors, other than to fill a casual vacancy. Nomination processes can limit candidates who are eligible for election to board positions.
- Can have independent (non-member) directors, provided they are minority on board
- Management by board, except major decisions – sale of major assets that impact on undertakings to be decided by members
- Directors of a co-operative are subject to fiduciary duties and express statutory duties in same terms as directors of companies. The exception is that business decisions are tempered by the impact of co-operative principles, rather than to act in the best interests of shareholders.

## 5. Co-operative types

- Distributing (must have share capital)
- Non-distributing with share capital
- Non-distributing without share capital<sup>6</sup>
- Transfers permitted, subject to process, between co-operative types
- Non-distributing co-operatives are prohibited from distributing trading surplus and asset surplus on winding up, this is similar to an ‘asset lock’. The rules of a non-distributing co-operative will provide a successor for any surplus assets on winding up.

## 6. Share capital

- Shares can only be issued to members
- Shares have fixed par value
- Shares can be issued with a premium, but not a discount
- Can issue bonus shares (unless it is a non-distributing co-operative)
- Shares can be withdrawable or transferable depending on rules. Shares withdrawals are limited to no more than 5% of the total issued share capital of the co-operative in any one year – there are possible exceptions
- A transfer of member shares may be at a price higher than par value as between the transferor and transferee, transfers are subject to board approval and based on whether the transferee is likely to be an active member<sup>7</sup>
- Share capital is repayable if member resigns or is ‘inactive’. Board has discretion to delay repayment of share capital if financial viability of co-operative is compromised by repayment. May substitute repayment of shares with a debt security

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<sup>6</sup> This type of co-operative is generally used for charitable purposes.

<sup>7</sup> Transfers at a higher price are common where the membership includes a right to occupy a place, e.g. some barristers’ chambers and ski clubs use the co-operative form. Transfers of these memberships are at a value associated with the right to occupy or use the facility. The shares are still at par value.

- Share repayment may be for less than par value
- No vote attached to shares (see membership)
- Minimum share requirement is prescribed in rules.
- Maximum permissible shareholding is 20% of total issued share capital. Registrars have discretion to allow more in special cases.

## 7. Membership and voting

- 1 vote : 1 member
- Members must be 'active' members (see rules)
- Members can resign, or must be cancelled for 'inactivity'
- No special categories of members such as 'employee members': members will simply have different obligations according to the active membership rule.
- Ordinary resolutions are passed by a simple majority; special resolutions are passed by a two thirds majority. The legislation provides for certain decisions to be passed by a 'special postal ballot'. This procedure requires 21 days' notice, a disclosure statement and a 75% majority.<sup>8</sup> Required voting majorities can be increased in the rules.

## 8. Distributions

- Non-distributing co-operatives cannot make distributions of surplus to members during life of co-operative or on winding up.
- Non-distributing co-operatives may provide rebates to members where the purpose of the co-operative is to deliver goods or services to members at the cheapest cost. The rebate will represent the cost savings obtained by the co-operative on behalf of members.
- Distributing co-operatives may distribute a limited dividend<sup>9</sup> to members according to shareholding, or may provided a rebate or distribution based on patronage.

## 9. Rules

- Rules are drafted and presented to Registrar for approval by proposed co-operative; co-operatives legislation provides 'Model Rules' for each co-operative type
- Stating a purpose or objects is optional (*will be relevant to obtain charitable status*)
- Required to set out 'primary activities' of the co-operative, and

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<sup>8</sup> A special postal ballot is required for major decisions identified in CNL, such as changing the type of co-operative, merger, scheme of arrangement, considering an offer in a 'takeover bid', voluntary winding up.

<sup>9</sup> Dividend limit is linked to interest rate on Commonwealth Bank term deposits, no more than 10% more than the quoted interest rate.

- “Active membership” requirements of a member to contribute to the primary activities.  
*e.g.: a producers’ co-operative will require members to sell a minimum amount of product to the co-operative; a consumers’ co-operative will require a minimum purchase of members. These are generally set at low levels to minimise cancellation events (and consequent repayment of any share capital) and to avoid conflict with trade practices legislation.*
- A co-operative can have many ‘primary activities’ and active membership may be expressed as alternatives. *E.g. a co-operative that buys and sells goods and services and provides educational services may require a members to either supply to, or buy from the co-operative or attend a training course.*

## 10. Disclosure requirements for issue of securities

- A distributing co-operative will require a new member to subscribe for a minimum number of shares and must give a current disclosure statement to a person before he/she agrees to take up the shares – regardless of minimum share requirement. A member may purchase additional shares.
- Disclosure standards primarily relate to membership obligations, because membership is what is being offered. The minimum share subscription is an obligation arising from membership.
- Disclosure obligations under the CNL govern all offers of membership/shares within a State. Issues of membership/shares across a State border are potentially also governed by disclosure requirements under Federal company law.
- Disclosure requirements focus on the rights and obligations of membership, including any active member requirements, state the nature of member shares, and provide financial information considered necessary according to the level of activity required and share ‘buy-in’ amount.
- Advertising shares without having lodged a disclosure statement is an offence.
- There are rights to recover damages for material misstatement or omission from the disclosure statement.
- Disclosure for debt securities or CCUs is of a lower standard if offer is made only to existing members. Offers of debt securities to the public are governed by a higher standard of disclosure, similar to disclosure requirements for companies. As for offers of member shares, an offer of debt securities when made across a State border will potentially be required to satisfy both State and Federal laws including the costs of lodgement for disclosure documents with two regulators.

## 11. Co-operative finance

- Co-operatives can compulsorily require members to buy additional shares or to make loans to the co-operative. Compulsory funding is not a popular practice, but was mostly used by larger agricultural co-operatives to fund asset acquisitions.
- CCUs were introduced in New South Wales legislation in 1996 to provide an alternative means for co-operatives to raise capital for growth. They do not permit CCU holders to have a vote. They were proposed as a flexible transferable and redeemable security that could be classed as capital or equity on a balance sheet. CCUs were not adopted by any other State, but they are part of the Co-operatives National Law and will eventually be available in all States.
- The Australian Accounting Standards Board adopted International Accounting Standards in 2005. The interpretation of equity under these standards meant that co-operative shares, even if they were not withdrawable, were classed as liability because they were repayable on resignation or cancellation through 'inactivity'.
- CCUs, despite the name, are also classed as liability, even if they are convertible to shares.
- There is no upper limit on borrowing by a co-operative through the issues of securities, either as a borrowing limit per member or as a whole. Market forces will dictate a limit in the light of the uneven balance sheet.
- A co-operative cannot take deposits unless it belongs to a special class of grandfathered co-operatives formed before 1992 that were permitted to take deposits.
- Co-operatives cannot carry on the business of banking.<sup>10</sup>

## 12. Auditing and financial reporting

- Under the CNL a co-operative may choose (in its rules) to not have its accounts audited, and may instead have no audit procedure or may have a review of its accounts if the co-operative is a small co-operative.<sup>11</sup>
- A small co-operative that does not have an audit requirement will be required to conduct an audit if 5% of members, or the Registrar, require it in a particular year.
- A small co-operative that does not have an audit requirement must furnish members with basic financial statements each financial year, and lodge a short annual return with the Registrar with a declaration of solvency.
- Large co-operatives must lodge full audited reports with the Registrar each financial year.

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<sup>10</sup> Building societies, friendly societies, credit unions and other 'co-operative or mutual finance' organisations were transferred to become companies under federal law and under control of the Australian Prudential Regulation Authority in 1999.

<sup>11</sup> A small co-operative is one that has at any two of the following characteristics: Less than \$8million revenue; less than \$4million in assets; fewer than 30 employees.

### 13. Mergers, acquisitions and takeovers

- A co-operative can merge with another co-operative after special resolutions in each co-operative
- A co-operative can acquire shares in another company and can form a company in which it holds substantial or all of the issued shares
- A co-operative may be the target of a takeover bid, but only in circumstances where the bidder acquires shares and the co-operative transfers simultaneously to a company. The process requires a series of approvals, special resolutions and disclosure.
- Persons who were members in the two years previous to a conversion or takeover event have certain shareholder rights under these processes.