

**SGECOL**

Study Group on European Cooperative Law

**DRAFT PRINCIPLES OF  
EUROPEAN COOPERATIVE LAW**

**– Draft PECOL –**

**Draft PECOL. May 2015**

This draft, still subject to changes, contains only a synthesis of the comments that will accompany PECOL in their final version, together with the national reports on the basis of which PECOL were formulated.

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The Study Group on European Cooperative Law (SGECOL) is a group of cooperative legal scholars from different European countries. It aims to conduct comparative research on cooperative law in Europe, with a view of promoting increased awareness and understanding of cooperative law within the legal, academic and governmental communities at national, European and international level (see Fajardo, Fici, Henry, Hiez, Meira, Münkner and Snaith, *New Study Group on European Cooperative Law: “Principles Project”*, Euricse WP, n. 24/2012, in [www.ssrn.com](http://www.ssrn.com); Id., *El Nuevo grupo de estudio en Derecho cooperativo europeo y el proyecto «los principios del Derecho cooperativo europeo»*, in *Revista de Derecho de sociedades*, 2012, pp. 609-618, and in CIRIEC-España, *Revista Jurídica de Economía Social y Cooperativa*, n. 24, 2013, pp. 331-350).

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### **List of abbreviations**

CCBSA	UK Co-operative and Community Benefit Societies Act 2014
FCA	Finnish Cooperatives Act n. 1488/2001
FrCA	French Cooperation Act n. 47-1775 of 10 September 1947
FCA Note	UK Financial Conduct Authority’s “Mutual Society Information Note”
GCA	German Cooperative Act (1889-2006)
ICA P	International Cooperative Alliance’s Principles of 1995
ICC	Italian Civil Code of 1942
PCC	Portuguese Cooperative Code n. 51/1996
SCE	European Cooperative Society
SCE R	Council Regulation n. 1435/2003 on the Statute for an SCE
SCA	Spanish Cooperatives Act n. 27/1999 of 16 July 1999

## INTRODUCTION

### 1. The Principles of European Cooperative Law (PECOL)

Publishing sets of European law principles has become almost commonplace in the last twenty years, with each new set reflecting a different and new area of European private or commercial law.<sup>1</sup> Thus, it is no surprise that a group of European scholars who generally focus on the law of cooperatives decided to enter the fray. The Group (defined below) undertook, over a three-year period, the necessary research and made the necessary comparisons to compile just such a set of European principles for their distinct body of law (the “PECOL Project”). The results of the PECOL Project are hereby published under the less-than-imaginative name “The Principles of European Cooperative Law” or PECOL for short. Unlike some other sets of European principles published in recent years, PECOL can rely on previous principles: cooperative principles established by cooperators themselves<sup>2</sup>. This arises new questions about the place and function of PECOL. But another particularity derives from the research on cooperative law, in which two typical aspects stand out. First, there has been, to date, only few adequate research in the field of cooperative law, as discussed below. Secondly, to the extent such research does exist, much of it has been authored by members of cooperatives themselves or by legal practitioners working with cooperatives rather than by academic scholars studying this type of entity<sup>3</sup>. These different features give an original flavour to the

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<sup>1</sup> From as far back as 1982, and encouraged over the years by resolutions of the European Parliament, various European legal scholars have been coming together to create sets of common European private law principles. The most famous example is the formation of the Lando Commission (initially formed in 1982) and the resulting Principles of European Contract Law (PECL), published in three parts in 1995, 1999, and 2003, respectively. Since then, a plethora of such sets of principles have appeared, for example, in European tort law, European family law, European security law, European company law, and European insolvency law.

<sup>2</sup> See below, 3.1.

<sup>3</sup> These works are not easy to disseminate, since they concern national cooperative laws, are written in the corresponding languages. Nevertheless, few academic works exist, among which are to be mentioned: D. Cracogna, A. Fici & H. Henry (Eds.), *International handbook of cooperative law*, Springers, 2013; D. Hiez (Ed.), *Droit comparé des coopératives européennes*, Larcier, 2009. Another special mention must be made to the Study on the Implementation of the Regulation 1435/2003 on the Statute for European Cooperative Society (SCE), 2010, [http://ec.europa.eu/enterprise/policies/sme/files/sce\\_final\\_study\\_part\\_i.pdf](http://ec.europa.eu/enterprise/policies/sme/files/sce_final_study_part_i.pdf).

PECOL compared to other sets of principles recently established. This will be explained by the presentation of the project (2) and its goals (3).

## **2 The PECOL Project**

### **2.1 The Group**

The PECOL Project brought together a small group of European scholars who have all chosen to focus on the law of cooperatives (the “Group”) from those EU Member States with the prominent cooperative traditions (i.e., France, Germany, Italy, Spain, Portugal, and the UK) as well as one Member State that developed its own unique approach to cooperatives (Finland).<sup>4</sup> Thus, the Group<sup>5</sup> includes (in alphabetical order): Isabel Gemma Fajardo Garcia (Spain); Antonio Fici (Italy);<sup>6</sup> Hagen Henry (Finland); David Hiez (France); Deolinda Meira (Portugal); Hans-H. Münkner (Germany); and Ian Snaith (the UK).<sup>7</sup>

The Group’s small size facilitated its work; the PECOL Project generated its projected set of principles in just three years, after only seven meetings<sup>8</sup>. The group’s work has been possible by the support of EURICSE and other research centers<sup>9</sup>, thanks to them.

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<sup>4</sup> Finnish cooperative law is interesting in several different respects, but most notably because it is very liberal. In fact, its most recent iteration completely breaks with existing cooperative law traditions. The most convincing example is probably the possibility to create a cooperative with only one member: actually, article 1 of Chapter 2 of Finnish Law 421/2013 does not make any reference to a minimum number of members (as did the previous law). While PECOL does not adopt any of the uniquely Finnish solutions to the various problems cooperatives face, the ability compare the broad range of possible alternatives, including the Finnish solutions, proved invaluable to the PECOL Project.

<sup>5</sup> Although research assistance was sporadically sought from various PhD candidates and cooperative law practitioners in other countries, it was not possible to bring in more academics from other jurisdictions.

<sup>6</sup> The Group expresses its sincere thanks to Prof. Fici, the PECOL Project’s Secretary, for his tireless efforts to coordinate the Group’s research and documents, with all of the logistical headaches that entails.

<sup>7</sup> The Group also benefited from, and greatly appreciated, Prof. Snaith’s linguistic help, which was given without stint.

<sup>8</sup> Trento (Italy), 27-31 October 2014; Valencia (Spain), 24-26 March 2014; Brussels (Belgium), 21-23 October 2013; Trento (Italy), 8-10 April 2013; Manchester (UK), 31 October 2012; Luxembourg (Grand Duchy of Luxembourg), 28-30 May 2012; Trento (Italy), 29-30 September 2011.

<sup>9</sup> The main support has been brought by Euricse. The second support came from the University of Luxembourg. The University of Valencia may also be mentioned for its

## 2.2 The PECOL Project's European Scope

As its name implies, the PECOL Project's scope was limited to European cooperative law principles. Thus, like other sets of published European principles, PECOL is neither a set of national principles nor a set of principles inspired by the laws of non-European jurisdictions. What sets PECOL apart, however, is the existence of positive EU law – that is, actual legislation – addressing cooperatives in the form of the European Cooperative Society (SCE).<sup>10</sup> Thus, the field of European cooperative law is no longer just an academic field; that legislation has, to some extent, already defined the cooperative's legal construct for Europe.

However, that particular construct was, in fact, too specific to be the Group's only reference for PECOL because SCEs are, by their features, secondary cooperatives (i.e., a cooperative entity formed by existing cooperatives), even if the legislation does not expressly require its secondary character<sup>11</sup>. Thus, the SCE Regulation could not be given any greater importance in preparing PECOL than more comprehensive national legislation. Moreover, decisions rendered by the European Court of Justice did not play a major role in generating PECOL, as it has not yet had the opportunity to directly address the SCE Regulation and its progeny. Rather, its only decision relating to a cooperative actually addressed a State aid question;<sup>12</sup> the Court was asked to decide whether the application of beneficial national tax rules to cooperatives constituted prohibited State aid.<sup>13</sup> Thus, although the perspective from which PECOL was generated is

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welcoming, as well as the Italian cooperative movement for its provision with premises for meeting in Brussel.

<sup>10</sup> REGULATION No 1435/2003 on the Statute for a European Cooperative Society (SCE).

<sup>11</sup> The SCE may be created by five natural persons, but many provisions deal with questions which arise, mainly, when it is composed of legal persons and, more, of cooperatives.

<sup>12</sup> See *Paint Graphos, Adige Carni, and Franchetto*, Joined Cases C-78/08, C-79/08 and C-80/08, ECLI:EU:C:2011:550. The First Chamber of the Court held:

Tax exemptions, such as those at issue in the main proceedings, granted to . . . cooperative societies under national legislation . . . concerning rules on tax benefits constitute State aid . . . only in so far as all the requirements for the application of that provision are met. . . . [I]t is for [the national] court to determine [if the national rules were] selective and whether they may be justified . . . by establishing [if] *cooperative societies* . . . are in fact in a comparable situation to that of other [profit making] entities and, if [so], whether the more advantageous tax treatment enjoyed by those cooperative societies, first, forms an inherent part of the essential principles of the tax system applicable in the Member State concerned and, second, complies with the principles of consistency and proportionality.

<sup>13</sup> Nevertheless, the *Paint Graphos* decision is still interesting, as it acknowledged that cooperatives may be a unique entity such that the application of special tax rules to them could be justified.

European, that fact should not suggest that PECOL’s scope is limited to legislation and case law produced by the European Union.

Although the PECOL Project’s European scope necessarily limited the Group’s consideration of non-European legislation or case law, it was impossible, in a globalized world, to make a strict distinction between what could or should be included within the concept of “European” cooperative law, particularly in a scientific work. This proved especially true as the state of existing global knowledge about cooperatives is quite limited. Information on and research regarding cooperative law principles in many jurisdictions are virtually non-existent or, if such information or research exists, it has not been widely disseminated or made particularly accessible<sup>14</sup>. The unfortunate consequence thereof is a very limited understanding of cooperative law principles around the world. Moreover, US legislation, which often has a significant influence on general legal principles, is not particularly important in the area of cooperative law. Scholarly attention has been paid mainly to legislation promulgated in South America and the Canadian province of Québec, since such legislation forms an integral part of the major developments in the field of cooperative law. Thus, despite their somewhat tangential relationship to Europe, they inform PECOL.

A last precision deals with the scope of cooperative law itself. The PECOL deals only with substantial cooperative law, which means the organisation of cooperatives. Indeed, the underlying issues related to taxation, labour law, consumer law and other questions arising from the relationship between cooperative law and other branches of law are not considered as elements of cooperative law itself. These questions are, however, very important, but depend so much on national jurisdictions that it is impossible, so far, to draw general conclusions.

### **2.3 The PECOL Project’s Methodology**

Once formed, the Group agreed to divide the (organizational) law of cooperatives into five distinct areas, with each area intended to serve as a separate chapter of PECOL: (1) definition and objectives (first draft by Antonio Fici), (2) governance (Ian Snaith), (3) financial structure (Isabel Gemma Fajardo Garcia and Deolinda Meira), (4) external controls (Hans-H. Münkner), and (5) cooperation among cooperatives (Hagen Henry). Each of these five areas was then assigned to one or two Group Members (the “Chapter Lead”), who then prepared guidelines regarding the information needed with respect to the particular area. Those guidelines gave a uniform

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<sup>14</sup> For exceptions, see above, footnote 3.

structure to the national reports (each a “National Report”) that were prepared by each Group Member with respect to the development and current state of cooperative law in his or her Member State<sup>15</sup>.

Each Chapter Lead then drafted his, her or their chapter on the basis of the information provided in the National Reports. Those draft chapters were then circulated amongst the Group for initial review and comment. The Group would then gather for face-to-face discussions of the various chapters and would propose revisions thereto<sup>16</sup>. As changes to one chapter often instigated changes to other chapters, the Group met one final time, to collectively review all of the revised chapters and agree on the final version of PECOL. The same methodology has been adopted for the introduction (first draft by David Hiez). This work is the result. But, as each principle may echo differently in the diverse member states, they are completed by comments, which intend to develop their context, their possible interpretation, or the way they are coordinated with other provisions.

### **3. PECOL’s Goals**

The obvious objective of the PECOL Project was to formulate PECOL. Nevertheless, the Group’s aspirations for PECOL – that is, what they firmly believe PECOL can accomplish in relation to European and international cooperative law – are the PECOL Project’s ultimate objectives. Of course, the Group’s aspirations for PECOL are somewhat different from those expressed by the authors of other sets of European principles in other areas of law, due to the unique nature of cooperative law. For example, almost 20 years ago, Ole Lando expressed his hope that his Principles of European Contract Law (PECL), as well as other sets of European principles, would achieve several objectives. Among other things, he expected them to: promote cross-border trade; enhance the single market; provide direction to European and national legislatures and courts with respect to future legislation and legal interpretation and potentially enhance harmonization efforts; and, finally, create of a bridge between the Roman and Common law systems. He also mentioned that PECL (as opposed to other sets of

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<sup>15</sup> These national reports are extensive and provide with a very rich presentation of national cooperative legislation. Like PECOL, they are structured by the five topics detailed above. Therefore, they are precious for themselves, and will be part of the book. Even if the goal of the group has always been the establishment of PECOL, and the collective work focused only on it, the individual work produced will facilitate the dissemination of cooperative law as well.

<sup>16</sup> These face to face discussions occurred during the meetings detailed above, footnote 8.

principles) could act as modern expression of *lex mercatoria* and might even be directly adopted by the parties to private contracts. Although the Group's aspirations for PECOL mirror a few of these aspirations, the remainder are simple inapplicable in the area of cooperative law. First, the law of cooperatives already benefits from internationally-recognized cooperative principles that have existed, in various forms, for over a century. The Group's aspirations for PECOL are inevitably informed by that history, which is briefly described below. Secondly, the academic debate surrounding the "descriptive v. normative" use of the term *principle* has also affected the Group's aspirations for PECOL, which debate and effect are discussed briefly below, too. Thirdly, relying on the reader's understanding of these two influences, the Group's specific aspirations and objectives for PECOL are described in more detail. Finally, major justifications for the establishment of PECOL will be given.

### 3.1 A Brief History of Cooperative Law Principles

Very early on, in contrast to many other economic actors, cooperative entities recognized that theirs was a unique approach to economic activity. To better define and encourage the use of their distinctive economic approach, they created a body in which cooperative members (so-called cooperators) could debate, among themselves, the proper organization and functioning of cooperative entities and to promote the use and proliferation thereof. Thus, in 1895, the International Cooperative Alliance (ICA) was born. One of its main goals was to establish a common identity for cooperatives around the world<sup>17</sup>. After vigorous debate,<sup>18</sup> the ICA finally adopted and published a variety of principles, generally based on those of The Rochdale Equitable Pioneers Society,<sup>19</sup> that were intended to describe the structure and management of cooperatives on an international scale.<sup>20</sup>

The cooperative pattern did not, of course, stagnate over the next century; it underwent significant changes over time. The ICA Principles were, as a result, subject to a number of revisions. The latest version was adopted in

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<sup>17</sup> <http://www.ica.coop/en/history-ica>

<sup>18</sup> J.-F. Draperi, *La République cooperative*, Larcier, Bruxelles, 2012, ps. 155 s.

<sup>19</sup> <http://www.cooperativegrocer.coop/articles/2004-01-09/co-op-principles-then-and-now-part-2>

<sup>20</sup> For example, major discussions took place regarding the place of salaries in cooperatives: F. Espagne, "*Principes coopératifs? Lesquels?: histoire et lecture des principes coopératifs selon l'alliance coopérative internationale*", Paris, 2008 [http://cediasbibli.org/opac/index.php?lvl=notice\\_display&id=38082](http://cediasbibli.org/opac/index.php?lvl=notice_display&id=38082)

1995<sup>21</sup> and remains the touchstone for cooperatives around the globe. Through those the different iterations, not only the content of the ICA Principles changed; their functions changed as well. In 1937, for example, certain of the ICA Principles were obligatory or considered as defining criteria for a cooperative entity. In subsequent years, however, some of the ICA Principles became merely advisory or reflected an attempt to describe the common denominators of then-current cooperatives<sup>22</sup>. Certainly, such changes in content and function reflect the relative status and strength of the ICA over time, but they are also quite telling when attempting to define the nature of the ICA Principles themselves as descriptive principles.

One of the most notable aspects of the ICA Principles is their international status. In fact, they have become a reference point for cooperative features for the international community. In 2002, for example, the International Labour Organisation (ILO) adopted Recommendation 193 on the Promotion of Cooperatives<sup>23</sup>, which includes these principles<sup>24</sup>, which refers to these principles. Although Recommendation 193 is not legally-binding, it still reflects an important contribution to the growing body of international cooperative law<sup>25</sup>. Moreover, regional legislation has explicitly acknowledged that they represent universally accepted cooperative principles<sup>26</sup>.

### 3.2 Cooperative Principles v. Principles of Cooperative Law

Academics love to argue about the polysemic term *principles*. Although the theoretical debate still rages about the difference between a *rule* and a *principle*, national and international legislation(see, e.g., the International

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<sup>21</sup> Y. Macpherson, *Les principes coopératifs vers le 21<sup>e</sup> siècle*, ICA publisher, Genève, 1996 ; A. Chomel & C. Vienney, « La continuité au risque de l'irréalité », RECMA, 1996, n° 260.

<sup>22</sup> F. Espagne, above.

<sup>23</sup> ILO Promotion of Cooperatives Recommendation, 2002 (No 193), [http://www.ilo.org/dyn/normlex/en/f?p=NORMLEXPUB:12100:0::NO::P12100\\_ILO\\_CO DE:R193](http://www.ilo.org/dyn/normlex/en/f?p=NORMLEXPUB:12100:0::NO::P12100_ILO_CO DE:R193) (last visited 19 January 2015)

<sup>24</sup> ILO Promotion of Cooperatives Recommendation, 2002 (No 193), [http://www.ilo.org/dyn/normlex/en/f?p=NORMLEXPUB:12100:0::NO::P12100\\_ILO\\_CO DE:R193](http://www.ilo.org/dyn/normlex/en/f?p=NORMLEXPUB:12100:0::NO::P12100_ILO_CO DE:R193) (last visited 19 January 2015)

<sup>25</sup> H. Henry, "The Contribution of the ILO to the Formation of Public International Cooperative Law", in S. Kott & J. Droux (Ed.), *Globalizing social rights The International Labour Organization and beyond*, Houndmills, Basingstoke, Hampshire ; New York : Palgrave Macmillan, 2013, p. 98.

<sup>26</sup> Acte uniforme sur les sociétés coopératives, adopté par l'Organisation pour l'harmonisation en Afrique du droit des affaires, 2010, Art. 6.

Court of Justice’s statutes<sup>27</sup>, as well as model laws (see, e.g., the Common European Sales Law<sup>28</sup>), use the term *principle* without clearly indicating which of the possible meanings is intended<sup>29</sup>.

Nevertheless, for the Group, the establishment of principles by academics brings necessarily an epistemological ambiguity. The most important distinction revolves around the term’s descriptive and normative meanings. Sometimes, the term *principle* is intended to mean a general feature described by academics (i.e., descriptive principles), while at other times, the term refers to the actual source law (i.e., normative principles). Clearly, such a distinction should be more fully analysed, as such generalities may be the ultimate basis for legal determinations, but such an analysis is beyond the scope of this work. Suffice it to say that, for PECOL’s purposes, the important aspect of the difference between the descriptive and normative uses of the term *principles* is to distinguish the generally descriptive nature of the ICA Principles from the generally normative nature of PECOL.

PECOL’s principles are, in fact, meta-principles. Whereas the ICA Principles describe the actual manner in which cooperatives function, PECOL describes cooperative law norms. In other words, PECOL does not claim to describe the organization or management of cooperatives, but rather the diverse regulations which govern such cooperatives, including their organization and management. Surely, though, any such distinction is tempered by the fact that the two concepts – the descriptive and the normative – can never be completely segregated. On the one hand, the ICA Principles are based, at least in part, on the way national legislation regulates cooperatives. On the other hand, PECOL necessarily addresses how cooperatives are actually organized and function. The difference, for PECOL, is that there is always intervening legislation that ensures the application of its *principles* to the cooperative entity.

### 3.3 The PECOL Project’s Ultimate Objectives

Like some of other sets of European principles,<sup>30</sup> the PECOL’s ultimate objectives included the creation of either a set of modern principles to exist

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<sup>27</sup> Statute of the international court of justice, art. 38 1. C., which refers to “the general principles of law recognized by civilized nations”.

<sup>28</sup> The word *principle* is used in the regulation on a Common European Sales Law proposed by the Commission (com(2011) 635), Art. 4, to designate the sources of law that must be used to fill the gaps therein.

<sup>29</sup> Y. Adar & P. Sirena, “Principles and rules in the emerging contract law: from the PECL to the CESL, and beyond”, European review of contract law, 2013, p. 1-37; B. Pozzo, « Les principes directeurs en droit comparé », Revue des contrats, 2013, 400.

<sup>30</sup> See footnote [re Lando’s goals] \_\_\_\_, *supra*.

in parallel with European or national law (e.g., *lex mercatoria*) or a set of principles to be directly applied by private individuals and entities (e.g., contracting parties). Surely, the PECOL are not an alternative to existing legislation, which is mandatory, but they may become a promising pattern. However, the Group did not expect PECOL to promote further European Union legislation in the area of cooperative law<sup>31</sup>. Naturally, the Group believes that PECOL should still serve as an appropriate touchstone in connection with the application and/or reform of the existing SCE Regulation and associated legislation by EU institutions. But the SCE Regulation and the legislation adopted pursuant thereto is sufficient; for the Group, further EU legislation is neither desired nor desirable. As cooperatives have always established their functioning themselves, a top-down harmonization would be meaningless. Because written cooperative principles have been available for so long, any deviations therefrom adopted by Member States who already have cooperative legislation can only be considered intentional (i.e., a political choice to be different). To the extent that other Member States have no such legislation on the books (typically Eastern European countries), such that attempts to harmonize their national would be of little or no value. Nevertheless, the establishment of a set of principles provide with a pattern, which offers a toolbox, as well as it stands out the most promising orientations for future.

For that purpose, the PECOL Project's objective is to provide a better understanding of cooperatives, and the legal principles on which such entities rely, in order to maximize their potential. The Group recognized, though, that existing state of cooperative law principles is not always adequate to define what cooperatives are, much less what they could be, in 21st century Europe. Too many questions about cooperatives remain open<sup>32</sup>, despite the various iterations of the ICA Principles; the Group recognized that a modern, coordinated approach to 21<sup>st</sup> century cooperatives is needed. That is not to suggest, however, that the Group believed there is any need for fundamental changes to cooperative law principles. Instead, the Group

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<sup>31</sup> The PECOL cannot enhance cross-border commerce or the single market, as cooperatives typically are, by their very nature, a local phenomenon. Most of them might be local, but even then they do at times cooperate across borders, at times they have members from both sides of a border. Nevertheless, they are far from the issues arising from the transfer of seats in company law.

<sup>32</sup> Significant and important questions remain unanswered in the area of cooperative law. For example, what is the relationship between the cooperators' interests and the general interest? How should a cooperative's transactions with non-cooperators be addressed? How should cooperative transactions through subsidiaries be handled? What is the relationship between and/or what connections exist between cooperative law and company law? We do not discuss them in this introduction, they will be part of the PECOL and their comments.

expects PECOL to function as a coherent body of cooperative law (rules and/or guiding principles), fitted to present needs. In that regard, it envisions PECOL's use as a guide for cooperative law expansion and reform throughout Europe, and beyond, and as a general orientation to and a set of established best practices for both legislatures adopting new, expanded or reformed legislation and for courts interpreting cooperative law.

Although PECOL is clearly descriptive (as any scientific work must be), it also has a normative component. To the extent the Group found unanimous agreement with respect to certain cooperative law principles, it adopted them in PECOL. When faced with alternative solutions to a particular cooperative law issue, PECOL chooses the most suitable among them for modern cooperatives. And, to the extent no existing principle addressed a particular question, PECOL suggests an appropriate, modern solution consistent with its general orientation. Nothing less could provide a coherent body of rules and principles for 21<sup>st</sup> century, modern European cooperatives. Nevertheless, PECOL cannot, in the end, claim to be normative in that term's purest sense, as PECOL makes no pretence of making law. Legislating is left to legislature. At most, PECOL represents "soft law".

### **3.4 Three reasons to establish the PECOL**

#### **3.4.1 The PECOL as a legal cooperative identity**

The links between principles and identity is obvious, through the wording of Ica to qualify its statements: cooperative identity, values and principles. No doubt, therefore, that PECOL deal with cooperative identity. But, that proximity is not a hazard, and the determination of a cooperative identity is surely one of the main reasons to establish PECOL. We have mentioned that cooperative legislations, by their diversity and contradictions, did not provide with a clear cooperative identity. Nor the cooperatives principles established by ICA do, since they are too general<sup>33</sup>. However, it is crucial to precise that identity, since it is the only reason why cooperatives should be submitted to particular regulation. It violates no secrecy to say that some cooperative practices, as well as some legislations, did weaken the differences between cooperatives and companies, which can be described as a companization of cooperatives or, more positively, as hybridization. As law scholars, we have no opinion about the opportunity of these evolutions,

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<sup>33</sup> However, ICA is aware of the problem and awarded a mandate to a "principles committee" to create a guidance note, in order to shape the pillars of identity, strengthening the cooperative difference.

but we can say that they give arguments to abolish cooperative particular legal rules.

This is exactly the motivation of the ECJ decision in 2009<sup>34</sup>. This case relied on the cooperative identity, which put some constraints on the cooperative, which made legitimate the tax advantages. Therefore, it is very important to state a clear and updated cooperative identity. The PECOL, as the expression of the major evolutions of cooperative regulations, relying on comparative perspectives, may fulfil that function.

### **3.4.2 The PECOL as pattern for other enterprises**

The second reason why PECOL are useful right now is that they cooperative law can be a model. It is already used as such, even implicitly, when some of its techniques are included in the community interest companies. The contribution is, sometimes, explicit, like for social cooperatives in Italy, which chose the cooperative framework to regulate social enterprises. Even the Belgian “société à finalité sociale”, which aimed at favouring the pursuit of social object in any corporation, did not find any other solution to define the new modality.

The moment is crucial in a European perspective, since the Commission, after a decade of disinterest, seems to look again at social economy. It already started to make some regulations and, therefore, to define, at least indirectly, social enterprise<sup>35</sup>. The emphasis is put, more and more, to the specificity of the object of the enterprise, which would distinguish it from companies. But, cooperatives have another scope, based on the structuration of the enterprise. In order to have a chance to influence the EU choices, it is necessary to present a clear identity, fitting with the future concerns. Here, again, the PECOL could fulfil that function.

### **3.4.3 The PECOL as a tool to enter into academic debates**

Finally, PECOL are an occasion for cooperative law to go out of its isolation. International academic community has absolutely no interest in cooperative law. At the national levels, only Germany, Italy and Spain may claim for a scientific tradition on this topic. So far, cooperative law is mainly discussed among cooperators, or cooperative institutions, when it is not drafted by them. The establishment of European principles, if it is not

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<sup>34</sup> See above, footnote 11.

<sup>35</sup> *This is the case, through the designation of the beneficiaries of the european fund for social entrepreneurship : Règlement (UE) n° 346/2013 du Parlement européen et du Conseil relatif aux fonds d'entrepreneuriat social européens, article 3.*

considered as an imitation, could enlighten richness of cooperative law and its specific mechanisms.

This is not only the interest of researchers in cooperative law. Ongoing debates about companies, after the financial crisis and its consequences, could undoubtedly benefit from a better knowledge of cooperative law<sup>36</sup>. This requires, from cooperative law scholars, to keep some distance with cooperative institutions. Of course, discussions must be maintained and developed, since law has to be closely connected to the reality. Nevertheless, the researchers on cooperative law cannot be the advocates of cooperatives in the academic field<sup>37</sup>. Naturally, they will claim for the richness of cooperative law, but this is far from pleading for cooperatives themselves.

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<sup>36</sup> It is remarkable that an attempt, by a law Professor, to analyse the firm as commons, even if referring once to cooperative, makes no use of cooperative law: S. Deakin, “The corporation as commons: rethinking property rights, governance and sustainability in the business enterprise”, *Queen’s La Journal*, 2012, 339-381, spec. p. 352.

<sup>37</sup> Sometimes, cooperative institutions expect so, even if they don’t invest positively as businesses do. It is notable that, at least directly, the cooperative institutions did not support financially that work.

## **CHAPTER 1**

### **DEFINITION AND OBJECTIVES OF COOPERATIVES**

#### **SECTION 1.1**

##### *(Definition and objectives of cooperatives)*

(1) Cooperatives are legal persons governed by private law that carry on any economic activity without profit as the ultimate purpose and

(a) mainly in the interest of their members, as consumers, providers or workers of the cooperative enterprise (“mutual cooperatives”), or

(b) mainly in the general interest of the community (“general interest cooperatives”).

(2) “Profit as the ultimate purpose” means making profits mainly for the payment of interest, dividends or bonuses on money invested or deposited with, or lent to, the cooperative or any other person.

(3) For the purpose in paragraph (1)(a), “cooperative enterprise” may include an enterprise carried out by a subsidiary if this is necessary to satisfy the interests of the members and the members of the cooperative maintain the ultimate control of the subsidiary.

(4) Cooperatives shall include in their registered name the word “cooperative”, “coop”, or similar. The words “cooperative”, “coop”, or similar, may not be included in the name of entities not formed and managed as cooperatives in accordance with cooperative law and universally recognised cooperative values and principles.

#### **SECTION 1.2**

##### *(Law applicable and cooperative statutes)*

(1) Cooperatives regulated by special laws for their type of cooperative are subject to the general cooperative law only to the extent that it is compatible with their particular nature.

(2) As autonomous organizations, cooperatives are free to govern themselves by their statutes within the limits of cooperative law. For this

purpose, “statutes” includes both the instrument of incorporation and statutes which are the subject of a separate document.

(3) In the case of matters not regulated or partly regulated by cooperative law and cooperative statutes, other laws, including company law, may apply to cooperatives only to the extent that they are compatible with their particular nature.

### **SECTION 1.3** ***(Membership requirements)***

(1) The members of a cooperative may be cooperator members or non-cooperator members.

(2) Cooperator members are natural or legal persons who engage in cooperative transactions as consumers, providers or workers of the cooperative enterprise.

(3) Non-cooperator members are natural or legal persons, such as investors, volunteers, or public bodies, who do not engage in cooperative transactions but are interested in the pursuit of the cooperative objective.

(4) A cooperative shall always comprise no fewer than two members, who in a mutual cooperative must be cooperator members.

(5) Mutual cooperatives may admit to membership non-cooperator members only if their statutes so provide.

(6) Cooperative statutes may make membership subject to reasonable conditions related to their particular type or objective, without gender, social, ethnic, racial, political or religious discrimination or artificial restriction of membership.

### **SECTION 1.4** ***(Cooperative transactions)***

(1) Mutual cooperatives pursue their objective mainly through cooperative transactions with their cooperator members for the provision of goods, services or jobs.

(2) In the conclusion and execution of cooperative transactions cooperatives shall observe the principle of equal treatment of cooperator members.

(3) Cooperative statutes shall include provisions about the participation of cooperator members in cooperative transactions, with particular regard to the minimum extent and/or level of such participation.

(4) Without prejudice to any other legal remedy, failure by the cooperator member or by the cooperative to engage in cooperative transactions is a justified condition respectively for member expulsion and for member withdrawal.

### **SECTION 1.5**

#### ***(Non-member cooperative transactions)***

(1) “Non-member cooperative transactions” are transactions between cooperatives and non-members for the provision of goods, services or jobs of the same kind as those provided to cooperator members.

(2) Without prejudice to section 1.4(1), mutual cooperatives may engage in non-member cooperative transactions unless their statutes provide otherwise.

(3) Mutual cooperatives engaging in non-member cooperative transactions shall give those non-members an option to become cooperator members and inform them about it.

(4) When mutual cooperatives carry out non-member cooperative transactions they shall keep a separate account of such transactions. General interest cooperatives may also do so.

(5) Profits from non-member cooperative transactions are allocated to indivisible reserves.

## COMMENTS TO CHAPTER 1

### **Section 1.1**

#### **The definition of cooperatives and the cooperative identity**

The first provision of the PECOL contains a definition of cooperatives. This is consistent with the common practice in European cooperative laws [see art. 2511 ICC; art. 2 PCC; chap. 1, sec. 2(1), FCA; par. 1(1) GCA; art. 1(1) SCA; art. 1(1) FrCA]. In contrast, a proper definition of an SCE is lacking, although the SCE R immediately identifies an SCE by some characteristics, including member and capital variability and the objective pursued [see art. 1 SCE R]. In a more complex manner, the CCBSA identifies cooperatives by a negative requirement, namely, the non-profit purpose [sec. 2(3), CCBSA], and by a positive requirement, that of being *bona fide* cooperatives according to the conditions laid down by the Financial Conduct Authority as the registration authority [sec. 2(2)(a)(i), CCBSA; FCA Note]. The ICA Statement on the Cooperative Identity begins with a definition as well, which is followed by the ICA P proper.

A definition certainly helps to shape the cooperative identity and thus to distinguish cooperatives from other types of entities. This explains the choice to include in the PECOL a cooperative-defining provision. However, the importance of a definition must not be overemphasized. In fact, the cooperative identity comprises several aspects and is the result of the overall cooperative regulation, including those provisions dealing with the organizational and the financial structure of a cooperative (in PECOL, sec. 2 and 3, respectively). Therefore, a definition can hardly be so comprehensive as to include all the distinguishing features of cooperatives, and even a definition which purports to do so, should be read in conjunction with other provisions explaining the meaning and showing the contents of the features (only) mentioned therein. Moreover, different definitions may be found in European cooperative laws, some more comprehensive (e.g., PCC, SCA, and CCBSA by reference to FCA Note), others less such (e.g., ICC), and their substantial contents vary. The only common element in all the legal definitions examined is the fact that they all make reference to the objective of a cooperative.

Consequently, the PECOL on the one hand provide a definition, and on the other hand center it on the objective pursued by cooperatives, leaving aside other defining features (capital/member variability, democracy, etc.) which will be considered by other PECOL provisions. Indeed, although it is not the only element of the cooperative identity, the objective is probably the feature that more than others helps to distinguish cooperatives from

other business organizations, especially companies (also taking into consideration the trend in company law not to attribute a specific purpose to companies, which emerges, for example, from the comparison of the SCE R and the European Company Regulation of 2001).

In the PECOL definition of a cooperative, attention must also be paid to the fact that cooperatives are considered legal persons governed by private law (the PECOL do not go into the details of how the legal personality is acquired by cooperatives, which however normally stems automatically from their registration). The legal personality stresses the autonomous legal subjectivity of cooperatives relative to their members, as well as their full legal capacity, and in some jurisdictions it also conveys their patrimonial autonomy (see PECOL, sec. 3.5). The reference to private law emphasizes the private nature of cooperatives and their being one of the organizational types made available by legislatures to citizens to shape their business.

In PECOL cooperatives are identified only by the title of “cooperatives”, like in the FCA and in the PCC, as well as in the ICA P. Therefore, they are neither referred to as “cooperative companies”, like in the ICC, FrCA, and SCA (in which jurisdictions the word “society” is substantially the equivalent of “company”), nor as “cooperative societies”, like in the CCBSA and the SCE R.

On the one hand this choice was made to highlight the difference between cooperatives and (for-profit) companies; on the other hand, this choice does not affect the possibility to apply company law to fill the gaps of cooperative law (see below in this comment). This is demonstrated by the fact that cooperatives are subject to the supplemental and additional application of company law provisions both in countries, like France and Italy, where they are referred to as “cooperative companies”, and in countries, like Portugal, where they are referred to simply as “cooperatives”. From a theoretical point of view, the fact that cooperatives are considered companies is not a great problem once it is recognized that that of “company” is a genus within which companies without a profit purpose and with the particular characteristics of cooperatives may be included, as is the case in the Italian legal doctrine. The same conclusion applies if we adopt a broader notion of “profit” and “for-profit” as characterizing the category of companies (as in the Portuguese but also in the Italian legal scholarships), which also includes the pursuit of economic interests (e.g., cost savings) different from capital remuneration. In this last case, too, a cooperative could be included in the genus of companies, without this representing a problem in terms of cooperative identity.

### **The cooperative objective**

The definition in PECOL sec. 1.1(1) is a general definition, so conceived as to cover all types of cooperatives, including those that in many countries fall within special laws. A general definition reflects the nature of the PECOL as proposed general principles of European cooperative law, covering all types of cooperatives regardless of their sector of activity.

The definition in PECOL sec. 1.1(1) also covers secondary or higher-degree cooperatives, i.e., cooperatives formed by cooperatives, thus not requiring an explicit provision for them. Indeed, secondary cooperatives (or “consortia of cooperatives” as they are referred to in some jurisdictions) carry out an enterprise in the interest of their member cooperatives as consumers/users or providers of the (enterprise carried out by the) secondary cooperative. This does not mean, however, that secondary cooperatives might not need a specific regulation. In fact, they will be explicitly dealt with elsewhere in PECOL.

The PECOL definition refers explicitly to two general types of cooperatives, “mutual” cooperatives and “general interest” cooperatives, and three broad sub-types of mutual cooperatives (consumer-, producer-, worker cooperatives) according to the nature of the members and their relationship with the cooperative. These sub-types are apt to cover all the existing particular types of cooperatives in all the sectors of the economy (agriculture, banking, etc.).

Notwithstanding worker cooperatives are in fact a species of producer cooperatives (they are producer cooperatives where work is the input provided by the members), it has seemed opportune to mention them separately as some European cooperative laws do [artt. 6 and 80 SCA; artt. 2512 and 2513 ICC; art. 1(3) SCE R], also because worker cooperatives sometimes are recipients of a special regulation due to the particular nature of the relationship which takes place between the cooperative and its worker-members, which creates specific problems of regulation in relation to labor law and its mandatory principles [see Italian law n. 142/2001; French Law of 1978; in Spain labor law its mandatory for cooperatives only if the cooperative law call for its application].

In addition, it must be underlined that nothing in the PECOL definition precludes the possibility – as happens in many countries and is also explicitly stated in some cooperative laws [art. 4(2) PCC; art. 105 SCA; art. 2513(2) ICC] – of a mutual cooperative being formed to act in the interest of more than one category of members, e.g., consumer-members and worker-members, thereby undertaking more than one type of cooperative transactions with its members.

In the PECOL definition, the objective also comprises a negative element, the non-profit purpose, which is described by recourse to the wording of CCBSA sec. 2(3). Indeed, this would not be a necessary element

of the definition of a cooperative as long as a positive statement of the objective pursued does already exist, and refers to an objective of a different nature. However, not only is the non-profit purpose of cooperatives explicitly stated in their very definition by some European cooperative laws [sec. 2(3) CCBSA; art. 2(1) PCC], but it also serves to trace yet more clear borders between cooperatives and companies.

Indeed, according to a line of thought shared by some authors, notably economists and law and economics scholars, companies are cooperatives, more precisely, a particular type of producer cooperatives or “capital cooperatives”, as shareholders are providers of capital and the service rendered by the company to shareholders is capital remuneration. In this regard, the cooperative would be the genus to which also companies pertain, and the difference between cooperatives and companies would almost dissolve. This is a partial and incomplete view of cooperatives, which takes into consideration only the ownership structure (and not the other features of cooperatives) and neglects to consider that a company’s shareholders do not possess the double quality a cooperative’s members possess. Shareholders are not consumers/users, providers or workers of the company enterprise; they only buy and hold shares of the company capital. This also explains why in defining a cooperative it is necessary to refer to the enterprise performed, while in defining companies this is not necessary (companies are “neutral” also in this respect).

The reference to the non-profit aim of cooperatives does not prevent a cooperative from remunerating within certain limits the capital subscribed by the cooperators and/or investor members, as will be pointed out in PECOL chapter 3.

### **Mutual cooperatives**

As said, PECOL comprises two general types of cooperatives, termed “mutual cooperatives” and “general interest cooperatives”, in conformity with a trend that may be observed in European cooperative law with particular regard to the jurisdictions covered by PECOL. Providing for these two general types is one of the main achievements of the PECOL and advancements in the cooperative legal theory.

These two general types are distinct from each other, first of all because of the different objective pursued.

In mutual cooperatives, which are the more traditional general type (and the only one referred to by the ICA P), the institutional objective consists of both the ultimate purpose to act in the interest of the members and the conduct of a particular activity to fulfill that purpose, namely, the cooperative enterprise with the members.

The objective of mutual cooperatives substantially coincides with that which current cooperative laws in Europe assign to cooperatives.

Cooperatives are legal entities that conduct an enterprise in the interest of their members/owners, as consumers/users of the goods or services provided by the cooperative enterprise, as providers of the goods or services employed for running the cooperative enterprise, or as workers of the cooperative enterprise. In other words, the final objective of mutual cooperatives is to satisfy the needs and maximize the utility of their consumer-, provider- or worker-members. Relative to share companies established to maximize shareholders' value (by distributing profits to them and/or increasing the exchange value of the shares they hold), mutual cooperatives are different not because they do not act in the interest of their members, but because their purpose is not to satisfy the members' interests in maximizing the value of a capital investment but in obtaining or providing goods (including knowledge or other immaterial things) or services or in working at the best possible conditions, which is an economic but not a lucrative purpose in a strict sense.

The definition in PECOL sec. 1.1(1) does not contain a reference to the nature of members' needs, whether economic, social, cultural, or ideological, as in contrast provided for by some European cooperative laws [par. 1(1) GCA; chap. 1, sec. 2, FCA; art. 1(1) SCA; art. 2(1)PCC; art. 1(3) SCE R]. Indeed, the nature of members' needs either relates to internal motivations which are not relevant for the qualification of the legal entity or, if identified by the law, may show the legislature's intention to make available the cooperative form for the pursuit of a particular function, which is atypical in relation to that normally assigned to mutual cooperatives. In particular, when national cooperative laws refer to social, cultural, ideological needs of cooperative members they may pave the way for general interest cooperatives to exist, which are, however, explicitly contemplated by PECOL.

The mutual purpose of cooperatives does not exclude that cooperatives pursue additional objectives, which go beyond the interests of their members and may be qualified as "altruistic" [see explicitly par. 1(2) GCA]: the use of "main" in the PECOL definition of mutual cooperatives serves also this specific objective. The outward orientation of mutual cooperatives may result, for example, from the use of part of the surplus in the interest of the cooperative movement and/or the community, thereby strengthening that "social function" that many jurisdictions assign to cooperatives (including at the Constitutional level: see art. 45 of the Italian Constitution; art. 129 of the Spanish Constitution, which however does not make explicit reference to the social function of cooperatives; and the numerous provisions in the Portuguese Constitution). However, mutual cooperatives that externalize a

portion of the value that they are able to generate still do not coincide with general interest cooperatives, in which, as will be soon pointed out, the (main) outward orientation shapes their institutional objective as opposed to that of mutual cooperatives.

### **General interest cooperatives**

While mutual cooperatives correspond to the traditional model of cooperative as found in the origins of the cooperative movement, general interest cooperatives have emerged in the European legislation more recently, due to the recourse by legislatures to the cooperative form to provide a suitable legal structure for entrepreneurial activity of general interest or social enterprises.

However, different situations as well as different theories may currently be found across European jurisdictions.

Italian Law n. 381/1991 provide for the formation of “social cooperatives”. Social cooperatives “pursue the general interest of the community in the human promotion and social integration of citizens through: *a*) the provision of social-health and educational services; *b*) the carrying out of various activities – agricultural, industrial, commercial, or service – for the work integration of disadvantaged persons”. Social cooperatives, therefore, do not act in the interest of their members as such, but in the general interest of the community. They are not mutual but general interest cooperatives, as explicitly stated by law and recognized by some legal scholars.

The SCA recognizes “social initiative cooperatives”, namely, “non-profit cooperatives which irrespective of the class to which they belong have as their objectives either the provision of welfare services through health, education, cultural or other activities of a social nature, or the conduct of any economic activity with the purpose of integrating those who suffer any kind of social exclusion into the labour market and, in general, meeting social needs that are not being attended to by the market” (art. 106(1)).

Being classified as non-profit, social initiative cooperatives are also subject to the following restrictions (*Disposición Adicional Primera*, SCA): not distributing surpluses or profits to their members, not paying more than the legal rate of interest (currently 3.5%) on the capital, unpaid cooperative office-holders and limitations on the salaries of the workers (members or otherwise), which may not exceed 150% of the levels set out in the applicable sector agreement (*convenio colectivo*).

Notwithstanding the above, these cooperatives are considered mutual in their essence. Consequently, the activity in question will be conducted

mainly to attend to the needs of its members, whether these be consumers, users, suppliers or workers.

Portuguese Law n. 78/98 regulates “social solidarity cooperatives” whose objective consists in supporting situations of social and economic vulnerability, based on a paternalistic paradigm of social intervention with families, children, youth, seniors, disabled, unemployed and other vulnerable groups, in view of their professional integration, education, training, occupational and residential care. These cooperatives base their entire activity in a logic of solidarity, so that the legal framework which they fall in has peculiarities. One should stress, from the outset, the impossibility of distributing cooperative advantages to cooperative members, which means that all surpluses will revert, mandatorily, to reserves (art. 7). In spite of this, however, like in Spain, the Portuguese scholarship considers social solidarity cooperatives mutual cooperatives characterized by the sector of intervention and not by a particular purpose as compared to other cooperatives.

The FrCA (art. 19*quinquies*, introduced in 2001 and last modified in 2014) allows for the establishment of “collective interest cooperatives” whose objective is “the production or supply of goods and services of a collective interest, with a social utility character”. They are meant as non-mutual cooperatives by the French legal doctrine. Their altruistic purpose, their being directed at satisfying a wider public and not simply their members, as opposed to what happens within traditional cooperatives, is moreover explicitly pointed out in the preamble to the law introducing them in FrCA.

In the UK, a Community Interest Company (registered under the Company Act 2004 and the CIC Regulations 2005) operating as a cooperative, i.e., controlled democratically by its members, provides a similar structure. On the other hand, the CCBSA puts an alternative between registering a society as a bona fide cooperative and registering it as a community benefit society (“BenCom”). The latter option requires the society to conduct business for the benefit of the community, namely, “primarily for the benefit of people who are not members of the society” and “in the interests of the community at large” (FCA Note).

In Germany the reference to the possibility that cooperatives are formed to serve the social or cultural interests of their members might open the door to the possibility to foresee non-mutual cooperatives, but for many German scholars, perceiving cooperatives as self-help organizations, general interest cooperatives would be a contradiction in terms.

The FCA allows a cooperative to pursue an ideological goal. Moreover, Finnish Law 1351/2003 on social enterprises allows also a cooperative (Osk) to be qualified as social enterprise.

The choice for the PECOL has been to follow the Italian, French, and UK approach, and strengthen it, thus considering general interest cooperatives separately from mutual cooperatives with regard to the objective pursued. Moreover in the PECOL, for qualifying a general interest cooperative, no reference is made to the nature of the activity that it must conduct (e.g., social services, health services, etc.). This is consistent with the generic formulas found in French law and also in the UK regulation of CICs. Of course, support policies and tax law could provide a stricter definition of general interest cooperatives in order to award benefits to them.

General interest cooperatives as foreseen in the PECOL, are not only instruments for health, social services and work integration of disadvantaged people, as originally conceived in European legislation. They may well be employed for organizing and providing public services to a given community, such as electricity, renewable energies, and the like. This corresponds to a practice emerging in some European countries and increasingly object of research by cooperative scholars.

The general interest purpose requires that this type of cooperatives be separately considered by the law relative to mutual cooperatives. In particular, as regards PECOL chapter 1, general interest cooperatives are not obligated to conduct a cooperative enterprise with and in the interest of their members as consumers, providers or workers. Nor are they regarded by limitations on transactions with non-members [see art. 19*sexies* FrCA]. Accordingly, general interest cooperatives may require a diverse treatment with respect to their membership, organizational and financial structure, as well as to external control, as demonstrated by the national rules presently applicable to them. The PECOL try, therefore, to differentiate their treatment when necessary.

A final remark on the relationship between mutual and general interest cooperatives: Mutual cooperatives do complementarily serve a social function, either indirectly by way of their system of administration or finance, or directly due to the destination for the community benefit of part of the resources generated by their enterprises. Therefore, between the two general types identified in PECOL there is not a big divide, but a sort of continuum having regard to their social dimension or role.

To put it differently, while “concern for the community” is an additional objective for mutual cooperatives observing the 7th ICA principle, “concern for the community” is the main or even exclusive objective of general interest cooperatives, as delineated in the PECOL, based on a legislative trend found in European cooperative law.

### **The economic activity**

Cooperatives are legal entities running an enterprise, as stems from the definitions of cooperatives or from the statements of the cooperative objective contained in European cooperative laws, as well as from the definition of a cooperative in the ICA P. Therefore, legal entities that conduct an activity which is not an enterprise in a strictly legal sense (e.g., grant-making; provision of free services, etc.), cannot be considered cooperatives.

In the definition of a cooperative in PECOL sec. 1.1(1) the use of “any” with regard to the economic activities that a cooperative may conduct, is deliberate. It should suffice to make it clear that cooperatives are in principle business organizations that may be employed to conduct any lawful economic activity, and that restrictions in the use of the cooperative legal form to conduct a certain business must be justified in order to be legitimate under the principle of equal treatment. Indeed, in some cooperative laws it is explicitly stated that cooperatives are free to conduct any economic activity and operate in any sector of the economy [*Elle exerce son activité dans toutes les branches de l’activité humaine* (art. 1(2) FrCA); *cualquier actividad económica lícita podrá ser organizada y desarrollada mediante una sociedad constituida al amparo de la presente Ley* (art. 1(2) SCA); *desde que respeitem a lei e os princípios cooperativos, as cooperativas podem exercer livremente qualquer actividade económica* (art. 7(1) PCC)]. But stressing this in PECOL has seemed counterproductive, as the starting point is that cooperatives are a type of legal entity which acts in parity with the others. Thus, it might have signaled a sort of weakness of the legal form, as a developing, but yet not developed, legal form. This explains the choice to simply refer to “any” without additionally underlining the cooperative freedom as regards the types of economic activity to undertake.

### **The use of subsidiaries**

According to PECOL sec. 1.1(3), a cooperative exists also when the cooperative enterprise is not run directly by the cooperative but through a subsidiary. This possibility is explicitly foreseen by chap. 1, sec. 2(1) FCA and art. 1(3) SCE R. Only implicitly by other jurisdictions, which allow a cooperative to hold shares of a company [par. 1(2) GCA; art. 79(1) SCA; art. 27-*quinquies* of Italian legislative decree n. 1577/1947]. It also corresponds to an increasingly diffuse cooperative practice.

However, in the PECOL, the use of subsidiaries to implement the cooperative objective is subject to restrictions (like in German cooperative law: see par. 1(2) GCA). It is considered possible only if two conditions are met: if it is necessary to satisfy the interests of the members and if the members of the cooperative maintain the ultimate control of the subsidiary.

These two conditions are laid down to prevent the abuse of subsidiaries to the detriment of the interests of the members and more in general of the identity of cooperatives as member-driven organizations. In fact, the subsidiary may be a filter which reduces the possibility for cooperative members to direct and control the enterprise that fulfill their interests. Thus, if this filter is necessary for the better fulfillment of the members' interests, it may be employed, but only on the condition that it is structured in a way that ensures the members' ultimate control of the business through the ultimate control of the subsidiary running it.

### **Protection of the legal denomination of cooperative**

The title of “cooperative” is protected by PECOL sec. 1.1(4), following the analogous provisions found in art. 14(2) PCC and art. 2515(2) ICC, among others. Therefore, legal entities which are not cooperatives in their substance, may not formally qualify themselves as cooperatives. This would generate confusion in the public and damage the cooperative image.

On the other hand, in PECOL cooperatives are required to include the word “cooperative” in their name, and thus to signal their legal nature (and identity) to the public.

### **Section 1.2**

#### **Sources of cooperative law**

PECOL sec. 1.2 deals with the sources of cooperative law and their interplay. This is an extremely important point from both a theoretical and a practical point of view.

#### **General cooperative law and special cooperative laws**

Usually, national jurisdictions provide a general law on cooperatives, which is to say, a set of rules applicable to all cooperatives irrespectively of their particular type, sector of activity, etc. What may change (without having, however, substantial consequences) is only the qualification or location of this set of general rules, which in many countries (like those considered for the PECOL: Finland, France, Germany, Portugal, Spain, UK) may be found in a separate act specifically dedicated to cooperatives (normally referred to as the “law on cooperatives”), while in other countries may be found within a more general act, including the civil code (like in Italy) or the company (e.g. in Belgium) or commercial code (e.g., in the Czech Republic). The PECOL, too, deal only with cooperatives in general.

It is not uncommon that the same jurisdictions providing a general law on cooperatives also provide special laws on particular types of cooperatives, which is to say, subsets of rules applicable only to some cooperatives identified by their particular activity (e.g. cooperative banks), type of mutual relationship with the members (e.g. worker cooperatives), or purpose (e.g. social cooperatives). In general, special laws on particular types of cooperatives exist in many countries, whilst what may vary is the number of these special laws and their scope (France provides the best example in this regard, namely, of a jurisdiction where the number and scope of special laws on cooperatives is so high and broad that they end up reducing the role of the existing general law on cooperatives to its lowest terms).

Which is the relationship between general law and special laws on cooperatives?

PECOL sec. 1.2(1) resolves this issue giving priority to special laws over general law (*lex specialis derogat generali*), and at the same time recognizing the applicability of general law to special cooperatives on the condition that the former's provisions are compatible with the latter's particular nature (a similar criterion is found in art. 2520, par. 2, ICC). This solution preserves the specificity of a certain type of cooperative, and on the other hand does not prevent special cooperatives from enjoying the general regulation of cooperatives.

### **The role of cooperative statutes (by-laws)**

PECOL sec. 1.2(2) promotes the autonomy of cooperatives by emphasizing the role of cooperative statutes (by-laws) in the regulation of cooperatives. According to this provision, cooperative statutes have a general power of regulation being only subject to cooperative law proper; in other words, they can regulate any matter not regulated or only partly regulated by cooperative law. Of course, cooperative statutes may also derogate to provisions of cooperative law which are not mandatory (*ius dispositivum*). Therefore, only mandatory cooperative law limits the cooperative freedom of self-regulation by their statutes.

### **Filling the gaps of cooperative law**

Like any other body of law, cooperative law might present a gap in the regulation of its subject matter, which raises the question of how the lacuna must be filled when cooperative statutes do not do that.

This is a very important issue (although, admittedly, the role awarded by the PECOL to cooperative statutes partly reduces its relevance), since the recourse to other bodies of law to fill the gaps of cooperative law might

affect cooperative identity in a negative manner. Conversely, the application to cooperatives of other bodies of law, including company law, might be beneficial to them, to the extent that they are thus allowed to seize opportunities granted by these bodies of law to other types of entities. As Ian Snaith observes, “While certain differences between company law and cooperative law are necessary for the protection of cooperative identity, others, such as the example of insolvency rescue procedures, simply reflect a failure to update the law applicable to cooperatives which results in obstacles for societies when they operate as businesses in the market place”.

Therefore, the point needs to be dealt with so carefully to preserve the particular nature of cooperatives on the one hand, and on the other hand to ensure that cooperatives have the same opportunities as other business organizations within a given jurisdiction.

In Spain, failing applicable cooperative legislation, the civil or commercial law most closely related to the nature of the activity in which the cooperative is engaged applies. Nevertheless, the tendency in Spain to take capital-based companies as the company model and extend the rules for these to other companies, irrespective of their nature and objects, needs to be considered.

The PCC (art. 9) provides for the application of the provisions of the Code of commercial companies, and in particular of stock companies, to fill the gaps of cooperative law (general and special), to the extent that these provisions respect the cooperative principles.

According to the ICC (articles 2519 and 2522), company law, more precisely either the law of stock companies or that of limited liability companies, may additionally and residually apply to cooperatives. This is possible only when cooperative law presents a gap and the potentially applicable company law provision is deemed compatible with the particular nature of a cooperative.

Being qualified as “companies” in the FrCA, French cooperatives are subject to the residual and additional application of company law.

In Germany, Commercial Code provisions may supplement the GCA (although they apply only in very rare cases, because the GCA offers almost complete regulation).

FCA is a very detailed and comprehensive law, which however contains several explicit references to company law.

The nature of the UK legal system implies that any gaps in the legislation governing cooperatives are filled by common law rules, because the company legislation (Companies Act 2006) explicitly does not apply to cooperative societies. This is not a satisfactory solution, as common law rules are not updated due to the subsequent entry into force of company legislation which took its place in regulating companies.

The choice in the PECOL, based on the Italian and Portuguese systems, has been to admit that other bodies of law, and notably company law, may apply to cooperatives to fill the gaps of cooperative law. To preserve cooperative identity, however, the PECOL provide that these rules may apply to cooperatives only if they are compatible with their particular nature (PECOL sec. 1.2(3)).

### **Section 1.3**

#### **Membership and its requirements**

In the PECOL a cooperative's owners are referred to as "members" (sec. 1.3(1)), thus following European cooperative laws [see art. 2511 ICC; art. 2 PCC; chap. 1, sec. 2(1), FCA; par. 1(1) GCA; art. 8 SCA; art. 1 FrCA; FCA Note; art. 1 SCE R], since this is a more neutral term than "shareholders", as owners are termed in company law. This is not to state that cooperative members do not, and may not, hold shares of the cooperative capital (as we shall see in PECOL chapter 3), but to highlight their diverse position relative to a company's shareholders. Cooperative members are "users" of the cooperative enterprise and not only contributors of the capital of the cooperative organization. In fact, they have the "double quality" of members of the cooperative organization and users of the cooperative enterprise (something which is also referred to as "identity principle"). Furthermore, the term "members" is that which more reflects the "personal" character of the participation in a cooperative, where rights and obligations are linked to the person of the member and not to the capital contributed, differently from for-profit capitalist companies.

More precisely, the PECOL identify two general categories of cooperative members: cooperator members and non-cooperator members. Cooperator members are those engaging in cooperative transactions with their cooperatives, thereby exchanging goods or services or working with them (sec. 1.3(2)). In contrast, non-cooperator members do not participate to transact with their cooperatives, but to support the fulfillment of their objectives by their contributions (of capital, of voluntary work, etc.) (sec. 1.3(3)) [see art. 19*septies*, par. 1, FrCA].

In general, due to their different purposes, a mutual cooperative is expected to comprise cooperator members, while a general interest cooperative is expected to comprise non-cooperator members. Accordingly, for a mutual cooperative to be established, it must have no less than two cooperator members (sec. 1.3(4)), and for it to admit non-cooperator members, a provision in its statutes is necessary (sec. 1.3(5)), whereas these requirements do not apply to general interest cooperatives. This does not

impede, however, that non-cooperator members, such as investor members, be present in a mutual cooperative, and that cooperator members participate in a general interest cooperative.

In the PECOL the minimum number of members for the formation and operation of a cooperative is two. The provision makes it clear that a cooperative cannot operate, and should be dissolved, when only one member remains during its life (“shall always comprise”).

Notwithstanding the average minimum number of members in European cooperative law is three [see, among others, art. 2522(2) ICC; chap. 2, sec. 1(1) FCA; par. 4 GCA], there is no apparent reason to treat cooperatives differently from companies in this regard. What is inconceivable is a cooperative with only one member. Differently from companies, cooperatives cannot be treated as a legal instrument to merely separate a patrimony for conducting a business.

The number of two, in addition, permits to include secondary (or higher-degree) cooperatives in the same provision (sec. 1.3(4)), for the operation of which existent cooperative law usually requires a lower number of members than for primary cooperatives [see, e.g., sec. 2(2)(b) CCBSA].

As regards general interest cooperatives, a choice was made in the PECOL not to follow the French example of the compulsory multi-stakeholder membership in collective interest cooperatives [art. 19*septies*, par. 2, FrCA].

In the PECOL it is finally stated that “Cooperative statutes may make membership subject to reasonable conditions related to their particular type or objective, without gender, social, ethnic, racial, political or religious discrimination or artificial restriction of membership” (sec. 1.3(5)).

Therefore, the PECOL allow cooperative statutes to provide for requirements for membership, but at the same time, in order to ensure the open character of a cooperative, they seek to prevent cooperatives from abusing of this faculty. This PECOL provision needs to be coordinated, and read in conjunction with that on the admission of new members in PECOL, section 2.2.

## **Section 1.4**

### **Cooperative transactions with members**

PECOL section 1.4(1) deals specifically with mutual cooperatives and identifies those particular acts through which they seek to reach their (mainly) mutual purpose, that is, transactions with their cooperator members for the provision of goods, services or jobs.

Therefore, sec. 1.4(1) needs to be read in conjunction with sec. 1.1(1)(a). The latter defines the objectives of mutual cooperatives. The former the way in which this objective is pursued. Nevertheless, “mainly” here has a slightly different meaning from “main” in sec. 1(1)(a).

This provision seeks to anchor the mutual cooperative to its institutional objective and typical activity. It is not only a provision directed at limiting the activity with cooperator members in relation to that with non-members, but the cooperative activity in relation to the non-cooperative activity, which includes, but is not limited to, the activity with non-members in the strict sense, which in the PECOL is specifically dealt with in the following section 1.5. Therefore, “mainly” limits the activity with non-members but also extra-cooperative activities, i.e., activities different from the cooperative enterprise with the members (e.g., financial activities not directly related to the cooperative enterprise), which therefore the cooperative may perform but only up to this limit.

The PECOL do not require mutual cooperatives to be fully mutual (as it does not require general interest cooperatives to be fully outward oriented), which is line with existing European cooperative law.

It is important that the PECOL give a name (“cooperative transactions”) to the typical transactions that, in a mutual cooperative, take place between the cooperative and its members. Again, this is not new. They are referred to as “mutual relationships” in the ICC, and “cooperative acts” (or rather, “cooperative activity”) in SCA. In German scholarship they got the name of “purpose transactions on the internal market”, as they enact the purpose of the cooperative on the one hand, and on the other hand are viewed as a sort of “internal”, and thus special-market, transactions between the cooperative and its members. Outside Europe, the category of the “cooperative act” is well-known in the Latin American experience.

PECOL section 1.4(2) is relatively new in European cooperative law, although the underlying idea is common. This provision is found in art. 2516 ICC and is almost literally reproduced here as it is important for the correct functioning of a mutual cooperative [see also art. 16(2)c) SCA, prohibiting member discrimination and founding the “principle of equality” in decisional law]. It is connected to the provision and the type of problems solved by following sec. 1.4(4), i.e., the obligation for a cooperative to transact with its members, thus implementing its institutional aim.

A member’s right to be equally treated relative to all the other members may determine the cooperative’s obligation to transact with that member when a refusal would be in contrast with the equal treatment rule (but also an obligation not to enter into a contract with a member when this would be in contrast with the duty to treat another member equally). This also has effects on the cooperative’s freedom to transact with non-members.

The member's right to be preferred over non-members (a sort of pre-emption right) is easily and broadly acknowledged by Italian scholars. Moreover, the Italian Supreme Court has affirmed that "the mutual aim ... implies the impossibility for the general meeting or the board of directors to dispose of the member right to participate in the planned benefits of the cooperative activity. Said aim, in a building cooperative, does not permit the housing provision to third parties" when this damages member interests, in which case the cooperative resolution to sell to third parties is null and void as its subject is illicit (Cass., 25/9/1999, n. 10602).

Is there a members' obligation to transact with their own cooperative? Or rather, should cooperative law provide for such an obligation?

In Italy, neither the law states nor courts have ever affirmed that the status of cooperative member carries an obligation to transact with the cooperative. There are some scholars, however, who argue that member participation in mutual transactions is a necessary consequence of the mutual aim and of the status of a member (Buonocore). Normally cooperative statutes, especially in agriculture, explicitly lay down an obligation for the members to provide all their produce (or a given minimum percentage of them) to the cooperative, also providing for penalties in the case of non-performance.

On the other hand, in the PCC (art. 34, n. 2(c)) there is a provision related to this point, which puts a generic obligation upon members but refers to "what is due" which is not stipulated by law but evidently left for other sources to specify.

In sec. 1.4(3) the PECOL follows art. 15(2)(b) SCA, which stipulates the member obligation to transact with the cooperative to the minimum extent provided for the by-laws.

This is probably the best way to deal with this matter, as the law could not state in advance a precise, complete, obligation, and the contents of this obligation may only be determined by cooperative statutes.

PECOL also follows the SCA in connecting (in sec. 1.4(4)) the obligation to transact with the possibility to expel the member who does not perform it. This does not prevent cooperative statutes from dealing with the matter in a more specific manner, as it must be intended as a default rule awarding a power and not putting an obligation to expel. Therefore, cooperative statutes may also provide for a different regulation, e.g., penalties for the non-executing member.

The PECOL also deals with a cooperative's non-execution of its institutional objective, in which case they award members a legitimate cause for withdrawal.

### **Section 1.5**

#### **Mutual cooperatives and the problem of the cooperative transactions with non-members**

Operations with non-members create a problem of regulation in mutual cooperatives, since acting with the members is an essential element of their particular identity. On the other hand, there are several reasons why cooperatives cannot be required to be fully mutual. By operating with non-members they can solve a problem of shortage of members' contributions, they may spread the cooperative idea of business, they may try to enlarge membership, or they may want to benefit (also) non-members. Therefore, in general, the activity with non-members should not be prohibited in a mutual cooperative, but only limited. These restrictions should on the one hand serve as incentives for mutual cooperatives to be more mutual and on other hand preserve their distinct identity as compared to other business organizations acting on the market.

Following what one may find in existing European cooperative law, the PECOL identify different criteria for combining the need of cooperatives to act with non-members and the need to protect their identity. Thus, the activity with non-members is permitted upon certain conditions.

The activity with non-members may not be the main activity (sec. 1.4(1)); may be prohibited by cooperative statutes (sec. 1.5(2)); may be conducted only if non-members is given the real possibility to become members of the cooperative (sec. 1.5(3)) and if profits from non-member cooperative transactions are allocated to indivisible reserves (sec. 1.5(5)). In particular, these last two PECOL provisions (the former taken from the English experience; the latter from the SCA) prevent the abuse of the cooperative legal form.

Opportunely, PECOL sec. 1.5(1) clarifies that “non-member cooperative transactions” are transactions between cooperatives and non-members for the provision of goods, services or jobs of the same kind as those provided to cooperator members. Thus, the problem of the activity with non-members only regards the activity by which the mutual cooperative pursues its mutual purpose. In housing cooperatives, for example, the provision of housing to non-members instead of members. In agricultural cooperatives, buying grapes from non-members rather than from members. Etc.

## **CHAPTER 2 COOPERATIVE GOVERNANCE**

### **SECTION 2.1** *(General principles of cooperative governance)*

(1) Cooperatives are directed and controlled by or on behalf of their members, who have ultimate democratic control through their governance system.

(2) Cooperative governance reflects their jointly-owned, democratically controlled and autonomous nature. It facilitates operation based on universally recognised cooperative values and principles, including cooperative social responsibility.

(3) In mutual cooperatives, the governance organs are structured to pursue economic activities mainly in the interest of their cooperator members. In general interest cooperatives, they are structured to pursue such activities mainly in the general interest of the community.

(4) Cooperative governance structures may vary according to:

- (a) the size and type of cooperative enterprise;
- (b) the sector in which it operates; and
- (c) whether it is a mutual or a general interest cooperative.

(5) Cooperative governance structures must always ensure cooperative autonomy and member control.

### **SECTION 2.2** *(Open membership)*

(1) Without prejudice to section 1.3, membership of a cooperative must be open to any person able and willing to accept the responsibilities of membership.

(2) Cooperative statutes shall ensure that:

(a) membership applications are dealt with by a designated organ within a reasonable time;

(b) reasons are given for refusal;

(c) the applicant can appeal to the members' meeting if a different organ refused admission; and

(d) the applicant has the right to be heard before a decision is made on the appeal.

(3) No one has a legally enforceable right to join a particular cooperative. The entity responsible for the registration and/or the auditing entity of section 4.3 must ensure that membership is open in accordance with paragraph (1).

(4) Cooperative statutes shall govern the grounds and procedure for termination by either party of cooperative membership. They shall deal, in particular, with:

(a) the notice period required;

(b) any adjustment of capital contribution or other financial arrangements; and

(c) other consequences of such termination.

(5) Termination of membership by the cooperative shall be subject to:

(a) the member having had the right to present their case before the decision was made;

(b) the member's right to be informed of the reason for the decision against them; and

(c) the member's right to appeal to the members' meeting against an adverse decision and to exercise any other legal remedy.

**SECTION 2.3**  
***(Members' obligations and rights)***

(1) The obligations of cooperator members include:

(a) participation in cooperative transactions to a minimum extent and/or level, when applicable under section 1.4(3);

(b) the contribution of capital, when applicable in accordance with sections 3.2(1) and 3.2(2);

(c) a minimum level of participation in the governance of the cooperative;

(d) participation in education and training provided for members; and

(e) other obligations imposed by law or cooperative statutes which may, in some cases, include an obligation to bear a proportion of the cooperative's liabilities or losses.

(2) The obligations of investor members include the provision of the capital subscribed but do not include participation in governance. In mutual cooperatives, they must respect the limits of their role and the need for cooperator members to control the cooperative.

(3) The statutes of a general interest cooperative shall state the obligations and rights of cooperator members including the different roles of different groups in the pursuit of the general interest of the community.

(4) Cooperator members have the following individual rights:

(a) to engage with education and training appropriate to their role in the cooperative;

(b) to participate in the governance of their cooperative, in principle by attending and fully participating in meetings in person, but by proxy if necessary;

(c) to vote in elections for members of the organs or on any issue decided by direct member vote (at a meeting, electronically, or by post);

(d) to stand for election;

(e) to request and receive financial and other relevant information as laid down by law or cooperative statutes;

(f) to receive any compensation on their shares decided under cooperative statutes; and

(g) when applicable, to engage in cooperative transactions and to receive any cooperative refund under cooperative statutes or the law after it is determined by the competent organ.

(5) Together with the number of other members that is laid down by law or cooperative statutes, members have a collective right:

(a) to receive or request any information needed to perform the member's role in their cooperative;

(b) to propose candidates for election as directors or delegates to another organ or meeting;

(c) to require a members' meeting to be called;

(d) to propose resolutions or add matters to the agenda of a members' meeting;

(e) to demand an audit of the cooperative by the auditing entity of section 4.3;

(f) in accordance with procedures laid down by law or cooperative statutes, to amend cooperative statutes and restructure or dissolve the cooperative.

## **SECTION 2.4**

### ***(Cooperative governance structures: direct member control)***

(1) Cooperative governance structures must ensure that members democratically control the cooperative and can actively participate in policy making and major decisions, in principle on a one member one vote basis.

(2) Unless cooperative statutes provide otherwise,

(a) in small cooperatives all members participate directly in making every decision, and

(b) in other cooperatives, governance is divided between a structure or organ giving members ultimate control of the organisation (the “members’ meeting”) and one or more boards or committees, responsible for day to day management and accountable to the members.

(3) The powers of the decision-making organs of a cooperative are either:

(a) fixed by law or cooperative statutes, or

(b) can be delegated by the members’ meeting on a basis of revocable delegation.

(4) The members’ meeting may be organised as one meeting or several separate meetings. In cooperatives with a large or widely dispersed membership or in cooperatives with different categories of members, cooperative statutes may provide for sectorial meetings instead of the general meeting, with members represented by proxies or delegates. Meetings may be actual or virtual.

(5) The members’ meeting has power to appoint and remove directors. The members’ meeting must have power to make fundamental decisions. Fundamental decisions are decisions about restructuring or dissolving the cooperative, amending its statutes, participating in legal entities or groups, or establishing subsidiaries.

(6) The members’ meeting:

(a) receives and considers financial and other information about the economic and cooperative performance of the cooperative, and the activity and the results of companies or other entities in which the cooperative participate, including structures of cooperation with other cooperatives;

(b) appoints and removes financial auditors;

(c) elects and removes members of an elected board or committee; and

(d) exercises any other powers conferred by law or cooperative statutes.

(7) Voting in a members’ meeting is in principle on the basis of one member one vote regardless of the capital held.

(8) When necessary for the better functioning of a cooperative, cooperative statutes may confer plural votes not related to capital contribution, and reflecting, for example,

- (a) participation in cooperative transactions;
- (b) the number of members in particular subdivisions; or
- (c) the balanced representation of different member groups.

(9) When cooperative statutes exercise the option in paragraph (8), they must in any case ensure that investor members or a minority of cooperator members do not control the cooperative.

(10) Total plural votes held by any cooperator member can never exceed a certain percentage of all members' votes cast at any members' meeting at which they vote, as defined by the law. However, investor members may have plural votes according to capital limited to a total of a certain percentage of votes cast at the members' meeting at which they vote, as defined by the law.

(11) Adequate notice of the agenda to be considered, the time and the place of meetings ensures that members have the opportunity to attend. Quorum requirements ensure that decisions are not unrepresentative of the membership.

(12) Decisions are made by simple majority of the votes cast but special majorities are required for the fundamental decisions defined in paragraph (5), which are always made on the basis of one member one vote.

(13) Cooperatives must hold annual members' meetings. The designated organ can also convene extraordinary members' meetings between the annual meetings. It must do so if a certain number or proportion of members or an organ so empowered by law or cooperative statutes or the auditing entity of section 4.3 requires it to do so.

(14) In cooperatives with a large or widely dispersed membership a smaller elected body may perform the role of supervising and monitoring the board in a one tier system.

## **SECTION 2.5**

***(Cooperative governance structures: management and internal control)***

(1) The functions of cooperative boards (if any) include executive management, representation and supervision. The three functions may be performed by one administrative board (“one tier system”) or divided between a supervisory board and a management board (“two tier system”). The distribution of powers will be laid down by law and cooperative statutes.

(2) Executive management powers are all those not reserved to another organ. Representation means the authority to represent the cooperative in dealings with third parties and in legal proceedings.

(3) The powers of representation and executive management of the cooperative are allocated to:

- (a) the administrative board in the one tier system or
- (b) the management board in the two tier system, or
- (c) one or more directors or managers.

These powers may be delegated by those on whom they are conferred except to the extent that cooperative statutes provide otherwise.

(4) Supervision is concerned with the economic and social performance of a cooperative. That function involves the internal oversight and monitoring of executive directors or managers. In the two tier system, the supervision and executive functions are carried out by different boards. In the one tier system, subcommittees of the administrative board or of the members’ meeting may be used for supervisory purposes. The designated organ will liaise with external auditors as provided in section 4.

(5) Board composition, especially in general interest cooperatives, shall take into account the composition of the cooperative membership, including, for example, by geographical constituency or category of member. Where substitutes have not been elected in advance, the board may have power to co-opt members to fill casual vacancies pending an election.

(6) In mutual cooperatives the majority of members of administrative and supervisory boards shall be cooperator members.

(7) Law or cooperative statutes lay down:

(a) the maximum and minimum number of members for each board;

(b) the term of office and any limits on the number of terms that may be served;

(c) any requirement for gender balance;

(d) appointment or election procedures; and

(e) the qualifications for board membership which, separately or in combination, must not unduly limit the democratic right of the members to elect, or be elected as, board members. Law or cooperative statutes may also provide grounds for disqualification.

(8) The duties of cooperative board members and managers include an obligation to adhere to the defining values, principles and practices of cooperatives in addition to their obligation to comply with law and cooperative statutes and their duties of honesty, loyalty, good faith, care and skill.

(9) Board members must have or gain professional qualifications proving an appropriate level of competence with particular regard to the nature of cooperatives and their special features.

(10) The remuneration (if any) of board members is decided by the members' meeting, taking into account the nature of cooperatives and their special features.

## **SECTION 2.6**

### ***(Information rights of members and transparency requirements)***

(1) Board members and managers shall ensure that the cooperative operates with a high level of transparency and shall give members sufficient clear information to enable them to control the cooperative.

(2) In particular, they shall ensure that full annual accounts and, if appropriate, consolidated accounts are drawn up, audited, and published to members with an annual report and cooperative and financial audit reports as required by law. Such documents shall be available to the public at the

cooperative's registered office at a price not exceeding their administrative cost.

(3) Members and applicants for membership have a right to information on their obligations and rights.

## COMMENTS TO CHAPTER 2

### **Section 2.1**

#### **General principles of cooperative governance**

The Chapter opens with a statement about the centrality of the role of members in cooperatives and the importance of ensuring that cooperatives are ultimately controlled by their members, even if functions and powers are divided among a number of organs such as boards and managers. **PECOL 2.1(5)** focuses specifically on the role of governance structures in upholding the autonomy of the cooperative and member control. Cooperative groups and subsidiaries are dealt with at PECOL 5.2. PECOL 2.1.(1) also defines “governance” as being concerned with the direction and control of the jointly owned autonomous cooperative enterprise.

**PECOL 2.1(2)** then places cooperative governance in the context of the whole ICA/ILO definition of a cooperative. It links the specifics of governance to the values embodied in the ICA definition. They are both operational (self-responsibility, democracy, equality, equity and solidarity) and ethical. The principle of cooperation among cooperatives is also included. These matters are important in the definition of a cooperative and therefore represent an aspect of the decision-making of the organs of the cooperative. Ultimately decisions which call the nature of the cooperative into question are to be avoided by the organs whether or not they are constrained by specific legal rules. Therefore PECOL 2.1.(2) contains this statement of principle as a requirement to “facilitate” operation on the basis of the values and principles.

**PECOL 2.1(3)** emphasises the centrality of the member control principle to both mutual and general interest cooperatives (as defined in PECOL 1). If a business entity is to be defined as a cooperative at all it must be subject to member control and in the absence of that a general interest association or society will not be a cooperative. The distinction is about the purpose, not the governance structure. For example, while some UK societies registered as benefit of the community societies will be general interest cooperatives in PECOL terms, others will not. All such societies registered as bona fide cooperatives will be cooperatives. That arises from the nature of registration of societies which, from 1st August 2014, has been as either a bona fide cooperative or as a community benefit society. Community benefit societies may have a stakeholder governance structure with one member one vote but they will never permit any distribution of

surplus to members and their purpose must always be altruistic rather than being focused on meeting the needs of their own members (s2(2) of CCBSA).

**PECOL 2.1(4)** emphasises the importance of the principle of autonomy while also acknowledging the need for diverse governance structures. That diversity is necessary to accommodate the variety of cooperatives. The needs of the different types of cooperative (e.g. consumer, producer, worker) will vary and so will the needs of those with large or small membership and those with members across a wide or narrow geographical area. Similarly, the scale and range of the cooperative's economic activities and the number of employees will affect the governance structure it needs.

**PECOL 1.2.** indicates the sources of the legally binding rules about cooperatives and in the case of governance guidance on best practice (often in the form of Codes of Practice) is significant (see, for example, Co-operativesUK, *Corporate Governance Code of Practice for Consumer Co-operatives*, 2013, Co-operativesUK, *The Worker Co-operative Code*, 2012 and, in Germany, the DGRV Code of 23rd November 2010). In the context of companies that source is also greatly emphasised by the EU Commission - See Recommendation 2005/162/EC and Recommendation 2014/208/EU).

## **Section 2.2**

### **Open membership**

**PECOL 2.2(1)** restates the concept of open membership from the ICA Principles. The rationale and basis of the principle is the avoidance of artificial restrictions on membership to increase the value of the rights of existing members at the expense of potential new members (e.g. FCA Notes p 9). This is an expression at a high level of abstraction of the purpose of the open membership principle. Those who are already members should not be able to profit from transactions involving people with the same economic relationship with the cooperative by “closing” membership for that group.

The limit of the open membership principle to those with the economic relationship on which the cooperative is based is found in the ICA's reference to people “able to use its services”. This is usually seen as pointing to the type of cooperative. In a consumer cooperative membership must be open to consumers who buy from it. In a workers' cooperative, all employees must be able to join. In a producer cooperative, the concept will apply to producers or suppliers. In hybrid (or multi-stakeholder)

cooperatives it will be open to members of more than one of those groups. The ICA limitation on the principle is explicit in arts 1(3) & (4) of SCE R and implicit in art 14(1) SCE R where the membership of investor members not expecting to use or produce is permitted only if the Statutes so provide and then only by decision of the members' meeting.

In those legal systems that have special laws for particular types of cooperative this will be expressed more precisely for those subject to particular laws and in those with only a general law it will be found in the statutes of particular types of cooperative (e.g. art 2 FCA, art 15(2)(c) PCC, art 1 SCA). An example of that is the UK system of model rules provided by cooperative sponsoring organisations which can be used for the registration of new cooperatives for a reduction in the registration fee (see FCA FEES section of FCA Handbook and FCA List of Sponsoring bodies). However, PECOL 2.2(1) expresses a useful abstract rationale for the open door principle and its limits.

**PECOL 2.2(2)** indicates that the allocation of power to decide membership applications may be found in the law or the statutes and is usually vested in the board with a right of appeal as stated (art. 14(1) SCE R, art 15(1) GCA, arts. 2527 & 2528 ICC, arts 33(1) & 53(d) PCC). It uses criteria similar to those found in PECOL 1.3. The importance of due process for those refused or expelled from cooperative membership is reflected in PECOL 2.2(2) & 2.2(5). They require reasoned decisions which are subject to both appeal and the right for the member or prospective member to be heard.

**PECOL 2.2(3)** notes the absence of a justiciable individual right to acquire membership of a cooperative. That seems to state the position in most of the systems we considered. The open door principle does not give a potential member a legally enforceable individual right to become a member (see, for example, art. 14(1) SCE R which gives discretion to the organ deciding whether to admit a potential member). However, open membership is a core element of the definition of a cooperative (ICA P1) and is, for the reason given in the comment on 2.2(1), a central value of cooperatives. In most systems it is upheld collectively on behalf of potential members by the registering body (FCA Note p9, and comment to PECOL 1.3)).

**PECOL 2.2(4) & (5)** indicate that membership can be terminated by either the cooperative or the individual member.

The voluntary nature of membership implies a right to for the member to resign but resignation may require agreement by the directors, a period of notice or a period of earlier membership and have only partial effect for a period. In addition, payment of money due on shares to a resigning member may not be immediate and may reflect losses by the cooperative. This protects the liquidity of the cooperative and ensures that its capital base reflects its true financial position (Art 16 SCE R, Art 36 PCC, Art 65 GCA, Art 2532(1) ICC, Arts 11, 15, 45(8) & 51 SCA). Where, as in some agricultural marketing cooperatives, a member has a separate contract with the cooperative, the resignation of the member will not terminate his or her obligations under that contract if they are expressed to continue after membership ends. Membership will also terminate when the member ceases to exist - on the death of an individual or dissolution of a legal entity. It may also be triggered if the member is subject to other insolvency proceedings if cooperative statutes so provide.

Cooperatives usually have the power to expel a member. PECOL 2.2(5) refers to the procedural safeguards found in the various legal systems (art 15(3) SCE R, art 2316 FrCA, art 68 GCA, arts 2531 & 2533 ICC, arts 15 & 37 PCC, art 18(5) SCA). The grounds for such termination are left to cooperative statutes as they need to be tailored to the particular circumstances of different cooperatives.

All the national systems provide judicial redress or independent arbitration to deal with expulsion and other disputes. Arbitration or other alternative dispute resolution procedures are commonly used for disputes between a cooperative and its members after internal processes are exhausted. That conforms with the cooperative ethos and acknowledges the value of ADR where members have limited funds – as will be the case for some of the people who use cooperatives to meet their needs. Typically, the mechanisms for ADR will be found in cooperative statutes rather than the law. Use is made of arbitration and mediation procedures under general contract or commercial law. However, some provisions of national cooperative law encourage the use of ADR for reasons that are more relevant to cooperatives than to some other enterprises (see. e.g. Chap3 Sec 5 & Chap 23 sec 4 FCA, ss 137-140 of CCBSA).

### **Section 2.3** **Members' obligations and rights**

The contractual basis of the cooperative as an association is common to all of the systems analysed. So is the inclusion of members' rights and duties in either the law or the cooperative statutes. For example, art. 5(4) (6<sup>th</sup> indent) SCE R requires the cooperative statutes to include:

“- the rights and obligations of members, and the different categories of member, if any, and the rights and obligations of members in each category.”

**PECOL 2.3(1)-(3)** outlines some of the obligations that are imposed on cooperative members. PECOL only deals with those rights and obligations which relate to the very nature of cooperatives by being linked to the ICA definition, values and principles. In order to emphasise the fact that members have obligations as well as rights, the obligations are discussed first.

PECOL 1.4 and 1.5 require a substantial proportion of all transactions by mutual cooperatives to be cooperative transactions with cooperator members.

**PECOL 2.3(1)(a)** deals with the individual member's obligation to participate economically in the cooperative by using or supplying goods and services. The requirement is usually found in the statutes of particular cooperatives (art 14(2) SCE R and see commentary on PECOL 3). PECOL 1.4(3) reflects the importance of the requirement, particularly for cooperator members of mutual cooperatives. The obligation will be crucial for the successful operation of certain cooperatives e.g. agricultural marketing cooperatives which need to ensure that members sell their produce only through the cooperative. As a result some systems restrict the freedom of the member to resign with immediate effect on the economic relationship (e.g. arts. 2532 & 2533 ICC, ).

Since the economic activity of general interest cooperatives is carried on mainly in the interests of the community, this obligation is not relevant for their members whose rights and obligations will depend on the cooperative statutes – PECOL 2.3(3). PECOL includes this obligation on that basis. Members of general interest cooperatives must never receive any distribution of surplus – PECOL 3.6(7).

**PECOL 2.3(1)(b)** acknowledges the importance of member contributions to cooperative capital. While the question of whether or not a minimum level of capital is required for the cooperative will be determined

by law, any minimum contribution required of individual members will normally be a matter for cooperative statutes (art 4(7) SCE R, and commentary to PECOL 3) This is sometimes an explicit ground for the expulsion of a member from the cooperative (e.g. art. 2531 ICC) or at least for extending the notice period required for resignation as in art. 65 GCA, and art 36 PCC.

Similarly, in **PECOL 2.3(1)(c)** any minimum requirement for participation in cooperative governance is likely to be a requirement of cooperative statutes. It could take the form of minimum attendance at members' meetings. Expulsion and removal from the member register may be based on non-attendance at meetings or the absence of any contact with the cooperative through transactions, voting, attendance at meetings or voting in elections. National laws showed few concrete examples of this obligation (but see arts 33 & 34 of PCC). All of them either lay down quorum requirements for members' meetings or authorise the cooperative statutes to do so e.g. art 5(4) (indent 11) SCE R. The quorum requirement effectively imposes the penalty of an inability to make decisions on the members collectively if too many of them fail to attend the members' meeting in person or by proxy.

The **PECOL 2.3(1)(d)** obligation to participate in education and training links strongly with ICA P5. It is unusual for that obligation to be imposed on members (other than directors, employees or managers) as a condition of membership. Because it is important to encourage members to engage with education and training PECOL chooses to model itself on art. 3 of PCC which acknowledges the importance of ICA P 5. PECOL also follows the PCC's requirement that a mandatory reserve be built up for that purpose (PECOL 3.4(2)&(8) and see art. 70 PCC).

**PECOL 2.3(1)(e)** indicates the variety of other obligations that may be imposed on members. In particular, it suggests the possibility of provisions requiring members to bear part of the cooperative's losses (art 16(1) SCE R, and see comment on PECOL 3.6).

**PECOL 2.3(4)** Notes that the rights of cooperative members are conferred by law or through the statutes of their cooperative and seeks to list the most common individual member rights in both mutual and general interest cooperatives. Many of the listed rights are the mirror image of the obligations listed in **PECOL 2.3(1)**.

Participation in education (**PECOL 2.3(4)(a)**) perhaps fits more easily into the category of rights than into a list of obligations and, even as a right,

seems to be available in only certain jurisdictions such as Portugal and Spain. Elsewhere cooperative societies are permitted to finance or provide this and in practice many of them do.

Participation in governance as a right of cooperative members is listed in **PECOL 2.3(4)(b) to (d)** and is, in one form or another, a requirement in all jurisdictions. As an individual right, attendance at meetings and voting, either in person or by proxy on resolutions or in elections is a core right found in virtually all laws and arts 52-62 SCE R reflect the general position (chapter 4 FCA, arts 4-6 FrCA supplemented by the Commercial Code, art. 43, GCA, arts 2538-2539 ICC, arts 44-47 PCC, arts 21-25 SCA). Similarly, many of the national laws permit or facilitate the use of sectorial and delegate meetings rather than a general meeting of all members (e.g. art 63 SCE R, s149 CCBSA, arts FrCA, arts 43a GCA, art 54 PCC , & arts 5 & 22 SCA).

The right to stand in elections, which is usually subject to finding other members willing to propose the individual, is a necessary concomitant of those rights. However, for some roles the right may be qualified to meet the need for candidates in some roles to show a certain level of competence and experience. Generally the detail of the nomination process is dealt with in cooperative statutes.

The 2014 changes to the statutes of the UK Co-operative Group, which have been registered by the FCA as registrar on the basis that the organisation remains a bona fide cooperative, have provided for a majority of the board of directors to be appointed by the board, subject only to endorsement by members without contested elections and both those appointed directors and the minority of three “member nominated directors”, whose appointment can be subject to contested elections by members, can be nominated as directors only after approval by a nominations committee of the existing board on the basis of their experience and competence, taking account of the resulting composition of the board in terms of the range of skills and experience it needs. This application of the practices and procedures of the UK PLC sector within a cooperative which retains one member one vote resulted from the 2013 commercial and financial failures of the organisation. The changes are controversial among UK cooperative activists.

The individual right to request and receive financial and other relevant information (**PECOL 2.3(4)(e)**) is a necessary support for the members' participation in governance as only with access to such information can the

direct rights to vote and to participate in meetings be exercised effectively. This is acknowledged in many of the national laws, particularly in respect of financial information. There is an obligation on other organs to publish information to members as well as a right for a certain number of members to demand such information (art 60 SCE R, art ch 4 s 15 & ch 7 ss6-7 FCA, arts 46 & 59 GCA, art 2545 ICC, arts 9,3 & 56 PCC, arts 16(3) SCA). Few laws go beyond the provision of financial information but the German Law in arts 31 & 43a provides a right to lists of members and delegates and the UK law enables members to find similar information by inspecting records held at the society's registered office - s 30(7) CCBSA 2014.

**PECOL 2.3(5)** provides for the additional collective rights of a certain number of members facilitate the exercise of member control indirectly by ensuring that motions and amendments can be proposed and meetings called by members without requiring the agreement of the board or other elected or appointed officials of the cooperative - art. 55 SCE R is typical in this respect in defining the number of members required by a combination of a number of members and a proportion of votes.

In most general interest cooperatives and in multi-stakeholder mutual cooperatives the governance related rights of members may involve different roles for different groups of members. For example, employees and users of services may have different voting rights and elect limited proportions of a board to ensure equitable representation of different member interests.

**PECOL 2.3(4) (f) & (g)** highlight the economic right of members to receive interest on shares actually declared or decided under the statutes and to engage in cooperative transactions with the cooperative and receive any cooperative refund once the interest and refund have been determined by the appropriate organs. These rights are vital to the functioning of mutual cooperatives. A right to interest on shares may also apply to some members of general interest cooperatives. These financial or economic rights are dealt with more fully in PECOL 3.3(5) & 3.6 and the comments to those paragraphs.

Both mutual and general interest cooperatives require member engagement in the governance system but they differ on the economic rights of members which relate mainly to mutual cooperatives which serve members and can distribute surplus to them.

**PECOL 2.3(5)** attempts to bring together the collective rights of the members in both mutual and general interest cooperatives. Collective rights are those that require a number of members for their exercise. For example, calling a special (Emergency) members' meeting without board agreement, placing resolutions on the agenda of a members' meeting, deciding through a procedure laid down by law or the cooperative statutes to dissolve or restructure the cooperative or to amend its statutes. These rights support member control of the cooperative and complement the individual rights of members.

The question of the enforcement of the members' rights and duties raises the same issues as in the case of any other private law rights, including those of company shareholders and members of associations. However, the use of alternative dispute resolution systems such as arbitration and mediation that either deal with the issue outside the court system or encourage a negotiated solution is common in cooperative laws and statutes and is an aspect of the ethos of cooperation. It also reflects the particular need of those likely to use cooperatives for inexpensive and fast resolution to problems without the need for the use of the judicial system. Only the model rules for French worker cooperatives, art 44 SCA, and ss 137-140 CCBSA in the UK go beyond the general availability of ADR for private law disputes by encouraging internal dispute resolution for cooperatives. As a result PECOL contains no provisions on this issue.

## **Section 2.4**

### **Cooperative governance structures: direct member control**

**PECOL 2.4 (1)** sets out the democratic control requirements of ICA P2 as the objective of all provisions on the governance of cooperatives.

**PECOL 2.4 (2)** then provides a two-fold classification of direct member control of all decisions: a model sometimes referred to as a “collective”, and a model based on the members' meeting which provides ultimate member control and one or more boards, committees or councils responsible for day to day management but accountable to the members. Both choices are subject to the possibility of variation by the statutes of particular cooperatives. Where boards and similar organs are used, a classic dichotomy is provided by the SCE Regulation which furnishes a choice between a unitary board (“administrative organ”) and a two tier board structure consisting of a supervisory board and a management board.

The “collective” model suits small cooperatives where it is feasible for all decisions to be made by all members. **PECOL 2.4. (2)** gives a default provision which may be changed by the cooperative statutes. It includes the all member “collective” model at **PECOL 2.4. (2) (a)** as the purest form of member control but acknowledges that its use will be limited to small cooperatives. Apart from Italy, where some legal scholars believe that a collective structure can be used by cooperatives registered as Srl private companies, most laws require the use of one or more boards or committees in addition to the members' meeting. Some UK worker cooperatives operate in this way by making all members directors to comply with the legal requirement that the society or company must have directors (Co-operativesUK, *The Worker Co-operative Code*, 2012). That is a benefit of the liberal approach of UK Business Organisation Law.

That is reflected in **PECOL 2.4(2)(b)** which leaves room for the unitary board system, the two tier board and other variations.

The unitary board system provides for a single organ to be elected by the members. It has all the powers of day to day decision-making, leaving the annual meeting to receive reports and to make fundamental decisions. Articles 42 to 48 of SCE R deal with that option and bring together powers of management and representation in one administrative organ. This reflects the systems found in the UK and Finland, and can be chosen by French cooperatives that use the SA structure and Italian cooperatives (see Chapter 5 section 1 FCA, art L.225-17 of Fr Code of Commerce, art 2380bis par 4 Italian CC). French cooperatives, like French Srl companies, commonly have a structure in which a single manager is appointed by the general meeting but those using the SA company structure have a board of directors. German cooperatives with fewer than 20 members have been able to choose a unitary board system since 2006 and need only have one board member (art 24 GCA).

The two tier system is outlined in articles 37 to 41 and 45 to 51 of SCE R and is used in Germany for cooperatives with more than twenty members (see arts 37-38 GCA). In Spain and Portugal and for those who choose it in Italy, a version of the system with a supervisory committee mainly concerned with verifying accounts is available as a two tier system (arts 49-63 PCC, arts 21, 32 & 38 SCA & art 2400 ICC). In these examples both the supervisory committee and the board are elected by the general meeting. In the SCE and German two tier models, the members elect the supervisory board and it appoints the separate management organ.

**PECOL 2.4(3)** highlights another contrast drawn from the legal systems considered. In some systems, such as the UK and Germany, the powers and role of a cooperative's decision-making bodies is fixed either by the law or by the cooperative statutes. In others, all power is vested in the members' meeting which can choose to delegate those powers to other organs and although that is the usual arrangement and the one contemplated by the cooperative law, the general meeting is ultimately the sovereign body (see, for example art 44(1) PCC). PECOL acknowledges the two options.

**PECOL 2.4(4)** acknowledges another range of choices about the functioning of the members' meeting. Cooperatives with a large or widely dispersed membership or with a number of different classes of member, such as employees, users, and suppliers, may need to divide the members' meeting into a number of parts. This can be done on a geographical basis or on the basis of the classes of member and may involve either a single “serial” meeting of members with cumulative voting or a delegate structure. In the case of a delegate structure, the delegates may either be free to make their own decisions on how to vote or they may be bound by the mandate of the members who appoint them. If the delegates are bound, the weighting of their votes at the next level may either reflect the proportionate vote of the members who mandated them or be counted 100% on the side favoured by the majority of appointing members.

Article 63 of the SCE R provides a typical example of these possibilities. It permits the statutes of the cooperative to fix a range of such meetings where the cooperative “undertakes different activities or activities in more than one territorial unit, or has several establishments or more than 500 members” This provides a good summary of the grounds on which sectorial meetings may be required and PECOL draws on that adding the possibility of different categories of members as another basis for adopting this procedure. PECOL aims to allow flexibility and freedom to a cooperative's own statutes.

The items normally dealt with by the members' meeting as described in **PECOL 2.4(5) & (6)** reflect most national laws which empower the members' meeting to appoint and remove directors and make fundamental decisions as well as the more frequent matters of surplus distribution and receipt or approval of accounts and reports The matter is normally determined by the cooperative law (see, for example, chap 4 ss3 & 14 and Chap 2 s6 FCA, art 6 FrCA, art 24 GCA, arts 43 & 49 PCC, arts 28 & 34.1. SCA, s14 CCBSA).

**PECOL 2.4(7)-(10)** emphasises the principle of one member one vote as a key defining feature of cooperatives. The principle is expressed in ICA P 2:

“In primary cooperatives members have equal voting rights (one member, one vote) and cooperatives at other levels are also organised in a democratic manner.”

Despite the apparently universal requirement of one member one vote for primary cooperatives, many cooperative laws allow plural voting even in primary cooperatives if that produces a more equitable system. That may be justified by the type of member served by the cooperative, for example, cooperatives of entrepreneurs.

**PECOL 2.4(7)** expresses the general principle and emphasises the contrast with joint stock companies in which voting power is usually linked to capital contribution, thus placing power and control in the hands of investors rather than other stakeholder groups. That is done by expressing the principle as one member one vote “regardless of capital contribution” (see, for example, art 59(1) SCE R which sets out this general proposition).

**PECOL 2.4(8) to (10)** then elaborate on the permitted exceptions to one member one vote.

**PECOL 2.4(8)** lays down the basis of permitted plural votes with examples of acceptable criteria for additional votes. The principle is necessity - “when necessary for the better functioning of a cooperative” the authors of PECOL have chosen to extract this pragmatic rationale for the exceptions. The examples of acceptable bases for plural voting are then set out.

**PECOL 2.4(8)(a)** deals with participation in cooperative transactions. That could apply to either primary or secondary cooperatives and links voting power to cooperative inputs (work in a worker cooperative or supplied goods or services in producer cooperatives) or outputs (purchases of goods or services in a consumer cooperative). This system is more common than any other exception to the general one member one vote principle, perhaps because it seems equitable than one member one vote for cooperatives of entrepreneurs. Art 59(2) SCE R refers explicitly to this basis for plural voting, Chapter 4 section 7 of the FCA permits plural voting without specifying the basis for it, art 5 of the French Law of 1947 permits this for secondary cooperatives and some French laws for particular types of

cooperative such as agricultural, artisan and banking cooperatives allow it for primary cooperatives. Art 43 of the GCA, like art 2538(4) of Italian CC and some examples of plural voting permitted by the SCA, permits a strictly limited increase in the number of votes on this basis without fully proportionate weighting according to transactions.

**PECOL 2.4(8)(b)** allows for plural voting based on the number of members in particular subdivisions of a cooperative which is an indirect reflection of the one member one vote principle. This is most likely to apply to cooperatives with large numbers of members who are widely dispersed geographically. It might also be used by secondary cooperatives to balance the influence of different primary cooperatives in membership of the organisation. In each case, this system will raise questions about how the votes of the members in particular subdivisions are to be assessed. Are the votes for and against a resolution cumulated separately when added together from each subdivision or are all of a subdivision's votes cast in accordance with the view of the majority within that subdivision? PECOL follows arts 59(2) & 63 SCE R by leaving that choice to the statutes of each cooperative.

**PECOL 2.4(8)(c)** is most likely to apply to hybrid or multi-stakeholder cooperatives (including, in PECOL terms, general interest cooperatives) where employees, users, suppliers and investors may all have membership. In such cases, voting rights based simply on one member one vote across all types of member would give one or more particular groups unfair dominance in decision-making. For example the number of user members may greatly exceed the number of employees. Art 59(2) SCE R provides the clearest example and it permits the practice based on number of members only in wholly of mainly secondary cooperatives (“SCEs the majority of members of which are cooperatives”).

**PECOL 2.4(9)** requires that any plural votes available to investor members be particularly strictly limited. This is to reflect the de-emphasis of capital at the heart of the concept of a cooperative. The principle of control by user members rather than investors supports the limitations on the return to capital explored in PECOL 3 and the centrality of denying votes on the basis of capital stake in the cooperative model. The SCE chooses a limit of 25% of total voting rights (SCE R 59(3)). In **PECOL 2.4(10)** the model of “percentage of total votes cast” at a meeting is used but no specific percentage is given as this is a principle rather than a rule. The same approach is taken to a minorities of cooperator members.

These provisions apply equally to general interest cooperatives and mutual cooperatives whether multi- stakeholder based or not.

**PECOL 2.4(12)** reflects the almost universal practice of requiring a simple majority for decisions other than the fundamental changes listed in PECOL 2.4(5) such as amending the statutes or restructuring or dissolving the cooperative. Article 61(2) & (4) of SCE R are typical of national law provisions on majorities required (66.6% for amendments to the statutes) but apply a higher (but not lower) national law requirement. They also include a quorum requirement of 50% of eligible for changes to the statutes at a meeting convened for the purpose but no special quorum if an inquorate meeting is reconvened.

Similarly, **PECOL 2.4(11)** requires adequate notice of the business, venue and time of meetings as well as a quorum to ensure that decisions are not unrepresentative of the membership. This is typical of the approach of national laws. Arts 5(4), 56 & 57 of SCE R are typical provisions.

**PECOL 2.4(13)** requires annual members meetings and ensures that the organ responsible for calling extraordinary meetings can always do that and must do so if a certain number or proportion of members or any organ empowered by law or auditing body requests it. This reflects the general practice found in national laws as expressed in arts 54 & 55 SCE R.

**PECOL 2.4(14)** acknowledges the option found in, for example, Italian Cooperative Law of interposing a body elected by the general meeting between the board and the general meeting and giving that body the role of supervising and monitoring the board in what would otherwise be a one tier system (see arts 2397 to 2405 ICC). This is particularly appropriate when it is unlikely that all members will be able to participate in frequent members' meetings but the supervisory and monitoring role needs to be carried out on an ongoing basis.

In most systems, mechanisms to protect creditors, or minorities of members or employees are added to the general mechanisms for member control if fundamental restructuring decisions are likely to affect those groups. Classic examples are to be found in the SCE provisions concerning mergers, conversions and the transfer of registered office - see arts 7, 19 to 34, 35 and 76 of the SCE R.

PECOL 5 deals with governance issues involving secondary and tertiary cooperatives.

## **Section 2.5**

### **Cooperative governance structures: management and internal control**

As noted in the comments to PECOL 2.4, most legal systems use boards or committees – either the unitary board system or the two tier board reflected in SCE R. This part of PECOL outlines the functions powers and composition of organs in each of those systems.

An organ which consists of more than one member, operates as a collective body but may delegate particular functions to subcommittees or individuals. In the one tier system this may include the appointment by the board of specialist audit or supervisory committees. Separate committees to perform particular functions may also be created by law or by cooperative statutes. Boards usually make decisions by simple majority. Procedural matters about board meetings such as convening meetings, quorum, and who chairs meetings are usually laid down in or under cooperative statutes.

**PECOL 2.5(1) & (2)** defines the three key functions of cooperative boards: executive management; representation; and supervision.

**PECOL 2.5 (3)** indicates the various ways in which the powers to carry out the representation and executive management functions are distributed under the one tier and two tier systems and those that recognise a role for executive directors or managers as a separate organ of the cooperative rather than the recipients of delegated powers. This follows arts 37(1), 39(1) and 42(1) of SCE R. PECOL 2.5(3) acknowledges the possibility of having one or more managing directors or managers rather than a full administrative board to carry out the management and representation functions. That allows for the French limited liability company (Srl) system used by some cooperatives. That is distinct from the possibility of delegation by any of the organs acknowledged in PECOL 2.5(2) in that it contemplates a single manager constituting the executive and representative organ under the statutes or the law.

**PECOL 2.5 (4)** concerns the organs that carry out the supervision function in cooperatives. In the two tier system that is the function of the supervisory organ. In the one tier system it is often the role of a subcommittee of the administrative organ made up of directors who are not personally also executive managers or of a separately – see art 39(1) SCE R,

Co-operatives UK Code of Practice on Governance in Consumer Co-operatives, chap 5 section 12 of the FCA, and arts 2397 to 2405 of ICC

**PECOL 2.5 (5) & (6)** concern board composition. That should reflect the composition of the membership in general interest and multi-stakeholder cooperatives while in mutual cooperatives a majority of board members should be members. Clearly this allows some variation in board composition in general interest cooperatives by proportionate constituencies for board composition for based on geography or the representation of users, employees, and suppliers. In each case, the PECOL provisions is a reflection of the basic principle of member control. The provision from mutual cooperatives represents their purpose of serving their own members on a mutual and self-managed basis.

**PECOL 2.5 (7)** deals with maximum and minimum numbers of board members, the term of office of members of the organ, any limits on the number of terms a person can serve and any requirement for gender balance. These matters will vary from one context to another. A board should be small enough for effective operation and large enough to represent a range of members – especially in a multi-stakeholder or general interest cooperatives where member interests may diverge. PECOL does not specify figures. SCE R leaves this to the cooperative's statutes, subject to national law (arts 37(4) and 42).

Similarly, the term of office provision needs to balance the need for continuity against the democratic right of members to remove and replace directors. Article 45 of SCE R provides for six year terms with a maximum of two terms. Many national systems provide for three year terms and some allow for the retirement of one third of organ members each year to encourage stability and continuity.

To ensure democratic control by members, appointment or election must either be by the members in general meeting or directly by members in elections. In both cases proxy voting and electronic communications should be used to encourage maximum participation. Most systems use the members' meeting option – see, for example, arts 39(2) & 42(3) SCE R. In the two tier system the supervisory board classically appoints the members of the management organ and no-one can be a member of both organs - see art 36(3) SCE R. Article 37(2) SCE R permits the election of management organ members by the general meeting if national law requires it.

Qualifications for board membership may include membership of the cooperative. That may be extended to a minimum period of membership and may be complemented by a requirement of service on a different organ of the cooperative such as a regional committee or council as part of a delegate based governance structure. A requirement of participation in a particular form of cooperative activity may apply to multi-stakeholder cooperatives. In the case of general interest cooperatives, such a qualification may be replaced by a requirement for a connection with a particular geographical region.

Minimum legal capacity requirements, such as age and mental capacity, apply as they do to other legal entities. A minimum level of trade may be required for a mutual cooperative, a minimum capital holding could apply to a mutual or a general interest cooperative. Neither should be at a level amounting to a serious obstacle to members qualifying. The 2014 reforms to the UK Co-operative Group statutes laid down a requirement for substantial minimum levels of business expertise or experience. That is applied to potential directors by a Nominations Committee of the existing board as a condition of nomination – rules 48 & 51 and Appendix 1 of the rules of the Co-operative Group (2014). A parallel members' council exists in the Co-operative Group and less demanding requirements apply for election to that. Those provisions did not prevent the registration of the 2014 amendments by the FCA under ss 2 & 16 of CCBSA as creating statutes appropriate for a bona fide cooperative.

Any grounds for disqualification as a director will be found in the law, for example personal insolvency, court order of disqualification, or unfitness due to mental incapacity, or the statutes of the cooperative. Others may be added by the statutes of the cooperative.

**PECOL 2.5(9)** specifically acknowledges the particular importance of a minimum level of cooperative training or experience. That reflects ICA Principle 7 which requires training and education for elected representatives and managers.

Removal of directors or members of organs by decision of the members with or without cause and by a simple or special majority will be laid down by law or in the statutes.

**PECOL 2.5(8)** adds the specifically cooperative duties of directors to the duties laid down by law for anyone with such a role in a business entity. Article 51 SCE R aptly summarises the general legal liabilities of organ

members. PECOL adds the requirement that people meet specifically cooperative requirements.

**PECOL 2.5(10)** Any remuneration for members of organs or senior managers who participate in governance must be decided or approved by the members' meeting and should take account of nature of cooperatives and their special features of equity, equality and de-emphasis of capital. However, the market rate paid to people with particular skills or experience can also be a relevant factor, particularly for managers or executives.

## **Section 2.6**

### **Information rights of members and transparency requirements**

**PECOL 2.6(1)** applies the ICA Value of transparency to member control of the cooperative through cooperative governance. It requires that members are given sufficient information to enable them to control the cooperative. Members collectively, or the supervisory or audit organs acting on their behalf, must be given all the information they need to: conduct the business of members' meetings or participate in other democratic processes, such as elections; to appoint or remove directors; to set the cooperative's business, member promotion, and social responsibility strategies; and to decide on changes to the cooperative's statutes or any other fundamental reorganisation of its structure.

**PECOL 2.6(2)** Legal requirements in respect of the contents, audit, and publication of information for members and the wider public on the accounting, financial and cooperative performance of a cooperative and the powers of regulators and courts to investigate or inspect cooperatives are dealt with in PECOL 4.

**PECOL 2.6(3)** Member, director and manager education on members' rights and obligations is vital to the functioning and governance of cooperatives. It should be available either through individual cooperatives or cooperative federations and colleges and the law should promote and facilitates this by permitting or mandating the use of funds for this purpose.

## **CHAPTER 3 COOPERATIVE FINANCIAL STRUCTURE**

### **SECTION 3.1** *(General principles of cooperative financial structure)*

(1) As private legal persons that carry on an economic activity without profits as the ultimate purpose, cooperatives have a specific financial structure aimed at the success of their objectives, with respect to universally recognized cooperative values and principles.

(2) As business organisations, cooperatives can use shares, reserves, loans and other financial instruments as sources of capital, providing they are compatible with their cooperative nature.

### **SECTION 3.2** *(Cooperative share capital)*

(1) Cooperatives are established without minimum capital, unless the law or cooperative statutes provide otherwise.

(2) Cooperative statutes may fix a minimum share capital and the minimum amount and nature of the contribution of each member, with respect to the principle of open membership as laid down in sections 1.3(6) and 2.2.

(3) In any case, the share capital is variable, which means that variations in the amount of the capital, due notably to increased or reduced membership, do not require amendments of the cooperative statutes nor disclosures.

(4) Reduction of the share capital below any minimum prescribed may be cause for cooperative dissolution.

### **SECTION 3.3** *(Members' contributions to capital)*

(1) Membership is acquired in accordance with section 2.2. The sole acquisition of shares does not confer the status of member.

(2) Cooperator members contribute equally to cooperative capital unless cooperative statutes provide for another criterion, such as in proportion to participation in cooperative transactions.

(3) The law may allow cooperative statutes to require new members to contribute more capital or a higher contribution than the minimum, to adjust to new conditions in a reasonable manner.

(4) No member may hold a percentage of the share capital higher than the maximum defined by law or cooperative statutes.

(5) The paid-up capital may be paid interest if cooperative statutes so provide and the members' meeting decides to do so. The interest rate may differ according to the nature of the contribution, whether mandatory or optional, and of the category of members providing it, whether cooperator members or other types of members. In any case, the interest rate cannot be higher than a reasonable rate, necessary to obtain and retain enough capital to run the business.

(6) Cooperative shares may be transferred only among members or candidates for membership. The transfer of member shares is always subject to approval by the designated organ as well as to any other conditions laid down in cooperative statutes. Shares subscribed by investor members are not transferable without permission from an organ of the cooperative. Member shares cannot be attached by the personal creditors of the members.

(7) The member who leaves the cooperative may be reimbursed for the nominal value of their shares and their portion of divisible reserves, as provided in the cooperative statutes, which may subject the reimbursement to reasonable conditions. The amount repayable to the member may also take into consideration any outstanding interest or cooperative refunds due to the member and any debts due from the member to the cooperative.

### **SECTION 3.4** ***(Reserves)***

(1) In cooperatives there are mandatory reserves and voluntary reserves.

(2) Mandatory reserves include the legal reserve and other reserves required by law or cooperative statutes, such as the reserve for cooperative education, training and information.

(3) The legal reserve and the reserve for cooperative education, training and information are indivisible, even in the event of cooperative dissolution.

(4) The legal reserve is established by:

(a) a percentage of the net annual cooperative surplus, subject, in principle, to a cap set by law or cooperative statutes;

(b) a percentage of net annual profits, as provided in the cooperative statutes;

(c) and a percentage of other resources, as provided in the cooperative statutes.

(5) The legal reserve can only be used to cover a balance sheet loss that is not covered by other reserves or otherwise, and cannot be used to increase the share capital.

(6) Voluntary reserves are reserves that depend on the collective will of the cooperator members, embodied in a resolution of the members' meeting which determines the mode of their constitution, implementation and liquidation, and in particular their indivisible or divisible nature, also on the basis of individual accounts.

(7) The reserve for cooperative education, training and information is established by:

(a) a percentage of the annual net cooperative surplus;

(b) the part of profits not allocated to the legal reserve;

(c) other resources as provided in the cooperative statutes.

(8) The reserve for cooperative education, training and information is used for the technical and cultural education and training of members, members of the organs, managers and employees of the cooperative, and the provision of information about cooperatives to the general public.

(9) The reserve for cooperative education, training and information can be treated as a separate patrimony if the law so provides.

**SECTION 3.5**  
***(Member limited liability)***

(1) Cooperatives have legal personality and enjoy patrimonial autonomy.

(2) No member shall be liable for the debts of the cooperative for more than the amount they have subscribed, unless cooperative statutes provide for the liability of the member by guarantee subject to a cap.

**SECTION 3.6**  
***(Economic results from cooperative transactions with members)***

(1) The economic results from cooperative transactions with members are “cooperative surplus” or losses in member cooperative transactions.

(2) Cooperative surplus is the excess of revenues over costs of the cooperative transactions.

(3) In a mutual cooperative, by resolution of the members’ meeting, the cooperative surplus may be:

(a) distribute to the cooperator members as cooperative refunds in proportion to the quantity and/or quality of their participation in cooperative transactions, either cash or by shares or other financial instruments, or

(b) between indivisible reserves and divisible reserves

(4) Cooperative surpluses may not be distributed if and insofar as they are needed to cover existing losses, or to restore the legal reserve to the level it reached in the balance sheet for the previous financial year.

(5) Losses in member cooperative transactions are the excess of costs over revenues of cooperative transactions with cooperator members.

(6) In a mutual cooperative, by resolution of the members’ meeting, losses in member cooperative transactions may be covered:

(a) using the reserves of the cooperative, beginning with the voluntary reserves;

(b) by the cooperator members in proportion to the quantity and/or quality of their participation in cooperative transactions within the limit of the value of the goods and services received.

(7) General interest cooperatives may not distribute cooperative surpluses to their members.

**SECTION 3.7**  
***(Profits and other losses)***

(1) Cooperatives may also have other results, including results from non-member cooperative transactions and results from ownership of company shares or other assets. Whatever their origin, these results are allocated to indivisible reserves.

(2) Losses from non-member cooperative transactions and other sources are covered by reserves beginning with voluntary reserves.

**SECTION 3.8**  
***(Liquidation)***

(1) In case of liquidation of a cooperative, members shall be entitled only to recover the nominal value of their shares and their portion of divisible reserves as provided in the cooperative statutes. The amount repayable to the member should take into consideration, in addition to the nominal value of their shares, any outstanding interest and any other amount due to the member according to cooperative statutes.

(2) Residual net assets shall be distributed in accordance with the principle of disinterested distribution.

(3) In the event of the cooperative losing its legal form through conversion, merger, splitting, or any other restructuring, paragraph (2) applies to assets to the value of the indivisible reserves on the date of this event, unless the new legal entity is subject to the rule in paragraph (2) about the distribution of assets on liquidation.

## COMMENTS TO CHAPTER 3

### **Section 3.1**

#### **General principles of cooperative financial structure**

Cooperatives have a distinct financial structure as shown below.

The social object of the cooperative, closely linked to its mutualistic vocation, makes it compulsory that the cooperative financial structure is aimed at the promotion of the interests of cooperator members, i.e., at meeting their economic, social and cultural needs. As a matter of fact, and unlike commercial companies, the cooperative conducts an economic activity whose aim is not primarily profit but has a mutualistic scope (see Section 1.1.). However, as outlined in Chapter I, the mutualistic scope pursued by the cooperative does not mean that the cooperative conducts its activity exclusively with its members, as it may also engage in non-member cooperative transactions (see Section 1.5.), which will have consequences for its financial structure.

The financial structure of cooperatives is thus based on a logic of its own, resulting not only from the specific characteristics of the cooperative objective, but also from the necessary obedience to cooperative values and principles. The cooperative develops its social object in an organized and professional manner and, like business organizations, needs to use various management and financial instruments to make it more efficient in achieving its goals. In this sense, according to PECOL, cooperatives can use shares, reserves, loans and other financial instruments as sources of capital, providing these are compatible with their cooperative nature.

### **Section 3.2**

#### **Cooperative share capital**

Cooperatives, to start carrying on their activity, need economic resources, which will be obtained *ab initio* through the contributions of cooperator members to the share capital. These contributions are, however, a mere instrument for the development of cooperative transactions and do not contribute to determining the rights and duties of cooperator members. *De facto*, in principle, financial rights in a cooperative are determined by (the quantity and quality of) mutual transactions, while governance rights are determined by membership *per se*.

The justification for this instrumental nature of share capital in cooperatives is the fact that cooperatives, in order to conduct their economic

activity, need not only their own assets, but also, and mainly, the participation of cooperator members in the activity that constitutes their object (cooperative transactions).

As pointed out in PECOL 1, the cooperative operates with its members, who participate in the activity carried out by the cooperative (cooperative transactions). The fulfilment of the social object of the cooperative entails, therefore, that the cooperator members will pay for or provide the goods or services to the cooperative: in legal Spanish scholarship, this set of inputs that cooperator members bring to the cooperative is called mutualistic capital (“*masa de gestión cooperativa*”). That is why, according to art. 52.3 SCA, “the assets of any kind provided by the members for management by the cooperative and, in general, payments made to obtain cooperative services do not form part of the share capital and are subject to the conditions set by and agreed with the cooperative”. In all the other legal systems analysed, mutualistic capital is not provided for in law.

Moreover, the ICA cooperative principle of economic participation of members does not require share capital to incorporate a cooperative. This cooperative principle refers to capital as a synonym for assets, stressing the indivisible assets of the cooperative.

In this context, PECOL’s choice, based on the UK legal system, has been to admit the possibility of constituting a cooperative without share capital, unless the law or cooperative statutes provide otherwise. It is, therefore, possible to organize a cooperative without share capital, counting solely on the accumulation of collectively-owned indivisible reserves by cooperator members. As a matter of fact, in the UK a cooperative that uses the CLG (Company Limited by Guarantee) structure is not entitled to have any share capital (s 5 CA 2006). In the Spanish legal system there is also the possibility of the cooperator member not effecting any contribution to the share capital at the moment the cooperative is established (art. 58.3 of Andalusian Law 2011). In all the other legal systems analysed it is not possible to set up a cooperative without share capital [see art. 2521, par. 3, n.4 and 2525, par. 1 ICC; art. 19 PCC; chap. 1, sec. 2(1) FCA; § 7.1 GCA; art. 45.2 SCA; art. 27 FrCA; art. 3 SCE]. At present, the common practice in European cooperative laws has been that no one can become a member of a cooperative by buying a share (as in a company). The share contribution is rather an obligation of the person admitted to membership upon application.

Despite the minor importance of cooperative share capital, according to PECOL sec. 3.2(2) cooperative statutes may fix a minimum share capital and both the nature and minimum amount of the contribution of each member, with respect to the principle of open membership.

Cooperative statutes may fix the nature of the contribution of each member. These contributions to share capital can be in cash or in kind [see,

among others, art. 21.1 PCC; art. 45.4 SCA; § 7.3 GCA]. Contributions in services are not permitted as contributions to share capital, because the share capital is formed solely of assets whose economic value can be assessed [see art. 4.2 SCE].

The minimum share capital operates as a limit to the variability of share capital and to the reduction of the cooperative assets, representing a minimum guarantee for the interests of creditors.

In some legal systems the requirement of a minimum share capital is mandatory (art. 18.2 PCC; § 8a GCA; art. 3.2 SCE and in most of the Spanish laws), so there is an obligation to specify the share capital in the statutes (principle of determination).

In the legal systems of Italy and the UK, for example, no minimum capital requirement will apply to cooperatives. In the Italian legal system, the law requires only that statutes shall indicate the amount of capital subscribed by each member (art. 2521, par. 3, n. 4, ICC) and that the loss of the capital is a cause of cooperative dissolution (art. 2545*duodecies* ICC).

In the French legal system, the requirement of a mandatory minimum share capital will depend on the form adopted by the cooperative, taking as reference the legal framework provided in company law. A minimum share capital will only be required if the cooperative takes the legal form of a public company (art. 27 FrCA).

Under PECOL, the variability of capital is an essential feature of cooperatives. Since cooperatives are governed by open and voluntary membership, capital variability facilitates the entry and exit of members.

The variability of capital is fundamentally influenced by the members joining or leaving the cooperative. However, this equation is not always true, because members can join or leave by transferring participations in the capital, which therefore does not change, and the capital can also be changed without any members joining or leaving. For instance, it can be increased through new contributions made by existing members or by applying surplus or reserves, and it can be reduced through the allocation of losses.

PECOL refers explicitly to the fact that capital variability means that variations in the amount of social capital, due notably to the increase or reduction of membership, do not require amendment or disclosure of the cooperative statutes.

It has been a common practice in European cooperative law to include variability of share capital in the definition of a cooperative (articles 2511 and 2524, par. 1, ICC; art. 2 PCC; art. 1 SCA; art. 1.2 SCE).

The main consequence of this variability is the reduction in the financial quality of the share capital, particularly the economic and social security that the share capital represents for creditors, which can cause difficulties

for cooperatives in raising external finance and, on occasion, can lead to undercapitalisation.

That explains why, although the variability of cooperative share capital is a recognized feature of their identity, the common practice in European cooperative laws tends to enshrine some measures to ensure the cooperative share capital enjoys a minimum of stability, such as the possibility of deferred redemption for a period of time provided for in the statutes (art. 36.3 PCC; art. 51.5 SCA; art. 2535 ICC; art. 16.3 SCE); the possibility of making deductions from the right to redemption (art. 36.4 PCC; art. 51.2 SCA; art. 2535, par. 2 ICC; art. 18 FrCA; art. 16.1 SCE), the application of deductions to the face value of the member's shares whenever losses are attributable to the cooperator member within the financial year in which the right to redemption originated; statutory minimum periods of membership and rules fixing notice periods needed for a withdrawal (art. 36.2 PCC; art. 17.3 SCA; art. 2532 ICC).

Nevertheless, according to PECOL and based on the Portuguese and Spanish legal system (art. 36.2 PCC and art. 17.1 SCA), under no circumstances may these mechanisms suppress the right to withdraw, given the need to respect the cooperative principle of open membership. This question is of particular importance and immediacy, given the effects that international accounting regulations have had in the Spanish legal system, where, after the accounting law reform, cooperative law provided a different criterion for classifying capital contributions, namely contributions with the right to redemption in case of leaving, or contributions for which redemption in case of leaving can be unconditionally refused by the board.

For PECOL, it is clear that cooperative share capital (like company capital) is and remains equity/risk capital (i.e. funds provided by members in exchange for membership). Nevertheless, it has many characteristics of debt capital, and therefore is the property of the cooperative and not a sum borrowed from members. In that respect, the issue of international accounting standards has not raised any questions in PECOL.

Cooperative share capital can be increased under several circumstances: by requiring new contributions from the members (art. 46.2 SCA), even if the common practice in European laws is that cooperatives cannot impose the subscription of new shares to meet the financial needs of the cooperative; when new members join the cooperative (art. 46.7 SCA, art 3.5 SCE); through voluntary contributions from the cooperative members (art. 47 SCA); or by allocating cooperative refunds to the share capital (art. 58.4 SCA; art. 2545sexies, par. 3, ICC) or converting available reserves into share capital (art. 2545quinquies, par. 3, lit. b, ICC).

Cooperative share capital will be reduced by repayment to members who leave the cooperative or by allocation of losses, as we point out below.

According to PECOL, and based on the Spanish legal system [art. 45.8.d) of art. 70.1, both SCA], the reduction of the share capital below any minimum prescribed may be cause for cooperative dissolution. This will be a means of ensuring that the minimum share capital operates as the minimum limit to the variability of share capital, in order to avoid undercapitalisation of the cooperative, and represents a minimum guarantee for the interests of creditors.

### **Section 3.3**

#### **Members' contributions to capital**

Taking into account that, according to PECOL, it is possible to set up a cooperative without share capital [see 3.2(1)], contributions to capital are not a necessary condition for acquiring membership [see 2.2]. To acquire membership a person must accept the responsibilities of membership [see 2.2.1], in particular he/she must engage in cooperative transactions [see 1.3.2] and be accepted by the designated organ of the cooperative [see 2.2].

However, it is usual for both laws and statutes to establish a contribution to the capital of the cooperative as an obligation of members [2.3.1(b)]. According to PECOL, contributions to capital are not a condition for membership but may be an obligation to be met by members.

To become a member of a cooperative (either as a cooperator member or as an investor member), the conditions for membership laid down in the statutes must be met (see section 2.2).

Taking into account also the ICA cooperative principle of “member economic participation”, which provides for equitable contribution from members to the share capital of cooperatives, PECOL Section 3.3(2) states that cooperator members contribute equally to the cooperative capital, while assuming, however, that the cooperative statutes may provide another criterion, such as contribution in proportion to participation in cooperative transactions. In some cooperative laws there are provisions regarding the minimum mandatory contribution to capital [see, among others, art. 19 PCC; art. 2525(1) ICC; chap. 2, sec. 1(1) FCA; par. 4 GCA]. In other legal systems, the amount of any minimum contribution to capital that may be required is a matter for the statutes of the cooperative to establish [see, art. 46.1 SCA; § 7.1 GCA; ???? CCBSA; No. 4 and 7 of art. 4 SCE].

Some European cooperative laws explicitly state that the minimum mandatory contribution to capital may vary according to the members' participation in cooperative transactions [art. 46.1 SCA; § 7.1 and 7a GCA]. The Spanish legal system also provides for the possibility that the minimum mandatory contribution to capital may vary according to the type of

member, more specifically according to whether the capital contribution is made by cooperator members or investor members.

In general, the contributions to capital must be paid at the moment of subscription and the remainder must be paid as provided for in the cooperative statutes or the resolutions of the General Meeting. Contributions in kind must be paid in full. Contributions in cash can be paid in part at the time and the rest at the request of the board, if cooperative statutes so provide [art. 21(3 and 4) PCC; art. 2531 ICC; § 7.1 GCA]. Finally, it should be noted that, in all cases, the minimum share capital must be fully paid-up at the moment the cooperative is founded [art. 45.2 SCA].

Not to make the contribution to capital or not to disburse it on time may be cause of exclusion, without prejudice to enforcing payment or taking other punitive measures, such as suspension of rights [see, among others, art. 37 PCC; art. 46.6 SCA]

The value of the share will be fixed in the statutes. A good practice, worthy of notice, set out in the Spanish [art. 49 SCA], Italian [art. 7 of Law n. 59/1992] and German legal systems is the possibility to increase the value of shares by available reserves in order to update their value by offsetting depreciation over time. Share value can, likewise, be reduced by charging losses.

The law may allow the cooperative statutes to require new members to contribute with more capital or with a higher contribution than the minimum in order to adjust to new conditions in a reasonable manner [Section 3.3(3)]. This possibility can be made effective in different manners: a) by the new member's making a higher contribution to capital to equal his/her status to that of the contributions made by previous members, or simply to compensate for their depreciation over time; b) by requiring an admission fee [see, among others art. 25 PCC; art 52.2 SCA]. The requirement of the admission fee will function: (i) as an outright grant, required of every cooperator member and motivated by the expenses that his/her admittance entails which will be borne by the cooperative (cost of installing new work tools, increased maintenance expenses, and any others); (ii) as a way to compensate, in part, for the contribution of existing cooperator members to the common assets of the cooperative.

The use of the expression “in a reasonable manner” aims to highlight the need for respect for the ICA principle of voluntary and open membership, which will prevent the establishment of excessively burdensome conditions of admission for the aspiring cooperator members. Indeed, the establishment of higher admission fees or of a contribution higher than the minimum may collide with the right of admission.

The Spanish legal system provides for the possibility that, apart from the mandatory contributions required by cooperative statutes or the General

Meeting, members can make other non-mandatory (voluntary) contributions. These contributions require the authorization of the General Meeting or, in some cases, of the Board. The former are the same for every member or proportional to member participation in the cooperative business. These voluntary member contributions confer certain advantages in the return paid, transfer and redemption. Similarly, in the German legal system, the following distinction is consecrated: capital subscription as an obligation of membership (compulsory contribution); supplementary contributions at the request of the cooperative (staggered share contributions in proportion to use made of the services of the cooperative enterprise) and laid-down in the statutes (§ 7a GCA); and voluntary supplementary contributions. In the other cooperative laws analysed, in principle, a cooperative cannot require supplementary contributions (or other forms of financial participation) from members, unless cooperative statutes authorise the directors to do so and, even in this case, only up to a certain amount.

Cooperatives can issue financial instruments with fixed, variable or mixed returns (loans, bonds, equity securities, etc.) [see, among others, art. 21.2 SCA; art. 2526 ICC; art. 26 to 30, PCC; art. 11, 11 *bis* and 19, FrCA] and some legislations still allow the creation of credit sections within the cooperative to meet the financial needs of the cooperative and its members [see, among others, art. 5 SCA].

For PECOL, no member may hold a percentage of the share capital higher than the maximum defined by law or by cooperative statutes. This provision is consistent with the Spanish Law, which establishes that no member can make contributions that exceed a third of the share capital, unless that member is a cooperative, a non-profit entity, or a company owned, in its majority, by cooperatives (art. 45.6 SCA).

According to PECOL, it is appropriate to fix the maximum amount of the cooperator member's contributions to share capital, thus avoiding the risk of allowing a cooperator member with an excessive participation in the cooperative share capital to determine, in practice, the cooperative decisions.

Following the ICA principle of member economic participation, which prescribes that “members usually receive limited compensation, if any, on capital subscribed as a condition of membership”, PECOL section 3.3(5) states that “the paid-up capital may be paid interest if cooperative statutes so provide and the members’ meeting decides to do so”. This provision is consistent with the common practice in European cooperative law [see art. 2514 and 2545 *quinquies*, par. 3, ICC; art. 73.3 PCC; chap. 1, sec. 2(1), § 21a, GCA; No. 1 and 2 of art. 48, SCA; art. 14 FrCA; art. 67 SCE].

In any case, remuneration is not a cooperative member’s absolute right. Instead, it is always dependent on a statutory provision, on approval by the

General Meeting and on the existence of positive results in the financial year.

Remuneration of capital is not considered an application of results but a cost to the cooperative. The purpose of this compensation will be to obtain and retain enough capital to run the business but, in any case, the interest rate cannot be higher than a reasonable rate, since this operation is not speculative in nature.

According to PECOL, and based on the Spanish legal system (art. 48.1 SCA), the interest rate may vary according to the nature of the contribution (whether mandatory or optional) and according to the category of the members providing it (whether cooperator members or other types of member).

PECOL section 3.3(6) deals with the legal regime of transfer of capital contributions, which may take place *inter vivos* or *mortis causa*.

In the first case, member shares may not freely circulate, which is consistent with the *intuitus personae* that characterises this class of members. So, member shares may be transferred *inter vivos* only among members or candidates for membership [see, among others, art. 50.a SCA and art. 23 PCC]. Transfer of member shares to non-members is not possible. A transfer of member shares is always subject to approval by the designated body and is subject to any other conditions laid down in the cooperative statutes.

So, for PECOL, the transfer of member shares is dependent on meeting two conditions: the prior authorization of the cooperative board, which will be a condition of effectiveness of the transfer; and the acquirer already being a member of the cooperative or, if not, requesting such admittance.

For PECOL, shares subscribed by investor members are not transferable without permission from a body of the cooperative.

In the Italian legal system it is explicitly stated that the statutes may even provide for share non-transferability, but, in that case, members are entitled to withdraw, although not earlier than two years after joining the cooperative (art. 2530.6 ICC).

As to *mortis causa* transfer, the common practice in Europe allows transfer to the member's heirs, if they are already members and if they so request, or, if they are not members, provided that the conditions for membership, as stipulated in the statutes, are met. Heirs who do not intend or are not able to be members will be entitled to receive the value of the shares of the testator.

Member shares cannot be attached by the personal creditors of the members, but the latter are allowed to seize their reimbursements, interest and patronage refunds to collect their debts [see third additional provision, SCA; art. 2537 ICC; § 66 GCA]. The reason for this prohibition stems from

the strictly personal character of the cooperator member's participation in the cooperative and the consequent need to avoid the possibility that through an enforcement procedure, private individuals who do not meet the conditions for membership, as stipulated in law or in statutes, might become members.

For PECOL [Section 3.3(7)], it is possible to redeem member contributions to share capital if a member leaves the cooperative. This is a natural consequence of the ICA principle of voluntary and open membership and the reason for the variability of the share capital [section 3.3(3)]. Cooperative shares are capital contributions of the member to finance the cooperative for the duration of his/her membership. So, taking into account the European common practice, PECOL states that “the member who leaves the cooperative may be reimbursed for the nominal value of their shares and their portion of divisible reserves, as provided in the cooperative statutes, which may subject the reimbursement to reasonable conditions. The amount repayable to the member may also take into consideration any outstanding interest or cooperative refunds due to the member and any debts due from the member to the cooperative”.

The provision makes it clear that there are limitations to the right to redemption (the statutes may “subject the reimbursement to reasonable conditions”) such as minimum periods of membership, rules fixing due notice periods for members wishing to leave the cooperative, the possibility of deferred redemption for a period of time provided for in the statutes, and the possibility of making deductions from the reimbursement [as we saw in section 3.2(3)].

Moreover, capital contributions by cooperator members may not be totally redeemed. In fact, before the member’s capital contribution is redeemed it must first be liquidated, deducting any losses accountable to the member and any other amounts owed by the member to the cooperative [see, among others, art 36.4 PCC; art. 2535 ICC; art. 51.2 SCA].

As mentioned above, the reimbursement may not entail reducing the share capital below the minimum capital laid down in the statutes [see section 3.2(4)].

### **Section 3.4** **Reserves**

PECOL section 3.4 (1) deals with the cooperative reserves. They are a part of the assets that is not freely available to the management but must be used for specific purposes. According to the scholars, given the limited relevance of the cooperative share capital (see sections 3.2 and 3.3), the

reserves are the financial resource of best quality in a cooperative, favouring implementation of the cooperative's social function and strengthening its financial structure.

PECOL identifies two types of reserves: mandatory reserves and voluntary reserves.

Mandatory reserves include the legal reserve and other reserves required by law or cooperative statutes, such as the reserve for cooperative education, training and information.

In PECOL the legal reserve and the reserve for cooperative education, training and information are indivisible, even in the event of cooperative dissolution [(see Section 3.8).

It may be emphasised that their indivisible nature does not mean non-usable, although the functions performed by indivisible reserves justify limitations in the use of such reserves.

The reasons for the indivisibility of the reserves (mandatory or otherwise) are: to counterbalance the variable share capital; to increase the creditworthiness of the cooperative and to protect creditors; to avoid speculative winding-up, i.e. present cooperator members' winding up a cooperative in order to share the assets built up by previous cooperator members; and to create common property and solidarity over generations.

The legal reserve is not mandatory or absolutely indivisible in all the European legal systems considered. In the UK, there is no legal requirement for indivisible reserves.

Regarding the sources of this reserve, and taking European common practice as reference, PECOL stated that this reserve is established: a) by a percentage of the net annual cooperative surpluses, usually to a certain limit set by the law or the statutes; b) by a percentage of the net annual profits resulting from transactions with non-members or any activity unrelated to the purpose of the cooperative, as provided in the statutes and without time limits or amounts; c) and by a percentage of other resources, as defined in the statutes [art. 55 SCA; art. 2545*quater*, par. 1, CC; § 7 N<sup>o</sup>. 2 GCA; art. 69(2) PCC].

In general, this allocation is not indefinite, but is made until a certain percentage has been reached, as provided by law or cooperative statutes [art. 69.4 PCC; art. 16. FrCA; art. 65.2 SCE; in contrast, no limits are set, for example, by Italian or Spain cooperative law].

The legal reserve can only be used to cover losses which cannot be covered by other reserves and by setting limits [§ 7 N<sup>o</sup>. 2 GCA; art. 2545*ter*, par. 2, ICC; art. 69 (1)PCC]. This use of the legal reserve exclusively to cover losses highlights the only purpose of the legal reserve: to be the first line of defence of the share capital, preventing losses arising from the

business activity of the cooperative from affecting the share capital directly and thus causing its reduction.

As a general rule, the losses compensated by the legal reserve shall refer (mainly) to social losses (losses of the cooperative), excluding, in principle, the losses attributable to the cooperator members (those resulting from their participation in the cooperative transactions). In the event of using the legal reserve to cover losses attributable to the cooperator members, these may be required to replenish the amount of the legal reserve to the level that existed prior to its use to cover such losses, according to the terms of the resolution adopted by the general meeting [art. 69.4 PCC].

In that regard, the special case of the French cooperative law should be mentioned. In this legal system, some special laws state explicitly that the reserves deriving from transactions with non-members are autonomous. This is the case of farmers' cooperatives (art. L.522-5 al. 3 Rural Code) and artisanal cooperatives (1983 law, art. 25). These reserves cannot be used to cover the losses resulting from the transactions with members. Whereas the Rural Code details the reserves that must be used to compensate these losses, the 1983 law states that if they cannot be compensated by the legal reserve (called the indivisible account in the French law), they must be immediately divided among members or, if this choice is not made, either compensated by the capital or postponed to the next financial year.

The cooperative legal reserve cannot be used to increase share capital, unlike in commercial companies. As far as cooperatives are concerned, it is PECOL's understanding that increasing the share capital by incorporating reserves cannot be carried out using reserves whose funding includes results of non-member cooperative transactions and results from ownership of company shares or other assets (see section 3.7). If the share capital were to be increased by incorporating any such reserves, the cooperator members would end up with either more shares or the same shares with a higher nominal value. So, as provided for in section 3.3., the cooperator members who leave the cooperative are entitled to the amount of their contribution to share capital according to the nominal value of the shares. It is, therefore, evident that increasing share capital by incorporating these mandatory reserves violates the principle of *disinterested distribution* upon winding up.

Voluntary reserves are reserves that depend on the collective will of the cooperator members, embodied in a resolution of the members' meeting. So it is not a matter of law, but rather of business prudence.

According to PECOL, this resolution of the members' meeting should determine the mode of their constitution, implementation and liquidation, and in particular their indivisible or divisible nature, also on the basis of individual accounts [art. 71.2, PCC].

In the Portuguese and Spanish legal systems, voluntary reserves can only be established with the annual net surplus that remains: after interest on shares, if applicable, is paid; after the allocations for the various reserves are made, after losses of previous years are offset, or, having used the legal reserve to compensate for these losses, after the legal reserve is back at the level prior to its use [art. 73(2 and 3) PCC and art. 58.3 SCA].

Determining the divisible or indivisible nature of the voluntary reserve is very relevant for the following reason: the voluntary reserve must be indivisible if it is established with results from non-member cooperative transactions and results from ownership of company shares or other assets [see, among others, art. 72 PCC].

The use of the expression “on the basis of individual accounts” refers to voluntary reserves established from cooperative surpluses which may be distributed among members at membership termination or if the cooperative is transformed or wound up. Even if only cooperator members who have contributed to the formation of such cooperative surplus benefit from this distribution, and only in the precise amount of that contribution, we consider that when cooperator members pass a resolution to allocate surplus generated by them to voluntary reserves, individual accounts should be created to identify the contributor and the contribution of each cooperator member to this voluntary reserve fund.

The reserve for cooperative education, training and information is not envisaged in all the legal systems analysed.

In the Spanish and Portuguese legal systems this reserve is mandatory [art.56 SCA; art. 70 PCC]. In the Italian legal system we find a similar reserve, the mutual funds of art. 11, Law 59/1992 (mutual funds are those established and led by cooperative federations for the promotion of cooperation) (art. 2545*quater*, par. 2, CC) or (a specific fund maintained by) the State if the cooperative is not affiliated with any federation.

The existence of this reserve is derived directly from the ICA principle of education, training and information and from the principle of concern for the community. According to PECOL, the aim of this reserve is to provide for the technical and cultural education and training of members, members of the organs, managers and employees of the cooperative, and the provision of information about cooperatives to the general public.

Indeed, the formation of this type of reserve, for this purpose, means that the cooperative is not only an economic organization, but also an organization with educational and social purposes. This reserve fund will be allocated to cover activities that go beyond the satisfaction of purely individual interests of its members and that, although not strictly economic, can produce, directly or indirectly, immediate or deferred economic effects for either the cooperative or the community where the cooperative operates.

Regarding the purposes of the reserve for cooperative education, training and information, PECOL follows the SCA [art. 56] and stipulates that this reserve can be treated as a separate patrimony if the law so provides. Thus, this reserve is not attachable except for the payment of debts incurred in the fulfilment of its purposes [see section 3.5].

### **Section 3.5**

#### **Member limited liability**

Cooperatives have a specific legal form or take the form of a partnership or corporation, are recognized by law, and have legal personality when they are constituted with the formalities required by law.

Recognition of legal personality will lead among other consequences to full patrimonial autonomy, that is to say, the cooperative has its own assets to allocate to fulfil its purposes and respond to its creditors.

The cooperative is liable with all its assets for meeting its obligations. However, some legal systems provide for separate funds to serve specific purposes, in which case the only liabilities in respect of those assets are the obligations generated in meeting these purposes. In Spain the Cooperative training and promotion fund can only be used to cover debts arising through the fulfilment of its purposes (art. 56 SCA). In the UK it is also possible to allocate part of the funds and assets of the IPS to trusts, in which case they can only be allocated in favour of the beneficiaries of the trust.

Moreover, although historically the laws contemplated the possible subsidiary responsibility, including unlimited liability of the partners for corporate debts, today the trend is to exclude members from liability for the debts of the cooperative.

Nevertheless, some legal systems provide for the possibility that the members' liability for the debts of the cooperative may in some cases extend beyond the subscribed capital.

Thus, in France, in cooperatives established in the form of a civil society, such as fishing cooperatives, the liability of the members extends to five times the subscribed capital. In Germany, the statutes should determine whether members will be responsible for additional contributions in the event of insolvency of the cooperative, and must specify whether such liability is unlimited or limited to a specific sum (art. 105 GCA). In Portugal, art. 35 PCC establishes that the liability of the cooperator members for the debts of the cooperative is limited to the amount of the subscribed capital, although the statutes of the cooperative may determine that the liability of cooperator members, or of some of them, be unlimited.

When a member leaves the cooperative, free membership and the integrity of the assets of the cooperative must be reconciled. Therefore, if the member is reimbursed the contributed capital must previously be liquidated (taking the equity of the cooperative into account). Likewise, the member can be bound to refund the amount reimbursed if the cooperative becomes insolvent and incapable of meeting the obligations assumed prior to his or her withdrawal. This responsibility of the member has a double limit: not exceeding the amount that has been repaid, and not exceeding a period starting from the time of repayment, normally set at five years (art. 15.4 SCA or in France: art. R.523-5 al. 6 of the Rural Code). This responsibility does not apply if the cooperative constitutes a restricted reserve for that period for the amount reimbursed.

### **Section 3.6**

#### **Economic results from cooperative transactions with members**

As we saw in Section 1.1. (1), a cooperative is a legal person that carries on any economic activity, mainly in the interests of its members and without having profit as its ultimate purpose. When cooperatives carry out non-member cooperative transactions, they must keep a separate account of such transactions (Section 1.5 (4)) and the profits from these non-member cooperative transactions must be allocated to indivisible reserves (Section 1.5 (2)).

The economic result of cooperative transactions with members may be positive (surplus) or negative (losses). In any case the General Meeting is the competent body to decide how to distribute this result.

“Cooperative Surplus” is the excess of revenue over cost in cooperative transactions:

In service cooperatives, which includes consumer and producer cooperatives, prices charged for goods or services delivered to members that are higher than is necessary to cover the cost of the cooperative enterprise, or prices paid for goods or services received by the cooperative from members that are lower for reasons of business prudence or due to market conditions, are provisional prices to be corrected or adjusted when the actual costs are known at the end of the financial year. Refund of the cooperative surplus (*le trop perçu*) to members at the end of the financial year allows the cooperative to charge for/receive goods or services at near cost.

In worker cooperatives, below-capacity wages paid by the cooperative to worker members for reasons of business prudence or due to market conditions are “advance payments” on salary (*anticipo*) and subject to final

calculation when full information on the income and expenditure of the cooperative enterprise is available. Surplus is paid out as wage supplements.

“Losses” in member cooperative transactions are the excess of costs over revenues and are shown in the audited balance sheet. They are covered by the reserves, starting with the voluntary reserves. The statutes may stipulate that losses are born by members:

- a. In service cooperatives, in the form of a reduced (final) price for goods and services delivered to the cooperative or increased charges for goods and services received from the cooperative as calculated at the end of the financial year, when full information on income and expenditure from cooperative transactions is available, in order to provide the goods or services at near cost in retrospect.
- b. In worker cooperatives, in the form of reduced (final) wages paid by the cooperative to worker members.

It should be noted, as we saw in Section 1.1 (3), that the cooperative enterprise may include an enterprise of a subsidiary if this is necessary to satisfy the interest of the members and if the members of the cooperative maintain the ultimate control of the subsidiary. In this case, this rule shall apply to the results of the activity carried out by the subsidiary which is necessary to satisfy the interest of the cooperative members.

The cooperative surplus may be distributed to the cooperator members as cooperative refunds or allocated to reserves (see in Section 3.4).

In the distribution of the surplus, the cooperative must obey the following rules. The law regulates surplus distribution primarily by establishing some compulsory allocations with a view to implementing the social function of cooperatives and strengthening their financial structure.

- a. The allocation of reserves may be to either indivisible reserves or divisible reserves. The cooperative must allocate part of its surpluses to a compulsory reserve called the legal reserve (15% art.16.1 FrCA; 30% art. 2545 quater, par. 1 ICC; 20% art. 58.1 SCA or 5% art. 69.2 PCC;). Normally this allocation is compulsory until the legal reserve is equal to the subscribed capital (art. 16.2 FrCA, art. 69.3 PCC, art. 65.2 SCE or, in Spain, art. 68.2 Valencian Law 2003). Some legal systems have other compulsory reserves. In Spain and Portugal, the cooperative must allocate part of its surpluses to an education and training fund (5% art. 58.1 SCA or 1% art. 70 PCC); in Italy to the mutual fund for cooperative promotion and development (3% art. 11 Law 59/1992). In France the development reserve is compulsory in workers’ cooperatives and must be allocated at least 25% of the surplus. This obligation may be reinforced by the statutes.

The cooperative refunds may be distributed to the cooperator members in proportion to the quantity and/or quality of their participation in cooperative transactions, because — as we saw earlier — the return complements the provisional price paid or received by the member in the cooperative transactions (art.15.1 FrCA; art. 2545-sexies ICC or art. 58. 4 SCA). In German law, any distribution of the profit or loss of a financial year to the members must be distributed among them in a special way: in the first financial year the distribution is proportional to the payments made on shareholdings; in each successive year it is in proportion to their credit balance, established at the end of the previous financial year as a result of the profit added or loss written down. (art. 19 GCA).

The distributions of refunds may be made in cash, shares or other financial instruments. Distribution in shares may be made by increasing the value of the shares or distributing new free shares (art. 2545-sexies, par. 3, ICC). The latter has been possible in France since 1992, if the statutes so provide, but is limited to 50% of the existing available reserves at the end of the previous financial year (art. 16 FrCA).

Cooperative surpluses may not be distributed if and insofar as they are needed to cover existing losses (art. 58. 1 SCA or art. 19.2 GCA, art. 73.2 PCC), because ensuring the solvency of the cooperative should be a priority.

For the same reason, cooperative surpluses may not be distributed if the cooperative does not cover the required minimum reserve or insofar as the legal reserve level is below that achieved in the previous financial year (art. 19.2 GCA; art. 73.2 PCC).

Losses in member cooperative transactions may be covered by decision of the General Meeting using the reserves of the cooperative or by the cooperator members. In this distribution the cooperative must obey the following rules:

- a. The allocation to reserves must begin with the voluntary reserves (art. 2545-ter ICC or art. 59 SCA).
- b. The distribution of losses among the members should be in proportion to the quantity and/or quality of their participation in cooperative transactions (art. 59. 2 c SCA; art. 69.4 PCC), in the same proportion as for the positive results.
- c. No member should sustain losses that exceed the value of the goods and services delivered or received in the cooperative transactions. Members should not incur more risk than that derived from transactions with the cooperative in their own interest (in Spain: art. 69 3 Valencian Law 2003).

### **Section 3.7**

## **Profits and other losses**

As we saw in PECOL 1.5 (4), when cooperatives carry out non-member cooperative transactions they must keep a separate account of such transactions.

The economic results from non-member cooperative transactions (as well as from other extra-cooperative sources) may be called profits or losses to distinguish them from the surpluses or losses from member cooperative transactions.

As a general rule, profits are allocated to indivisible reserves.

Losses are covered by reserves, beginning with the voluntary reserves (see Section 3.4).

French law does not distinguish profits and surplus but expressly prohibits both the distribution among members of surpluses (*excédents*) from transactions with customers (art. 15.2 FrCA) and using the reserves from the cooperative transactions with non-members to compensate losses from the cooperative transactions with members. In Italy only that part of the profits that derives from transactions with members may be refunded (*ristorni*), as ministerial communication 53/E of 18 June 2002 has clarified. In Portuguese law, the results from non-member cooperative transactions may not be shared by the cooperator members (art. 73.1, PCC) but must be allocated to indivisible reserves (art. 72 PCC). This solution is also present in the Spanish laws of Extremadura (art. 61.2), Galicia (art. 66.3), Madrid (art. 60.1) and Valencia (art. 68.4).

In many German cooperative societies which are authorized by their statutes to carry out transactions with non-members (e.g. cooperative banks), there is no separate recording of transactions with members and with non-members. Only where cooperative societies wish to have patronage refund payments recognized by the tax authorities as being tax-deductible operating expenses of the cooperative society rather than ordinary profit distribution is keeping separate accounts for transactions with members and with non-members one of the conditions. And in agricultural cooperatives the “purpose transactions” are usually made only with members, so separate recording of transactions is not important.

Indivisible reserves can be intended to cover losses, as is the case of the legal reserve, but they can also be used for other purposes such as remunerating capital or financing received, within the limits laid down in the statutes.

## **Section 3.8 Liquidation**

As we saw when a member leaves the cooperative [Section 3.3 (7)], and also in the case of liquidation of the cooperative, members are only entitled to recover the nominal value of their shares and their portion of the divisible reserves as provided in the cooperative statutes. If the divisible reserves were generated through transactions with members, the allocation should be made in proportion to the transactions with each member. The amount repayable to the member may also take into consideration any outstanding interest or cooperative refunds due to the member and any debts the member owes to the cooperative (art. 75 SCA).

Residual net assets shall be allocated in accordance with the principle of disinterested distribution, e.g. distributed to the community or other associated cooperatives (3<sup>rd</sup> principle ICAP). In France they must be assigned to another cooperative or to an aim of general or professional interest (art. 19 FrCA). In the UK, the destination of any surplus assets is governed by the statutes and most cooperatives provide for transfer to other cooperatives, cooperative organizations or charities and other disinterested purposes. In Spain the remaining assets, if any, must be assigned to the cooperative or federation nominated in the statutes or by the general meeting, or otherwise to the Public Treasury for the advancement of the cooperative spirit. If these assets are assigned to another cooperative, they must be kept in the mandatory reserve fund and remain unavailable for fifteen years. If they are received by a federation, the funds must be used to support investment projects promoted by cooperatives. In addition, any member of a cooperative being wound up who intends to join another cooperative may request that his or her proportional part of the remaining liquid assets should be deposited in the mandatory reserve fund of the cooperative that he or she is joining, provided that such a request has been made before the general meeting approves the final winding-up balance sheet (art. 75.2 SCA). In Portugal, upon liquidation of the assets of the cooperative, art. 79. 2 PCC stipulates that the amount of the legal reserve not allocated to covering losses of the financial year and which may not be used for any different application “*can move, with the same purpose, to a new cooperative entity to be formed following the merger or division of the cooperative in liquidation*”. But No. 3 of the same article of the PCC states that “*when no new cooperative succeeds the cooperative in liquidation, the application of the mandatory reserve balance will be allocation to another cooperative, preferably from the same city, to be determined by a federation or confederation that represents the main activity of the cooperative.*”

Sometimes the laws offer other solutions, as in France (art. L.124-14 C.com), where the minister of commerce may allow merchant cooperatives to distribute their assets among the members. In the UK, a distribution

among the members on the basis of their transactions with the cooperative over a fixed period near the end of its life has been allowed in IPS rules and is used by some agricultural IPSs. On the other hand, IPSs registered on the basis of operating for the benefit of the community are permitted to “lock” the assets of the IPS in for the purpose for which the IPS is established. Also, upon winding up and during liquidation the German Cooperative Societies Act allows several options for dealing with the reserves: any surplus in excess of the total credit balances may be distributed among the members on a per capita basis (art. 91 par. 2 GCA); the statutes may prohibit any division of assets, or may stipulate different ratios when dividing assets (art. 91 par. 3 GCA); or members may vote for keeping the reserves indivisible and transferring the liquidated assets to “a natural or legal person for a specific purpose” or “to the community where the cooperative society was based”. The interest on this fund shall go to charity (art. 92 GCA).

The regulation of the reversion of assets in the case of dissolution also applies to cooperative conversion, merger, splitting or any other restructuring unless the new entity is also subject to the principle of disinterested distribution.

Some laws establish special rules in these cases. Thus, in France, when a cooperative (but not a workers’ cooperative) is transformed into a company, the indivisible reserves of the cooperative are allocated to a special reserve of that company which remains indivisible for ten years (art. 25 FrCA). The purpose of this rule is to avoid transformation of the cooperative in the hope of distributing the reserves.

## **CHAPTER 4 COOPERATIVE AUDIT**

### **SECTION 4.1** *(General principles of cooperative audit)*

(1) Cooperatives are obligated and entitled to be audited.

(2) The specific aim of cooperative audit is to verify that cooperatives pursue their objectives as defined by the law and their statutes in accordance with section 1.1, and that their structure and activity are consistent with their identity as cooperatives.

(3) Cooperative audit must be conducted by specifically qualified and independent auditors in forms that ensure the autonomy of cooperatives and are consistent with their specific features.

(4) Cooperatives are also obligated and entitled to be financially audited as prescribed by law, according to the nature and scale of their activities, their size, and the need to protect creditors, and other stakeholders in addition to the members and the pursuit of the cooperative objective.

### **SECTION 4.2** *(Scope and forms of cooperative audit)*

(1) Cooperative audit includes, but is not limited to, the volume of cooperative transactions with members and with non-members; the use and results of subsidiaries; member participation in cooperative governance; member democratic control of the cooperative; the composition of assets; the origin and allocation of the economic results; the amount of the indivisible and divisible reserves; the economic sustainability of the enterprise; the existence of practices of cooperation among cooperatives and of cooperative social responsibility; the level of engagement in cooperative education and training; the manner in which the general interest has been pursued and the stakeholder involvement in general interest cooperatives.

(2) Cooperative audit is conducted through the analysis of books, accounts, balance sheets, reports and other relevant documents, of the cooperative and its subsidiaries, as well as by other means, such as the

access of the auditor to the cooperative premises, the interview of cooperative members and members of cooperative organs, and also following a checklist provided by the auditing entity of section 4.3.

(3) Cooperative audit may be ordinary, extraordinary, or special.

(4) Ordinary cooperative audit is carried out at regular intervals as defined by the law taking into account the size and the type of the cooperative, or by the cooperative statutes if they provide for more stringent intervals.

(5) Extraordinary cooperative audit is carried out whenever requested by a number of members as defined by the law or by cooperative statutes, the union or federation of which the cooperative is a member, the competent public authority, or the cooperative competent organ, by specifying the reasons.

(6) Special cooperative audit is carried out in the event of the cooperative losing its legal form through conversion, merger, splitting, or any other restructuring.

(7) The costs of cooperative audit are born by the cooperative. The costs of extraordinary cooperative audit are born by those requesting it when no irregularities are found.

### **SECTION 4.3** ***(Auditing entity and auditors)***

(1) The auditing entity is the entity in charge of the cooperative audit, which conducts it through independent auditors specifically qualified for cooperative audit according to minimum standards established by the law.

(2) Auditing entity may be the state, another public authority, unions or federations of cooperatives or other private entities recognized by the state according to minimum requirements established by the law.

(3) The auditing entity ensures:

- (a) continued training of the auditors and provision of a list of them;
- (b) compliance with the standards in paragraph (1);

(c) that the costs of audit are reasonable taking into account the activity performed by the auditor, as well as the activity, size and financial capacity of the audited cooperative.

(4) The state ensures compliance with the requirements in paragraph (2) and the obligations in paragraph (3). Any violation may be sanctioned as provided for by the law.

**SECTION 4.4**  
*(Conclusion of cooperative audit and effects)*

(1) Upon completion of the cooperative audit, the auditor issues an auditing report.

(2) The auditing report, which includes a summary, testifies the auditing activities and findings and may also contain advice on how to deal with deficiencies discovered.

(3) The auditor communicates the auditing report to the cooperative boards. The auditor also communicates the summary of the auditing report to the competent public authority.

(4) The cooperative communicates the summary of the auditing report to all its members and informs them that they may have access to the auditing report provided the member agrees to be legally bound to maintain confidentiality, unless the law provides for its public disclosure.

(5) The auditing report is discussed at the next members' meeting. The cooperative adopts adequate measures to deal with the audit findings.

(6) When irregularities are found, the competent public authority adopts the measures provided for by the law.

## COMMENTS TO CHAPTER 4

### Introduction

The list of laws to be considered for this topic includes general national and European Union organisation law on audit and external control, laws and regulations governing the profession of public chartered or certified accountant, provisions regulating self-control of the cooperative movement including external control by federated cooperative structures and members' rights to appeal to the judicial system. In the following text, the country reports on PECOL Chapter 4 served as a valuable source of information.

### *General principles of cooperative audit – Section 4.1*

The objective of cooperative audit is to verify that cooperatives societies comply with the provisions of organisation law regarding books, accounts and reporting and observe the rules defining their function (member-promotion, mutual aim) and structure (democracy).

When designing the right measure of external control and deciding how far it can go, a possible conflict between cooperative autonomy and control by authorities has to be taken into account<sup>38</sup> (see section 4.1 (3)). While granting freedom of choice of the legal form, clear rules must be set especially for audit and external control to avoid confusion and abuse.

Main concern is to secure that members exercise ultimate authority also in the field of audit. Because of their special object of member-promotion, cooperatives need a special form of audit to assess their success in member-promotion, their member-oriented effectiveness (see section 4.2 (2) and *infra* p. 3). Therefore, the general trend to approximate cooperative audit to company audit should not be followed (see *infra* p. 9, Conclusion).

### *Forms of cooperative audit – Section 4.2*

Regarding the legal framework provided for audit of cooperative societies in EU-member states, different approaches can be identified:

General reference to commercial law or company law, general provisions for all cooperatives in the national cooperative law or special regulations for

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<sup>38</sup> Hiez, David: *Coopératives, Création, Organisation, Fonctionnement*, Editions Delmas, Paris 2013, p. 315; in the following quoted as Hiez 2013.

special types of cooperatives (e. g. France in case of agricultural cooperatives (Hiez 2013, p. 319). Audit by certified public accountants or auditing federation, by Commissaires aux Comptes (CCs) employed by a federation or on a list of specialists of the federation. Different professional standards can be observed: Certified public accountants, specially trained cooperative auditors, commissaires aux comptes and réviseurs, less qualified than CCs, and lay auditors.

In European cooperative legislation two extremes of regulation can be found:

- UK: Primarily financial audit; supplemented by discretionary regulatory monitoring and self-regulation, either by a federal cooperative body or other people.
- Germany: Audit of cooperative societies designed as a special type of “management audit” with detailed regulation in the law, prescribing management audit in addition to financial audit. Annual (or bi-annual) audit of all registered cooperative societies being mandatory with detailed regulations of the role of cooperative auditing federations in cooperative law (§§ 53-64c GCA). Auditing federations are special institutions in the legal form of association for carrying out cooperative audit. They have a monopoly to audit all registered cooperative societies with specially trained cooperative auditors, employed by the federation but independent in their position as auditors (§ 55 GCA).

Between these two extremes several mechanisms are offered by the national law-makers for solving the problem of appropriate audit and external control for cooperative societies while respecting their autonomy.<sup>39</sup>

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<sup>39</sup> In **Italy**: Monitoring or “*vigilance*” of cooperatives (Fici, p. 4) through the competent ministry (MED) as routine inspection is the ordinary form of cooperative revision, normally every two years, carried out by staff of cooperative federations authorized to audit cooperatives affiliated to them. Extraordinary inspection by the MED is carried out whenever the need arises, e. g. in cases of danger carried out by “*inspectors*” (functionaries of MED).

In **France**: Although cooperatives need a special type of external control: *révision* (Hiez 2013, p. 314), such *révision* is not regulated in the law, but in a decree of 1984 regulating procedures (Hiez 2013, p. 320). *Révision* has a dual objective: control of books and accounts and assessment of performance; analytical examination of the financial situation and of management (Hiez 2013, pp. 320-321, note 182.13). In practice external revision mainly consists of audit of books and accounts together with a verification of real performance and compliance with the law and an assessment whether the society is working in accordance with cooperative principles (Rural Code, art. 527). Another area of concern is the protection of indivisible assets (reserves) and compliance with the principle of disinterested transmission of assets in case of dissolution.

### ***Special provisions for small cooperatives – Section 4.1 (4)***

Small cooperatives are defined in the cooperative laws by number of members (e.g. not more than eight or twenty), by total of assets, annual turnover or number of employees. To reduce audit costs for such relatively small organisations, the law-makers can use several methods, e.g. by prescribing a routine audit only every second of fifths year, by reducing the scope of audit to only financial audit or the simplifying the required annual return.

In the UK, small cooperatives of certain branches of business, meeting certain financial thresholds and whose statutes do not require full audit, may '*opt out*' of audit, i.e. decide in general meeting to work without external control, provided there are no special reasons to return to audit routine. Some types of small cooperatives cannot use such exemption. However, small companies enjoy wider exemption than small cooperatives.

In Spain, small cooperatives are not obliged to draw up a management report (Fajardo 10). In Germany, small cooperatives with a balance sheet total of less than 2 m € shall be subjected to audit at least every second financial year, while other cooperatives are audited every year (§ 53 (1) GCA).

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**In Portugal:** Annual reports have to be submitted to CASES (Antonio Sérgio Cooperative for the Social Economy), a 'régie cooperative' assuming the public responsibilities of INSCOOP, attesting proper functioning and cooperative management audit with the legal obligation to respect CSR and the 7<sup>th</sup> cooperative principle covered by a social report (Aparício Meira, pp. 9 f) financial audit (4<sup>th</sup> EU Directive) plus a check regarding demutualisation.

**In Spain:** Cooperatives are subject to a double external control, by the Administration (Arts. 113 and 116 of the Cooperative Societies Act law 5/2000 on infringement of cooperative obligations) and by specialized cooperative auditors which are trained in several Spanish universities. There is mandatory audit required by law, by the statutes of the society, by the general meeting, by internal auditors or by a minority of members as well as voluntary audit called by the board of directors. Special provisions were adopted regulating accounting and auditing of cooperatives (Order EHA/3360/2010) not only prescribing financial audit, but also containing non-financial performance indicators allowing to assess cooperative effectiveness. Such indicators are: volume of transactions with members and non-members, variations in the number of members, activities undertaken in training of members and staff and measures of promoting cooperative development. Annual reports of cooperatives have to contain such cooperative-specific information.

### ***Special features of cooperative audit – Section 4.2 (1)***

External control is needed to protect the cooperative society as a legal body and as an enterprise, its members, its creditors and the general public.

For performing type-specific external control and assessment of cooperative success in promoting their members, special instruments have been developed by the cooperative movement or by cooperative science.<sup>40</sup>

- Success of cooperative societies operating as enterprises on the market is measured by economic results (excess of income over expenditure): economic efficiency.
- In transactions with their members (on an internal market, in cooperative transactions) success is measured by member-oriented effectiveness (cooperative advantage, service near cost, patronage refund). Instruments for measuring member-oriented effectiveness are a promotion plan (proposed by the board of directors and approved by the members in general meeting) at the beginning of a financial year and a promotion report presented by the board at the end of the financial year. It should be mandatory for cooperative societies under cooperative law to present annual promotion plans and promotion reports.

In addition, cooperative success is measured by success in contributing to social and regional development and in securing sustainable development (social report, bilan sociétal), reaching beyond corporate social responsibility of companies.

If management audit is prescribed, the tasks of the cooperative auditor include the following:

- to monitor operational efficiency of the cooperative enterprise,
- to understand the cooperative way of doing business and value-oriented management and to assess member-oriented effectiveness, e.g. service near cost, allocation of surplus and patronage refund,
- to verify the degree of transparency,
- to monitor the quality of the cooperative enterprise as employer and in labour relations and
- to assess the cooperative society's concern for the community beyond CSR.

If special cooperative audit is prescribed, the following additional criteria have to be considered as well:

- development of membership within the cooperative group,

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<sup>40</sup> E.g. promotion plan, promotion report. German cooperative literature offers a detailed debate of proposals for type-specific external control of cooperatives among scholars (e. g. Boettcher, Dülfer).

- cooperative advantage and “member-value” offered,
- volume of business with non-members compared to transactions with members.

To allow control of economic efficiency and member-oriented effectiveness of cooperative societies, separate accounts have to be kept for cooperative transactions with members and with non-members. This allows distinguishing between surplus (earned in cooperative transactions with members) and profit made in cooperative transactions with non-members and other transactions with business partners, being important for their different tax-treatment.

### ***Qualification of auditors – Section 4.1 (3)***

The qualification required for auditors of cooperative societies depends on the type of audit that they have to carry out.

- If cooperative societies are audited in the same way as companies (only financial audit), such audit can be carried out by chartered accountants. No special qualification is needed. The same professional standards apply as are required in case of company audit. However, in any case auditors of cooperative societies need to understand the special governance and financial structure of cooperatives.
- If cooperative societies are audited in a special way including the evaluation of success in member-promotion, specially trained cooperative auditors are needed, often trained and employed by cooperative federations in charge of audit of affiliated societies.<sup>41</sup>

The law has to safeguard the independence of cooperative auditors, especially when they are employed by auditing federations. *“Any person who may influence the outcome of the audit, is excluded from the audit if there are reasons to assume that they may cause the suspicion of bias ...”* (§ 55 GCA); section 4.1 (3)).

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<sup>41</sup> In Spain, external auditors have to meet standards of qualification, independence and accountability (Fajardo 12); independence of the organisation they audit and no other direct links. All external auditors are registered in the Official Register of Auditors of Accounts (ROAC). They must be authorised by the Accounting and Auditing Institute. Authorization requires: professional competence examination – theory courses, including legal system governing cooperatives. However, this is not a subject-matter required for proof of competence and not in the list of subjects to be examined. Evidently: in case of approved external auditors there is no guarantee of sufficient knowledge of the cooperative legal and financial system (Fajardo 13). In practice, the special nature of the cooperative way of doing business is often neglected in audit and external control of cooperative societies.

What is appropriate training of cooperative auditors depends on the task and the scope of audit. It depends on what is prescribed by law and what is done in cooperative practice.

A special problem in this context is the combination of audit and advice in the person carrying out the audit. On the one hand, the auditor may know best, what to do to correct identified mistakes. On the other hand, the auditors may be biased to criticize and audit a development that may have been influenced by their own advice. A solution could be to offer the services “*audit*” and “*advice*” by different departments of the organisation in charge of audit.

General training programs for auditors and chartered accountants should include an introduction into the special problems of auditing cooperative societies in their curricula and in their rules for examination.

#### ***Scope of cooperative audit – Section 4.2 (1)***

There are two basic differences between audit of commercial enterprises and cooperative societies regarding scope of audit and type of auditor. In case of companies, the only legally prescribed form of external control is financial audit. If the shareholders decide to call for a – usually expensive – management audit, they have to cover the cost. In case of cooperative societies, in addition to financial audit, the task of the cooperative auditor includes assessment of the suitability of the business policy for achieving the objective of member-promotion and usually cooperative audit is combined with advice for appropriate future business policy.

Cooperative audit covers audit of books and accounts (financial or formal audit) like in case of every enterprise, to verify whether books and accounts are correct, complete, duly vouched and in accordance with the law on the one hand and assessment of the quality of management in pursuing the special cooperative objectives (management audit or material audit) on the other (section 4.2 (1)). Criteria for measuring member orientation are for instance the degree of member-satisfaction expressed by the number of new members joining the cooperative society, by withdrawals from membership and by the volume of transactions with non-members.

Special enquiry can be invoked for special reasons or in special cases.

#### ***Procedures of cooperative audit – Section 4.2 (2) - (5)***

Audit procedures are usually prescribed in the law or in regulations.

In § 57 of the German Cooperative Societies Act of 2006, the following procedure is prescribed, which can serve as a case study of how external control can be regulated in the cooperative law.

- The board of directors has to allow the auditor to inspect books, accounts, documents, cash in hand, securities portfolio and stock of goods.
- The directors have to furnish all information and proof the auditor requires to conduct the audit in a conscious manner.
- The auditing federation shall advise the chairperson of the supervisory board in due course of the commencement of the audit. The chairperson of the supervisory board shall inform the other members of the supervisory board in due time of the commencement of the audit and shall call them in the auditing procedure if and when requested by the auditor.
- The auditor shall inform the chairperson of the supervisory board without delay of any important findings on the basis of which s/he deems it necessary for the supervisory board to take immediate measures.
- Immediately after completion of the audit, the auditor is to present the expected outcome of the audit orally in a joint meeting of the board of directors and the supervisory board of the cooperative society. S/he can, for that purpose, require the chairperson of the board of directors or the chairperson of the supervisory board to call a meeting; should the request not be complied with, s/he him/herself may call a meeting of the board of directors or of the supervisory board, indicating the reason for the call. (§ 57 (1) - (4) GCA).
- The federation has to present the outcome of the audit in writing to the chairpersons of the board of directors and of the supervisory board and every member of the supervisory board shall take notice of the audit report (§ 58 GCA).
- The audit report has to be confirmed by the general meeting. The board of directors has to submit a certificate of the federation, that the audit has taken place, to the Register of Cooperatives (§ 59 GCA).
- The auditing federation is entitled to call an extraordinary general meeting, chaired by a person appointed by the federation (§ 60 GCA).

***Links between internal and external control. – Section 4.4 (2)***

Audit of cooperatives is a two-way relationship. Persons in charge of audit have to be given the right to consult books, accounts, minutes and other documents of the cooperative society and to consult members and office-holders requiring any information needed to carry out their tasks. At the same time they serve as a source of information and advice for office-holders and members of the cooperative society. Forms and scope of cooperation between internal audit (supervisory board) and audit or external control have to be prescribed by the law, e.g. submission of the audit report to the supervisory board, follow up of audit findings, e.g. whether actions were taken to correct mistakes identified during audit and assessment of such follow-up actions.

### ***Types of cooperative audit – Section 4.2 (3) - (6)***

Pre-registration audit is prescribed in different form in some national cooperative laws: as full audit of the new project and its viability; as verification of whether the requirements for registration are met, e.g. whether the contents of proposed by-laws is in conformity with the cooperative law.<sup>42</sup> Registered cooperatives are subject to different forms of audit and external control: routine audit or inspection in regular intervals (annual, bi-annual, every five years); special revision, investigation or inquiry (special or extra-ordinary control) for reasons given in the cooperative law or on demand of entitled petitioners: office-holders, a minority of members, the federation to which the society is affiliated, the external auditor, the supervisory authority and creditors. For small cooperatives, light forms of external control are offered up to the option of voting out (UK), see supra p. 3. Different types of audit of cooperative societies have developed in the different EU member states.<sup>43</sup>

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<sup>42</sup> In Spain there is no pre-registration audit, but before a new cooperative can be registered, legitimacy and legality of the new cooperative project are ensured by a notary public and the Cooperative Registry examines the by-laws/articles of association. Cooperative federations advise founder-members and provide information together with model by-laws vetted by the Cooperative Registry.

<sup>43</sup> E.g. in the UK there are three categories of external control (Snaith, p. 2): (1) There are only legal rules regarding purely financial audit: (2) The FCA must be satisfied that minimum standards of accounts are met, i.e. proper books are kept, a proper system of control is in place and financial reporting meets standards. (3) Discretionary regulatory monitoring and self-regulation on behalf of the society and its members, either by a federal cooperative body or other people together with assessment of commercial and cooperative performance beyond accounts.

***Different approaches to audit of cooperative societies – Section 4.1 (3); 4.3. (3)***

Considering the legal framework provided for audit of cooperative societies in EU-member states, different approaches can be identified:

General reference to commercial law or company law, general provisions for all cooperatives in the national cooperative law or special regulations for special types of cooperatives (e. g. France in case of agricultural cooperatives, Hiez 2013, p. 319), audit by certified public accountants or auditing federation, by Commissaires aux Comptes (CCs) employed by a federation or on a list of specialists of the federation. Different professional standards can be observed: certified public accountants, specially trained cooperative auditors, commissaires aux comptes and réviseurs, less qualified than CCs, and lay auditors.

***Audit cost – Section 4.2 (7); 4 (3) (c)***

Where cooperative law prescribes comprehensive (formal and material audit) for cooperative societies, audit costs are higher than if only financial audit would be required. In addition, where the cooperative law prescribes affiliation of cooperative societies to an auditing federation, affiliation fees also have to be paid. The auditing entity has to ensure that the costs of cooperative audit are reasonable.

In case of routine audit or special audit called for by a federation or by the supervisory authority, the society audited has to pay the fees. If special audit is invoked by an office-holder, a member or creditor and the audit reveals no irregularities, the petitioner has to bear the cost.

There are special tariffs for small and new cooperatives and exemptions of small societies from full audit with the right to use “*lay auditors*” in the UK (see 4.1 (4), supra p. 3).

***Auditing entity and auditors – Section 4.3 (1) - (4)***

Power to carry out audit of cooperative societies is given to an auditing entity (e. g. cooperative auditing federations) and to cooperative auditors by the supervisory authority. This authority also lays down the rules with regard to training and experience of auditors. It can also prescribe procedures to be followed when carrying out cooperative audit and collaborating with those in charge of internal control of societies.

The supervisory authority has to safeguard independence and qualification of external auditors/controllers and the professional and financial stability of cooperative federations entrusted with carrying out external audit/control of affiliated societies. The supervisory authority has power to cancel the audit license of an auditor or a cooperative auditing federation for reasons laid down in the law (section 4.3 (3)).

Oversight over the performance of auditing entities (super-audit) means auditing of the auditors with regard to quality and effectiveness of audit. Auditing federations are supervised by competent ministries at state level, e. g. in Germany, where the audit licence of a federation can be withdrawn when its financial position is insufficient to finance the operations of the federation (§§ 64 (1), 64a GCA). In this way, public authorities guarantee compliance with the law, respect of quality standards for audit and independence of auditors and auditing federations (section 4.3 (4)).

External control of auditors is exercised by public authorities or institutes, which have to verify the federations' authorisation to audit, their auditors' registration as cooperative auditor and whether they participate in ongoing training and respect the rules of the disciplinary system e.g. in Spain. The German Cooperative Societies Act contains full regulation of quality control for auditing federations and their audit staff (§§ 56, 62, 63a, 63e, 63f, 63g, 64 and 64a GCA).

## **Conclusion**

### *Trends to approximate cooperative audit to company audit*

The development of the legal framework for audit of cooperatives in EU member states differs, but some general trends can be observed.

With growing size and complexity of cooperative enterprises working on international markets, there is a growing distance between members and their cooperatives and increasing professionalism among cooperative directors recruited outside the cooperative movement. Furthermore, there is a general trend to harmonise commercial law in such a way, that the differences between the different legal forms of enterprise are levelled. It is claimed that there are no longer good reasons for having special rules for companies and cooperatives in the fields of accounting, audit/control, merger, conversion and liquidation.

Rather than following this trend which weakens the profile of cooperatives, the law-makers should insist on keeping the tested rules of special cooperative audit, allowing to measure success in member-promotion and sustainable development and to demonstrate to the members

and to the market, that the cooperative form of organised self-help still has its place, even in a global economy.

## **CHAPTER 5 COOPERATION AMONG COOPERATIVES**

### **SECTION 5.1 *(General principles of cooperation among cooperatives)***

(1) Cooperatives cooperate among themselves to further their objectives and to support, promote, and develop other cooperatives, cooperation among cooperatives, and the cooperative business model.

(2) The purpose of cooperation is either economic or socio-political or a combination of the two.

(3) Cooperatives cooperate in forms and structures that safeguard their autonomy, are consistent with their specific features, and are guided by the principles of equality, solidarity and subsidiarity.

(4) The law may promote economic and socio-political cooperation among cooperatives as well as with other entities of the social economy.

(5) Cooperatives may not participate in structures of cooperation which prejudice their autonomy and the members' ultimate control of the cooperative.

### **SECTION 5.2 *(Forms of economic cooperation)***

(1) Forms of economic cooperation among cooperatives include the establishment of:

- (a) contractual relationships for the exchange of goods or services;
- (b) a secondary (or higher-level) cooperative; or
- (c) a cooperative group.

(2) The law may provide for specific treatment of the contractual relationships between cooperatives, including specific tax treatment, in order to promote their establishment.

(3) Two or more cooperatives may establish a secondary (or higher-level) cooperative to conduct an economic activity in the interest of its member cooperatives.

(4) A secondary (or higher-degree) cooperative's statutes may provide that each member has a number of votes in the members' meeting in proportion to:

(a) the number of its members;

(b) participation in cooperative transactions with the secondary cooperative; or

(c) according to other criteria but not the amount of capital contributed.

In any event, no member may have more than the maximum amount or percentage of the total number of votes cast in each members' meeting, as defined by the law.

(5) Cooperative transactions between a secondary (or higher-degree) cooperative and the members of its member cooperatives are cooperative transactions with members within the meaning of section 1.4.

(6) Two or more cooperatives may establish another type of business organization to conduct an economic activity in the interest of their member cooperatives, provided that their autonomy and cooperative identity are protected.

(7) Two or more cooperatives may establish a cooperative group to delegate to one of them, to a secondary cooperative, or to another legal type of entity which they control, the power to coordinate or direct their economic activity, provided that in any case the members' meetings of the member cooperatives retain the power to make fundamental decisions as defined in section 2.4(5). Any member must have the right to withdraw from the group whenever its permanence seems likely to prejudice its objectives or the interests of its members.

(8) Non-cooperative entities may participate in any form of economic cooperation among cooperatives, provided that the cooperatives retain the control of the structure.

**SECTION 5.3**  
*(Forms of socio-political cooperation)*

(1) Two or more cooperatives may establish an association or an entity of another legal type to promote their socio-political interests as cooperatives.

(2) These entities pursue their objectives through activities such as representation; assistance and protection; education and training; advisory services; financial, legal and technical assistance; audit; dispute settlement; support for the creation of new cooperatives or the development of existing cooperatives; and the promotion of the cooperative business model.

## COMMENTS TO CHAPTER 5

### General comments

Cooperation among cooperatives has been a feature of cooperatives since the beginning of their modern history in the mid nineteenth century.<sup>44</sup> It is now the 6<sup>th</sup> of 7 principles that “are [the] guidelines by which cooperatives put their values into practice,” as laid down in the 1995 International Cooperative Alliance Statement on the cooperative identity (hereinafter: ICA Statement).<sup>45</sup> The ICA Statement is one of the three international instruments on cooperatives. The other two are the 2001 United Nations Guidelines aimed at creating a supportive environment for the development of cooperatives (hereinafter: UN Guidelines)<sup>46</sup> and the 2002 International Labour Organization Recommendation No. 193 concerning the promotion of cooperatives (hereinafter: ILO R. 193).<sup>47</sup> Like the ICA Statement in its 6<sup>th</sup> Principle, the ILO R. 193 emphasizes the importance of cooperation among cooperatives (Paragraphs 6, 13 and 18)). The UN Guidelines refer to the ICA Statement (Paragraph 11).

These international instruments do not expressly regulate the way cooperatives should cooperate. However, a reading of the 6<sup>th</sup> ICA Principle in the context of all the ICA Principles lays the ground for the specifics of cooperation among cooperatives. It is an example of how the ICA Principles interact. As the ILO R. 193 integrates the content of the ICA Statement into its text, it indirectly points to this interaction as well. Furthermore, the 6<sup>th</sup> ICA Principle and Paragraph 6.(d) of the ILO R. 193 emphasize the ultimate objective of the cooperation among cooperatives, which is that it must serve the members of the cooperating entities. Insofar, the ultimate objective of cooperation is the same as that of “mutual cooperatives” in the sense of Chapter 1, Section 1.1 (1)(a). In line with Chapter 1, Section 1.1(1)(b), the objective may also be the pursuit of general interests by “general interest cooperatives”.

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<sup>44</sup> An extensive account of this history, as well as of the different forms this cooperation took over time in the European countries and the rationale behind it, has been published recently by Antonio Fici (cf. Fici, Antonio, *La cooperación entre cooperativas en el derecho italiano y comparado* [Cooperation among cooperatives in Italian and comparative law], in: *Boletín de la Asociación Internacional de Derecho Cooperativo. International Association of Cooperative Law Journal* 2014, 103-148. The same *Boletín* contains also other articles concerning the subject. Cf. also the forthcoming publication of the country reports).

<sup>45</sup> *International Cooperative Review*, Vol. 88, No. 4 (1995), 85 f..

<sup>46</sup> UN doc. A/RES/54/123 and UN doc. A/RES/56/114 (A/56/73-E/2001/68; Res./56).

<sup>47</sup> *The Promotion of Cooperatives Recommendation* (2002), adopted by the International Labor Conference on 20 June 2002. Cf. ILO document 90-PR23-285-En-Doc..

The mentioned international instruments on cooperatives also refer to international cooperation, a form of cooperation which this Chapter 5 does not explicitly elaborate on.

The European Union Council Regulation 1435/2003 on the Statute for a European Cooperative Society (SCE) is silent on the matter, i.e. national law applies to the cooperation among SCEs and there are no indirect effects of the Regulation on the subject discussed here.

Like they do for themselves, cooperatives should seek through cooperation to gain economic strength (economies of scope and scale), negotiating power and voice (advocacy, political representation) in order to (re)generate their autonomy. The 4<sup>th</sup> ICA Principle, the UN Guidelines (Paragraph 11 et passim) and the ILO R. 193 (Paragraph 6.(e)) insist on the importance of autonomy.

Cooperation among cooperatives – horizontally and vertically – must therefore reflect the nature of the cooperative enterprise model with its emphasis on the autonomy of the group of members on whom it centers. This does not, and has not, excluded other growth strategies, for example by merging. But cooperating has proven the most adequate one. It is a main factor of success of cooperatives. It is to be preferred over concentration.

If the members of the cooperating cooperatives are to be the beneficiaries of the cooperation and if they are to remain in control of the arrangement of cooperation, then the structure of this cooperation needs overcoming the dichotomy of concentration and cooperation by interweaving the corresponding structural elements, namely hierarchy and networking without merging the participating entities (heterarchy). A specific form of cooperation can be assessed therefore by asking whether and how it materializes the promotion of the members and their autonomy through, for example, an adequate voting rights system and governance structure, as well as the representation of different member groups/sectors, if any.

The conditions of autonomy and independence are repeated several times in Chapter 5. This is to underline their importance.

The national legal systems display two spectra of cooperation among cooperatives

- i.** a spectrum of forms of cooperation, varying by the degree of intensity, scope and permanence and reaching from total integration (for example through mergers/fusions), via groups of cooperatives and networks to contractual arrangements
- ii.** a spectrum of public policies, reaching from permitting and facilitating to actively encouraging and supporting cooperation.

The degree of autonomy retained by the cooperating entities varies accordingly, whereby horizontal cooperation seems to better suit this autonomy than vertical cooperation.

This Chapter does not consider all forms of cooperation which in some of the jurisdictions are seen as such. For example

- mergers/fusions of cooperatives or of cooperatives with other types of legal entities and transformation/ reorganization of cooperatives into another type of legal entity, are not considered here as forms of cooperation. The reason is that the notion of “cooperation among cooperatives” is held to imply the continued existence of the cooperating entities behind and beyond the cooperation arrangement.
- forms of cooperation whereby the cooperative arranges the service to its members <sup>48</sup> or to the general public through another legal entity, at least not as long this other legal entity is not a cooperative
- multi-purpose cooperatives that establish semi-autonomous sections for specific activities, for example a savings and credit section, within the cooperative where the main objective is another activity. As the same services could be, and often is being, offered through several-single purpose, institutionally linked cooperatives, this could be seen as a form of cooperation
- cartels and groups, which unite or control legally independent entities, unless the members of the participating cooperatives are able to control at least indirectly these cartels or groups
- investments by cooperatives in other cooperatives and
- intercooperative agreements, <sup>49</sup> whereby one cooperative may have cooperative transactions with the members of another cooperative.

## **Section 5.1**

### **(1)**

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<sup>48</sup> For example under the Finnish cooperative law.

<sup>49</sup> For example in Spain.

This subsection regulates the main purpose of cooperation, which is the furtherance of the objectives of the participating cooperatives (member promotion or general interest promotion).

It also mentions the promotion of the cooperative business model in general. This complies with the 5<sup>th</sup> ICA Principle.

**(2)**

More often than not forms of cooperation combine the economic <sup>50</sup> and the socio-political <sup>51</sup> purpose. In France, Germany and Italy these purposes have - typically- their separate structures.

**(3)**

The principles of solidarity and subsidiarity are general cooperative principles in the sense that they apply to cooperatives in general.

In law, *the principle of solidarity* expresses in ‘obligationes in solidum’, i.e. the acceptance of legal obligations knowing that their fulfillment might remain without corresponding advantages. An example are cooperative interbank guarantee schemes.

*The principle of subsidiarity* requires a careful articulation of the tasks and competences of the structure of cooperation, on the one hand, and that of the participating entities, on the other hand. It requires balancing the autonomy of the participating entities with the group discipline which is necessary to achieve the objectives of cooperation, as well as balancing cooperation with concentration. Cartel-like behavior in violation of competition law needs avoiding.

**(4)**

This Subsection addresses public policy issues, recognizing the economic and social benefits of cooperation among cooperatives and among cooperatives and social economy entities. A growing number of European countries are passing laws on the social economy, <sup>52</sup> which will facilitate the implementation of such policies.

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<sup>50</sup> At times called “intercooperation/economic integration”.

<sup>51</sup> At times called “associative/representative”.

<sup>52</sup> For example France (Loi relative à l'économie sociale et solidaire (2014); Portugal (*Social Economy Law* (2013); Spain (Ley de Economía Social (2013). See also the 2004 British Act on Community Interest Companies; the 2003 Finnish Law on social enterprises (Law 1351/2003); and the Italian Law on social enterprises 155/2006.

Apart from the policy stated in this Subsection,<sup>53</sup> governments may facilitate a specific type of cooperation, such as<sup>54</sup> setting up (tax preferred) cooperative development funds,<sup>55</sup> apply a special tax regime to financial contributions to cooperation structures or support the investment by cooperatives in cooperatives.

**(5)**

This Subsection underlines, once more, the importance to not let cooperation become a way to compromise the autonomy and independence of the participating entities. The notion of cooperation is therefore understood as antonymous to the notion of concentration and subordination. Some jurisdictions enshrine this principle;<sup>56</sup> in some countries this is the result of an interpretation of the law; in some it is a recognized legal practice.

In addition, the cooperating entities must undertake to refrain from any activity that could jeopardize the existence of any of their partners in the cooperation.

**Section 5.2**

**(1)**

**(a)**

Forms of cooperation are meant to last over time. Prima facie one-time contracts do not fulfill this requirement. The formulation “establishment of contractual relationships” is to indicate this duration, an indication of which can be a de facto or de iure (statutes, byelaws) preference of such contracts over contracts with non-cooperatives. It can be classified as a “light institutionalization”, for example joint ventures between cooperatives. Subsection 2 supports this interpretation.

The term “goods and services” includes, here as in general, non tangible goods, such as knowledge.

**(b)**

Cooperation in the form of a cooperative (secondary or higher level), i.e. a cooperative of cooperatives, is the most adequate form of economic cooperation, as its structure accommodates the main conditions of cooperation, which are the respect for the autonomy of the cooperating

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<sup>53</sup> which reflects the policies in France and in Spain

<sup>54</sup> This is the case in Great Britain and in Italy.

<sup>55</sup> This is the case in Italy.

<sup>56</sup> Like for example in the Portuguese law.

entities (4<sup>th</sup> ICA Principle) and the ultimate control by the members (2<sup>nd</sup> and 3<sup>rd</sup> ICA Principles) of the affiliated entities.<sup>57</sup>

Different denominations are used, for example “unions” for secondary cooperatives and “federations”, “confederations” or “apexes” for the 3<sup>rd</sup> or 4<sup>th</sup> tier, if any. Generally, the tiers are visualized by the so-called cooperative pyramid where the members at the base, through their primary cooperatives, finance and control the higher level structures. Their activities are to serve, in turn, the members of the primary cooperatives.

**(2)**

Cf. comment on Subsection 5.1 (4).

**(3)**

This subsection contains no limitation as to class, activity/sector or geographical location of the cooperating entities or the administrative division of the country, i.e. cooperatives are free to cooperate with whom they want.

To be repeated that the ultimate objective of cooperation, which is the promotion of the members’ or the general interest, is to be pursued through such arrangements. This is an indirect consequence of text referring to the “in interest of its member cooperatives”.

A controversial question is whether cooperatives may have a legal obligation to cooperate. A systematic interpretation of the 6<sup>th</sup> ICA Principle (Cooperation among cooperatives), the 1<sup>st</sup> ICA Principle (Voluntary and open membership) and the 7<sup>th</sup> ICA Principle (Concern of community) indicates that members of the ICA have accepted a limitation of their fundamental rights (especially their Freedom of association). By integrating the content of the ICA Statement into ILO R. 193 this self-limitation might have become a legally binding obligation for all cooperatives, if indeed ILO R. 193 is legally binding.<sup>58</sup> But, even if ILO R. 193 is legally binding, the content of this obligation would remain open. Independently of this question, one could argue that cooperation among cooperatives forms part of the identity of cooperatives.<sup>59</sup> This seems to be also the opinion of the

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<sup>57</sup> This form is typical in France and Italy.

<sup>58</sup> Cf. for arguments in favour of the legally binding character of ILO R. 193 Henry, Hagen Public International Cooperative Law: The International Labour Organization Promotion of Cooperatives Recommendation, 2002, in: International Handbook of Cooperative Law, ed. by Dante Cracogna, Antonio Fici and Hagen Henry, Heidelberg: Springer 2013, 65-88

<sup>59</sup> Cf. Fici, op. cit..

German Constitutional Court which ruled that obligatory membership of cooperatives in audit federations does not violate the right to associate.<sup>60</sup> This opinion is debatable, both from the point of view of German law and from a comparative law perspective. The German cooperative law does not establish membership in an audit federation as a definitional criterion of cooperatives. It rather obliges cooperatives to adhere to an audit union. From a comparative law perspective, the opinion of the German Constitutional Court is not tenable as it assumes a necessary characteristic of cooperatives which in many, if not most countries is not required.

The Italian cooperative law reaches the same goal (regular audit of all cooperatives) without such obligation; instead it gives strong incentives to opt for the audit by a cooperative audit union, failing which the cooperatives are audited by public authorities.

**(4)**

Where economic cooperation is carried out through secondary or higher level cooperatives their structure, as laid down in the cooperative law, might need adjustments. Apart from a specific voting rights system, as alluded to in the 2<sup>nd</sup> ICA Principle and as suggested in this Subsection, adjustments might be necessary as concerns for example the minimum number of members (which is usually lower than that required of primary cooperatives) and the composition of the board. As concerns the attribution of plural voting rights under Paragraph (c), “other criteria could reflect the heterogeneity of interests of different classes of members or that of public and private interests in general interest cooperatives.

**(5)**

This Subsection yet again stresses the respect for the ultimate purpose of cooperation.

**(6)**

Such third structures are mainly used to access the financial market or to establish buying or selling pools.

Where the participating cooperatives are pure holding cooperatives, they cease to be cooperatives as they lack economic activity as the basis of cooperative transactions. Consequently, this is not a case of cooperation. Where the companies controlled by the cooperatives are used by them in partial fulfillment of the cooperatives’ objectives, it might be difficult to ensure control.

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<sup>60</sup> Cf. Bundesverfassungsgericht, Decision No. 1759 (19.1.2001).

(7)

In joint cooperative groups <sup>61</sup> where the direction may be delegated to one or several cooperatives of the group, the autonomy of the others might easily be at risk. The unconditional right to withdraw is therefore a necessary tool to prevent the risk from materializing.

(8)

Again, the text recalls the conditions of cooperation.

### **Section 5.3**

(1)

Cf. comment on Section 5.2 (3) concerning the question of a legal obligation to cooperate.

(2)

To the list of activities and tasks one might add the support for research and the devolution of public prerogatives, for example registration or feasibility reports as part of the registration process, as well as the devolution of audit/ control powers, respectively.

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<sup>61</sup> To be found mainly in France, Germany and Italy.