Co-operatives
A national approach

Co-operatives National Law

Decision Making
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Executive Summary

In 2007, the Ministerial Council on Consumer Affairs (MCCA) agreed to implement nationally uniform legislation for co-operatives, to address inconsistent State and Territory legislation and competitive disadvantages that exist in comparison to entities operating under the *Corporations Act 2001*.

A draft Co-operatives National Law and consultation regulatory impact statement were released for public consultation in December 2009. The objectives of the proposed Law are to ensure that there are no competitive advantages or disadvantages for co-operatives as compared to corporations by providing:

- freedom to operate on a national basis;
- better access to external capital funding; and
- an accessible modern legislative environment.

Three options have been considered as possible mechanisms to meet these objectives and to address the problems identified with the existing arrangements:

1. maintain the status quo;
2. repeal existing State and Territory co-operatives legislation;
3. implement the Co-operatives National Law

Option 3, implementing the Co-operatives National Law, is the recommended option. This option best serves the needs of the co-operative sector and responds to the virtually uniform stakeholder view that there is a need to retain specialist legislation for this unique corporate structure. A single uniform template together with alternative consistent legislation (i.e. alternative legislation that is recognised as being consistent with the Co-operatives National Law) will also achieve cost savings to governments, and deliver an effective and more equitable regime for all jurisdictions.

1 Background

Co-operatives are mutual organisations principally operated for the benefit of their members. There are two types of co-operatives: distributing and non-distributing. Distributing co-operatives predominantly operate in wholesale and retail trades, transport, agriculture, manufacturing and property services. In general, distributing co-operatives maintain a proportion of any surplus to build the capital of the organisation and then disperse any remaining surplus to members. Non-distributing co-operatives are restricted from making distributions to members. These co-operatives deliver benefits to their members through mechanisms such as access to shared equipment and business services and lower charges for services or products. Non-distributing co-operatives are found in agricultural produce handling, consumer co-operatives, professional organisations, as well as cultural or sporting clubs. Traditional not-for-profit activities such as child care and community services can also be found in the non-distributing co-operative sector.

Legislative power in respect of co-operatives rests with the States and Territories. State and Territory legislation enabling a co-operative to become incorporated as a legal entity is very similar across jurisdictions as it is based on a set of core consistent provisions developed in 1996 by the Standing Committee of Attorneys-General. However, these provisions have been implemented inconsistently by jurisdictions and true consistency across Australia has not been achieved at any stage.

In 2007, State and Territory Ministers agreed, via the forum of the Ministerial Council on Consumer Affairs, to implement nationally uniform co-operatives legislation. A draft of the Co-operatives National Law and a consultation regulatory impact statement were released for public comment in December 2009. The Co-operatives National Law has been amended as a result of the public consultation process, which included submissions from stakeholders including the Ministerial Council on Corporations and the Australian Government Treasury.

The Co-operatives National Law scheme makes no conceptual changes to the nature of a co-operative, rather it remakes existing co-operatives legislation as laws of each State and Territory in a uniform manner. The terms of the supporting inter government agreement permits a jurisdiction to make consistent legislation as well as applying the Co-operatives National Law as a template. The Law does not effect any changes to the existing regulatory environment under Commonwealth legislative responsibility.

2 The Problem

The existing regulatory regime imposes restrictions and compliance costs on the co-operatives sector, resulting in a competitive disadvantage when compared to other entities. Existing co-operatives legislation

- imposes additional burdens on co-operatives through outdated corporate governance provisions and financial reporting requirements;

- imposes additional compliance costs on co-operatives that wish to trade across state and territory borders; and
- makes inconsistent provision for access to capital markets to enable expansion through external funding.

Co-operatives form a small but significant part of the Australia economy. They are strongest in the rural sector having been the principle factor in the development of Australia's dairy and grain handling industries. They provide opportunities for individuals and small businesses to acquire goods and services through buying co-operatives or selling co-operatives in an economy increasingly dominated by large corporate organisations. As a corporate structure they utilise democratic principles of one member, one vote and work by encouraging member participation and co-operation. The co-operative model can deliver non-pecuniary benefits by building social and community capital through engagement in the delivery of community services. They are of great importance to rural communities, enabling them to retain and develop services that are gradually eroded by the withdrawal of other corporate businesses that focus upon the delivery of profits to investors.

Existing co-operatives legislation in each jurisdiction is inconsistent and has not kept up to date with modern corporate governance principles. Regulatory inconsistencies between jurisdictions, financial reporting requirements that are not risk based and cost barriers to carrying on business in other jurisdictions place co-operatives at a competitive disadvantage to companies. Australia now operates as a national market, particularly with trade increasingly being conducted over the internet. Whilst a proportion of co-operatives operate within a local area, particularly those in the not for profit sector, many co-operatives operate on a national basis and need to do so in order to develop and continue to provide services to their members and communities.

The number of co-operatives in Australia has declined in recent years. Using available data it is estimated that the number of co-operatives registered in Australia declined by 26% from June 2000 to the present. Stakeholder consultation confirms that the restrictions and additional compliance costs in the existing regulatory environment tend to be a disincentive to the formation of new co-operatives, and recent transfers of incorporation by larger distributing co-operatives to become companies reveal a need to access external capital, but a continued desire to retain a co-operative type structure.

Consultation between State and Territory supervisory agencies reveals that jurisdictions with small numbers of registered co-operatives find it difficult to justify resourcing supervisory agencies, and the continuation of a state and territory based regime for this structure would benefit from uniformity of regulation and administration. Resources to adequately oversee the regulatory environment at state and territory level are better utilised under a uniform scheme supported by inter-governmental agreement and co-operation.

The Co-operatives National Law scheme is designed to deliver more consistent regulation across jurisdictions and address unnecessary or outdated regulation, to reduce excessive compliance costs on business, restrictions on competition and distortions in the allocation of resources in the economy. This is consistent with the National Partnership Agreement to achieve a Seamless National Economy as endorsed by COAG in July 2008.

Uniform regulation for co-operatives will contribute to the creation of a seamless national economy. The removal of competitive disadvantages for co-operative corporate structures will enhance productive capacity at a national level by providing access to services and the capital market for a greater range of businesses.

Placing co-operatives on a more level playing field with companies potentially delivers a stronger and more resilient economy comprised of a variety of corporate structures to meet diverse interests in the economy. Co-operatives have the capacity to deliver pecuniary and non-pecuniary benefits to the community in which they operate and are not readily subject to takeover by larger, sometimes global corporate organisations.

The Co-operatives National Law provides a vehicle for State and Territory jurisdictions to work co-operatively to maintain a regulatory regime that reflects best practice. Proposed administrative uniformity and consultation between jurisdictions will lead to a capacity to respond more efficiently to reform requirements such as the review of legislation dealing with director's liability for corporate fault required by the COAG National Partnership Agreement.

More broadly, it is recognised that a nationally approach to regulation offers a range of benefits, not only to direct stakeholders, but also to the Australian economy as a whole. The benefits flowing from a common and consistent regulatory approach across jurisdictions include:

- reduction in the compliance burden for industry, particularly those operating across State/Territory borders;
- increase in competition and productiveness through the creation of a level playing field and removal or minimisation of jurisdiction-specific barriers to markets;
- increase in the potential for businesses develop innovative solutions, be entrepreneurial and respond creatively and quickly to market opportunities and/or threats;
- increase in workforce mobility;
- potential increase in compliance and enforcement efforts, with individual jurisdiction-based regulators able to leverage off each other, share information and develop national approaches to compliance and enforcement; and
- potential reduction in the administrative burden for individual governments.

It is noted that the benefits of a national regulatory approach have been recognised by Australian governments at both federal and state levels. The Council of Australian Governments has a strong commitment to introducing national regulation across a number of areas, particularly through its National Partnership to Deliver a Seamless National Economy, agreed in 2008.

3 Objectives

By introducing the National Co-operatives Law, the MCCA's objective is to ensure that there are no competitive advantages or disadvantages for co-operatives as compared to corporations by providing:

- freedom to operate on a national basis;
- better access to external capital funding; and
- an accessible modern legislative environment.

4 Options

Option One: Maintain the status quo

Under this option, existing co-operatives legislation would be maintained in each State and Territory. The existing legislation in six jurisdictions provides for a registration process to enable a co-operative to carry on business across state borders. The requirements for registration differ depending upon whether the co-operative is from a jurisdiction subject to a corresponding co-operatives law or whether it is from a jurisdiction, including a jurisdiction outside Australia, whose law is not recognised as corresponding with the law in the particular State or Territory. Two jurisdictions, Western Australia and Victoria, have a notification process to enable co-operatives in their respective jurisdictions to carry on business. The utility of notification provisions in Victoria and Western Australia is largely negated by the lack of similar requirements in the other six jurisdictions.

Co-operatives seeking to carry on business across a border not only need to comply with notification or registration requirements and costs, they must also inform themselves of any different regulatory requirements that might impact upon their operations in each jurisdiction.

Only 26 of the 1700 or so co-operatives in Australia have engaged in the registration process to enable trading across a state or territory border. It is believed that there are many more co-operatives that carry on business across borders contrary to the legislative restrictions simply because of their location in border areas, but there is no practical way to determine the number of co-operatives that might be in breach of these legislative restrictions.

The regulatory burden currently faced by co-operatives wishing to operate nationally means that there is a competitive advantage for companies.

There are also currently no consistent appropriate financial reporting and audit measures suitable for small co-operatives. Other than in Western Australia, all co-operatives, regardless of size are required under existing legislation to prepare and lodge full audited financial statements. Variations to these requirements exist between jurisdictions as a result

of individual Registrar exemptions and class orders. Experience of the core consistent provisions scheme indicates that consistency for financial reporting and auditing will be difficult to achieve between jurisdictions without a uniform scheme of regulation and administration.

The prevalence of the company as a corporate entity in Australia means that the interpretation and application of statutory duties for directors and officers by Courts is based on duties expressed in the Corporations Act. Existing co-operatives legislation expresses directors' duties in the same manner that was used in the Corporations Law during the 1990's. The content of these duties has changed since the 1990s along with the processes to secure compliance. Existing co-operatives legislation has not maintained parity with directors' duties for companies, and it is difficult to rely upon judicial authority when dealing with breaches by directors of co-operatives.

The ability to issue hybrid securities called co-operative capital units to access external capital is only available in three jurisdictions. This limits the utility of the instrument because market knowledge of these instruments is limited. Continuation of existing legislative arrangements under Option 1 will mean that knowledge of the marketability of these instruments will remain limited. Lack of access to external capital places co-operatives at a competitive disadvantage to companies.

The status quo has not been successful in achieving the uniformity or consistency required to address the identified problem and is likely to continue to place co-operatives at competitive disadvantage to companies.

Option Two: Repeal existing State and Territory co-operatives legislation

States and Territories could cease to regulate co-operatives and repeal existing co-operatives legislation. Under this option the choice of corporate structure for a co-operative would be as a company or an incorporated association. For the majority of co-operatives, incorporation as an association will still pose a restriction upon carrying on business in another jurisdiction and substantially reduces the ability of the entity to raise capital or conduct profit oriented business activities. Current Commonwealth proposals for a National Not for Profit Regulator will not have any impact on the incorporation of co-operatives and will have only a modest impact upon some of the activities and obligations of not for profit co-operatives.

The unique nature of the co-operative makes it difficult for it to be properly accommodated under the Corporations Act. Maintaining a co-operative identity would require a specially drafted constitution and the co-operative principles for the entity would only be enforceable by members through the constitution as a contract and without any statutory support. Key differences between the rights attaching to shares as opposed to membership of a co-operative would potentially erode the co-operative nature of the entity and the benefits of member control as opposed to control by investors.

Restrictions on the number of members and the ability to issue securities to the public would mean that co-operatives would not consider it suitable to become a proprietary company. This would result in incorporation as public companies and there would be no reduction in financial reporting obligations for small entities.

While this option would remove the national trading limitations that currently apply to co-operatives, it would be more difficult for these organisations to retain their character as a co-operative. Public consultation indicated a strong resistance to being subsumed into the Corporations Act regime.

The legislative power with respect to co-operatives is a matter for States and Territories under the terms of the Corporations Agreement 2002 between the States, Territories and the Commonwealth. The Australian Securities and Investments Commission provided no comment on the exposure draft of the Co-operatives National Law noting that it made no change to the status quo existing under the Corporations Legislation.

The repeal of existing co-operatives legislation would not be possible without alteration of the Corporations Agreement, which would require unanimous agreement from all parties and amendments to referral of powers legislation in each jurisdiction. Unanimous agreement is not likely in the light of public consultation on this point, and it is not likely that the Corporations Act 2001 would be amended to include statutory protection of co-operative principles in the same manner as the Co-operatives National Law.

Option Three: Implement the proposed Co-operatives National Law

This option involves the implementation of the Co-operatives National Law with NSW as the host jurisdiction. An overview of the Co-operatives National Law is attached at Appendix 1.

Co-operatives registered in a jurisdiction that adopts the Law or passes consistent co-operatives legislation will have automatic authority to carry on business in other jurisdictions. The Law also proposes the removal of the requirement to lodge audited financial reports by small co-operatives and will enable regulations to specify simplified member reporting and the availability of a review as opposed to an audit. This will deliver a significant cost saving to small co-operatives that compete with small proprietary companies and small public companies limited by guarantee. Both company types enjoy significant reductions in financial reporting and lodgement requirements.

The Law has revised the content of statutory duties for directors and officers of a co-operative in line with corporate governance standards under the Corporations Act. It also constructs a civil penalty regime to ensure compliance with duties that are not considered essentially criminal in nature. Consistent with the Corporations Act, it introduces a business judgment rule defence for directors and officers facing proceedings for breach of their duty of care. The business judgment rule is expressed to enable the director or officer concerned to take into account co-operative principles.

The liability of directors and officers for corporate fault has been reviewed in accordance with COAG principles and this reflected in the Law by the removal of blanket liability type provisions. In general terms, a director or officer will face liability when there is a clear link between the officer's responsibility and action or inaction and the contravention.

Liability for contraventions of compliance matters such as the lodgement of annual reports or other particulars are identified more clearly as being the responsibility of officers with a

clear duty to ensure compliance. In this regard, the role of the secretary is more clearly identified and linked to requirements for the lodgement of specified particulars or documents.

The Law clearly provides for the ability for co-operatives in all jurisdictions to issue co-operative capital units which have the potential to enable co-operatives to access external capital without compromising member democratic control.

Financial reporting requirements are more clearly expressed in the legislation and applied Corporations Act provisions are conveniently located and identified in the Law.

Some co-operatives may still choose to transfer incorporation to a company under this option. The implementation of the Law would not preclude this from occurring. Recent transfers of incorporation in the dairy and rice industries demonstrate that this may still be perceived as an attractive option to pursue further capital. Equally these transfers of incorporation have led to more or less successful takeover bids.

Impact on federal laws

In examining the impact of Option 3 it is necessary to address any potential impact that the scheme might have upon existing or proposed federal laws with respect to incorporated bodies. The Co-operatives National Law scheme is a co-operative scheme of legislation within the legislative power of States and Territories and is confined to the limits of that legislative power. It makes no provision which directly impacts upon federal laws, other than the Corporations legislation. Legislative limits of the jurisdiction of States and Territories in respect of incorporation are governed by the Corporations Agreement 2002. The Law does not exceed the jurisdictional limit and this has been confirmed by the approval by the Ministerial Council on Corporations of provisions in the Law that exclude the operation of the Corporations legislation in respect of co-operatives. Option 3 has no impact on the operation of the Corporations Act on the company sector.

The Law clearly articulates the relationship with the Commonwealth *Personal Properties Securities Act 2009* and makes provision for the migration of securities registered over co-operatives' assets to the proposed Personal Properties Securities Register.

The Law makes no direct impact on provisions under Commonwealth income tax legislation because of the limits to the legislative powers of States and Territories.

In examining if there is any possible indirect impact to the federal tax system, if there is a significant increase in the number of registered co-operatives as a result of the commencement of the Law, it is necessary to examine taxations principles that possible favour co-operatives.

Not for profit entities such as clubs and associations may benefit from the common law principle of mutuality. The principle of mutuality operates when contributions or subscriptions are made by members to a not for profit entity to enable the provision of services or access to facilities for members. Income from this source is not treated as income according to ordinary concepts. Not all transactions by a club or association are

mutual. Mutuality is assessed by reference to the nature of the transaction, not the type of incorporated body. Any increase in the number of not for profit co-operatives will not result in any competitive disadvantage to companies because the mutuality principle applies to all not for profit entities that exhibit mutual income. In other words, all not for profit entities – whether co-operatives or otherwise – may potentially derive a taxation benefit through the mutuality principle. The not for profit sector in this category includes incorporated and unincorporated associations and registered clubs that are companies or co-operatives.

Distributing co-operatives may qualify for special deductions in respect of rebates and bonuses paid to members. These special deductions apply because of the manner in which the entity carries on its business and they are not dependent upon whether the entity is a registered co-operative or a company. Sections 117 – 120 of the *Income Tax Assessment Act 1997* define the circumstances when an entity may qualify as a 'co-operative company' for a particular tax year. Co-operative companies exist in both the co-operative and the company sectors; and an entity's status as a co-operative company may change from year to year depending upon the type of transactions in which it engages in a particular year. Further detailed explanation of the operation of tax law on these issues is contained in Appendix 2.

Tax principles of mutual income and provisions relating to co-operative companies are not specific to co-operatives, but apply to any entity type. Any increase in the number of registered co-operatives as a result of the Law will not impact upon the operation of federal laws and will not provide any competitive advantage to co-operatives over other entity types.

Option 3 meets the objectives of ensuring that there are no competitive advantages or disadvantages for co-operatives as compared to corporations.

5 Summary impact analysis of each Option

Option	Co-operative sector	Government	Competition	Consumers/ members	Broader community
1	Negative impact due to continued inconsistent and outdated regulatory regime and associated higher compliance costs	Duplication of costs whereby each jurisdiction would be required to maintain legislative regimes, particularly if the sector continues to decline	Competitive disadvantages in interstate trading and access to capital would continue to be evident	Long term negative impact as a result of the loss of co-operatives in the market. Inability to access lower cost product through consumer co-operatives and lower cost services through producer or service co-operatives	Potential restrictions on consumer choice and industry choice as to entity structure through a gradual phase out of co-operatives. The not for profit sector in particular may lose flexibility around options for organisational structure.
2	Short term positive impact of providing a national regime, but long term negative impact as co-operative sector would erode due to the loss of statutory support for the structure type	Initial impact on State & Territory governments would be a cost in providing advice and support to transition existing co-operatives to Corporations Act. Costs of regulatory supervision would then shift to the Commonwealth, along with the cost of legislative requirements, if any, to deal with transition and any other sector demands	No impact on national competition	Potential restrictions on consumer choice of entity structure through a gradual phase out of co-operatives particularly for rural communities with limited services. Rural producers would lose market options for their product.	The not for profit sector may lose flexibility around options for organisational structure. Rural co-operatives, as companies, would face takeovers from outside interests and community ownership would be gradually lost

3	Positive impact by addressing some of the reasons for decline of the sector	Positive impact by enabling cost sharing of maintenance of regulatory regime and policies between States & Territories	Positive impact by improving competitive basis where appropriate between regulatory regimes for co-operatives and other corporate entities and no impact on any associated legislation.	Positive impact by providing a strong basis for the co-operative sector to grow and provide alternative choices for consumers, particularly in rural and regional areas that face loss of services due to economic rationalisation.	Maintenance of flexibility and choice around types of organisational structure for entities, particularly for not for profits. Retention of community ownership

6 Consultation

The draft Co-operatives National Law and Consultation Regulatory Impact Statement were released by MCCA for public consultation from 4 December 2009 to 26 February 2010.

Twenty four written submissions, including submissions from the national co-operatives representative body and 5 state based co-operative federations were received, and six respondents completed an online survey. A list of stakeholders who were provided with the opportunity to comment on the proposed Law and all respondents is at Appendix 2.

The consultation process resulted in changes to the exposure draft of the Law, particularly in relation to:

- clarifying definitions and terminology;
- clarifying disclosure requirements;
- ensuring consistency with the Corporations Act;
- outlining specific voting requirements; and
- establishing minimum standards of reporting to members by small co-operatives.

The Ministerial Council on Corporations was specifically consulted to ensure that provisions excluding the operation of the Corporations Act were consistent with the terms of the Corporations Agreement 2002. Approval of the draft exclusion provisions was formally obtained from Ministerial Council on Corporations in January 2011. The Australian Government Treasury also provided a written submission which formed the basis of further consultation with that agency.

Changes to the draft were managed through consultation with members of the working party of officials, who, in turn sought comment from representatives of the co-operative sector in their jurisdictions. A summary of changes made in response to public comments is at Appendix 3.

The NSW Co-operatives Council, which acts as an advisory body to the Minister for Consumer Affairs, has considered the proposed Co-operatives National Law and, on 12 July 2011, endorsed the draft law and scheme for uniform legislation.

7 Implementation and Review

The introduction and operation of the Co-operatives National Law will be managed via the Australian Uniform Co-operatives Legislative Agreement. Under the Agreement, NSW will enact the Law as the host jurisdiction and all other jurisdictions will then have 12 months to apply the legislation or enact alternative consistent legislation. The Commonwealth Government is not a party to the Agreement.

The Agreement provides that the Ministerial Council on Consumer Affairs (or any replacement Ministerial forum) will be responsible for the consideration and review of the Law. As a result of new Ministerial Council arrangements, the Consumer Affairs Legislative and Governance Forum will be responsible for carrying out the functions of the Ministerial Council on Consumer Affairs under the Agreement.

Ongoing governance arrangements for the Law will need to be formalised once these new structures are in place. It is anticipated that an inter-jurisdictional committee will be responsible for ongoing monitoring and review of the Law, reporting to Ministers via the Consumer Affairs Legislative and Governance Forum as required. The development of consistent administration arrangements covering education, training and compliance for the Law will be included in any implementation plans.

8 Conclusion

Option 3 effectively transposes the principle elements of the existing regulatory regime into a nationally uniform code. It also achieves significant regulatory modernisation which has not been able to be achieved under the core consistent provisions scheme. It imposes modest familiarisation costs on co-operatives but delivers potentially significant cost reductions in financial reporting and cross-border trading activities. A single uniform template law (together with alternative consistent laws) will achieve costs savings to governments, and deliver an effective and more equitable regime for all jurisdictions regardless of localised budgetary constraints in this field of legislation. This option best serves the needs of the co-operative sector and responds to the virtually uniform stakeholder comment supporting the retention of specialist legislation to regulate this unique corporate structure.

Option 3 is the recommended option.

9 Appendices

1. Appendix 1: Proposed *Co-operatives National Law* (Overview and Chapter Summary)
2. Appendix 2: List of consultation submissions and online surveys received
3. Appendix 3: Summary of changes resulting from public consultation