

# LEGAL FRAMEWORK ANALYSIS

within the ICA-EU Partnership

## National Report of Australia

ICA - Asia and Pacific (ICA-AP) is the voice of cooperative enterprises in the Asia Pacific region. ICA-AP, as a regional office of the ICA, is also a co-signatory of a Framework Partnership Agreement signed between the International Cooperative Alliance and the European Commission in March 2016, which aims at strengthening the cooperative movement and its capacity to promote international development. This agreement underpins the 'Cooperatives in Development' program and includes knowledge building activities at the global (harmonized) and regional (decentralized) level.

The activities planned within the framework of the program include diverse research activities conducted at the global and regional level. The primary activities undertaken at the global level include a Legal Framework Analysis (A2.2), which is led in a coordinated way by all ICA offices. Within this framework, ICA-AP oversees implementing the research in the Asia and Pacific region.

The study on legal frameworks under the Legal Framework Analysis (A2.2) will evaluate jurisdictions and policy regulations according to their enablement of cooperative development. The document will present recommendations for the next steps in renewing the legal frameworks and helping to shape the policy agendas in a targeted way in the different regions and countries. It will evaluate the cooperative legal framework in place with common indicators, delivering on a scale of how 'cooperative-friendly' the legislation in a country is. In the same context, this report deals with the Legal Framework Analysis of Australia.

## Introduction

This report on the legal framework analysis on cooperative law in Australia is prepared by Ms Ann Apps, national and sub-regional expert appointed by the

International Cooperative Alliance Asia and Pacific (ICA-AP).<sup>1</sup> The process of preparing this report began with the completion of a standard questionnaire for the analysis of the legal framework. The completed questionnaire was referred to Australia’s peak body for cooperatives and mutuals, Business Council of Co-operatives and Mutuals (BCCM) for review and comment and their feedback was considered and integrated into this final National Report.

The legal framework analysis on cooperative legislation in Australia aims to:

- Provide a general overview of the uniform model law known as the Co-operatives National Law and its main features including how the legal framework secures the cooperative identity and distinguishes it from other types of business organizations, notably the public company.
- Evaluate if Australian cooperative law supports or hampers the development of cooperatives, and to the extent that it is not “cooperative friendly”, make recommendations for reform.

## Co-operative National Law – Australia

### General Context

Despite its title, the ‘Co-operatives National Law’, the relevant legislation for cooperatives in Australia is a product of the various state and territory legislatures and not the national legislature. The Australian Constitution limits the law-making powers of the Commonwealth parliament to those matters listed in the Constitution as exclusive or concurrent law-making powers. These powers do not extend to making laws with respect to the formation of cooperatives. Consequently, the power to make laws with respect to cooperatives continues to reside with the parliaments in Australia’s six states and two territories. The state governments have been grappling with the issue of uniformity of business law since federation in 1901. They have dealt with the problem in the latter half of last century by referring law making powers to the Commonwealth in relation to taxation and employment. In 2000, they agreed to refer law making powers with respect to the formation of companies,

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<sup>1</sup> Ann would like to acknowledge the work of research assistant Ms Elizabeth Makin who provided valuable assistance in preparing and reviewing this report. Also, the contributions and feedback provided Melina Morrison, CEO, BCCM, Anthony Taylor, Policy Advisor, BCCM and Robyn Donnelly, consultant to BCCM.

which led to the transferral of regulatory responsibility of mutuals and financial cooperatives to the national system.

Cooperatives were expressly excluded in that referral of power and so remain regulated at the state level. In 2012, the states and territories agreed that uniform cooperative law was desirable. A template or ‘model law’ known as the Co-operatives National Law (‘CNL’) was drafted and passed by New South Wales, as lead legislature for the new law.<sup>2</sup> The other states and territories entered into the Australian Uniform Co-operative Law Agreement (‘AUCLA’) and agreed to adopt the CNL or a consistent law as the law applying to cooperatives in their state or territory. In 2019 NSW, Victoria, ACT and Tasmania have adopted the CNL as a template law,<sup>3</sup> Northern Territory and South Australia have adopted the CNL, but with scope for modification by their own legislatures,<sup>4</sup> and Western Australia, has adopted consistent legislation. Queensland withdrew from the AUCLA in 2015 and its current legislation, the Cooperatives Act 1997 (Qld) is similar but is not entirely consistent<sup>5</sup> Reliance upon the continuation of the AUCLA framework (as opposed to referral of law making powers to the Commonwealth, as with companies) is a key example of differential treatment of companies and cooperatives in the Australian context.

This analysis will deal exclusively with the CNL. In New South Wales, the lead jurisdiction, the legal framework established by the CNL is found in the following legislation:

Co-operatives (Adoption of National Law) Act 2012

Co-operatives National Law (NSW) (CNL)

Co-operatives National Regulations (NSW) (CNR)

Co-operatives (New South Wales) Regulation 2014 (Local Regulations)

Australia has no special laws for specific types of cooperatives (i.e. worker cooperatives, social cooperatives, producer cooperatives etc.). Most types of cooperatives can be accommodated within the CNL framework, except for banks,

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<sup>2</sup> Robyn Donnelly explains that the CNL was passed by NSW as the model or template law. NSW is the lead legislature and this means that the NSW Governor is the authority to make national regulations. However there is scope for further modification at the level of each state . The AUCLA controls the process for achieving and retaining uniformity but, arguably it is a fragile framework.

<sup>3</sup> This means that any amendments to the CNL by the lead jurisdiction, NSW, will automatically be received as amendments to the co-operative legislation in the adopting jurisdictions.

<sup>4</sup> In South Australia and NT the CNL is included as an appendix or schedule to the co-operative legislation, but any amendments to the CNL must be approved by the Governor or Administrator who will pass a regulation amending the text of the CNL appendix or schedule.

<sup>5</sup> At the time of writing (February 2020), the Co-operatives National Law Bill 2020 is before a parliamentary committee in Queensland and may pass into law later this year.

credit unions and certain types of insurance cooperatives, which are required to be registered as companies under the Corporations Act 2001 (Cth).

The CNL distinguishes between two main types of cooperatives: distributing cooperatives which may distribute surplus to members and non-distributing cooperatives, which may not distribute surplus to members (CNL sections 17-19).

### Specific elements of the cooperative law

#### Definition and objectives of cooperatives

#### Cooperative Principles

Table 1

| Application of Cooperative Principles (General)   | Regulation | Relevant section (link) |
|---|------------|-------------------------|
| General reference to principles   | CNL        | S10, s11                |
| Requirement for registration that business is designed to function in accordance with cooperative principles or if not must satisfy registrar that it should be so registered   |            | S27(2)(c)               |
| Design of share capital structure so that rights of shareholders complies with cooperative principles   |            | S76(3)                  |
| Limitation on dividends that are issued to members by way of distribution of surplus or reserves – contributes to non-speculative nature of cooperative shares  |            | S357(1)(c)              |
| Registrar empowered to refuse the terms of issue of new securities if they will result in a failure to comply with cooperative principles   |            | S350(4)                 |
| Cooperative groups can admit a body not registered as a cooperative if board is satisfied it is designed to function in accordance with cooperative principles  |            | S111(2)(b)              |
| Directors entitled to take cooperative principles into account when decision making (providing directors with some measure of protection where decision is called into question as a potential breach of duty of care |            | S192(2)                 |

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| and diligence – an adjustment to traditional ‘business judgement rule.’ ) |  |  |
|---|--|--|

Table 2

| Application of Cooperative Principles (Specific)  | Regulation | Relevant section (link)  |
|---|------------|--|
| Voluntary and open membership, subject only to a cooperative’s internal governance rules on membership and requirement that persons will not qualify for membership unless there are reasonable grounds to believe that they will be an active member of the cooperative.   | CNL        | S110, s112   |
| Democratic member governance by providing that voting rights (in general meetings) attach to membership rather than shareholding.<br>Voting is one-member, one-vote, except for cooperative groups where a member may hold up to five votes.<br>Also, by limiting the shareholding of any one member to no more than 20% of a cooperative’s total share capital the influence of any one member is limited.   |            | S228<br><br>S 228(3)<br><br>S363(1)  |
| Member economic participation. The CNL’s active membership provisions (set out in part 2.6) requires all cooperative members to be active members of their cooperative meaning that they must either use or support ‘an activity of, or maintain a relationship or an arrangement with, the cooperative, for carrying on a primary activity of the cooperative, in the way and to the extent provided in the rules of the cooperative.<br>For distributing cooperatives (which must have a share capital) this feature of the CNL requires members to purchase shares in, |            | S145(a) also CNR 2.5 for minimum thresholds for determining the cooperative’s primary activities.<br><br><br><br><br><br><br><br><br><br>S 120 (1); S150 |

|   |  |               |
|---|--|---------------|
| <p>and use the services provided by, their cooperative.</p> <p>For non-distributing cooperatives (which may or may not have a share capital) these active membership provisions require either the purchase of shares (if the cooperative has share capital) and/or payment of an annual subscription, along with use of the cooperative’s services.</p>  |  | S 120(1) S151 |
| <p>Concern for community. A cooperative may apply part of its annual surplus for any charitable purpose or, in the case of distributing cooperatives, for supporting any activity approved by the cooperative. In this way, cooperatives may demonstrate ‘concern for community’ through financial contributions towards charitable purposes and other approved activities. However, a cooperative’s rules must limit the amount that may be applied towards such a purpose to a stated proportion of that surplus, thereby protecting member interests in the cooperative.</p> |  | S356          |

Specific elements of the CNL which secure the cooperative identity when compared to the identity features of a for-profit company.

The CNL does not precisely define a cooperative. Section 4 CNL states that a cooperative is ‘a body registered under this Law as applying under the Co-operatives National Law Act of this jurisdiction as a cooperative (including a cooperative group)’. However, this provision when combined with section 27(2) means that a cooperative is an organisation that is designed to function mainly under the cooperative principles.

The following table outlines some of the key differences between for-profit companies and distributing cooperatives under Australian law:



Table 3

|                        |  |   |
|------------------------|--|---|
| Legal Model:           | Company (limited by shares) registered under Corporations Act 2001 (Commonwealth) (subject to modifications in the company's constitution) | Distributing cooperatives registered under Co-operatives National Law 2012 ("CNL")  |
| Ownership:             | Minimum: 1 shareholder<br>Maximum: 50 shareholders for proprietary, no maximum for public companies  | Minimum: 5 members (or 2 cooperatives in a cooperative group)<br>No maximum<br>CNL – sections 18 and 19                   |
| Capital structure      | Share price is variable<br>Shareholding is not limited   | Share price is fixed<br>A member may not hold more than 20% of shares in a cooperative<br>CNL – sections 76(2) and 363(1) |
| Distribution of power: | Shareholder governance at general meetings (1 vote per share)  | Member governance at general meetings (1 vote per member)<br>CNL – section 178(1)   |
| Control:               | Board of directors & secretary<br>(Independent directors recommended by voluntary code for good corporate governance)                      | Board of directors & secretary<br>(Majority must be members)<br>CNL – section 174   |
| Director duties:       | Legal & fiduciary director duties to maximise profit & share value   | Legal & fiduciary director duties to create, protect & return member value consistent with ICA Principles                 |

|             |   |   |
|-------------|---|---|
|             |   | CNL – sections 192-196  |
| Engagement: | No shareholder participation in business is required by law (company shareholders may be passive investors) | Member economic participation in primary activities of the cooperative is a requirement of membership.<br><br>CNL – part 2.6 (active membership provisions) |

### The promotion of members as an objective of the CNL

The legislation does not specifically address the objectives of cooperatives i.e. it does not have a preamble, setting out ‘the role and the function of cooperatives in society in general and in the economy of the country in particular’.<sup>6</sup> The promotion of members is prioritised by some specific legislative requirements in the CNL around member economic participation and rules relating to the distribution of any surplus. Schedule 1 of the CNL requires all cooperatives to set out both their primary activities and active membership requirements (in relation to these primary activities) in their internal governance rules. A member of a cooperative is an active member of the cooperative if the member ‘uses or supports an activity of, or maintains a relationship or an arrangement with, the cooperative, for carrying on a primary activity of the cooperative, in the way and to the extent the rules of the cooperative provide’: CNL s145.

For cooperatives with a shared capital, this minimum active membership requirement will include the purchase of the minimum number of shares and may also include the payment of an annual subscription or a minimum annual economic participation in a primary activity of the cooperative. For some producer cooperatives, separate contractual arrangements are also common – such as an agreement to provide the cooperative with a minimum amount of produce each year. In this respect, Australian cooperatives are required to focus on their transactions with members and the delivery of value to those members. The CNL does not prohibit cooperatives from transacting with non-members, however cooperatives may specifically limit this

<sup>6</sup> Hagen Henry, Guidelines for Cooperative Legislation (International Labour Office, 2012) 64.



within their rules. (See relevant requirements for distributing and non-distributing cooperatives in Table 2 above).

#### Transacting with or acting in the interests of non-members or the community at large

Australian cooperative law does not specifically recognise a type of cooperative that allows the cooperative to prioritise the interests of non-members / the community at large nor does it specifically provide for social cooperatives, however the current legal framework can accommodate cooperatives designed for the pursuit of the social/general/community interests where the target group are also cooperative members. For example, a non-distributing cooperative can be established with a social, environmental or community purpose and may also, in certain circumstances, be registered as a charity with the Australian Charities and Not-for-Profits Commission or a deductive gift recipient with the Australian Taxation Office to receive favourable taxation status. For these types of cooperative, active membership requirements can be satisfied through a low annual subscription or a commitment to voluntary labour in return for the benefits of membership, e.g. volunteer hours worked to obtain a member discount for products sold at an organic bulk-foods consumer cooperative.

The CNL framework also accommodates the establishment of multi-stakeholder cooperatives using the mechanism of active membership requirements, as set out in the cooperative's rules, to establish different types or classes of member that may benefit from the primary activities of the cooperative.

#### Limits on economic activities that can be carried out by cooperatives under the CNL

It is currently not possible to register an authorised deposit-taking institution (“ADI”) - i.e. a cooperative / community bank, building society or credit union - under Australian cooperative law.<sup>7</sup> Nor is it possible to be a life insurance, general insurance or superannuation body. Instead, ADIs and insurance bodies must be registered as companies under the Corporations Act 2001 (Commonwealth) and regulated by the Australian Securities and Investment Commission (“ASIC”) and prudentially regulated by the Australian Prudential Regulatory Authority (“APRA”) – both federal bodies. These organisations typically function as mutuals,<sup>8</sup> which may or may not adopt ICA Principles in their rules.

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<sup>7</sup> Section 333 of the CNL expressly prohibits deposit-taking by co-operatives, with the exception of those co-operatives formed at a time when deposit-taking was permissible by law and which are also expressly authorised by their rules to take deposits.

<sup>8</sup> A ‘mutual’ has been defined as ‘a business that is owned by its members, and run exclusively for their benefit, rather than for the benefit of outside investors.’ UK Government, Department for Business Innovation & Skills, A guide to Mutual Ownership Models, November 2011, p. 2., see discussion in

## Establishment, cooperative membership and governance

### Legal requirements for the establishment of a cooperative

Registration is necessary for the establishment of a cooperative under the CNL, see generally part 2.1. All cooperatives must develop rules in accordance with the requirements of Schedule 1 and these rules must also be approved by the relevant Registrar prior to registration. Distributing cooperatives must also have a disclosure document outlining their share capital structure approved by the Registrar prior to registration. Non-distributing cooperatives are not required to produce a disclosure document unless directed to do so by the Registrar. After holding the formation meeting adopting these rules and electing the first directors of the cooperative to achieve registration, cooperatives can apply to the Registrar to register the cooperative.

All cooperatives (other than cooperative groups which must have a minimum of 2 corporate bodies as members) must have 5 or more active members, unless a lesser number is approved by the Registrar. Cooperatives with less than the minimum number of allowed members must make an application to the Register to continue carrying on business or must otherwise be wound up and de-registered.

### Admission of new members

Australian cooperatives are not obliged to accept third parties as members and the admission of new members is regulated by a requirement that persons must not be admitted to membership unless there are both reasonable grounds to believe that they will be an active member of the cooperative and the person is otherwise eligible for membership under the cooperative's rules (CNL s112). A cooperative's active membership requirement/s must be set out in the rules and may be either open or restrictive, depending upon the nature of the cooperative's primary activities. Cooperatives are obliged to cancel the membership of members that are inactive for an amount of time stipulated in their rules (CNL s156).

### Member's voting rights

CNL s228(1) provides that 'the right to vote attaches to membership and not shareholding' thereby enshrining the ICA Principles of democratic member

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Australian Senate Standing Committee on Economics (2016) *Senate Report on Co-operatives, Mutuals and Member-Owned Firms* 22. Please note that the *Corporations Act* recently amended its legislation to include a definition of "mutual entity" in the *Corporations Act*. The definition is based on the governance requirement that "each member has no more than one vote for each capacity in which that person is a member." *Corporations Act 2001* (Cth) s 51M(1).

governance in Australian cooperative law. However, the right to vote is limited by the following exceptions:

If a cooperative's rule provides: a member of a cooperative group may have the number of votes (up to 5) at a general meeting that is stated in the rules (s228(3)), and the chairperson has a second vote at a board meeting or general meeting (s228(4)).

In the case of joint membership: the joint members have only one vote between them; and that vote may be exercised (subject to the grant of a proxy or power of attorney) only by the joint member decided under the rules (s228(5)).

### Governance structure

Cooperatives must be governed by a board of at least 3 directors: CNL s172(1) and most directors must be member-directors, who are active members of the cooperative, however members may elect / appoint non-member (independent) directors, provided they do not comprise a majority of the board: CNL s174(2).

CNL s172(3) provides that the board may exercise all the powers of the cooperative that are not by the CNL or the cooperative's rules to be exercised by the cooperative in general meeting. The board can also delegate any of its functions (other than the power of delegation) to a director, committee, groups of members or an employee, however the board retains ultimate responsibility for exercise of these powers or functions (CNL s178). For larger cooperatives, boards are likely to have a stronger governance role, with less involvement in the management of day to day affairs.

There is no provision under the CNL for supervisory boards however committees comprised of one or more members may be established to provide advice or recommendations to the board on certain matters relevant to the cooperative.

Under the CNL, directors are subject to a range of legal and fiduciary duties that are like those of company directors under the Corporations Act 2001 (Commonwealth) – with the exception that cooperative directors must consider the ICA Principles when making a business judgment. These duties are subject to civil penalty provisions and failure to discharge these duties may result in fines to the director in question and may also result in disqualification from being an officer of any corporation (CNL parts 3.1 division 2, and 7.2). Criminal penalty provisions are also enlivened where actions constituting a breach of certain duties are committed with either recklessness and / or intentional dishonesty (CNL s196).

Cooperative boards of 'large' cooperatives are accountable to their members through requirements for annual reporting to members through audited or reviewed financial reports and director reports, and members are entitled to appoint an auditor

(CNL part 3.3).<sup>9</sup> ‘Small’ cooperatives may choose to have their financials audited or reviewed and have no requirement to lodge financials with the regulator, but must resolve as to solvency each year. Australian cooperatives are not presently required to engage in any social (non- financial) auditing or reporting to demonstrate the cooperative’s economic, social and cultural performance in light of the common needs and aspirations of their members.

As per the requirements of democratic member governance, members will generally elect the board of directors at general meetings (as per a cooperative’s rules and CNL s173) and, in this way, have a degree of control over the governance of their cooperative. Additional member protections include a requirement that certain matters may only be decided by special resolution, needing a higher proportion of members to be in favour of the proposal than for ordinary resolutions and in some cases undertaken by way of a regulated procedure known as a special postal ballot (CNL ss248 and 253). These types of decisions include the acquisition or disposal of assets in certain circumstances (CNL s359) and the amendment of a cooperative’s rules (CNL s61).

## Cooperative financial structure and taxation

### Capital contributions

A member is not entitled to exercise the rights of membership until they have made any payment to the cooperative required for membership or acquired the minimum number of shares as required by the cooperative’s rules: CNL s120(1).

Diverse share contributions to the cooperative’s capital are possible and tied to the cooperative’s active membership provisions so, for example, multi-stakeholder cooperatives may have various minimum share requirements depending upon each type / class of membership (see generally part 2.6). A cooperative may also require members to take up additional shares (CNL s82). However, a member may not hold more than 20% of a cooperative’s share capital (CNL s363(1)).

Membership contributions to capital may be linked to the member’s volume of transactions (patronage). This may occur by issuing bonus shares in proportion to the value of business done by each member with the cooperative or profits earned on the business done by each member of the cooperative: CNL s357(1)(b). The member

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<sup>9</sup> Please note that ss270-272 of the CNL provides for these reporting requirements, which are differentially applicable to those co-operatives defined by the CNR as either ‘small’ or ‘large’.

may also consent elect to receive any rebate as either an issue of bonus shares (s357(2)(a)) or as a deduction from their loan to the cooperative (s357(2)(b)).

The board may delay repayment of shares to former members if doing so would adversely affect the cooperative's financial position or if the cooperative and former member otherwise agree (CNL ss107 and 163). If a cooperative repurchases shares, it may issue or allot debentures or cooperative capital units ("CCUs") to the former member in satisfaction of the amount owed or (for deposit-taking cooperatives only) apply the amount as an interest-bearing deposit (CNL s108).

#### Other sources of finance

The CNL recognizes that cooperatives may issue debentures and / or Co-operative Capital Units ("CCUs"), both of which may be issued to members and non-members (see generally part 3.4). CCUs are hybrid forms of instruments which can be structured as either debt or equity, subject to their terms of issue (CNL part 3.4 division 2). The rights attached to CCUs do not affect democratic member governance of the cooperative and confer an interest in only the capital (but not the share capital) of a cooperative: CNL ss345(1) and 349. CCUs provide Australian cooperatives with additional flexibility in raising capital and allow for more diverse contributions to a cooperative's capital structure. However, they are not widely known or used outside the cooperative sector, so external investment tends to be limited to former members of the cooperative.<sup>10</sup>

Member loans to the cooperative are also possible. CNL s343(1) provides that a cooperative may require its members to lend money to the cooperative if approved by special resolution of a cooperative, passed by special ballot, and subject to other requirements set out in that section. The proposal may include members contributing to the compulsory loan by way of deduction from money payable by the cooperative to the member for their dealings with the cooperative (s343(4)) or by application of their rebate (s357(2)).

#### Distribution of surplus to members

Only a distributing cooperative may distribute its profits to members (CNL s17), and the board may elect to distribute surplus to members in proportion to the capital subscribed: s357(1)(c). The CNL does not require distributing cooperatives to distinguish between surplus that arises from transactions with members and other receipts when distributing surplus to members, however there may be tax incentives

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<sup>10</sup> One former cooperative (which has since demutualised) listed CCUs on the ASX, however these were mainly held by 'dry' or non-active former members of the cooperative.

for doing so in some circumstances.<sup>11</sup> Non-distributing cooperatives cannot distribute profit to members, although a rebate based on patronage is possible. Also, non-distributing cooperatives with a share capital may return the nominal value of shares to members: CNL s19.

For both types of cooperatives, the board may resolve to retain all or part of a cooperative's annual surplus, to be applied for the benefit of the cooperative: CNL s355. Additionally, CNL s356 provides that a cooperative may apply part of its annual surplus for any charitable purpose or, in the case of distributing cooperatives, for supporting any activity approved by the cooperative, however a cooperative's rules must limit the amount that may be applied towards such a purpose to a stated proportion of that surplus.

#### Distribution of surplus upon dissolution

The CNL part 4.5 sets out winding up provisions for Australian cooperatives. For distributing cooperatives, the remaining surplus (after the satisfaction of all debts and liabilities, and the costs associated with winding up) of a cooperative are distributable to members upon a winding-up or conversion of the cooperative to another corporate form.

In the case of non-distributing cooperatives however, the CNL does not allow the distribution of any remaining surplus to members other than for the nominal value of their shares. It also requires the cooperative's rules to make provision for the disinterested devolution of any remaining surplus (s448). For cooperatives registered as charities or deductible gift recipients (under charities or taxation law) this will usually require the distribution of surplus to one or more organisations with a similar purpose.

#### Taxation of cooperatives

The Income Tax Assessment Act 1936 ("ITAA") ss117-120 provides tax incentives for 'cooperative companies' (this may include some producer or service cooperatives registered under the CNL) where not less than 90% of its business is with its members. For these organisations, any assessable income that is distributed back to members is an allowable deduction for the cooperative company (but is taxed in the hands of the members). The cooperative company may choose to pay income tax pre-distribution on all or some of its surplus and attach franking credits in respect of any paid tax.

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<sup>11</sup> See discussion on mutuality principle under "taxation of cooperatives" below.

Cooperative companies may also be eligible to deduct the repayment of both interest and principal payments on certain government loans. This provision does provide cooperative companies with a significant tax advantage and has been used to allow eligible cooperatives to invest in infrastructure and expand facilities to the benefit of local communities. Unless it meets the specific requirements of the ITAA ss117–118, income treatment for cooperatives is no different from any other business.

The ‘mutuality principle’ does offer some cooperatives (as well as other types of business organisation that operate a mutual fund) a tax advantage. This principle provides that receipts derived from mutual dealings with members that are not for the purpose of trade - are not assessable as income for taxation purposes. Where the cooperative is trading with its members for profit e.g. a producers’ cooperative, the mutuality principle may not apply. However non-distributing cooperatives, e.g. a cooperative formed to acquire and manage irrigation infrastructure for its members, may be able to apply the mutuality principle to any surplus income which is retained in the mutual fund or applied for the benefit of its members.

### Other specific features

Cooperatives, like other corporate entities in Australia, are not subject to overt government interference and influence. The Registrar does have power to intervene and to appoint an external administrator in the case of insolvency (CNL s383) or on other specific grounds (CNL s 455).

The CNL s111(2) does provide for the formation of cooperative groups (comprising two or more cooperatives or a corporation or other body otherwise allowed to obtain membership of the cooperative group), so that cooperatives may choose to form secondary cooperatives, however the principle of cooperation among cooperatives is not otherwise implemented and there are few remaining cooperative federations in Australia.<sup>12</sup> There is no specific legislative provision that provides for control or self-regulation by any federations or representative organisations. This is potentially an obstacle to cooperative development and will be discussed further below. As they have diminished in size and number, it is difficult for the remaining cooperative federations to exert any political power, particularly at the federal level. In 2013, the formation of the Business Council of Co-operatives and Mutuals BCCM has filled this

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<sup>12</sup> Only two state federations of cooperatives remain active, Co-ops NSW and Co-ops WA.



gap and ‘punched above its weight’ by acting as a as a policy advocate for cooperatives and mutuals at the national level.<sup>13</sup>

### Degree of “cooperative friendliness” of the CNL

The CNL is quite significantly ‘cooperative friendly’ in the sense that the legislation is designed so that it is conducive to registered cooperatives operating in accordance with the first four of the cooperative principles. The legal barriers to cooperative growth and development in Australia lies in the wider regulatory and constitutional framework rather than within the CNL and these issues are outlined below.

#### Legal obstacles or barriers

The main legal barrier to cooperative development in Australia is that it is a business vehicle regulated at the state level where there is a lack of resources and interest in business policy development. There is no legal framework for cooperatives at the federal level. Although this is largely due to the constitutional barrier, it could be overcome if there was political will at both state and federal level to transfer at least some of the regulatory responsibility for cooperatives to the federal jurisdiction. While cooperatives remain the responsibility of state governments, they are excluded from national policy formulation and although most states and territories have adopted the CNL or agreed to adopt a consistent law, Queensland remains an exception.<sup>14</sup>

The adoption of CNL in most states and territories is a positive development for cooperative law in Australia, but the remaining regulatory and administrative inconsistency causes complexity for any cooperative that wishes to operate across state boundaries, for example platform cooperatives. It also makes it difficult for cooperatives to compete with companies. Companies are regulated only at the national level and the regulatory and supervisory body, ASIC, is self-funding and well-resourced and plays a significant role in providing education and information resources for companies. However, the effectiveness of supervisory and enforcement powers of the Cooperative Registries in each state are subject to the allocation of enough resources. Since most business regulatory services have been transferred to the Commonwealth level – there has been a corresponding transfer of

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<sup>13</sup> See the website for BCCM, <https://bccm.coop/what-is-the-bccm/>

<sup>14</sup> At the time of writing (February 2020), the Co-operatives National Law Bill 2020 is before a parliamentary committee in Queensland and may pass into law later this year.

financial and knowledge resources to the various bodies at national level leaving the state registries behind. The decline in numbers of registered cooperatives is an economic justification for a corresponding reduction in government funding and resourcing of the registries, but it has a ‘knock-on’ effect so that cooperative development including education and information for new cooperatives has been neglected.<sup>15</sup>

Other regulatory and policy frameworks that have negatively impacted the development of cooperatives in Australia include:

- competition law, particularly the National Competition Policy regime which underpinned the deregulation of statutory marketing schemes and prioritised the interests of consumers over smaller scale agricultural producers, leading to the demutualisation of many agricultural cooperatives;
- financial service sector reforms which effectively separated credit unions and building societies i.e. financial cooperatives, from other cooperatives by moving the formation and regulation of non-bank financial institutions to the federal jurisdiction;
- prudential and accounting standards that fail to take the ‘member benefit’ provided by cooperatives and mutuals into account (and also require cooperatives to report shares as liabilities under general purpose financial statement standards, thus affecting overall equity);

federal funding schemes for business development programs exclude cooperatives on the basis of legal form alone. For example, indigenous business development funding excluded cooperatives from receiving larger scale grants, resulting in the conversion of some indigenous cooperatives to Aboriginal and Torres Strait Islander corporations or companies so they were not excluded from access to this funding.<sup>16</sup>

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<sup>15</sup> More recent website upgrades have improved information resources provided by co-operative registry websites, see for example <https://www.fairtrading.nsw.gov.au/associations-and-co-operatives/co-operatives/about-co-operatives>

<sup>16</sup> Under the Indigenous Advancement Strategy, Commonwealth Government grant funding above \$500,000 was only available to Indigenous organisations incorporated under the *Corporations Act* (2001) or the *Corporations (Aboriginal and Torres Strait Islander) Act* 2006: Australian Senate Standing Committee on Economics (2016) *Senate Report on Co-operatives, Mutuals and Member-Owned Firms*, 38 – [https://www.aph.gov.au/Parliamentary\\_Business/Committees/Senate/Economics/Cooperatives/Report](https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Cooperatives/Report).



## Features of CNL that stand out as ‘best practice’

The CNL is a well-designed legal framework for cooperatives and has a number of aspects that may be worth modelling in other jurisdictions:

The express inclusion of cooperative principles (s10) and the requirement that the law is to be interpreted to promote cooperative principles (s11) are worthwhile features of the CNL.

Another distinctive feature is the flexibility of the CNL to accommodate within one framework all ‘types’ of cooperatives including worker, producer and consumer cooperatives. The streamlining of categorisation into ‘distributing’ and ‘non-distributing’ cooperatives is useful and allows for a simplified governance regime for non-distributing cooperatives (particularly those that do not issue shares). This model is particularly useful for small scale community organisations and clubs; however, it can also be used by larger infrastructure and service cooperatives.<sup>17</sup>

The requirement for member economic participation through active membership is a legal design feature that can help the model stay true to the cooperative principles.

CCUs have been specifically developed to allow cooperatives to raise capital using a hybrid capital instrument. The instrument can be used to allow external investment, but it has not yet been widely used for this purpose in Australia. It is arguably a more useful instrument to accommodate internal member investments and loans and rotating funds.

The distinction between large and small cooperatives is also a practical feature which simplifies and reduces the cost of financial reporting requirements for smaller cooperatives. This feature is modelled on a similar provision for companies under the Corporations Act.

The introduction of civil penalty provisions for breaches of director’s duties is another feature of the CNL which has been adapted from the Corporations Act. The advantage is that it makes it easier for the regulator to prosecute and penalise directors who may have acted negligently or dishonestly. However, its effectiveness is limited by the resources available to the regulator to monitor, investigate and prosecute suspected breaches. Arguably the state cooperative registries are not nearly as well-resourced as ASIC and so are less likely to prosecute breaches of the legislation.

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<sup>17</sup> An example of the latter is CBH Group, see <https://www.cbh.com.au/> .

## Features from other jurisdictions that might encourage cooperative development in Australia.

There are some features of cooperative law in other jurisdictions which might inspire useful reforms in Australia.

Canada has a similarly structured federal system but has both national and provincial laws for cooperatives. The Canada Cooperatives Act (S.C. 1998, c. 1) and Canada Cooperatives Regulations (SOR/99-256) govern the incorporation, operation and liquidation of non-financial cooperatives that carry on their business in two or more provinces and have a fixed place of business in more than one province. At federal level, there is a single regulator, Corporations Canada, and one portal for registration of incorporated models including business, not-for profit and cooperatives. (Note: The Australian Tax Office is working on a project to modernise business registers so there is a single national register of businesses, see <https://treasury.gov.au/consultation/c2018-t310411>).

The UK recognises a community benefit society, Cooperative and Community Benefit Societies Act 2014 – we have no equivalent in Australia. The CNL recognises a non-distributing cooperative, which does not distribute surplus to its members and has a voluntary asset lock. The community benefit society differs in that it is expressly for community benefit not member benefit and may adopt a statutory asset lock. A voluntary asset lock can be removed by members (e.g. by passing a resolution to change from a non-distributing to distributing cooperative). The advantage of recognising a community benefit society as a specific and separate type of entity is that it helps to solidify the legal identity of a cooperative as being for member benefit. In Australia many of the cooperatives registered as non-distributing cooperatives are community organisations. This may unintentionally create a perception that the cooperative is primarily a 'not for profit' vehicle for community purposes.

Some European countries mandate 'disinterested devolution' on some or all assets of cooperatives in a winding up, which makes the model resistant to pressure from corporate raiders. Australian law does not currently adopt this feature.

The cooperative audit is an important mechanism in German cooperative law, and it does not have an equivalent in the CNL. The cooperative audit looks at a wider set of indicators beyond financial performance and verifies the organisations compliance with cooperative values and principles.

## Recommendations for the improvement of the national legal framework

The following recommendations for improvement relate to the CNL specifically rather than the broader regulatory framework for businesses in Australia:

- The transfer of legislative and regulatory power for cooperatives to a single federal regulator.
- A single registration portal for incorporated businesses including cooperatives as a specific type of corporation (as in Canada).
- The recognition of social or community benefit cooperatives with a simplified formation requirement and the option of a statutory or voluntary asset lock (as in UK), along with an equivalent option for distributing cooperatives (i.e. providing for disinterested devolution of assets to limit demutualisation of cooperatives).
- The adoption by the CNL of accounting standards that are tailored for cooperatives.<sup>18</sup>
- The adoption by the CNL of a mandatory cooperative governance code.<sup>19</sup>

## Conclusions

The CNL is a relatively new law for cooperatives in Australia. If Queensland does adopt the CNL this will be the first time in the history of the Australian cooperative law that each state and territory has a consistent law. The main advantage of this consistency is that each state or territory jurisdiction will recognise every other jurisdiction as a participating jurisdiction. If a cooperative registered in one state wishes to raise capital by recruiting new members who reside in another state – they will not need to register in that state and any issue of securities (shares or debentures) will not be subject to dual regulation under both cooperative law and

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<sup>18</sup> See Duncan Wallace, *Accounting Standards and Co-operatives: Proposed Solutions to the Problem of AASB 132* (2016, BCCM) available at <https://bccm.coop/wp/wp-content/uploads/2018/09/AASB-submission.pdf>

<sup>19</sup> The BCCM has published voluntary governance principles. The debate over voluntary or mandatory codes of governance for investor owned corporations is ongoing, however the CNL already recognises the role of the cooperative principles. A mandatory code is arguably not a bold step and may help directors stand their ground against executive management who are often inclined not to prioritise cooperative principles. Moreover, mandatory requirements for cooperative specific reporting may increase understanding and focus on all of the cooperative principles under the law. See CME Governance Principles: <https://bccm.coop/wp/wp-content/uploads/2018/09/BCCM-Governance-Principles.pdf>

the Corporations Act.<sup>20</sup> However, as many cooperatives are local organisations, the ability to fund raise across state borders may not have a significant impact on cooperative development.

The Australian Parliament conducted an inquiry into cooperatives, mutuals and member owned firms in 2015/2016 hearing written and oral evidence from around 60 representatives from the cooperative and mutual sector. It published a report of its findings in 2016.<sup>21</sup> The report identified the following barriers to cooperative development in Australia:

- The absence of statistics and data so that an accurate picture of the scale and extent of the contributions of the cooperative sector are available to input into policy discussions and debates.
- The lack of recognition and understanding of the model by Government agencies, so that it is often forgotten and neglected in policy discussions.
- The invisibility of the cooperative model in business and law curriculum in education at secondary and tertiary levels.
- The lack of information and resources to support cooperative formation and development by government agencies.
- The cost and complexity of setting up and registering a new cooperative and lack of expertise among professionals (accountants and lawyers) who are likely to discourage the adoption of the model.
- The application of inappropriate accounting standards may make it difficult for co-operatives to access debt capital.
- A lack of access to ‘patient capital’.

The 2016 Senate Report on Co-operatives, Mutuals and Member-Owned Firms did not only focus on cooperatives but also mutuals which are regulated under the Corporations Act. However, the core legal framework issues that can be extrapolated from the report link to recognition of the cooperative identity. The transfer of regulatory power from the states to the Commonwealth may not resolve all issues but will increase the visibility of cooperatives at the national level where most law and policy decisions affecting Australian businesses are made.

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<sup>20</sup> At present because Queensland does not have a consistent law, it is not a participating jurisdiction and cooperative fund raising beyond state or territory boundaries involving Queensland will be subject to Chapter 6D Corporations Act, 2001 (Cth). However this may change if the CNL is adopted in Queensland.

<sup>21</sup> Australian Senate Standing Committee on Economics (2016) *Senate Report on Co-operatives, Mutuals and Member-Owned Firms* available at

[https://www.apf.gov.au/Parliamentary\\_Business/Committees/Senate/Economics/Cooperatives/Report](https://www.apf.gov.au/Parliamentary_Business/Committees/Senate/Economics/Cooperatives/Report)