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# Cooperatives National Law

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## NSW Fair Trading

**5 March 2010**

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## Table of Contents

<b>Executive Summary</b> .....	<b>3</b>
Introduction .....	3
Additional option not considered – Federal legislation .....	4
Issues with loans by members to a cooperative .....	4
Dealing with resigning members.....	5
Directors’ Duties.....	5
Replacing forgiveness resolution with business judgment rule .....	6
Errors and Minor Issues .....	7
<b>Attachment A: Profile of the Law Council of Australia</b> .....	<b>8</b>

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## Executive Summary

This submission has been prepared by the Corporations Committee of the Business Law Section of the Law Council of Australia for the Business Law Section (“**the Committee**”). Due to time constraints, this submission has not been reviewed by the dDirectors of Law Council of Australia Limited. It is appreciated that this submission is being made outside the closing date.

### Introduction

1. The Committee welcomes any initiative to have uniform legislation regulating cooperatives. The presence of only 1,726 cooperatives throughout Australia (compared to 1,700,891 companies)<sup>1</sup> suggests that the cooperative (as a corporate entity) is increasingly becoming an anachronism.
2. This submission makes these suggestions in the following paragraphs:
  - (a) that consideration be given to a referral of power by the States to the Commonwealth so that cooperatives can be regulated by Commonwealth legislation with a single Commonwealth regulator in place (e.g. ASIC) instead of having separate State and Territory regulators under State/Territory legislation;
  - (b) some technical changes to the proposed CNL are suggested:
    - (i) reconsider the need for a cooperative to have a power to compulsorily require members to make loans (with or without security) to the cooperative. At least a ceiling on the amount of the loan should be prescribed if no change is made (refer clause 3413). Additionally, at call loans should be prescribed as the default standard rather than for term loans of up to seven years, thereby allowing members to call up a loan made in an emergency situation. These prescriptive measures are suggested because the only resource of a member who does not want to be a part of the compulsory loan commitment is to resign their membership;
    - (ii) address the purchase and repayment of paid up amounts on shares where a member has resigned given that resignation is the only apparent remedy for a member who does not want a loan commitment;
    - (iii) align provisions in the CNL relating to directors’ duties and offences with those in sections 180 to 184 of the *Corporations Act 2001*. In particular, include a ‘business judgment rule’ for cooperative directors and decriminalise clause 3119; and
    - (iv) delete the defence entitling a director to be absolved for negligence e.g. the passing of a ‘forgiveness’ resolution by the cooperatives’ members. The business judgment rule, as a defence to negligence, creates a standard of governance that should apply to cooperatives rather than a ‘forgiveness’ resolution.

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<sup>1</sup> As cited in ASIC’s 2009 Annual Report

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3. Some errors have been detected and other minor issues.

### **Additional option not considered – Federal legislation**

4. The regulatory impact statement prepared by the Ministerial Council for Consumer Affairs covers three options for the future of cooperatives:
- (a) encourage incorporation under the *Corporations Act 2001*;
  - (b) status quo; and
  - (c) proposed CNL.
5. The report neglects to address a fourth option of the States and Territories referring necessary constitutional power to the Federal Government. This could result in a single Federal Act for the entire country instead of each jurisdiction having to enact the same legislation. ASIC would also be able to act as the single regulatory body for cooperatives, removing the need for each individual State or Territory to have a regulator. This approach would also remove the need for the notification regime, as the law would be uniform and the cooperatives could then operate freely across borders, removing the competitive disadvantage of cooperatives not incorporating under the *Corporations Act 2001*. Under the CNL, individual States and Territories can choose whether to enact certain sections of the proposed legislation which would create disunity. Additionally, States and Territories can prescribe CNL regulations to override the regulations set out by NSW Government.
6. Savings to the community of \$400,000 nationally as mentioned in clause 6.3.1 of the regulatory impact statement would expectedly still be obtained and the rollout time of the laws could be significantly reduced without the need to wait for each individual State or Territory to enact the laws separately. The Committee suggests that this approach should be considered by the Ministerial Council for Consumer Affairs as this option has clear advantages for both government (at State and Federal levels) and cooperatives. ASIC is the logical regulator to appoint. By having a national regulator, the idea of having CNL enforced in a consistent manner is highlighted. Additionally, the need for the States and Territories to devote staff and infrastructure to the regulation of cooperatives would be obviated as ASIC should be able to absorb this role with only a minor increase to its resources.
7. Using ASIC as the sole regulator would enable the non-distributing and the distributing cooperatives to be regulated separately by ASIC and this could possibly be handled by a suggested 'not for profit' regulatory section within ASIC.<sup>2</sup> Separating the regulation should lead to fairer and more equitable regulation as shown by the separation of 'for profit' and 'not for profit' entities. This would act to reduce compliance costs for non-distributing cooperatives.

### **Issues with loans by members to a cooperative**

8. Whilst small loans to cooperatives are tolerable, clause 3413 imposes an obligation on a member to make a compulsory loan to a cooperative without inadequate prescription of safeguards. Ideally, a compulsory loan should only be at call, rather than up to seven years. The impact of the currently worded clause 3413 appears to be harsh on members. A member who does not want to be part of a loan commitment only has resignation from membership as an option. Ideally, if

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<sup>2</sup> As suggested in 'Contribution of the Not-for-Profit Sector – Research report' by the Productivity Commission

compulsory loan provisions remain, could the 'default' standard be an at call loan, and, could a loan ceiling be imposed (perhaps by regulations)?

## Dealing with resigning members

9. Section 2441(6) of the CNL does not include voluntary resignations from the cooperative. The Committee suggests that this be amended to mirror section 171(5) of the South Australia Act which includes resignations in this section. These suggestions, if adopted, would therefore result in a cooperative being able (through its rules) to repurchase the shares of members who have been expelled or who have resigned. Without those types of provisions, forfeiture of a member's shares is a likely consequence.
10. It is appropriate to have power to buy out shares held by members who voluntarily resign from a cooperative because of personal reasons such as requiring the redemption of their investment for private purposes or because they may have left the district and are no longer able to utilise a cooperative's services. Any request for purchase of a member's shares would always be subject to the Board's approval.

## Directors' Duties

11. The CNL should be looked upon as an opportunity to harmonise the law applying to directors of companies with the law applying to directors of cooperatives. Clauses 3118 to 3122 of the CNL do not achieve this. The following table shows some of the anomalies present in comparing these clauses of the CNL with the closest comparable provisions in the *Corporations Act 2001*.

CNL provision	Corporations Act provision	Differences
3118 – officers and employees to act honestly. Maximum Penalty: Up to two years imprisonment or \$24,000 or both for fraud. Otherwise \$6,000.	Section 184(1) – directors, officers and employees not to act dishonestly or recklessly. Penalty: Up to five years imprisonment or \$220,000 fine or both.	Corporations Act imposes a significantly higher penalty.
3119 – officers of cooperative must exercise care and diligence expected of a reasonable person in their cooperative's circumstances. Maximum penalty: \$2,000	Section 180(1) – directors or officers must act with care and diligence expected of a reasonable person if they were a director or officer in the position of that person. Civil penalty applies, i.e.: 1 Statutory penalty of up to \$200,000. 2 Civil compensation available. 3 Banning order can be made.	Corporations Act imposes a significantly higher penalty plus exposure to civil liability and a banning order.

CNL provision	Corporations Act provision	Differences
3119(2) – officer cannot be convicted if members have passed a forgiveness resolution.	No comparable provision in Corporations Act. Section 180(2) imposes a statutory defence for directors and officers if criteria are met. Only the Court can grant forgiveness – in terms of a ‘not liable’ order. See section 1318.	Clause 3119(2) does not compare with section 180. Clause 3119(2) allows ‘forgiveness’ given by a cooperative’s member to be a ban on criminal proceedings. Civil liability is still recognised in clause 3119(2). Section 180 of the Corporations Act decriminalises negligence and provides for a defence.
3120 – officer or employee or committee member cannot improperly use their position or information for the purposes of gaining an advantage. Maximum penalty: If fraud involved, \$24,000 or two years imprisonment or both. If other causes, \$6,000.	Sections 184(2) and (3) are broadly similar. Penalty: \$220,000 or imprisonment for five years or both.	Corporations Act imposes significantly higher penalties.
3121 – contravention of clauses 3118 to 3120 creates civil liability on the contravenor to pay compensation.	Section 1317E creates civil liability for directors of comparable provisions for the contravenor.	The Corporations Act civil penalty regime does not apply to cooperatives.
No duty to act in good faith and for a proper purpose.	Section 182 imposes this duty. Civil penalty applies: 1 Statutory penalty of \$200,000. 2 Civil compensation available. 3 Banning order able to be made.	CNL does not have the equivalent of section 182 of Corporations Act. Also civil penalties under section 1317E of Corporations Act do not apply to cooperatives.

## Replacing forgiveness resolution with business judgment rule

In section 3319(2) of the CNL, it states:

*“An officer is not liable to be convicted for a contravention of this section if the cooperative has resolved by ordinary resolution to forgive the contravention.”*

The use of this forgiveness resolution should be replaced (with appropriate adaptations) with the ‘business judgment rule’ the *Corporations Act 2001* s180(2):

“(2) A director or other officer of a corporation who makes a business judgment is taken to meet the requirements of subsection (1), and their equivalent duties at common law and in equity, in respect of the judgment if they:

(a) make the judgment in good faith for a proper purpose; and

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(b) do not have a material personal interest in the subject matter of the judgment; and

(c) inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate; and

(d) rationally believe that the judgment is in the best interests of the corporation.

The director's or officer's belief that the judgment is in the best interests of the corporation is a rational one unless the belief is one that no reasonable person in their position would hold."

This clause still limits the director's liability but creates a standard of governance for cooperatives instead of a forgiveness resolution.

## **Errors and Minor Issues**

### **Duplicate definitions**

In clause 1 of 'Part 1 Preliminary' of Schedule 6 to the CNL there are two definitions of 'prospective liability'. It is suggested that the second 'prospective liability' should read 'registrable charge' – refer, for example, to clause 1 of 'Part 1 Preliminary' of Schedule 3 to the SA Cooperative Act.

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## **Attachment A: Profile of the Law Council of Australia**

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The Law Council of Australia is the peak national representative body of the Australian legal profession. The Law Council was established in 1933. It is the federal organisation representing approximately 50,000 Australian lawyers, through their representative bar associations and law societies (the “constituent bodies” of the Law Council).

The constituent bodies of the Law Council are, in alphabetical order:

- Australian Capital Territory Bar Association
- Bar Association of Queensland Inc
- Law Institute of Victoria
- Law Society of New South Wales
- Law Society of South Australia
- Law Society of Tasmania
- Law Society of the Australian Capital Territory
- Law Society of the Northern Territory
- Law Society of Western Australia
- New South Wales Bar Association
- Northern Territory Bar Association
- Queensland Law Society
- South Australian Bar Association
- Tasmanian Bar Association
- The Victorian Bar Inc
- Western Australian Bar Association
- LLFG Limited (a corporation with large law firm members)

The Law Council speaks for the Australian legal profession on the legal aspects of national and international issues, on federal law and on the operation of federal courts and tribunals. It works for the improvement of the law and of the administration of justice.

The Law Council is the most inclusive, on both geographical and professional bases, of all Australian legal professional organisations.