

SHOULD YOUR CO-OPERATIVE CHANGE OVER TO THE MODEL RULES?

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Introduction

This paper considers the "Model Rules" that members of a co-operative might adopt when forming a new co-operative – or members of an existing co-operative might adopt to help regulate the operation of the co-operative.

Rules must be adopted when forming or running a co-operative: they are an important aspect of the legal regulation of a co-operative. The rules provide the platform for the regulation of the relationship between:

- the co-operative and the outside world,
- each of the members of the co-operative, and
- the co-operative and its members.

However, because "the rules" are often a "dry" and uninteresting area (compared to, for example, the very business or pursuits for which the co-operative was formed) the importance of the rules might be neglected or not well understood by the members.

Hopefully, this paper will provide an insight into the importance of the rules and provide some instruction for those who might want to look at the rules of the co-operative and consider what rule changes might assist the co-operative.

Background

The *New South Wales co-operatives Act 1992 (Co-Ops Act)* regulates the formation, operation, administration, division and winding up of co-operatives. The Co-ops Act was the result of an extensive review of the *Co-operation Act 1923*, and was carried out in 1989-1990. In 1990 the Commonwealth and State Ministers for Agriculture approached the Standing Committee of Attorneys General (**SCAG**) to review the inconsistency in the co-operatives legislation having regard to the law in each of the states and territories.

In late 1995 the Victorian Government introduced a new Co-operatives Bill based on the New South Wales "*Co-operatives Act 1992*" as it then existed. The Victorian Bill built on the work of the SCAG Working Party by including core consistent provisions. The Victorian legislation became the base document for the model co-operatives legislation that was the subject of discussion.

In order to assist with consistency across jurisdictions, the NSW "Co-operatives Amendment Bill 1997" was introduced to the NSW Parliament. Following its passage through the Parliament, the Co-ops Act was substantially amended in line with that Bill.

This background to the legislation is important because it is the legislation in each of the relevant states and territories that provides for the requirement for a set of rules for the co-operative – and the content which the rules must have.

Before turning the rules and their requirements, it is important to understand why rules are necessary at all.

Why have rules?

Individuals have traditionally had legal personality at law. The law in New South Wales (together with all Australian jurisdictions (far as I am aware)) recognises a number of different legal "personalities" other than individuals:

- companies (now formed under the *Corporations Act 2001*);
- incorporated associations;
- partnerships; and
- co-operatives.

These organisations are given legal recognition by force of statute.

A feature of the "legal personalities" listed above is that each of these personalities allows a number of individuals to come together and, subject to legislation, form a separate and independent legal entity through which objectives can be achieved (there are special matters to note for partnerships that are not reviewed here). In the case of companies, for example, they are more often than not legal personalities designed to undertake business and achieve profit for their shareholders.



As we all know, co-operatives are a unique legal personality, operated with regard to the "co-operative principles" (as set out in section 6 of the Co-ops Act).

Once a co-operative is incorporated under the Co-ops Act it is given a legal personality and the rights and obligations set out in that Act (for example the co-operative can sue or be sued in its corporate name (section 29)).

Together with the rights and obligations, the "legal personalities" noted above need to regulate the following:

- The relations between the legal personality and outside world;
- The relationship between the members of the legal personality amongst themselves (that is, member to member); and
- The relationship between the legal personality and the members (that is, between the member and (for example) the co-operative).

Like a company, rules are required for a co-operative (as a matter of law), to at least provide the framework for regulating the relationships identified immediately above. The rules become a "contract", binding the relevant parties (section 106).

Without these rules there may be no common understanding between the members as to their respective rights and obligations and there may be no common understanding as to how, for example, the members might participate or influence the management of the co-operative.

The law therefore requires, on the establishment of any legal personality, including a co-operative, that there be a set of rules which regulates these matters.

What are the Model Rules?

Part 5 of the Co-ops Act sets out the law with respect to "Rules". Section 107(1) provides:

"The rules of a co-operative must set out or otherwise make provision for the matters specified in Schedule 1".

Schedule 1 is attached. Note that there are:

1. Requirements for all co-operatives;
2. Additional requirements for co-operatives with share capital; and
3. "Additional" requirements for non-trading co-operatives.

These provisions are consistent between New South Wales, Victoria and Queensland. By operation of the legislation, these rules are deemed to be the minimum required for the effective, transparent and lawful operation of a co-operative.

Because the Co-ops Act sets out the matters that the rules must provide for, it was a relatively simple and short step for the Registrar of co-operatives in New South Wales (together with the regulatory authorities in other jurisdictions) to create "model rules" that:

- address the matters required by that legislation;
- give content to the requirements set out in the Schedule; and
- in the experience of the Registrar, provide content and rules that assist with the smooth and efficient operation of co-operatives.

The model rules obtain their legal force by virtue of section 109A of the co-operatives Act:

The Registrar may by notice published in the Government Gazette approve model rules for co-operatives or for any class of co-operatives and alter or repeal the model rules from time to time.

Furthermore, if the rules of a co-operative are deficient – that is, they do not provide for all of the matters that are covered in the model rules – the legislation provides that the model rules, with respect to that matter, are deemed to be included in the rules of that co-operative (s.109A(3)).

Model rules relevant to the following co-operatives have been drafted and are available the NSW Department of Fair Trading website:

- housing co-operatives;
- non-trading non-share co-operatives;
- non-trading share co-operatives;
- trading co-operatives; and



- co-operatives that operate as a club.

(see <http://www.fairtrading.nsw.gov.au/business/cooperatives/rules.html>)

Why Model Rules?

There is a legal, and a common sense, requirement for rules. This was discussed and reviewed under the heading "Why have rules?". In summary, the rules serve the purpose of good governance, accountability and openness between members. The rules for the conduct of a co-operative (like any other legal personality) are clearly stated in a written form and available to all members (s.108).

Furthermore, and as discussed above, there was a lack of consistency across state borders on the regulation of co-operatives. By making co-operatives legislation relatively uniform – including uniform rules – there is a consistency within the "co-operatives industry" (for want of a better term) that allows members of co-operatives to understand what goes on in other co-operatives, including co-operatives in other states.

This in turn helps facilitate, where relevant, dealings between co-operatives both within and across state borders. Furthermore, and again where relevant, it should assist with merger of these co-operatives.

It is also the case that straightforward and well drafted model rules serve the co-operatives principles of "voluntary and open membership" and "democratic member control". Members can be relatively certain that the model rules have been drafted and approved by the respective parliaments with a view to serving these co-operative principles (see also section 7 of the Co-ops Act).

Finally, and for the majority of co-operatives, it simply makes sense to "travel the road" already laid out by the Regulator. There is little point in trying to re-invent the wheel.

What do the Model Rules provide?

I noted earlier that Schedule 1 of the Co-ops Act sets out the "matters for which rules must make provision". The "model rules" as prepared by the Registrar of co-operatives has divided the model rules into three components:

1. Schedules.
2. Core rules.
3. Guidelines.

The Guidelines are what they say they are – a guide for the use and completion of the model rules.

The model rules themselves are divided into two components:

- A. Core rules
- B. Schedules

The core rules as published in the model rules address those matters in Schedule 1 that apply to the type of co-operative. Therefore:

- The matters identified in Clause 1 of Schedule 1 are common across all model rules.
- The matters addressed in Clause 2 of Schedule 1 are included in the core rules of co-operatives which share capital.
- The matters addressed in Clause 3 (in addition to Clauses 1 and 2) of Schedule 1 address those matters that are relevant to non-trading co-operatives.

Indeed the numbering of the provisions in Clause 1 of Schedule 1 is consistent with the numbering of the model rules in the core rules from Rule 1 to Rule 23.

With respect to the core rules, an amendment to the text of the core rules is not permitted (I suspect that this means that if the co-op adopts the model rules, then the Registrar will require those rules to be filed as published). However, it takes but a moment's attention to the core rules to note that the co-operative must turn its mind towards the provisions of the model rules and adopt some amendments.

It is readily apparent that a co-operative cannot simply printout the model rules and register them for the co-operative. There is a requirement for even simple "fine tuning" of the model rules to ensure that they apply to the co-operative. For example the rules must provide for



the co-operative's name, and includes a number of other matters that include whether the members will be fined for a failure to observe the rules.

I note that Item 26 of Clause 1 of Schedule 1 of the Co-ops Act states that:

"The Rules of all co-operatives must set out or make provision for each of the following ... any other matters that to the co-operative appear necessary or desirable".

Once again it is apparent that in addition to the amendment of the core rules, by reference to the Schedules, each co-operative is invited by the Act to consider inserting additional rules that appear to the co-operative to be "necessary or desirable". That is, the co-operative is not only invited to "personalise" the rules as is necessary to apply them to the co-operative – there is also an invitation to think about what other rules might be necessary to address the concerns of members of the co-operative.

As noted above, the text of the "core rules" of the co-operative should not be amended (it is not "permitted"). Where the core rules need to be personalised for the co-operative – for example, to insert the name of the co-operative, the objects of the co-operative and such other matters as are specifically provided for – then those amendments should be made by including the information in the schedules.

In addition to these relatively simple "personalisation" amendments, a co-operative can make an amendment to a core rule. The easiest example of this is to change the financial year from 30 June (as provided in Rule 17) to another date (for example the calendar year – 31 December). This clearly indicates that a co-operative can adopt the model rules, personalise the rules as required in the schedules, adopt such other rules as "appear necessary or desirable" – and then make amendments to the core rules themselves.

That is, the model rules can be used as the basis for the rules of the co-operative. Thereafter further amendments can be made that, depending upon the extent of modifications, may substantially change the final rules from the model rules.

When amending the model rules keep in mind that:

- The rules can only be altered as provided in the Act.
- Otherwise, the rules of the co-operative may be altered by special resolution (unless they are amended by resolution of the board, and the amendment does no more than give effect to a requirement imposed by the Act; or the Registrar is satisfied that the members do not need to approve the alteration).
- The alteration of the rules will not take effect until it is registered by the Registrar – and the Registrar must be satisfied that the alteration is not contrary to the legislation and the Registrar has no other reasonable cause to refuse the registration.

In summary, an alteration to the rules must be both lawful and satisfactory to the Registrar.

Advantages

There are a number of advantages to adopting the model rules:

- The model rules have the benefit of "pre-existing approval" of the regulatory authority (in New South Wales, the Registrar of co-operatives). That is, a co-operative at the formation stage can be assured that if the model rules are adopted they will be accepted.
- Any rules adopted for a co-operative must be consistent with the Co-ops Act and the regulations. It can be assumed that the model rules will always be consistent with the Co-ops Act and Regulations.
- All members of all co-operatives need only familiarise themselves (generally speaking) with one set of rules. There is a consistency in the management, operation and administration of co-operatives where they adopt the model rules.
- The model rules, as published, are in "plain English" and provide cross references to relevant provisions of the Co-ops Act. This is a helpful tool for members and those involved in the management of the co-operative.
- Co-operatives that deal with each other will better understand their mutual internal governance and control where model rules are adopted.



- This is also true for co-operatives across state borders. The advantage of consistent legislation from state to state means that co-operatives that deal with each other, across state borders, may deal with a common set of rules.
- A standard set of rules means a standard interpretation. Co-operatives looking for a consistent approach by the regulator, and by the Courts, to the interpretation and use of rules will take comfort in the fact that if the model rules have been adopted then there should be a similar application or attitude towards that rule.

Finally it must be said that regulators, whether it be the Registrar of co-operatives, solicitors, accountants, Courts and other professionals associated with the operation and administration of co-operatives like to see "standards". This leads to uniformity of interpretation and application of the law – and should result in less cost to co-operatives where they are obliged to deal with external consultants.

Disadvantages

It is important to note that even the model rules require fine tuning and personalisation for each co-operative.

It is not the case that the model rules, as provided by the Registrar, can simply be applied to the co-operative. The need to "personalise" the co-operatives rules, even for simple matters, highlights the fact that everyone is different.

Accordingly the personalisation of the rules can go beyond that which is required under the model rules.

For example, in New South Wales "co-operative capital units" are provided for in the co-operatives Act (Part 10 Division 2). It is not my intention to review the role or value of co-operative capital units. However, they are a feature of the New South Wales co-operative regime, they are not a feature of the model rules, and accordingly if they were to be issued by a co-operative then the rules should be amended to take account of those co-operative capital units.

A further example can be provided for a large trading co-operative that has taken on professional management. The members of such a co-operative, while not able to displace the management role of the board, might want the rules to reflect the power of the members to be involved in decisions that relate that professional management. Once again the rules would need to be transparent in relation to the rights of members – and also transparent to advise and foreshadow the role a manager might be undertaking when joining a co-operative.

As a co-operative becomes more sophisticated in its management and operation, there may be a need to amend rules, and draft new rules, to govern those changes.

How to adopt the model rules – or how to amend your current rules

The Co-ops Act provides that the rules can be amended in accordance with the Act. The best way to amend the rules – in accordance with the Act – is to adopt new rules through a special resolution of the members. Passing a special resolution requires a certain procedure to be adopted (see section 189 and the existing rules).

Any amendment to the rules will only have effect once registered – and there are certain requirements that must be met if the alteration is to be registered (see section 113).

Conclusion

The rules are an extremely important aspect of the operation of a co-operative. The model rules published in each jurisdiction are worthy of consideration. For a co-operative that is at the formation stage, whether considering incorporation or not, the rules should be adopted with the modifications as required. co-operatives that are already operating might consider whether the model rules will give the co-operative, and the members, a timely reminder of the nature of the "corporate body" and how those members are meant to relate to each other – and how the co-operative should relate to the outside world.



Co-operatives Act 1992

Schedule 1 Matters for which rules must make provision

1 Requirements for all co-operatives

The rules of all co-operatives must set out or make provision for each of the following:

- 1 The name of the co-operative.
- 2 Active membership provisions (within the meaning of Part 6).
- 3 The mode and conditions of admission to membership, and the payment to be made or the share or interest to be acquired before rights of membership are exercised.
- 4 The rights and liabilities of members, and of the estates of deceased members, and the rights and liabilities of representatives of members under bankruptcy or mental incapacity.
- 5 The circumstances in which members may be expelled or suspended, and the rights and liabilities of expelled or suspended members.
- 6 The circumstances in which membership ceases.
- 7 Any charges or subscriptions which are to be payable by a member to the co-operative.
- 8 The circumstances in which fines and forfeitures may be imposed on members of the co-operative, and the amount of the fines, not exceeding the prescribed maximum amount.
- 9 The grievance procedures for settling disputes under the rules between the co-operative and any of its members as defined in section 89, or between a member and any other member.
- 10 The restrictions, if any, on the powers of the co-operative and the board.
- 11 The number of directors, the qualification of directors, and the manner of electing, remunerating and removing directors and filling vacancies, the period for which directors are to hold office, and whether directors are to retire by rotation or otherwise and for the holding of annual elections.
- 12 The quorum for meetings, and the procedure at meetings, of the board.
- 13 The device, custody and use of the seal of the co-operative.



- 14 The manner in which the funds of the co-operative are to be managed, and in particular the mode of drawing and signing cheques, drafts, bills of exchange, promissory notes, and other negotiable instruments for and on behalf of the co-operative.
- 15 Provision for the custody of securities belonging to the co-operative.
- 16 The manner in which debentures may be transferred.
- 17 The date on which the financial year of the co-operative concludes.
- 18 Provision for the financial statements of the co-operative to be audited annually or more frequently and the manner of appointment of the auditor.
- 19 The manner in which any loss which may result from the transactions of the co-operative is to be provided for.
- 20 The manner of calling general and special meetings, the requisite notices of meetings and the quorum for meetings of the co-operative.
- 21 The procedure at meetings of the co-operative, including the rights of members in voting at meetings, the manner of voting, and the majority necessary for carrying resolutions.
- 22 The method of conducting postal ballots, including special postal ballots, including the sending and lodgment of information and votes by facsimile or electronic means.
- 23 The manner of altering the rules.
- 24 The manner in which the co-operative may be wound up.
- 25 Any matters that may be prescribed by the regulations, whether in addition to or in substitution for any matter specified in this clause.
- 26 Any other matters that to the co-operative appear necessary or desirable.

2 Additional matters—co-operatives with share capital

In addition to the matters specified in clause 1, the rules of a co-operative with a share capital must set out or make provision for each of the following:

- 1 The nominal value of each share in the co-operative.
- 2 The amount of the contingent liability, if any, attaching to shares.



- 3 The terms on which shares, not including bonus shares, but including shares, if any, with a contingent liability attached to them are to be issued.
- 4 The periodic subscriptions by which or the manner in which shares are to be paid for.
- 5 In the case of a trading co-operative, the manner in which any surplus may be distributed.
- 6 The allocation of a deficiency on the winding up of a co-operative.
- 7 Provision for the forfeiture of shares on expulsion or on failure to pay any subscription or call, the extent to which members whose shares have been forfeited are to remain liable for any amount still unpaid in respect of them, and the sale or cancellation of forfeited shares.
- 8 The manner in which shares may be transferred.
- 9 Any matters that may be prescribed, whether in addition to or in substitution for any matter specified in this clause.

3 Additional matters—non-trading co-operatives

In addition to the matters specified in clauses 1 and 2, the rules of a non-trading co-operative must provide:

- 1 that there must be no return or distribution on surplus or share capital to members other than the nominal value of shares (if any) at winding up, and
- 2 for the manner of distribution of the surplus property at winding up.

