

## *Practitioners' Corner*

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### THE CASE FOR THE LEGAL PROTECTION OF COOPERATIVE RESERVES IN 'OLD' COOPERATIVES IN GERMANY AND AUSTRIA

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In this article, the term 'old' cooperatives is used to refer to e.g. agricultural, consumer, credit or housing cooperatives that have been in existence for more than a generation. Legislation has provided a legal form for cooperatives in Germany and Austria since the late middle of the 19<sup>th</sup> century. Although cooperatives today are different from the time of their creation,<sup>2</sup> these 'old' cooperatives still can fulfill their historical and social functions.<sup>3</sup> In their areas of activity, their established systems and structures can contribute socially in the division of labor, and in an increasingly competitive economy they can counteract monopolistic concentration and economic and social imbalances.

#### **1. Solidarity and capital**

Cooperatives began in difficult circumstances. It was a time when many people were not able to obtain certain services at all or under less favorable conditions than others.<sup>4</sup>

For example, credit cooperatives provided financial relief to members by opening up access to a means of payment.<sup>5</sup> These credit cooperatives were founded without financial reserves and many of their first-generation members did not have enough money to fully pay up their membership share or even to pay an entrance fee.

The development of the solidarity (unlimited) liability basis took place parallel to the gradual build-up of the amount paid up on member's share and the cooperative's own capital (reserves). The more capital the members were able to make available to their cooperative, or the more the cooperative was able to form its reserves from successful dealings with members and non-members, the less it was necessary for the cooperative to maintain such a broad basis of liability. Eventually, liability was limited or reduced to the amount of capital that the member had committed to fully pay up. Liability had to be limited to encourage new members to join. At the same time, as the number of members

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<sup>2</sup> Ref. for Austria and Germany *Brazda* (2017), *Stappel* (2020).

<sup>3</sup> Ref. *Brazda* (2012).

<sup>4</sup> Ref. *Faust* (1965), *Kluge* (1991), *Aschhoff*, *Henningsen* (1995).

<sup>5</sup> Ref. *Schulze-Delitzsch* (1855), pp. 45 ff., 82.

increased, the level of personal acquaintance and trust between members reduced, and the potential for conflicting interests increased.

## 2. Beginning and ending of membership

When a membership ends there is a direct recourse to the cooperative. Exiting members (or their heirs) are refunded at least the amount paid up on each member's share(s). Even before the first cooperative law was introduced by the legislature in 1867, it was common practice that the cooperative could include in its by-laws the opportunity to extend the amount paid back (§ 38 German *Cooperative Act* of 1867 and § 39 German *Cooperative Act* of 1868)<sup>6</sup>. This rule is still valid in Austria and appears also worth considering in particular for the creation of cooperatives today. According to this, members do not participate in the reserve fund and in the other existing reserves of the cooperative *unless* the by-laws of the cooperative provide otherwise ((§§ 55 (3) or 79 (2) Austrian *Cooperative Act*, created 1873). In the German *Cooperative Act*, this explicit opportunity was omitted in 1889 when the law was amended to protect the cooperative's growing reserves, but it continued to be allowed in practice.<sup>7</sup>

### 2.1 Clarification by amendments of 1973

Just like the possibility of conversion in the *Stock Corporation Act* (1969, §§ 385m to 385q), the amendment to the German *Cooperative Act* (1973) was intended to preserve “the competitiveness of cooperatives compared to companies with other legal forms”<sup>8</sup>. A starting point was seen in “creating incentives for greater financial participation by the members and thus for increased equity formation”<sup>9</sup>. The amendment also cleared up legal uncertainties regarding the extent of participation.<sup>10</sup> Finally, according to the added § 73 (3) German *Cooperative Act*, in the event of termination of membership, the by-laws can grant to “members who have fully paid up their shares, a right to payment of a part of a profit reserve to be created for this purpose from the annual surplus”. Additional requirements can be regulated within the by-laws.

§ 73 German *Cooperative Act* for recourse (limited to the nominal value of the member's share) represents a protective norm preserved by the legislature and § 73 (3) has become only a supplement. The protection applies to the legal property unit of the cooperative as a whole, which results in its social dimension. Because a “cooperative is not suitable for investing according to the regulations of the *Cooperative Act*, since no participation of

<sup>6</sup> 1867 for Preußen (Prussia), since 1868 for the Norddeutscher Bund (North German Confederation).

<sup>7</sup> Ref. Meyer, Meulenbergh (1961), § 1, No. 3.

<sup>8</sup> Deutscher Bundestag (1971), Vorblatt, (1973), p. 1.

<sup>9</sup> Deutscher Bundestag (1971), Vorblatt, (1973), p. 1.

<sup>10</sup> Ref. Bauer (2000/1973), p. 6.

resigning members in any increase in value is provided and the cooperative is designed for an open number of members.”<sup>11</sup>

In this sense, a cooperative differs from its ‘competitors’. To the extent that each generation of members is willing to leave part of the profits in the cooperative to strengthen its substance, the cooperative contributes to the diversity, can moderate other business models and preserves a ‘social’ dimension within a competitive market economy. The situation is similar to the social welfare function of the state, provided that it does not place an undue burden on its population’s ability to pay taxes.<sup>12</sup> On a smaller scale, and within its sector, a cooperative can do this for its members and customers (not-yet-members). The protection of its reserves ensures that a cooperative can meet the expectations of its present and future members, and the contribution of members to the reserve provides the requisite mutuality in favor of the cooperative.<sup>13</sup>

If the regulations of inheritance law are transferred to membership in a company, then the inheritance law for a member of a cooperative states that the profit generated during membership and not paid back as dividends or reimbursed in the long term remains in the cooperative beyond the individual membership.

## 2.2 Cooperative reserves

The reserves of today’s ‘old’ cooperatives have grown over many generations – and possibly under a specific tax regime e.g. in the case of the Austrian limited-profit housing associations,<sup>14</sup> which indicates a general public interest in protection.<sup>15</sup> It could even be said that due to the constitution of reserves in the event of a recourse with the member, ‘something social’ has arisen through the contribution of the individual (which may or may not be supported by a state’s tax regime) as a renunciation of individual rights in favor of the whole, the cooperative.<sup>16</sup>

Over time, the accumulation of significant reserve funds may arouse greed,<sup>17</sup> and this places the cooperative at risk of being abolished (demutualised) or relocated (merger) with legal(ized) means. Many of the cooperatives, some of which have existed and been operating for more than 100 years, find themselves in this situation. With every merger and transformation, there are fewer and ever larger institutions that correspond to their

<sup>11</sup> Ref. Deutscher Bundestag (2019), p. 7.

<sup>12</sup> Ref. *Krejci* (2015).

<sup>13</sup> Ref. *Rößl, Pieperhoff* (2018).

<sup>14</sup> The legal form of Austrian limited-profit housing associations is either a corporation, limited or cooperative.

<sup>15</sup> Ref. e.g. Österreichischer Verband gemeinnütziger Bauvereinigungen – Revisionsverband, Österreichischer Mieter-, Siedler- und Wohnungseigentümerbund, Mietervereinigung Österreichs (2012), Österreichischer Verband gemeinnütziger Bauvereinigungen (2019).

<sup>16</sup> Ref. *Blisse* (2019), (2020), p. 16.

<sup>17</sup> Ref. *Beuthien/Klappstein* (2018), p. 123.

cooperative founding idea, which becomes more difficult to recognize.<sup>18</sup> Merger also reduces a cooperative's ability to promote members in its original local and regional area.<sup>19</sup>

### 3. Contribution to capital market or protection of cooperative capital?

At the turn of the 19<sup>th</sup> to the 20<sup>th</sup> century, many cooperatives were not viable on their own after their conversion.<sup>20</sup> In the course of time, people spoke out against converting cooperatives into joint-stock companies,<sup>21</sup> e.g., at the cooperative days in Rostock (1897) and Westerland (1905).<sup>22</sup>

Today, more and more 'old' cooperatives merge. The liquidation or conversion of cooperatives is an exception. In the case of a merger, assets are transferred to the absorbing cooperative (e.g., bank). A merger seems to be unproblematic, so long as the cooperative's orientation, local or regional size, and legal form are retained and the generation of the creators of the cooperative is living and completely represented in the cooperative. However, if there is a change in legal form or a merger with superordinate institutions within a multi-level cooperative association (federal system), then reserves that have been built up and kept for the service of the local or regional cooperative for generations will be relocated. If the absorbing companies are listed corporations, then cooperative assets are individualized and tradable, and available for exploitation in the capital market.

In cooperative sectors with a listed central institution, transfers of reserves to a leading institute which is listed on the stock exchange, appears to be extremely regrettable: On the one hand, the cooperatives whose offers helped to moderate prices are lost in the present and future system. On the other hand, one generation is allowed to profit from the reserves that have grown over many generations. In this way, a conversion or merger with listed affiliated companies allows investors on the capital market to receive a windfall profit that was built up by members over the generations. Present and future members are deprived, at least partly without their knowledge and consent, to the social functions of the cooperative.

Cooperative reserves that have been intended to grow locally or regionally over generations need to be protected and used responsibly. They can reduce part of the pressure to adapt or change the market and price mechanism within a money-based competitive economy. Cooperatives also complement state services, for example, by contributing to the economic and social protection of people who are particularly affected in phases of major social

<sup>18</sup> Ref. *Beuthien* (2019), pp. 108-111.

<sup>19</sup> Ref. *Scheumann* (2017).

<sup>20</sup> Ref. *Heyder* (1966), p. 39.

<sup>21</sup> For Schulze-Delitzsch, the cooperative represented only a transit station to the joint-stock company (corporation). He "never get rid of this idea" and writes "of the uplifting and education of the members through the cooperative, so that they become mature for the joint-stock company" (*Waldecker* (1916), p. 26, Fn. 1).

<sup>22</sup> Ref. *Crüger* (1910), p. 112.

change.<sup>23</sup> This is one of the reasons why awareness of the social dimension and the preservation of the assets of the ‘old’ cooperatives are required.

Generations of members in ‘old’ cooperatives have contributed to the reserves in good faith, trusting that their cooperative would continue in existence and be available for future generations, given the validity of the designated protective norm (§ 73 German *Cooperative Act*). This trust should be maintained or restored with suitable legislative protection.

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<sup>23</sup> Haubner (2019), (2020).

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