

Practitioners' Corner

A STUDY OF INDIVISIBLE RESERVES IN COOPERATIVES IN EU MEMBER STATES¹

Cliff Mills

Introduction

Indivisible reserves are a common feature of cooperatives. They can help to provide financial stability; build solidarity and sustainability for future generations; and can act as a disincentive to those seeking to take over its assets.

But the manner and extent to which different EU member states deal with indivisible reserves within their national legal system vary greatly. Some have sophisticated cooperative laws making significant provision. Others do not even have a cooperative law.

The purpose of this study is:

- To carry out a high-level review of the cooperative laws of the 28 EU Member States
- To identify relevant aspects of the cooperative laws relating to indivisible reserves
- To summarise the findings
- To draw some conclusions and make some recommendations which might be helpful for lawmakers.

The way it has been approached is as follows.

The cooperative law of each of the 28 member states has been considered, and a series of questions has been answered in relation to each of them. These questions are:

1. Does the national constitution of the member state refer to cooperatives?
2. Are there separate laws to govern cooperatives?
3. Are cooperatives defined?
4. What is the nature of capital?
5. Are “investor members” allowed?

¹ This is an abbreviated version of a paper originally published by Foundation for European Progressive Studies and Mutuo in their paper *Who Owns Europe?*¹ in January 2020

6. Must a proportion of trading surplus be set aside to reserves, not to be distributed?
7. Are capital surplus/indivisible reserves protected on winding up?
8. Is conversion to a company permitted?
9. Are capital surplus/indivisible reserves protected on conversion?
10. What are the legal advantages in having indivisible reserves?

The answers to these questions have been put in summary form into tables. For this purpose, states have been divided into two categories:

- those whose national constitution specifically refers to cooperatives in some way, namely Bulgaria, Greece, Italy, Malta, Portugal, and Spain (Group A): and
- those that do not, which comprises the rest (Group B). Norway is also included in Group B. Whilst it is not a member of the EU, its membership of the European Free Trade Association and inclusion in the European Economic Area means that it continues to be subject to the State aid rules. If the UK leaves the EU, it might end up in a similar position.

This categorisation is taken from the valuable work of Ifigeneia Douvitsa, to whom I am most grateful for permission to use her work.²

It is appropriate to acknowledge in addition the invaluable help provided by the following publications to which much reference has been made: the International Handbook of Cooperative Law, D. Cracogna, A.Fici and H.Henrÿ (eds.) Springer, Heidelberg, 2013; and Principles of European Cooperative Law, G.Fajardo, A.Fici, H. Henrÿ, D.Hiez, D. Meira, Hans-H.Münckner and I.Snaith. Reference has also been made to the Final Study Executive Summary and Part I: Synthesis and comparative report; and Part II. National Reports, 5 October 2010, the Study on the implementation of the Regulation 1435/2003 on the Statute for European Cooperative Society (SCE).

I am also grateful to Ifigeneia, to Deolinda Meira, Sonja Novkovic, David Hiez and Ian Snaith for their support in this study.

It is important to state that this study has been carried out mainly in August 2018, using the texts of 2013 and 2017 referred to above, supplemented by other sources including unofficial translations of national laws. In each of Tables A and B, in the first column, any other sources used are acknowledged. Also, the latest year is specified to which the entries for that state are up to date. Where those laws have changed

² National Constitutions and Cooperatives: an overview, Ifigeneia Douvitsa, International Journal of Cooperative Law, Issue 1 2018 at page 128 <https://iuscooperativum.org/wp-content/uploads/2018/08/Issue-1-2018.pdf>

after that date, this has not been taken into account in this study, and therefore to that extent this study is qualified.

This paper proceeds as follows.

- Section 1: Executive summary
- Section 2: The ICA Principles and reasons for indivisible reserves
- Section 3: What are indivisible reserves and what needs to be considered?
- Section 4: From an EU perspective
- Section 5: Summary of EU member states' approach to indivisible reserves
- Section 6: Conclusions
- Section 7: Recommendations

At the end of this abbreviated report are the following Appendices:

- Appendix 1 – Summary Table A covering Member States with constitutional recognition of cooperatives
- Appendix 2 – Summary Table B covering Member States without constitutional recognition of cooperatives (and Norway)

1. Executive Summary

Indivisible reserves are a powerful manifestation of cooperative distinctiveness and identity.

Whilst cooperatives exist to serve individuals and meet their needs, having indivisible reserves underlines how cooperatives are a collaborative endeavour, through which individuals forego (greater) personal financial benefits and rights in order that such endeavour may prosper and achieve its purpose.

This helps their cooperative to be more sustainable, creditworthy and financially secure; it supports wider cooperative development and education; and it sustains the cooperative beyond the current members' own life-time for the benefit of future generations.

Conclusions

- This study concludes that 23 of the 29 states consider indivisible reserves to be important, and sufficient to justify specific provision in their legislation. But only 10 of them protect those

reserves beyond the life of the cooperative, as is recommended by the PECOL project team of lawyers.³

- It also concludes that there is great variation between individual member states as to the extent to which they acknowledge the existence of cooperatives as a business form, have created cooperative laws and define cooperatives, as well as requiring cooperatives to set aside money from surplus into indivisible reserves, and protecting those reserves when the cooperative is wound up.
- Five of the six member states whose national constitutions expressly refer to cooperatives do all of those things, namely Greece (for some cooperatives), Italy, Malta, Portugal and Spain.
- But they are not the only states which do. So do Belgium (for some cooperatives), Croatia, Cyprus, France, Hungary and Romania. A number of states leave the fate of indivisible reserves to be determined by the cooperative's by-laws (Germany, Lithuania, Luxembourg, Netherlands, Norway and Slovenia).
- At the other end of the spectrum, five member states (Austria, Czech Republic, Denmark, Ireland and UK) and Norway, do not have any requirement for setting aside indivisible reserves.

Recommendations

- States should seek to recognise cooperatives in their constitutional document, or where this is not possible
 - recognise in ordinary legislation the existence of a range of different corporate purposes including cooperatives
 - require the promotion of corporate diversity
 - require that cooperatives should be considered in certain specific sectors such as energy and care
- States should have their own national cooperative law which
 - protects cooperative identity relative to investor-owned companies
 - defines cooperatives by reference to the essential features which are necessary to achieve the corporate objective or purpose of a cooperative

³ PECOL is a legal project to create a set of modern cooperative legal principles to underpin national and EU laws (see further in section 4 below)

- National cooperative laws should provide for the compulsory allocation of some part of surplus to indivisible reserves, in accordance with PECOL, and should ensure that indivisible reserves remain indivisible, even on dissolution or conversion
- States should continually keep their cooperative law under review alongside company law, including the extent to which other laws (tax, regulation, competition) work to the detriment of cooperatives
- The EU should
 - support and encourage member states to improve/optimize their own cooperative law, including through projects such as PECOL
 - support and enable cooperation within member states and within the EU
 - continually keep the EU's own laws and regulations under review to ensure that other laws (tax, regulation, competition) do not operate to the detriment of cooperatives.

This is a desk-top study which looks at the national laws of member states. It is not the purpose of this study to explore whether there is any correlation between having a supportive legal system and having a more vibrant cooperative economy. This study is only up to date according to the availability of relevant texts for each member state, as stated.

This is also a study by a lawyer qualified in one jurisdiction having the temerity to comment on the laws of 28 others where he is not. To the extent that this study unfairly represents those laws, that is his fault alone and those qualified to do so are humbly requested to correct him in the interests of our own cooperative legal endeavours.

2. The ICA principles and reasons for indivisible reserves

a. ICA Principle 3 is as follows:

Members contribute equitably to, and democratically control, the capital of their co-operative. At least part of that capital is usually the common property of the co-operative. Members usually receive limited compensation, if any, on capital subscribed as a condition of membership. Members allocate surpluses for any of the following purposes: developing their co-operative, possibly by setting up reserves, part of which at least would be indivisible; benefitting members in proportion to their transactions with the co-operative; and supporting other activities approved by the membership. [Highlighting added]

b. The concept of indivisible reserves was re-introduced into the ICA Principles in 1995 by the French delegation, to ensure that the concept of collective ownership did not disappear.⁴ As Professor Ian MacPherson explained subsequently, in the previous version in 1966 reference to indivisible reserves had been dropped because of increasing complexity, and variation of approach.⁵ The unfortunate result had been that many co-operators had lost sight of the importance of commonly owned capital, as a symbol of co-operative distinctiveness, as a security for its financial growth, and as a protector in times of adversity.

c. The ICA's recent Guidance on the Co-operative Principles takes the view that the formulation of the 3rd Principle shows that the key economic concept enshrined in it is that in a cooperative, capital is the servant, not the master of the enterprise. The Guidance goes on to argue that this Principle is mainly a financial translation of the definition of the identity of a cooperative and of the financial implications of the 2nd Principle of Member Democratic Control.

d. A number of reasons can be put forward for providing in cooperative laws for the indivisibility of reserves, including the following:

- i. to create commonly-owned property as a symbol of cooperative distinctiveness;
- ii. to counterbalance and supplement the variable share capital;
- iii. to increase financial security and provide protection in times of adversity;
- iv. to increase the creditworthiness of the cooperative and provide greater protection to creditors;
- v. to reduce the threat of speculative winding-up to liberate from cooperative control the assets built up by previous generations;
- vi. to demonstrate concern for the future and sustainability, and to create solidarity across generations;
- vii. as part of the financial implementation of cooperative identity.

3. What are indivisible reserves and what needs to be considered?

a. Indivisible reserves are funds which are set aside out of annual trading surplus or profits, and are thereby not available for distribution to members either as a patronage dividend or via a distribution. Therefore, a member who leaves the cooperative is entitled to the repayment of their share capital, but is not entitled to a share of that surplus represented by the indivisible reserves. Some jurisdictions permit the

⁴ See Table B and entries for France: until 1992 reserves were indivisible in French law, but in that year this was softened. Also collective interest cooperatives introduced in 1992.

⁵ See the quotation from his guidance on the 1995 Principles at page 29 of the ICA's recent Guidance on the Co-operative Principles <https://www.ica.coop/sites/default/files/publication-files/ica-guidance-notes-en-310629900.pdf>

creation of a divisible reserve from which a departing member may be entitled to claim a portion, but this is not common.

b. Indivisible reserves are generally intended to provide capacity to absorb trading losses. Recourse can be had to them before members' share capital is needed to perform that function. Individual jurisdictions also specify other categories of indivisible reserves, such as for education, or cooperative development and promotion.

c. From the members' point of view, since the creation of indivisible reserves establishes some form of common or shared ownership over some part of the cooperative's assets, it results in some restriction on individual rights. The allocated funds become inaccessible (non-distributable) to the members, as part of the contract between the members created by the cooperative's statutes.⁶ Instead, those funds become restricted to the use to which they have been allocated.⁷ In some cases, it is compulsory to allocate a proportion of surplus to these funds.

d. From the cooperative's point of view, the allocation of funds to reserves which are indivisible during the life-time of the cooperative thereby creates an asset (the value of those reserves) to which nobody has an individual current right of ownership, but which is held in common by the cooperative. It is the prospect of a winding up of the cooperative, while it is solvent and the reserves have significant value, which makes cooperatives and other mutuals (which in the UK includes building societies) attractive to predatory organisations looking to benefit from assets accumulated by previous generations, but to which no individual member has a right of ownership. So it needs to be considered how member states address the question of what happens to these indivisible reserves if a cooperative is wound up.

e. In some cases, there is no protection of such reserves, and they simply become distributable to members, either as provided by laws or by the cooperative's statutes. Traditionally, such distribution is in some way linked to the amount of members' trade with their cooperative; in others, the distribution can be in accordance with shareholding. In these instances, indivisibility only applies during the life-time of the cooperative. In other cases, at the point of winding up, the members have a choice as to whether to distribute to themselves, or to retain the indivisibility of the funds by transferring them to another cooperative or cooperative institution. In yet other cases, members have no choice and the funds must be

⁶ The document setting out an individual cooperative's internal regulations is called by a variety of different names, which in English can be translated as foundation document, rules, constitution, articles of association, statutes, by-laws or regulations. To avoid confusion, in this paper the document will be referred to as the cooperative's statutes or by-laws.

⁷ See for example Portugal: five categories comprising a general (legal) reserve, education fund, funds required by legislation, funds required by the cooperative's own constitution, and funds allocated by the general meeting.

transferred to another cooperative, or to an institution dedicated to a cooperative or community-based purpose. Where, at the point of winding up, members do not receive anything beyond repayment of their capital subscribed and payment of other entitlements arising during the life-time of the coop, this is generally described as a “disinterested distribution”.

f. In some states, as well as allocating funds to an indivisible reserve, there is a legal requirement to set aside a proportion of surplus which must then be paid to a secondary or tertiary coop or a cooperative federation for certain purposes, such as cooperative development and promotion,⁸ or the furtherance of co-operative education, training, research and the general development of the co-operative movement.⁹ In truth it is probably incorrect to characterise such allocations of surplus strictly as indivisible reserves in the sense that they no longer belong to the coop, even though they serve a similar function. They continue to be funds allocated to a specific and restricted cause, over which the coop may have some say as a member or participant in the organisation entrusted with the funds. Because these funds are no longer owned and controlled by the cooperative, they cease to be available on winding up, whether solvent or insolvent, or on conversion to a company. They therefore remain completely protected, and dedicated to a cooperative purpose.

g. In jurisdictions which make no provision in their cooperative laws for indivisible reserves, the same issue nevertheless arises about what happens to the capital surplus on a solvent winding up, after the payment of all liabilities including repayment of share capital. This is the situation in the UK, for example, where the legislation makes no provision for indivisible reserves. However individual coops can, and many do, provide in their statutes that members are not to be entitled to a share in those reserves on a winding up and that they must be transferred to another coop or specified type of organisation; but statutes can be changed, so whilst this provides an impediment to demutualisation, it cannot completely protect the assets and so they remain vulnerable.

h. So, the questions of indivisibility and asset protection need to be looked at both during the lifetime of the coop, and on a solvent winding up. In addition, coops need to be aware of the possibility of conversion into a limited company, as this provides another mechanism by which the cooperative sector can lose ownership of accumulated reserves. It is therefore necessary to consider whether the laws of member states make provision for what happens to indivisible reserves on a conversion, if that is permitted by their laws.

⁸ Table A, Italy – 3% of annual profits

⁹ Table A, Malta – 5%

i. Moving on from the intrinsic or inherent benefits of cooperatives having indivisible reserves, it is appropriate to give some consideration to the question of whether, where national laws which seek to acknowledge and protect cooperative identity, there are other legal benefits or advantages arising from having indivisible reserves. For example, in some states favourable tax provisions effectively encourage the setting aside of indivisible reserves.

4. From an EU perspective

a. There are four matters¹⁰ from an EU perspective that need to be briefly commented on:

- i. Council Regulation (EC) No 1435/2003 on the Statute for a European Cooperative Society (SCE)
- ii. A subsequent communication from the Commission to the Council and the European Parliament on the promotion of cooperative societies in Europe;
- iii. The PECOL Project; and
- iv. A decision of the European Court of Justice about preferential treatment for cooperatives.

Statute for a European Cooperative Society

b. This piece of EU legislation provided for the creation of a supranational legal form suitable for cross-border cooperative operations. An SCE is a legal corporate form with specific rules about the involvement of employees. It can be considered as the cooperative equivalent of the European Company (Council Regulation No 2157/2001) and was aimed at ensuring that cooperatives had a level playing field with for-profit companies. The EU was anxious not only to ensure equal relative treatment to companies, but also to contribute to their economic development.

c. It is relevant to note in passing what is stated about cooperatives in the recitals to this legislation, namely as follows:

- i. *Cooperatives are primarily groups of persons or legal entities with particular operating principles that are different from those of other economic agents. These include the principles of democratic structure and control and the distribution of the net profit for the financial year on an equitable basis.*
- ii. *These particular principles include notably the principle of the primacy of the individual which is reflected in the specific rules on membership, resignation and expulsion, where the 'one man,*

¹⁰ It might also be noted that indivisible reserves are referenced in ILO Recommendation 193 under the heading Policy Framework and Role of Governments (paragraph 6(b))

one vote' rule is laid down and the right to vote is vested in the individual, with the implication that members cannot exercise any rights over the assets of the cooperative.

iii. ...

v. A European cooperative society (... 'SCE') should have as its principal object the satisfaction of its members' needs and/or the development of their economic and/or social activities, in compliance with the following principles:

1. ...

5. ..., net assets and reserves should be distributed on winding-up according to the principle of disinterested distribution, that is to say to another cooperative body pursuing similar aims or general interest purposes.

d. It is significant to note here that the EU itself expressly recognises the existence of cooperatives as a different form of business, with “operating principles that are different from other economic agents”, and implicitly that those principles have a value which is worth addressing in legislation. There are various features of the European Cooperative Society which it is also worth noting for the purpose of this study.

i. Share capital is variable

ii. A legal reserve fund must be built up, until the point where it is equal to the registered capital

iii. Not less than 15% of available surplus must be paid into the reserve

iv. Members leaving the coop have no claim on the reserve fund

v. The SCE provides for disinterested distribution on a winding up, i.e. distribution to another coop or general interest purposes. However this is not compulsory (a matter of regret)¹¹, in order to reflect the fact that national laws normally allow alternative arrangements.

e. There is no need to consider this legislation further for present purposes, save to comment that although this legislation has hardly been used, it has important symbolic and political value, raising the profile and underlining the importance of cooperatives, and highlighting the importance of indivisible reserves and their protection. A comprehensive review of the SCE has been carried out and published in 2010.¹²

Communication on the promotion of cooperative societies

f. Subsequent to the Statute for a European Cooperative Society, the Commission issued a Communication to the Council, the European Parliament, the European Economic and Social Committee

¹¹ See the comments of Fici A. on page 146 of International Handbook of Cooperative Law, D. Cracogna, A.Fici and H.Henry (eds.) Springer, Heidelberg, 2013

¹² See “Final Study Executive Summary and Part I: Synthesis and comparative report 5 October 2010 the Study on the implementation of the Regulation 1435/2003 on the Statute for European Cooperative Society (SCE)” (accessible at http://base.socioeco.org/docs/sce_final_study_part_i.pdf)

and the Committee of the Regions, on the promotion of cooperative societies in Europe (Com (2004) 18). This noted that “All co-operatives act in the economic interests of their members, while some of them in addition devote activities to achieving social, or environmental objectives in their members’ and in a wider community interest.”

g. Having noted that the role of cooperatives had gained renewed interest following the adoption of the recent Statute, the Commission expressed the belief that “the potential of cooperatives has not been fully utilized and that their image should be improved at national and European levels. Particular attention should also be paid to the new Member States and candidate countries, where despite extensive reforms the instrument of co-operatives is not fully exploited.”

h. The Commission also noted “the important and positive role of cooperatives as vehicles for the implementation of many Community objectives in fields like employment policy, social integration, regional and rural development, agriculture, etc. The Commission believes that this trend should be maintained and that the presence of co-operatives in various Community programmes and policies should be further exploited and promoted.”

i. The main points of the Communication were:

- i. The promotion of the greater use of cooperatives across Europe by improving the visibility, characteristics and understanding of the sector
- ii. The further improvement of cooperative legislation in Europe
- iii. The maintenance and improvement of cooperatives’ place and contribution to community objectives.

j. Whilst it is not of direct legal impact, this Communication contains much that is relevant to this study’s subject (such as encouraging Member States to provide for disinterested distribution on a winding up of a cooperative). This Communication is also referred to by the ECJ in the judgement discussed below.

PECOL Project

k. The output of the PECOL project were published in 2017.¹³ A helpful summary of PECOL is contained in a recent review:

¹³ Principles of European Cooperative Law (2017) Intersentia, Gemma Fajardo, Antonio Fici, Hagen Henrÿ, David Hiez, Deolinda Meira, Hans-H Münckner and Ian Snaith

“The basic idea of PECOL is, as the name states, to determine the general principles that identify, according to European cooperative traditions, the features of a cooperative. It is based on principles and rules that are found in different European jurisdictions and therefore constitutes some kind of common denominator, which ultimately defines what might be understood under the notion cooperative. From this, it clearly follows that PECOL is applicable to European cooperatives rooted in different European jurisdictions. It has to be specified that these principles are meta-principles.

PECOL describes cooperative legal norms. In doing so, PECOL addresses how cooperatives are actually organised and function. The final goal of these principles is to create principles in parallel with European and national law. With this, the authors try to establish patterns that might help to better understand cooperative law.

In this regard, three reasons for establishing PECOL are identified: first, PECOL shall establish a legal cooperative identity. In this context, it has been correctly criticised that the principles established by the ICA are too general. Then, PECOL should work as a pattern for other enterprises and therefore PECOL can be used as a model. Last and not least important, PECOL should be used as a tool to enter into academic debates.” Georg Miribung¹⁴

1. The PECOL Project is therefore aspirational in nature, and does not purport to create something normative or prescriptive. Its relevance in the present context is as a possible baseline against which to consider the specific laws of individual Member States. The relevant section¹⁵ is as follows:

SECTION 3.4

RESERVES

- (1) *In cooperatives there are mandatory reserves and voluntary reserves.*
- (2) *Mandatory reserves include the legal reserve and other reserves required by law or cooperative statutes, such as the reserve for cooperative education, training and information.*
- (3) *The legal reserve and the reserve for cooperative education, training and information are indivisible, even in the event of cooperative dissolution.*
- (4) *The legal reserve is established by:*
 - (a) *a percentage of the net annual cooperative surplus ...*

¹⁴ International Journal of Cooperative Law, Issue 1 2018 at page 191 <https://iuscooperativum.org/wp-content/uploads/2018/08/Issue-1-2018.pdf>

¹⁵ At page 83

m. This extract provides a helpful summary of what national cooperative laws would ideally provide in this area.

ECJ decision

n. As mentioned in the introduction, six EU member states expressly refer to cooperatives in their national constitution. They recognise that cooperatives contribute something which private for-profit businesses do not. The Italian constitution, for example, recognises that they operate for mutual benefit, rather than private speculation. The Spanish and Portuguese constitutions expressly seek to support and promote the creation of cooperatives.

o. It will be seen below that those states whose constitutions refer to cooperatives have the most favourable and pro-cooperative laws. The degree of protection of indivisible reserves/capital surpluses against threats from outside the sphere of cooperation is significantly greater than that provided by the other states, with some notable exceptions. This links closely to the question of what individual states do to support and promote cooperatives when their national constitution requires them to do so. The most common approach is to provide tax reliefs, based on indivisible reserves, which are not available to other types of business.

p. This was challenged in Italy under EU law on the grounds that it was contrary to State aid rules. The decision of the European Court of Justice on 8 September 2011 found that such tax reliefs were not necessarily contrary to State aid rules subject to a number of factors.¹⁶ Essentially, the ECJ found that because cooperatives were at certain disadvantages when compared to other trading entities (lower profit margins than capital companies which are better able to adapt to market requirements), it was justifiable and proportionate to provide tax benefits to them, but not to those other trading entities.

q. The following characteristic of cooperatives meant that they could not, in principle, be regarded as being in a comparable factual and legal situation to that of commercial companies:

- i. Registration as cooperative societies conforms to particular operating principles which clearly distinguish them from other economic operators.

¹⁶ Ministero dell'Economia e delle Finanze and Agenzia delle Entrate v Paint Graphos Soc. coop. arl (C-78/08), Adige Carni Soc. coop. arl, in liquidation v Agenzia delle Entrate and Ministero dell'Economia e delle Finanze (C-79/08) and Ministero delle Finanze v Michele Franchetto (C-80/08) Court of Justice of the European Union, 8 September 2011 (C-78/08 to C-80/08) <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:62008CJ0078&from=EN>

- ii. The primacy of the individual, which is reflected in the specific rules on membership, resignation and expulsion.
- iii. Net assets and reserves should be distributed on winding-up to another cooperative entity pursuing similar general interest purposes.
- iv. Cooperative societies are not managed in the interests of outside investors.
- v. Control of cooperatives should be vested equally in members, as reflected in the 'one man, one vote' rule.
- vi. Reserves and assets are therefore commonly held, non-distributable and must be dedicated to the common interests of members.
- vii. As regards the operation of cooperative societies, in the light of the primacy of the individual, their activities should be conducted for the mutual benefit of the members, who are at the same time users, customers or suppliers, so that each member benefits from the cooperative's activities in accordance with his participation in the cooperative and his transactions with it.

r. This judgement took note of a number of things, including the European Cooperative Statute, the Communication referred to above, and the positive comments about cooperatives in the Italian constitution. But the presence of indivisible reserves, which are not distributable to members on a winding up, was also a significant factor.

5. Summary of EU member states' approach to indivisible reserves

Please see the tables set out in Appendix 1 and 2.

6. Drawing some conclusions

The key points from the two tables can be summarised as follows:

- i. There is significant variation between states across most of the 10 questions above
- ii. On the main question, a majority of states (23) require funds to be set aside to indivisible reserves
- iii. Fewer (10) protect such reserves on solvent winding up
- iv. Only 8 of these states protect such reserves in relation to conversion
- v. Most states have their own cooperative law, and define cooperatives in legislation
- vi. Share capital is variable in all the states considered

Some more supportive of indivisible reserves

a. From the analysis above, it can be concluded that a group of 10 states go further than others in requiring and protecting indivisible reserves, and generally supporting cooperatives. They all have separate cooperative laws, define coops in legislation, require a proportion of surplus to be set aside to reserves, and protect those reserves on winding up; the majority also protect reserves on conversion. They are supportive of cooperatives and regard the protection of indivisible reserves as important.

b. This group includes 5 of the Table A states whose constitutions refer to cooperatives; Bulgaria is the only state from this group where there is no requirement for the allocation of surplus to reserves, and no protection of assets on winding up. But this group of more supportive states also includes 5 of the Table B states whose constitutions do not refer to cooperatives. So it can be argued that having constitutional recognition of cooperatives makes it more likely that states will have more supportive cooperative laws; but it does not follow that without such recognition, a state will not have supportive cooperative laws.

Member state	1. Does national constitution refer to coops?	2. Are there separate laws to govern coops?	3. Are coops defined?	6. Must a proportion of surplus be set aside to reserves?	7. Are reserves indivisible on winding up?	9. Are indivisible reserves protected on conversion to a company?
Greece	Yes.	Yes.	Yes	Yes	Yes for some coops	Yes for some coops
Italy	Yes.	Yes.	Yes.	Yes.	Yes.	Yes.
Malta	Yes.	Yes.	Yes.	Yes.	Yes.	No provision
Portugal	Yes.	Yes	Yes.	Yes.	Yes.	Yes (conversion forbidden)

Member state	1. Does national constitution refer to coops?	2. Are there separate laws to govern coops?	3. Are coops defined?	6. Must a proportion of surplus be set aside to reserves?	7. Are reserves indivisible on winding up?	9. Are indivisible reserves protected on conversion to a company?
Spain	Yes.	Yes	Yes.	Yes.	Yes.	Yes
Croatia	No	Yes	Yes	Yes	Yes	Yes
Cyprus	No	Yes	Yes	Yes	Yes	Yes, conversion not permitted
France	No	Yes	Yes	Yes	Yes	Yes
Hungary	No	Yes	Yes	Yes	Yes	Yes
Romania	No	Yes	Yes	Yes	Yes	No provision

c. Whilst this group of states certainly includes some that are known to have strong cooperative sectors (Italy, Portugal, Spain), this study does not attempt to determine whether there is a correlation between having more supportive cooperative laws in relation to indivisible reserves and the strength of the national cooperative economy. Many other factors clearly play a part in this.

Some less supportive of indivisible reserves

d. There is another group of 5 states which are essentially at the other end of the spectrum, in providing no protection at all to cooperative reserves and generally being less supportive of cooperatives. All of these states are from Table B. Of these 5 states, one does not have cooperative laws at all, and 2 do not define “cooperative” in their legislation or fulfil all the requirements for a cooperative law as described by Fici above. None of these 5 require part of the surplus to be allocated to reserves or provide any

protection to surplus assets on a winding up or conversion to a company. In these states, there is no long-term protection of cooperative assets.

Member state	1. Does the constitution refer to coops?	2. Are there separate laws to govern coops?	3. Are co-operatives defined?	6. Must a proportion of surplus be set aside to reserves?	7. Are reserves indivisible on a winding up?	9. Are indivisible reserves protected on conversion to a company?
Czech Republic	No	Yes	Yes	No.	No.	No provisions
Denmark	No	No.	Yes.	No.	No.	No
Ireland	No	Yes	No	No	No	No provisions
Norway	No	Yes	Yes	No	Up to the statutes	[Unclear]
UK	No	yes	No	No	No	No

e. As with the more supportive group of states referred to above, this study makes no attempt to determine whether there is any correlation between having comparatively less supportive cooperative laws in relation to indivisible reserves and the comparative strength of the national cooperative economy.

So what?

f. The basic finding that there is such a wide variation between the 29 states in relation to indivisible reserves, and the supportiveness of their laws towards cooperatives, is not exactly dramatic. But does it matter? Is it important to have supportive cooperative laws – are they essential to the development of cooperatives?

g. This question was considered in depth by Fici in his article already referred to.¹⁷ He concludes that “the essential function of cooperative (organizational) law is to recognize and preserve the distinct identity of cooperatives relative to joint-stock (for-profit) companies. This function of cooperative (organizational) law is ‘essential’ inasmuch as workable substitutes for it could not be found elsewhere in the law and is ‘specific’ in comparison to the general, essential function(s) of company law.”

h. He goes on to conclude that “a definite, distinct legal identity of cooperatives is increasingly being seen by the cooperative representatives as a precondition for the cooperative defence and growth, also in light of the fact that a particular legal identity may justify a specific policy regime of cooperatives, especially under tax law. Once that the distinguishing traits of cooperatives are recognized by law, it becomes easier for cooperative advocates to invoke policy measures in favour of cooperatives and for the state to justify these policies in light of the principle of equal treatment.”

i. So the preservation and promotion of cooperative identity are essential requirements for developing cooperatives, and legislation is the foundation upon which such identity is built in individual states. For the reasons explored in this study, indivisible reserves play a sufficiently significant role in defining that identity and in distinguishing cooperatives from other forms of ownership that the concept was re-introduced by the ICA in 1995, that it is included in the cooperative law of the majority of states considered, and it is both a feature of the SCE and the PECOL project. Where national laws do not adequately protect cooperative reserves, they are left open to attacks by predators, endangering both substantial existing ventures which help to preserve corporate diversity, and losing the accumulated capital from previous generations which should remain dedicated to cooperative endeavours.

j. Based on these arguments, the wide variation in how the 29 states treat indivisible reserves is obviously a source of concern amongst cooperators. It should be of concern to the EU, given its broad support of cooperatives as evidenced by: the European Cooperative Statute which was aimed at ensuring that cooperatives had a level playing field with for-profit companies; the subsequent 2004 Communication on the promotion of cooperatives; the funding of research by EURICSE on the implementation of the European Cooperative Statute commenced in 2009; and its funding of the subsequent PECOL project.

k. It should also clearly be of concern to those individual states which recognise the need and wish to strengthen and grow their cooperative economy for a variety of reasons including:

¹⁷ Fici, A. (2014), The Essential Role of Cooperative Law, The Dovenschmidt Quarterly December 2014 no. 4

- To reduce the dominance by and dependence on investor-ownership, with a view to building more resilient economies through greater corporate diversity
- To change the drivers in law-making to be more focussed on future generations and protection of the environment, rather than on wealth-creation for today
- To enable cooperative initiatives to have the opportunity to address major challenges which governments and markets struggle to address efficiently, including human services, and the ownership of utilities, data, and property
- Specifically, to support collaborative endeavours between citizens to meet their own needs, rather than relying on markets and governments.

1. So, what actions should therefore follow?

7. Recommendations

Constitutional recognition

a. Reference to cooperatives in national constitutions (supreme or foundational laws) is desirable, but clearly a long-term matter, and opportunities to support cooperatives in this way are likely to arise infrequently. However, other approaches are possible. The fundamental issue is to address the default setting commonly adopted by governments (not always intentionally) when legislating in relation to any trading activity, namely that they are dealing exclusively or mainly with investor-ownership. Whilst investor-ownership is the dominant and most familiar basis for business, governments should be open to the possibility of other corporate purposes than profit maximisation, and other forms and models of business, including cooperatives and other forms of democratic or locally accountable business.

b. Alternatives to recognition in national constitutions might include:

- i. Recognising in ordinary legislation the existence of a range of different corporate purposes, including in particular cooperatives and the values and principles on which they are based
- ii. Requiring the promotion of corporate diversity by government departments responsible for business. This could include establishing/revising standard procedures when assessing the impact of all new legislation to make sure that all corporate purposes and forms are considered and appropriately treated.¹⁸

¹⁸ This is one of the recommendations in *Co-operatives Unleashed*, New Economics Foundation 2018, Lawrence M., Pendleton A. and Mahmoud S. which can be found at <https://neweconomics.org/uploads/files/co-ops-unleashed.pdf>

- iii. Requiring in legislation in particular sectors such as energy, or care, that cooperatives should be specifically considered¹⁹

A Cooperative Law

c. As argued powerfully by Fici referred to above, having a cooperative law which protects cooperative identity relative to investor-owned companies is essential, and a precondition to “defence and growth”. This point is affirmed in relation to the UK in *Co-operatives Unleashed*²⁰ where it is stated: “Our research finds that co-operatives and the wider cause of democratising and more evenly spreading the benefits of enterprise are held back due to an absence of legislation and policy, institutional support, advice, incentive and promotion. With an economy that does nothing to help co-ops thrive and everything to create a hostile environment for models of co-operation, it is unsurprising that the UK has one of the smallest sectors of any country.”

d. Where states wish to encourage the development of cooperatives, changing national laws to recognise and accommodate cooperative enterprise establishes an important foundation for other legislation to provide appropriate support and encouragement to establish or explore cooperative approaches. Cooperative law has an important role to play, both in helping to define and protect cooperative identity, and providing the basis for the appropriate treatment of cooperatives elsewhere in legislation including in relation to tax and competition law. This can also be an incentive for citizens, through self-help, to cooperate to meet their changing needs, and to rely less upon the state or markets to provide essential services.

e. If it is to be effective in supporting and promoting a healthy cooperative economy, cooperative law needs to be regularly reviewed and updated at state level, by every individual state to ensure that it meets changing needs. This has been normal in relation to company law for many years. For example, in the UK company law is generally reviewed comprehensively every 25 years or so (1925, 1948, 1985, 2006), involving a careful consideration of what changes are needed to enable companies to be as efficient and effective as possible. No such review has ever taken place in the UK for cooperative law. It needs to, in all states.

¹⁹ A good example of this is in Wales, where The Social Service and Well-being (Wales) Act 2014 expressly requires the promotion of cooperatives and certain other types of organisation (section 16).

²⁰ See previous footnote

Defining cooperatives

f. Without providing a definition of cooperatives in national law, there is no legal certainty, and no clear basis for appropriate policy making. Organisational laws (company law, cooperative law) need to set out the essential features which are necessary to achieve the corporate objective or purpose. By setting out these essential features for the corporate purpose, the organisational laws thereby create and define the identity. It is not sufficient to have internationally recognised principles (such as the ICA statement) unless the core features are anchored in national organisational laws. Without that, an organisational form will lack an identity. “In other words, when a legal entity, or category of legal entities, has a defining feature that relates to the objective pursued – whether negative (the profit non-distribution constraint that qualifies nonprofit entities) or positive (the mutual purpose that qualifies cooperatives) – the organizational law of that entity, or category of entities, plays the essential role of defining their particular identity in light of the objective pursued.”²¹

Indivisible reserves, variable capital

g. Indivisible reserves play a significant part in defining cooperative identity. Reference was made above to the removal of indivisible reserves from the ICA principles, and their subsequent reintroduction because, in the words of Ian MacPherson, “*many co-operators have lost sight of the importance of commonly owned capital, as a symbol of co-operative distinctiveness, as a security for its financial growth, and as a protector in times of adversity.*”

h. But arguably indivisible reserves provide a more fundamental role than that. In the laws of all of the states considered, cooperative share capital is variable. This is in direct contrast to company law, in which capital is basically fixed, though increasingly mechanisms are being introduced to enable capital to be more variable. But such measures have to take account of the need to protect creditors, for whom fixed capital otherwise provides basic protection. In cooperatives with variable capital, indivisible reserves provide some protection to creditors. So requiring cooperatives to set aside funds to indivisible reserves not only reinforces the concept of commonly owned capital among the members, it also helps to build their business credibility and creditworthiness when compared with companies.

i. The recommendation is to implement the PECOL provisions in relation to setting aside indivisible reserves.

²¹ Fici, A. (2014), The Essential Role of Cooperative Law, The Dovenschmidt Quarterly December 2014 no. 4

Protecting reserves

j. As well as specifically requiring indivisible reserves to be set aside, the subsequent protection of those reserves is also highly significant. The appreciation of the importance of corporate diversity has increased greatly as a result of the economic crisis ten years ago. Protecting organisations and assets which have been built up by people over generations in support of a particular purpose is not only important in order to give effect to those peoples' legitimate intentions. Protecting such organisations and assets should be a matter of public policy for wider public benefit. In particular, protection against changing the corporate purpose is essential. Where organisations have served their useful purpose and are to be wound up, allowing their surplus assets to continue to be committed to the particular purpose is simply completing the purpose of supporting such organisations in the first place. Likewise, where founders wish to allow the possibility for future generations to "cash in" on the organisation, they should have the freedom to do so.

k. These issues are too important to be left to chance. States should legislate clearly so that everybody knows what the position is in dealing with individual organisations. Just because companies have a well-known and understood failure and winding up regime, it should not be assumed that other types of corporation should follow suit. Those establishing organisations should ensure that they address the question of the destination of any surplus assets beyond the life of the organisation itself. Protection needs to be provided both on the winding up of cooperatives, but also on any other process of change of purpose permitted by national legislation, such as conversion into or take-over/purchase by an investor-owned company.

l. The recommendation, as above, is to implement the PECOL provisions.

Recommendations for EU

m. It has been pointed out that the EU is itself supportive of cooperatives as another form of business, as evidenced by its own legislation, the European Cooperative Statute, and the Communication referred to above. It is committed to the promotion of the greater use of cooperatives across Europe by improving the visibility, characteristics and understanding of the sector; the further improvement of cooperative legislation in Europe; and the maintenance and improvement of cooperatives' place and contribution to community objectives.

n. Since the establishment and maintenance of cooperative law is primarily a matter for individual states, the EU therefore has an important role to play in supporting and encouraging member states to optimise their own cooperative law. The PECOL project is an important example of valuable work which can be undertaken to advance the European cooperative agenda, and it provides an important and helpful tool for individual states. This should be built upon further.

o. But there is another important role for the EU to fulfil. Cooperation is a world-wide movement; cooperation between cooperatives is one of the underlying principles, and both supporting and enabling cooperation within member states and within the EU as a whole are important. This means continually keeping under review, at transnational level as well as at individual state level, the extent to which other laws (tax, regulation, competition) work in favour of investor-owned enterprise and/or to the detriment of cooperatives. The EU's own laws and regulations must be kept under continual scrutiny to ensure that this does not happen.

Final comments

Both in Europe and beyond, faith in democracy is at a low ebb. There are many contributing factors to this, not least the worrying level of politically unaccountable corporate power, which challenges the very sovereignty and even the relevance of smaller states. We should not be surprised if the sight of banks and other large businesses regularly getting away with scandalous behaviour, contributes to broader disillusionment with established institutions, fuelling more extreme electoral reactions.

Cooperatives are important, and different. Substantial entities trading for broader social purpose and differently accountable, smaller local enterprises empowering local people and meeting local needs, and the greater prominence of democratic control in the operation of businesses could all help to change the narrative, and reclaim the rightful place of individuals rather than money and class which still control modern society. The dominance of investor-owned business is one of today's major challenges.

Cooperative law may be particularly important in this context, in raising awareness about the role of business, improving its robustness and credibility, and providing incentives which encourage the start-up and development of businesses designed to meet the needs of people, rather than capital.

But it is important also for the future of the EU and its member states in addressing urgent challenges which governments struggle to meet, and where private ownership does not provide a solution or threatens to undermine democracy, including:

- the health and well-being of its citizens

- climate change
- information and communications
- the changing nature of work/employment.

Cooperative law is important, and for it to succeed, so are indivisible reserves.

Appendix 1

Summary Table A of Member States with constitutional recognition of cooperatives

Member state	1. Does national constitution refer to coops? ¹	2. Are there separate laws to govern coops?	3. Are coops defined?	4. What is the nature of capital?	5. Are “investor members” allowed?	6. Must a proportion of surplus be set aside to reserves?	7. Are reserves indivisible on winding up?	8. Is conversion to a company permitted?	9. Are indivisible reserves protected on conversion to a company?	10. What are the legal advantages of indivisible reserves?
1 Bulgaria	Yes	Yes	Yes	Variable	No provision	Yes	No	No provision	No provision	Some tax relief
2 Greece	Yes	Yes	Yes	Variable	No provision	Yes	Yes for some coops	No general provision, yes for some	Yes for some coops	Limited tax relief
3 Italy	Yes	Yes	Yes	Variable	Yes	Yes	Yes	Yes	Yes	Tax reliefs

¹ See Main Table A (Appendix 3) for explanation of sources, and further information about individual questions

	Member state	1. Does national constitution refer to coops? ¹	2. Are there separate laws to govern coops?	3. Are coops defined?	4. What is the nature of capital?	5. Are “investor members” allowed?	6. Must a proportion of surplus be set aside to reserves?	7. Are reserves indivisible on winding up?	8. Is conversion to a company permitted?	9. Are indivisible reserves protected on conversion to a company?	10. What are the legal advantages of indivisible reserves?
4	Malta	Yes	Yes	Yes	Variable	No provision	Yes	Yes	No provision	No provision	Tax reliefs
5	Portugal	Yes	Yes	Yes	Variable	Yes	Yes	Yes	No, forbidden	Yes (conversion forbidden)	Tax reliefs
6	Spain	Yes	Yes	Yes	Variable	Yes	Yes	Yes	Yes	Yes	Tax reliefs

Appendix 2

Summary Table B of Member States without constitutional recognition of cooperatives

	Member state	1. Does the constitution refer to coops? ²	2. Are there separate laws to govern coops?	3. Are co-operatives defined?	4. What is the nature of capital?	5. Are “investor members” allowed?	6. Must a proportion of surplus be set aside to reserves?	7. Are reserves indivisible on a winding up?	8. Is a conversion to a company permitted?	9. Are indivisible reserves protected on conversion to a company?	10. What are the legal advantages of indivisible reserves?
1	Austria	No	Yes	Yes	Variable,	Yes.	No.	No.	No	Effectively yes, as conversion not possible	None
2	Belgium	No	Yes	Yes	Variable	Appears to be possible	Yes	No	Yes	No	Limited tax advantages
3	Croatia	No	Yes	Yes	Variable	No	Yes	Yes	Probably	Yes	None
4	Cyprus	No	Yes	Yes	Variable	No	Yes.	Yes.	No	Yes, as	Some tax

² See Main Table B (Appendix 5) for explanation of sources, and further information about individual questions

	Member state	1. Does the constitution refer to coops? ²	2. Are there separate laws to govern coops?	3. Are co-operatives defined?	4. What is the nature of capital?	5. Are “investor members” allowed?	6. Must a proportion of surplus be set aside to reserves?	7. Are reserves indivisible on a winding up?	8. Is conversion to a company permitted?	9. Are indivisible reserves protected on conversion to a company?	10. What are the legal advantages of indivisible reserves?
						apparent reference				conversion not permitted	advantages
5	Czech Republic	No	Yes	Yes	Variable	No apparent reference	No.	No.	Yes	No apparent reference	None
6	Denmark	No	No.	Yes.	Variable	No	No.	No.	No provision	No	Limited tax benefits
7	Estonia	No	Yes	Yes	Variable	No apparent reference	Yes.	No.	No apparent reference	No apparent reference	None
8	Finland	No	Yes	Yes	Variable	Yes	Yes	Probably not.	Yes	Presumably not	Some other tax advantages

	Member state	1. Does the constitution refer to coops? ²	2. Are there separate laws to govern coops?	3. Are co-operatives defined?	4. What is the nature of capital?	5. Are “investor members” allowed?	6. Must a proportion of surplus be set aside to reserves?	7. Are reserves indivisible on a winding up?	8. Is conversion to a company permitted?	9. Are indivisible reserves protected on conversion to a company?	10. What are the legal advantages of indivisible reserves?
9	France	No	Yes	Yes	Variable	Yes	Yes	Yes	Yes	Yes	Tax exempt. Other significant tax advantages
10	Germany	No	Yes	Yes	Variable	Yes	Yes	No, unless provided in the by-laws	Yes	No specific information	Limited tax advantages
11	Hungary	No	Yes	Yes	Variable	Yes, if allowed by the statutes	Yes.	Yes	Yes.	Yes	Tax free up to a limit
12	Ireland	No	Yes	No	Variable	Nothing specified.	No	No	Yes	No	No significant advantages
13	Latvia	No	Yes	Yes	Variable	Nothing specified	Yes	No	No apparent reference	No apparent reference	None

	Member state	1. Does the constitution refer to coops? ²	2. Are there separate laws to govern coops?	3. Are co-operatives defined?	4. What is the nature of capital?	5. Are “investor members” allowed?	6. Must a proportion of surplus be set aside to reserves?	7. Are reserves indivisible on a winding up?	8. Is conversion to a company permitted?	9. Are indivisible reserves protected on conversion to a company?	10. What are the legal advantages of indivisible reserves?
14	Lithuania	No	Yes.	Yes	Variable	No apparent reference	Yes	No, unless provided in the by-laws	Yes.	No, unless in by-laws	Limited tax benefits
15	Luxembourg	No	Yes	Yes.	Variable	No provision	Yes	No, unless provided in the by-laws	Yes	No	None
16	Netherlands	No	Yes	Yes	Variable	Yes	Yes	No, unless provided in the by-laws	Yes	No information	Limited tax advantages
17	Norway	No	Yes	Yes	Variable	No provision	No	No, unless provided in the by-laws	Yes	No information	None
18	Poland	No	Yes	Yes	Variable	No	Yes	No	Yes, but limited	No	None

	Member state	1. Does the constitution refer to coops? ²	2. Are there separate laws to govern coops?	3. Are co-operatives defined?	4. What is the nature of capital?	5. Are “investor members” allowed?	6. Must a proportion of surplus be set aside to reserves?	7. Are reserves indivisible on a winding up?	8. Is conversion to a company permitted?	9. Are indivisible reserves protected on conversion to a company?	10. What are the legal advantages of indivisible reserves?
19	Romania	No	Yes	Yes	Variable	No provision	Yes	Yes	No express reference	No information	None
20	Slovakia	No	Yes	Yes	Variable	No provision	Yes	No	Yes	No apparent reference	None
21	Slovenia	No	Yes	Yes	Variable	No provision	Yes	No, unless provided in the by-laws	Yes	No	None.
22	Sweden	No	Yes	Yes	Variable	Yes	Yes	No	No provision	No.	Limited tax advantages
23	UK	No	Yes	No	Variable	Yes.	No for coops;	No for coops;	Yes	No	None

	Member state	1. Does the constitution refer to coops? ²	2. Are there separate laws to govern coops?	3. Are co-operatives defined?	4. What is the nature of capital?	5. Are “investor members” allowed?	6. Must a proportion of surplus be set aside to reserves?	7. Are reserves indivisible on a winding up?	8. Is conversion to a company permitted?	9. Are indivisible reserves protected on conversion to a company?	10. What are the legal advantages of indivisible reserves?
							yes for community benefit societies	yes in community benefit societies			