

# Memorandum

**Date** 26 November 2021  
**Matter no.** 2104166  
**To** Co-op Start Up  
**From** David Goodman  
**Subject** Standard company constitution for a co-operative registered under the Co-operative Companies Act 1996

## Background

- 1 The attached draft constitution is for a company to be incorporated under the Co-operatives Companies Act 1996 (**Act**). Please note that not all companies which are operated on a co-operative philosophy are necessarily co-operatives registered under the Act. You will need to consider whether a simple company (under the Companies Act 1993) is sufficient for your purposes.
- 2 The draft constitution is designed to assist parties who are considering becoming a co-operative understand the key issues they need to consider when preparing a constitution. It is recommended that anyone seeking to establish a co-operative under the Act seek legal advice.

## Principle activity (clause 3)

- 3 Section 2 of the Act defines a co-operative company as a company, which "*the principle activity of which is, and the state of the constitution has been, as co-operative activity and in which not less than 60% of the voting rights are held by transacting shareholders*".
- 4 Clause 3.1 of the constitution sets out the principle activities of the company which the company relies on to fall within the definition of a co-operative company. This can include the supplying or providing shareholders of the company of goods and services, or both, or providing goods and services to the shareholders.
- 5 Careful consideration will need to be given to how the principle activity of the company is defined for the company to fall within the definition of a co-operative company.
- 6 It should be noted that under section 3(2) of the Act, a company can carry out co-operative activities through a subsidiary and it is not necessary for it to carry out the activity itself (see clause 3.2).

## Shares (clause 4)

- 7 A co-operative may have a number of classes of shares. Full consideration will need to be given to the number of classes of shares and in particular the shares issued to its "transacting shareholders".
- 8 The draft constitution assumes one class of shares, which for the purposes of this draft is called "member shares". Depending on the nature of the co-operative, classes of shares could variously be called "supply shares", "purchaser shares", or any other name that might be appropriate given the nature of the co-operative and the goods and services either provided or purchased by the co-operative.
- 9 The constitution will need to set out the eligibility criteria for a person or entity to become a shareholder in the company. As noted for the company to be a co-operative, 60% of the shareholders will need to be "transacting shareholders" and as such the eligibility criteria will be linked to either goods or services that the company will provide the shareholder, or the

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shareholder will provide the company. For example, in a wine processing co-operative, the holders of supply shares may need to be wine growers within a certain region.

- 10 Typically a co-operative constitution will provide the board with strong powers in relation to who they issue shares to, to ensure that the shareholders meet the necessary eligibility criteria (see clause 4.3(d)).

## Services or supply agreements

- 11 A key part of a co-operative will be the relationship between the constitution and the agreement with transacting shareholders for the goods or services supplied by the company to transacting shareholders, or by the transacting shareholders to the company.
- 12 It should be a requirement that shareholders enter into and are bound by the agreement (called in this case "Members Supply Agreement") and that any supplied goods or services, or purchase of goods and services is conditional upon that agreement being entered into (see clause 4.8).

## Nominal value of shares

- 13 One of the key advantages of a co-operative is the ability under section 15 of the Act to issue shares at a nominal value which need not be necessarily at fair value. The idea is that a co-operative's ability to issue shares at a nominal value allows it to encourage membership and the greater the number of members, the stronger the co-operative.
- 14 From a member/shareholder point of view, they are more concerned about the co-operative providing cost effective goods or services, or receiving a good price for the goods or services they provide the co-operative, than the value of their shares and any dividend.
- 15 The nominal value for the shares must be specified in the constitution, but can be reviewed and amended annually by special resolution at the company's annual general meeting.
- 16 As the capital structure of a co-operative is significantly different from the capital structure of an ordinary company, it is important to receive specialist accounting advice before deciding on the capital structure of the co-operative company.

## Maximum and minimum holdings

- 17 Typically a co-operative constitution provides for the board to determine a maximum and minimum number of shares held in the co-operative. The board may determine a maximum to limit the degree of control by one member and a minimum to ensure that there is a minimum capital investment by new members in the company.

## Pre-emptive rights

- 18 There is typically no pre-emptive rights either in relation to the issue of shares or the transfer of shares in a co-operative.

## Rebates

- 19 Another advantage of a cooperative company is the ability of the company to rebate profit to the shareholders rather than declare a dividend. It should be appreciated that rebates can be a mechanism by which to encourage certain behaviours by members (i.e. the greater the level of through put by the member to the company, the higher the rebate). However, it should be noted that rebates represent taxable income in the member's hands and do not carry imputation

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credits in the same way that dividends can. Again, expert accountancy advice should be sought prior to finalising the company's rebate structure. The constitution is designed simply to give the company the ability to provide rebates if they so wish.

## **Surrender of nominal value shares**

- 20 It is important for a co-operative company to control its shareholder base to ensure its existence as a co-operative company. As such, a co-operative company has the power to require the surrender of shares by a shareholder for the reasons set out in the Act and in the constitution. Typically, these include the shareholder ceasing to be a "transacting shareholder" or breaching the terms of their member services agreement.

## **Shareholder meetings**

- 21 Consideration will need to be given to the appropriate number of shareholders present at a meeting to establish a quorum. This provision applies for co-operative and non-co-operative companies equally. As co-operatives tend to have a broad shareholder base, it is important not to have a quorum level that is too low to be too easily satisfied and not too high to be impractical.

## **Directors**

- 22 Consideration will need to be given to the number of directors, and the minimum and the maximum number of directors.
- 23 Typically, with a co-operative, there will be rotation provisions for the directors to ensure directors regularly retire, and place themselves up for re-election if they wish.
- 24 The provisions may be tailored to provide that directors may be members of the company, or alternatively provide for independent directors outside of the company.