

National Co-op UPDATE

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GIVE CO-OPERATIVES A 'FAIR GO' SAYS SENATOR

QUEENSLAND Senator **Ron Boswell** has congratulated the co-operative movement for its effort in defeating the budget plan to remove benefits accruing to co-operatives under Section 120(1)(c) of the Tax Act.

Speaking at the Queensland co-operatives' conference, Senator Boswell said it may have been a "fleeting brush of the pen" for treasury officials, but removal of these benefits may have been the beginning of the end for Australian producer-owned co-operatives.

Disadvantaged

He said the campaign brought out the disadvantaged position of co-operatives compared with large multi-national or national companies.

The deductions under Section 120 were the means by which co-operatives could plan for capital expansion to gain international competitiveness, Senator Boswell said.

"Corporations have obvious advantages such as access to dividend imputation and low-cost equity borrowings from trading banks. Franking credits that would normally go to companies go straight to treasury with co-operatives," he said.

Without Section 120, he said, many co-operatives would have been forced almost immediately to go public or bring in foreign investors.

"Australian producers would have lost control and become mere commodity suppliers and price takers ... serfs serving outside masters within their own industry," he said.

SNAPSHOT

Senator Ron Boswell says the campaign to defend co-operative tax benefits highlighted the disadvantaged position of co-operatives compared with large multi-national or national companies.

"As was realistically pointed out to a Senate inquiry on the issue, a number of large co-operatives have had takeover offers from multi-national companies in recent years.

"The same multi-nationals are buying strategic holdings of land with vertical and horizontal processes for the goods co-operatives produce.

"Directors would have little alternative at law but to recommend acceptance of a takeover bid if the incentive is not there to be an Australian business."

Senator Boswell said Australian Dairy Industry Council chairman, **Pat Rowley**, had warned that farmer-owned dairy co-operatives could be swamped by multi-national companies.

Mr Rowley has said balance would need to be kept between the co-operatives and multi-national proprietary companies if farmers were to retain some involvement in the processing sector and not just become sellers to it.

Foreign investment

Senator Boswell said the latest Foreign Investment Review Board annual report had shown that foreign investment in Australia was at its highest level ever in 1996.

"Over the past year, foreign investment in manufacturing has gone from \$3.3 billion to

\$17.2 billion," he said.

"The main competitors facing co-operatives in Australia are multi-nationals with enormous funds at their fingertips."

Food processing is one of the largest sectors of the Australian economy with sales of \$64 billion.

The senator said that while it may not be in Australia's interest to stop foreign investment in the food industry, it was in its interest to strengthen Australian co-operatives that keep returns with the producer, the co-operative and, very often, the local community.

Capital gains tax

He said other areas needing attention included allowing co-operatives to merge and capital gains tax relief when these mergers occurred.

Another important area involved the co-operative movement disseminating its own success story.

Senator Boswell conceded that Australia had always been divided in its support for co-operatives, but said there was a totally convincing argument that it is in the national interest that co-operatives survive as a strong component of the national economy.

"Co-operatives have proved to be enduring, adaptable and innovative structures that will remain so, providing they are given a fair go." □

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WHOSE SIDE IS THE BOARD ON?

'John Smith' retired from the board of his local co-operative confident he'd done the job well. The new board disagrees. John soon finds that defending himself might send him broke. Find out more on page 6.

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LEGISLATION CLARIFIES CO-OPERATIVE ISSUES

THE PROPOSED new co-operatives legislation in Queensland is long overdue and represents a distinct improvement in a number of significant areas, according to **Jeremy Martineau**.

It also offers some real and welcomed encouragement for co-operatives to keep their co-operative status, he says.

In particular, the Act will have a significant impact on the various 'stakeholders' in a co-operative, particularly directors' duties and corporate governance issues, which are being brought into line with the 'normal' company principles of corporations law.

This is welcomed, Mr Martineau says, as the existing legislation in this area is antiquated and inadequate.

The Bill also addresses the issue of fundraising.

The ability to raise capital commensurate with the scale of business operations remains a major concern for many co-operatives. Mr Martineau says anything which is likely to facilitate fundraising can only help put the co-operative sector on a nearly level playing field with its corporate competition.

Flexibility in fundraising

In future, co-operatives will be able to issue members with different classes of shares and recognise possibly differing interest groups among their membership.

Shares will still not be available to non-members, but they will be able to hold what the legislation refers to as 'subordinated debt' in the same way as companies. Subordinated debt is a flexible instrument and may be used as 'gearable' capital under Reserve Bank rules; the ASX has now proposed that subordinated debt issued by co-operatives should qualify for listing.

The ability to issue different classes of shares to members gives co-operatives flexibility in organising their internal financing arrangements, something which has not been available to them in the past, Mr Martineau says.

He suggests a practical application for this might be the creation of separate share classes to reward the holders on the basis of patronage and/or their financial investment in the co-operative, perhaps with fixed preferential dividends similar to those which might be paid by a company on preference shares.

In the area of mergers, he says the Bill's most significant features are specific provisions dealing with mergers involving co-operatives in other states and overseas.

SNAPSHOT

Jeremy Martineau, a solicitor with McCullough Robertson in Brisbane, discusses the application of the new Queensland co-operative legislation and highlights the benefit of co-operatives over conventional company structures. He spoke at the Co-operative Federation of Queensland's conference in April.

These provisions recognise that business – and not just big business – must increasingly compete globally, he said.

Tax status

Late last year, the Federal Government considered removing the opportunity for tax deductions under Section 120(1)(c), which allows repayments of principal to government or government-controlled lenders. However, as a result of pressure from the co-operative sector, the government relented at the last minute.

The tax position has now, in fact, been improved because the government has rejected the Tax Office's view that the deduction is only available when loan finance from a government source is used to buy assets from government. Now it does not matter who the assets are bought from – only that monies borrowed from a government source are used to acquire them.

The lesson here, Mr Martineau says, is that the co-operative lobby group can be highly effective when its efforts are closely focused on an issue as important as this one.

However, he had a word of warning on the subject of Section 120(1)(c), in view of the new legislation's subordinated debt provisions.

Tax deductions under Section 120(1)(c) depend on suppliers holding no less than 90% of the paid-up capital. However, there is no statutory guidance or help in case law as to the meaning of 'paid-up capital', therefore there is no assurance that subordinated debt is not included within it. The answer may depend on the terms of the subordinated debt in question.

Co-operative advantages

A co-operative may possibly be a suitable vehicle for investment purposes, Mr Martineau says, particularly for primary production ventures where there is a natural active supply relationship.

Combining a co-operative vehicle

with co-operative tax status and a primary production business could also result in a highly tax-effective structure and effectively add value to the basic business venture itself, he says.

According to Mr Martineau, the main advantages of co-operative status are:

- co-operative values and culture; and
- stability.

A highly stable business structure, coupled with the advantages of co-operative tax status and the new framework proposed under the Co-operative Bill, could considerably improve the attraction of co-operatives as a business vehicle, he said.

A comparison

Mr Martineau lists four key differences between co-operatives and companies:

- **Active membership** – membership depends upon an active relationship. The requirement for members to have an active relationship with the co-operative is reinforced by the further requirement in the new legislation for the rules to contain what are referred to as "active membership provisions".
- **Spread of ownership** – there are limits on ownership concentration in a co-operative which do not apply to companies. The new legislation imposes a maximum 20% shareholding in a co-operative (taking all classes of shares together) in favour of any one person. There is no such maximum shareholding which applies in the case of a company.
- **Basis of voting entitlement** – in a co-operative, voting is strictly on the basis of one vote per member and this will continue to apply with the new legislation, although it does permit a member of an association or a federation to have as many as five votes at a general meeting if the rules so provide. In a company, though, voting entitlement is in accordance with the number of shares held.
- **Exit** – a co-operative structure offers retiring members an in-built exit mechanism. There is no such mechanism in an unquoted company, except by agreement either in the articles or otherwise. Members' shares are repaid when they cease to be members. Membership in turn depends on continuation of an active relationship. This means that when the relationship comes to an end, shares must (broadly speaking) be repaid automatically in order to ensure that all members remain active members.

Other things being equal, these four factors can make for an inherently more stable structure than a company; one which offers a better prospect of retaining local ownership and control in core sectors of Australian business, Mr Martineau says. □

CONTACT

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ACCORDING TO THE RULES

THE NEW Queensland co-operatives legislation and rules aim to abolish the distinctions between registered co-operative societies and registered primary producer co-operatives, to make it possible to talk generally about 'co-operatives'.

However, **Britt Maxwell** says, the legislation does provide for two basic 'types' of co-operatives – trading and non-trading.

The difference is simply that the type of co-operative is defined by its rules rather than its certificate of registration, Ms Maxwell says.

When the new legislation takes effect, a body corporate that is now a society under the Co-operatives and Other Societies Act 1967 or an association under the Primary Producers' Co-operative Associations Act 1923 will become a "co-operative registered under the Act".

All co-operatives together

All trading societies, investment societies, community settlement societies, community advancement societies, mutual group buying societies and primary producing co-operative societies (whether they have share capital or not) will be 'co-operatives'.

A co-operative then has two years (or a period allowed by the registrar), to conform with the legislation.

The rules will be valid for that period and a co-operative bound by the provisions of the Act in relation to the procedures required to change the rules. In addition, the registrar will have the power to help co-operatives make their rules conform with the Act, Ms Maxwell says.

Each co-operative will then decide what type it is by changing its rules.

"The rules are very important to the internal governance of a co-operative, much

SNAPSHOT

New co-operative legislation dominated discussion at the Co-operative Federation of Queensland's annual conference. Britt Maxwell, a solicitor with Corrs Chambers Westgarth, discussed the 'rules' forming part of the new act and the powers they can bring to co-operatives.

more so than the memorandum and articles are to a company. The rules are the avenue for members to decide how they wish to co-operate, and what powers and procedures (within limits) they wish to be governed by," she says.

In several instances, existing co-operative rules are in conflict with the new Act, especially in relation to the rights and duties of co-operative members.

Under the new legislation, the rules will produce a contract under seal between:

- the co-operative and each member;
- the co-operative and each director, the principle executive officer and the secretary; and
- a member and each other member.

The matters that must be contained in the rules are found in Schedule 1 of the Act.

These are not substantially different from those matters now required under existing co-operatives legislation in Queensland. However, a substantial difference is the abolition of *ultra vires*, Ms Maxwell says.

In current legislation, each type of co-operative has a list of objectives and, usually, the necessary powers to perform those objects. If a co-operative performs an act that does not lie within one of its objects or powers, it is said to have acted *ultra vires* or 'beyond power' and the action is invalid.

"This generally makes the financial institutions nervous because they are not always aware of when the co-operative is acting within its powers, especially as the co-operative's corporate cousin has for a number of years had all the powers of a natural person and is not hamstrung in the same way," Ms Maxwell says.

The new legislation gives co-operatives all the powers of a natural person. A co-operative may restrict those powers (e.g. the amount of money the co-operative may borrow) and it may add additional powers that a natural person does not possess (e.g. the ability to take money on deposit).

"The catch is that, until the co-operative changes its rules, the current objects and powers are read as a restriction upon the co-operative's powers. You must change your rules to remove the restrictions on your powers," Ms Maxwell said.

New powers

Ms Maxwell said many new powers under the legislation were not available to a co-operative unless they were expressly adopted in the rules. For example:

- Contracts with members – the rules may contain provisions that require a member to have specified dealings with a co-operative for a fixed period and to enter into a contract for that purpose.
- Compulsory share issues or loans – if authorised by the rules, the board may require a member to take up additional shares or require members to lend money to the co-operative. The power may only be availed if approved by a special resolution of members, but the head of power must first appear in the rules.
- Distribution of surplus and reserves – the rules of a trading co-operative must generally make provision for the distribution of surplus, but the rules may also make provision for the distribution of "part of the reserves" by way of rebate, dividend or bonus share. □

THE WALLIS Committee report on the banking and finance sector has been applauded by Australia's peak credit union body, Credit Union Services Corporation (CUSC).

CUSC' chief executive, **Dr Vern Harvey**, says the recommendations recognise the significant competitive role of Australia's credit unions.

"The report recognises that credit unions have achieved a high prudential standing as safe and secure financial institutions," he says.

"Credit unions are Australian-owned, customer-focused institutions. This report recommends getting rid of

CREDIT UNIONS WELCOME WALLIS REPORT SUPPORT

costly and discriminatory regulatory hurdles handicapping our ability to compete."

According to Dr Harvey, implementation of the report will be a milestone for the credit union movement.

"The Wallis inquiry recommendations will ensure that credit unions hold equal status with banks by bringing them under a single national regulatory structure," he says.

"The committee has emphasised the need to allow mutu-

ally structured institutions such as credit unions to become major participants in the financial sector."

Dr Harvey says he welcomed the report's observations that: "The traditional focus of the board and management of a mutual is maximisation of benefits to members.

"Only credit unions remain a purely mutual industry in the Australian financial system. In contrast, in Europe and Canada, some 20% of banking

is conducted by mutual institutions and the largest bank in Europe is a mutual."

Credit unions have argued strongly that their state-based regulatory system needs urgent reform to allow credit unions to exert a competitive influence on the major banks.

He says the Wallis committee supports "in all respects" the recommendations made by CUSC on behalf of the credit union industry. However, he warns that the release of the report is just the first hurdle.

"We must now ensure that the report's recommendations are implemented quickly with a smooth transition to a national prudential regime," he says. □

NEWS FROM AROUND AUSTRALIA

NATIONAL

National support for co-operative legislation

The Co-operative Council of Australia (CCA) has given 'in principle' support to consistent legislation, with certain core provisions to apply in every state and territory in Australia.

CCA chairman, **Jim Howard**, says it is fundamental for the co-operative movement to support the progress of the legislation.

"It is a unique opportunity to ensure that co-operatives everywhere achieve at least 95% of what they require in modern legislation across Australia," he says.

"The Bill provides unparalleled progress for co-operatives in terms of interstate operations, fund raising and the mechanism for creating new co-operatives across Australia."

Mr Howard says discussions have already commenced with state officials in each area of the Bill's influence, while individual states will progress minor non-core issues appropriate to their state at their discretion.

CONTACT: JAMES HOWARD, CO-OPERATIVE FEDERATION OF QUEENSLAND, (07) 3355 3331 OR FAX (07) 3855 1113.

TASMANIA

New Act on the way

Tony Wright, registrar of Co-operatives with the Tasmanian Corporate Affairs Office in Hobart, says preparations are under way for the introduction of a new Tasmanian Co-operative Act.

Peter Maloney, director of legislation, policy and information resources with the Corporate Affairs Commission, has been closely monitoring the issue and believes the legislation should be introduced into the Tasmanian Parliament during its August/September session.

"A cabinet decision was made in early May to proceed with the legislation and hopefully we can get the legislation through the lower and upper house in the same sitting," he says.

While a number of co-operatives have indicated a passing interest when lodging returns with the registrar, Mr Maloney says the level of interest shown by Tasmanian co-operatives has been low.

"The Victorian Office of Fair Trading produced an executive summary of the Bill. We sent that to every co-operative in Tasmania asking for comment, but only three co-operatives responded. Those that did respond were supportive of the Bill," he says.

The interstate trading arrangements contained in the new legislation may increase interest in this area, as mainland co-operatives look to broaden their market by setting up their own trading operations in other states.

CONTACT: TONY WRIGHT, REGISTRAR OF CO-OPERATIVES, (03) 6233 3789, FAX (03) 6224 0743.

VICTORIA

Credit union goes bush

Victorians had cause to celebrate in early May, with the arrival of the first credit union to replace a bank in a Victorian country town.

Mark Genovese, operations manager with CreditCare, said the official opening of Enterprise Credit Union's branch in Rosedale was a breakthrough for regional Victoria.

"The credit union has filled a void left by the ANZ Bank, following its closure in August last year. Rosedale, in Victoria's Gippsland region, was without banking facilities for nine months," he said.

CreditCare is a co-operative joint venture between the Common-

wealth Government and Credit Union Services to assist rural Australia (including Aborigines and Torres Strait Islander communities) in regaining access to essential financial services.

CreditCare works with communities which have lost their last bank to determine the viability of extending credit union services to the towns. So far, credit unions have replaced banks in 29 locations around Australia.

A recent study by CreditCare quantified the serious impact bank branch closures can have on rural communities. Without some form of banking facilities, some country towns are in danger of becoming ghost towns.

CONTACT: CREDITCARE, (02) 9333 7374.

SOUTH AUSTRALIA

SA Act draft nears

The proposed new Co-operative Act for South Australia is still in the process of being drafted and will be made available to the SA Federation for comment in the near future.

Co-operative Federation of SA secretary, **David Osgood**, says it was anticipated that the SA Act would be introduced into state parliament during the autumn session, but delays make it unlikely that the original July 1, 1997, deadline will be met.

Conference anyone?

The Co-operative Federation of SA is calling for expressions of interest to attend a full-day seminar/conference on developments in the co-operative sector. It is important to gauge the level of interest from co-operative members in SA to facilitate successful organisation of the event.

CONTACT: DAVID OSGOOD, CO-OPERATIVE FEDERATION OF SOUTH AUSTRALIA, (08) 8216 5520 (MON/TUES) OR FAX (08) 8362 7455.

NEW SOUTH WALES

NSW Co-operatives Act

The NSW government is moving to amend the Co-operatives Act by the end of June to include core consistent provisions, bringing it into line with legislation in other states and territories.

The changes are designed to facilitate interstate membership of co-operatives and make it easier for co-operatives to compete with companies which are not restricted by state boundaries.

The NSW Department of Fair Trading is consulting with the federation on these changes, which are also the subject of discussion between interstate co-operative federations.

The NSW Federation is planning seminars later this year to assist co-operatives adjust to the new legislation.

Trading places

The Department of Fair Trading may become known as the Department of Trading Places if recent changes to its co-operative branch are any indication.

David O'Connor has been appointed acting director and registrar of co-operatives, replacing **Dr Liz Coombes**, who returns to the Premier's Department.

Dr Gul Izmir, past director of fair trading strategy (incorporating the co-operative policy unit), has left the department to be replaced in an acting capacity by **Susan Dixon**.

Nick Munk, chief policy officer with the Co-operative Policy Unit, has left the unit to join the NSW Department of State and Regional Development.

People on the move

Duncan Maclellan, chief executive officer of the University Co-operative Bookshop, has been elected to the board of the Co-operative Federation of NSW.

NSW Federation consultant, **Don Kinnersley**, said Mr Maclellan brings the interests of the retail sector (a significant sector of the co-operative movement) to the board, as well as strong personal skills which will strengthen the board's ability to develop policies and guide the federation.

Strategic directions and priorities

The NSW Co-operative Federation met recently to review its performance during the 3½ years of its existence. As a result of discussions, the following goals were set for the next two years:

- significantly lift the profile of the federation;
- increase membership;
- develop an appropriate training program for directors and managers;
- strengthen the Co-operative Council of Australia's approach to national issues; and
- review the board and management structure.

CONTACT: DON KINNERSLEY FAX/PH (02) 9975 7228. THIS IS A NEW NUMBER AND MR KINNERSLEY'S NEW ADDRESS IS: 2 CHATHAM CLOSE, BELROSE, NSW 2085.

Energy co-op feasibility study

Following an initiative of the NSW Federation, a feasibility study is under way into the benefits to the local community of forming an 'energy purchasing co-operative' involving a large NSW dairy co-operative which is a significant user of electricity.

Norco Co-operative on the north coast of NSW has agreed to be part of the study. Norco's farmer members, residents of the north coast in Lismore and adjacent towns, will also be potential beneficiaries of the proposal.

The study is being funded by the Department of Fair Trading and the Sustainable Energy Development Authority.

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QUEENSLAND

Co-operatives Bill (Qld)

The Co-operatives Bill 1997 (Qld) has been tabled in the state's parliament and is scheduled to be passed at its next sitting. The Co-operative Federation of Queensland believes it has bipartisan support for the legislation.

Community co-operative training

Community co-operatives were the focus of a weekend training session held at Luther Heights, Coolool, from May 16 to 18.

Britt Maxwell, from legal firm Corrs Chambers Westgarth; Queensland's registrar of co-operatives, **Paul Kerr**; and **James Howard** from the Co-operative Federation of Queensland addressed delegates on the new legislation, the image of co-operatives and the co-operative movement's aspirations for the future.

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AGRICULTURAL LEADERS GET DOWN TO BUSINESS

THE THEME for the agricultural co-operative leaders forum was 'Increasing the competitiveness of agricultural co-operatives' and the proceedings from that seminar have recently been published.

The NSW Federation is organising another seminar in November on fund raising for co-operatives.

NSW Co-operative Federation consultant, **Don Kinnersley**, says that while events such as the leaders forum have been useful in terms of understanding what is happening overseas, the Australian co-operative sector needs to get down to the nitty gritty of what are we going to do in Australia.

He hopes the November seminar will discuss the options for fund raising and how these can be handled in Australia under the new legislation.

The 1996 forum was divided into three sessions:

- **Funding for value adding**, where Don Kinnersley presented a paper by **John Tyrrell**, director-general of the Irish Co-

SNAPSHOT

During last year's Co-operative Week in NSW, the Co-operative Federation of NSW, Registry of Co-operatives and Commonwealth Department of Primary Industries and Energy joined forces to organise an Agricultural Co-operative Leaders Forum.

operative Organisation Society in Ireland, which looked in detail at the funding methods pursued by Irish co-operatives.

Professor Gert van Dijk, director of the National Co-operative Council for Agriculture in Holland, discussed innovative funding options for agricultural co-operatives in Europe.

Formal presentations were followed by extensive discussion of the issues in an Australian context.

- **Global strategies for success in the 21st Century** with presentations on the global success of Danish agricultural co-

operatives and an insight into customer requirements from global suppliers by **Isao Takamura**, president of the Japanese Consumers' Co-operative Union.

Topics included changing attitudes to trade barriers, the role of joint ventures, strategic alliances and mergers in international marketing, and the opportunities for Australian agricultural co-operatives as world suppliers.

- **Corporate governance in co-operatives** with **Dr Glenn Webb**, chairman of Growmark in the US, outlining co-operative governance models in his country and Australia's own **Bill Hill**, then chairman of Bonlac Foods, outlining the Bonlac model of corporate governance.

Issues discussed included effective new board structures, selection and remuneration of board members, changing legal obligations of directors, regional versus universal representation, communication for member involvement and the importance of educating directors in co-operative culture and values.

While the presentations all contained valuable insights into the topics addressed, just as valuable was the candid discussion of the issues by the co-operative managers and directors who were at the forum.

CONTACT

Don Kinnersley on fax/ph (02) 9975 7228.

LEAVING THE BOARD BEHIND ... BUT NOT THE LIABILITY

JOHN SMITH is a successful dairy farmer. He milks more than 1000 cows and his hi-tech farming operations are the envy of the industry. He also served as a director of the Golden Valley Co-operative during its evolution from a small dairy co-operative to a substantial Australia-wide dairy food manufacturing business.

However, his success won him enemies.

He was narrowly voted out of office as a director in 1995 after an acrimonious election campaign led by a dissatisfied shareholder faction group who called themselves the Dairy Action Group (DAG).

The election of three DAG-nominee directors and the mysterious defection of the existing board chairman to the DAG camp resulted in the board of the society being controlled by DAGs.

With their new-found power, the DAG directors initiated investigations into certain transactions by the co-operative in 1995 while Mr Smith was a director.

Allegations were raised that Mr Smith and his fellow directors of the time had not properly discharged their duties and had acted negligently.

Mr Smith was confident that he had discharged his duties properly.

While he was a director, he had read the monthly board papers, attended the board meetings, asked probing questions of senior management and made sure the society's lawyers gave advice on tricky matters. All must be well, he thought.

In any case, he felt that he had the fall-back security of an indemnity from the society itself – there was something in the rules of the society that said so, he recalled.

Then there was the society's Directors and Officers Liability (D&O) insurance policy that covered all the directors. Now, there was real protection, he was sure.

Nevertheless, Mr Smith knew that it requires a great deal of inexperience to be beyond the reach of anxiety, so he went to see his lawyer.

Reality bites

Mr Smith's lawyer didn't share his confidence. His basic message was that the board of which Mr Smith was part should have taken action earlier ... when you're thirsty, it's too late to think about digging a well.

Board papers

The first problem was that Mr Smith didn't have a copy of any of his board papers. At the time, he didn't see any point in filling his garage with old papers.

SNAPSHOT

Solicitor, David Ferguson, takes us backstage in a story of power and revenge. All directors would do well to heed the lessons and avoid becoming the star of their own courtroom drama.

His lawyer pointed out that, in the absence of these board papers, it would not be easy to demonstrate that Mr Smith had carried out his duties.

He would have to rely on the society to have kept not only minutes of board meetings (which it must do under section 219 of the Co-operatives Act) but also the related board papers which had been circulated to directors. These would demonstrate what Mr Smith then knew and, perhaps more importantly, what was withheld from him.

The lawyer anticipated that the society, under its DAG-controlled board, would be unlikely to co-operate and Mr Smith may have to wait until court proceedings had started and the expensive court process used before he could get access to the society's documents.

Further, the society would resist handing over any legal opinions the society had received in 1995 and which had been relied upon by Mr Smith and the other directors at the time.

Indemnity in rules

The second problem, the lawyer advised, was that the society's rules providing indemnification were probably of no use to Mr Smith at all.

By virtue of section 106 of the Co-operatives Act, the rules of a co-operative are a contract between the co-operative and each director. However, because Mr Smith was no longer a director, he was not a party to that contract and could not enforce it.

Anyway, the lawyer told Mr Smith that the indemnity is for liability – it does not cover

Without funding from either the society or the D&O policy, John Smith had to fund his own defence. The wolf was at his door so often he called it 'Rover'.

the looming legal bill for defending the action.

Even if he could take advantage of the rule on some equitable principle, the rule would not provide Mr Smith with defence costs. Instead, the rule expects Mr Smith to fund his own defence, win, and then seek reimbursement from the society.

D&O policy

So far it was bad news for Mr Smith, but there was still the D&O policy, which would provide both indemnity and defence costs.

His lawyer contacted the D&O insurer. More bad news.

While the insurer was not forthcoming as to what led to it, the policy was not renewed by the society when the policy came up for annual renewal six months after Mr Smith ceased to be a director.

Accordingly, Mr Smith did not have D&O coverage because, as with most D&O policies, it was a 'claims made' policy. This meant that Mr Smith had to have a current D&O policy at the time of the claim, not the earlier time at which events occurred over which he was about to be sued.

Mr Smith felt a distinct global warming in his world.

What happened?

Mr Smith was sued, along with a lot of other people.

He got access to a lot of Golden Valley documents, but he was never sure if it was all of them.

He had difficulty reassembling them to demonstrate what information he was given as a director and what information and documents he was not shown. He never got access to a critical 1995 legal opinion that the society had received.

The real crunch for Mr Smith was that, without funding from either the society or the D&O policy, he had to fund his own defence. The complexity and length of the proceedings took their toll financially.

Ignorance of the law is what keeps our appeal courts functioning. So it was that Mr Smith's case, with all its many parties, went on appeal.

By that stage, Mr Smith was not concerned; he had developed 'combat fatigue' in his private war with financial survival. The wolf was at his door so often he called it 'Rover'.

What should have been done?

What else could Mr Smith have done to put himself in a better position when the litigation emerged two years after he left the board? The following are some suggested steps.

Step 1: Keep board papers

Mr Smith should have kept all the board papers and other documents he received from the society. He should have planned

to keep them for at least seven years after he had left the board of the society.

Step 2: Access deed

If Mr Smith hadn't been prepared to keep a copy of all his board papers, he should have suggested that the society enter into a deed with its directors to the effect that:

- (a) The society must keep a complete set of all board papers, in chronological order, in suitable secure custody during the access period.
- (b) A person who is or has been a director is entitled to access to the board papers and to receive a copy of any of them, at no cost to him, on request during the access period.
- (c) Where the board papers include any information to which legal professional privilege attaches, that person is still entitled to a copy of the relevant documents, but on the basis that he cannot waive the privilege unless he is a party to proceedings by any person.
- (d) For these purposes:
 - (i) 'board papers' includes not only those documents circulated to a director during his directorship, but also all documents of the society referred to in any of those documents; and
 - (ii) 'the access period' is the time from when a person first becomes a director through to seven years after he ceases to be a director of the society.

Step 3: Indemnity and defence costs

Whether or not steps 1 and 2 were implemented, Mr Smith should have suggested to the society that it enter into a deed with its directors to the effect that:

- (a) The society must indemnify the directors against any liability incurred by Mr Smith as a director of the society.

A commercial prerequisite to those steps which involve the taking out of insurance is the availability of such insurance.

- (b) The society must pay all reasonable defence costs in relation to any claim alleging any liability on the part of a director of the society.
- (c) The exclusions from (a) and (b) are:
 - (i) if to do so would be prohibited by section 228 of the Co-operatives Act; or
 - (ii) to do so would be prohibited by any other statutory provision or the common law.

Alternatively, Mr Smith could have required the society to obtain an insurance policy under which its present and past directors are covered against costs incurred in defending litigation.

This would have had the benefit of avoiding the significant restrictions on the society's ability to indemnify Mr Smith, as insurance policies are not subject to the limitations imposed by section 228.

Step 4: On-going D&O coverage

Whether or not steps 1, 2 and 3 were implemented, Mr Smith should have suggested to the society that it enter into a deed with its directors to the effect that:

- (a) The society must maintain coverage of directors under a D&O policy for a period of seven years after the individuals cease to be directors of the society, that D&O policy being on terms not materially less favourable than the terms in the policy operating at the time the person ceases to be a director of the society.
- (b) The society must pay the premiums in

respect of that coverage for these people.

- (c) The society must provide the individuals with a copy of the insurance policy each year as soon as it is renewed.

Some qualifications

These suggested steps which Mr Smith could have pursued in 1995 would have had to have been implemented by decisions of the board of the society. These decisions could only have been made if the directors were satisfied that the decisions were in the best interests of the society (as opposed to the directors individually).

Each of the four steps identified would involve some level of cost to the society and this would have had to have been considered. Further, a commercial prerequisite to those steps which involve the taking out of insurance is the availability of such insurance.

Conclusion

Mr Smith found out the hard way about the potential liability of ex-directors and the common misunderstandings of the level of protection (or rather the lack of it) which exists in relation to such potential liability.

He wishes that he had examined the issues more adequately while he was on the board of the Golden Valley Co-operative.

Perhaps he would have made a decision to stick to his farming business. □

CONTACT

This article has been adapted by David Ferguson, a partner of Abbott Tout, solicitors, from an article written by his partner, Greg Bateman. The original article related to public companies. A copy of the original article can be obtained by telephoning Mr Ferguson on (02) 9334 8511.

NEWS FROM AROUND THE WORLD

The big are getting bigger

The number of co-operatives in the Dutch dairy industry has shrunk from 43 in 1985 to 18 today, with further rationalisation expected as the co-operatives strive to build global markets for their products.

In an industry dominated by co-operatives, the top three – Campina Melkunie, Friesland Dairy Foods and Coberco – handle more than 60% of the country's total milk production.

Not many people know this

CARE – one of the world's largest private relief and development organisations is a co-operative. The name is actually an acronym for the Co-operative for Assistance and Relief Everywhere.

CARE, which last year celebrated its 50th anniversary, was the brainchild of **Wally Campbell**, at the time the head of the Co-operative League of the USA's New York office.

Milk Marque's structural changes

The UK's giant milk supply co-operative, Milk Marque, has announced plans to consolidate its capital base by exchanging members' 'certificates of entitlement' (issued to all eligible dairy farmers when the industry was deregulated) for preference shares.

Preference shares, though not carrying voting rights, are tradeable and will pay a competitive market rate of interest.

Milk Marque will be putting the proposal to a vote of its members in the coming months.

Former co-op still growing

Avonmore, the Irish dairy co-operative that converted to plc status in 1988, is negotiating to buy Ireland's largest cheesemaker (also a former dairy co-operative), Waterford Foods. It is believed the move would make the combined group the world's fourth largest dairy company.

Happy birthday, CIRIEC

The International Centre of Research and Information on the Public and Co-operative Economy (CIRIEC) will mark its 50th anniversary in September.

The event, around the title, 'The public, social and co-operative economy and the general interest. Which roles in the 21st century?', will be held at the Brussels Congress Centre on September 26.

CONTACT: CIRIEC, UNIVERSITE DE LIEGE AU SART-TILMAN, BAT. B33, BTE 6, 4000 LIEGE, BELGIUM. FAX: 32 4366 2989; E-MAIL:

CIRIEC@ULG.AC.BE

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
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