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Reflections on the legal framework for relations between cooperatives and subsidiaries

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Deolinda Meira
Porto Polytechnic, Institute of Accounting and Business/CECEJ
meira@iscap.ipp.pt

Reflections on the legal framework for relations between cooperatives and subsidiaries

- In the Portuguese legal system, cooperative enterprises may include an enterprise carried out by a subsidiary, provided they conform to certain requirements.

- The aim of this paper is to reflect on the issue of the legal framework for the relationship between the cooperative and the subsidiary.

- **Problems:**

  - How to qualify such a relationship since corresponding to mere investments made by the cooperative? Should it be classified as non-member cooperative transactions or as extraordinary activities?

  - How to qualify such a relationship when related to the development of preparatory or complementary activities for the economic activity developed between the cooperative and its members? May we speak, in this situation, of a concept of "indirect mutuality", as provided in other legal systems?

  - How should we classify and what is the regime of the economic results from the activity developed by the subsidiary?

Requirements

- No. 1 of Art. 8 of *CCoop*:

"Cooperatives are allowed to associate with other legal persons of cooperative or non-cooperative nature, provided that this does not cause loss of their autonomy."

- From this rule it follows that:

  - Cooperatives can associate with two categories of legal persons: legal persons of cooperative or non-cooperative nature (associations, foundations, civil companies, commercial companies and other);

  - This association may or may not result in the creation of another legal person.

Requirements:
Maintaining cooperative autonomy as a necessary condition

- Maintaining cooperative autonomy is a necessary condition to its association with other legal persons (No. 1 of Art. 8 of *CCoop*).

- The legislator does not determine what constitutes autonomy nor provides criteria to assess their loss.

- Autonomy refers to the principle of autonomy and independence enshrined in Art. 3 of *CCoop*:

  - Autonomy will aim to ensure that the cooperative association with other legal persons does not question nor the independence of the cooperative nor the democratic member control;

  - Autonomy in the existence and winding up of the cooperative and autonomy in the management of its business and its assets, etc.

i. From the association of a cooperative with non-profit legal entities can be born cooperatives, associations or companies;

ii. From the association of a cooperative with legal entities with profit aims can be born associations or companies, provided that such association does not undermine the autonomy of the cooperative (No. 3, Art. 8, *CCoop*);

iii. In corporate legal regime, there is no restriction to participation of a cooperative in a commercial company since nor Art. 980 Civil Code nor the *CSC* (except for the cases in which the *CSC* requires that the partner has some corporate type, as in the system of affiliated companies, particularly in companies in a group relationship), pose no obstacle to the cooperative access to a partner in a commercial company.

The possibility of cooperatives constituting companies

- Under Art. 8 of *CCoop*, the cooperative may participate in a company but a company cannot participate in a cooperative.

- This lack of reciprocity is intended to prevent commercial companies, through their participation in a cooperative, from accessing benefits reserved for cooperatives, including tax (argument of public order) while there was no justifiable interest in fixing a symmetrical prohibition.

- Cooperatives may create companies, including commercial companies.

- However, cooperatives cannot constitute any kind of commercial company.

The possibility of cooperatives constituting companies

- Given the rules of Art. 8 of *CCoop*, namely the prohibition of loss of autonomy, the cooperative cannot assume unlimited liability in commercial company.

- Not all corporate types (or modalities of liability permitted by these types) will be accessible to the cooperatives.

- The cooperative cannot take a partner in a general partnership, or be a general partner in a limited partnership.

- In the case of a limited liability company, the cooperative cannot assume, by statute, liability for company debts.

The difficult problematic of the legal framework for the participation relationship between the cooperative (partner) and the established company

- How to qualify the relationship between the cooperative and the subsidiary, when this relationship corresponding to mere investments made by the cooperative? Should it be classified as non-member cooperative transactions or as extraordinary activities?

- The legal doctrine framed the relationship between cooperative partner and the company set up as an operation with non-members (third party- *terceiros*), taking into account the provisions of Art. 2, No. 2, of *CCoop*, which states that "cooperatives, in pursuit of their objects, are allowed to conduct business with non-members, subject to any restrictions laid down in the law applicable to each cooperative branch."

- "Non-members, from the cooperative point of view, are those who hold a business relationship directly related to the carrying on of the cooperative's primary object, as if they were members, although, in fact, they are not" (Rui Namorado).

- The business conducted with non-members, which the legislator refers to, is of the same kind of that business conducted by the cooperative with its members.

- The qualification of shareholdings or equity interests in companies as an operation with non-members, in the light of the subscribed concept of «non-members (*terceiros*)», does not seem adequate.

- Such equity interests should be described as an extraordinary activity, since outside of the cooperative social object, when it corresponds to mere investments made by the cooperative.

- In many cases, this equity interests in commercial companies is related to the development of preparatory or complementary activities of the economic activity developed between the cooperative and its members.

- The cooperative aims to obtain the segmentation of the activities that integrate its social object, delivering one or some of these activities to a subsidiary controlled by the cooperative.

- Several questions arise in this regard:

The establishment, by Portuguese cooperatives, of subsidiary companies, seems strange, since in Portugal cooperatives benefit from a more favourable tax treatment than commercial companies.

If the purpose is the segmentation of activities, why not form a multi-purpose cooperative?

The question of the "indirect mutuality”

- Various laws consecrate "indirect mutuality“ that is, the possibility that the cooperative transactions between the cooperative and its members for the provision of goods, services or jobs come directly to the cooperative or indirectly by companies controlled by the cooperative itself.

The concept of “indirect mutuality” is provided in other legal systems:

- Dutch law of 1989;

- Article 124.1 of the French Commercial Code, as amended in 2001 of the 2002;

- Finnish system, in which the exchange between the cooperative partner and a controlled society (at least 51%) by the cooperative is considered, explicitly, as "mutual" provided that the latter has control of the first;

- and Norwegian law, renovated in 2007, which provides (Article first, third paragraph of the Cooperative Act, 29 June 2007, n. 81) an express definition of the "indirect mutuality" : *A cooperative society also exists if the interests of the members (…) are promoted through the members’ trade with an enterprise, which the cooperative society owns alone or together with other cooperative societies, including a secondary cooperative (…)*” .

The question of the "indirect mutuality”

- The concept of "indirect mutuality 'is not defined in the Portuguese legal system.
- We have some doubts as to its admissibility.

- Admitting the possibility that the cooperative can continue its mutualistic scope indirectly, through a subsidiary company, and classifying some of the results from this activity as cooperative surplus will mean, to some extent, to disregard the legal entity of the participated commercial company (subsidiary).

- The cooperative and the subsidiary are two separate legal entities with autonomous assets.

- In this sequence, the profits from the activity performed by the subsidiary company, if there is a company resolution in the sense of its distribution among members, enter the assets of the cooperative as extraordinary results because they were not generated in transactions with members or with non-members, although they refer to activities that constitute the social object of the cooperative.

- Therefore, they shall be subject to the same regime of results from operations with non-members and cannot be appropriated by individual cooperators, being allocated to indivisible reserves.

Conclusions

We will conclude, advocating:

i. That the cooperative enterprise may include an enterprise carried out by a subsidiary if this is deemed necessary to satisfy the interests of the members;

ii. The inadmissibility of the concept of “indirect mutuality”;

iii. The application, to the economic results coming from the activity developed by the subsidiary, of the regime provided for in the Portuguese Cooperative Code to the results from non-member cooperative transactions;

iv. The economic results coming from the activity developed by the subsidiary cannot be appropriated by individual co-operator members, and so should be allocated to indivisible reserves.

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dl.meira@sapo.pt