Rechtskarakter en financiering van de cooperatie: een onderzoek naar de civielrechtelijke kenmerken van de cooperatie in het licht van de vraag of daaruit beperkingen voortvloeien voor de financiering van haar ondernemingsactiviteiten

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Summary

The central theme that runs through this thesis is whether the cooperative organizations, established under art. 53 section 1 Book 2 Dutch Civil Code (indicated by art. 2:53.1 DCC hereafter), can provide the basis for the attraction of investment capital without affecting or altering fundamentally the legal nature of the cooperative. This question is relevant for reason that, in contrast with non-cooperative enterprises, cooperatives do not attract investment capital form the external investor, although Dutch cooperatives have an increasing need for external investment. The purpose of this research is to examine the limitations of the cooperative form that derive form Dutch civil law in respect of the financing of their business activities. To address this concern, we look not only to the relevant Dutch legislation concerning the cooperative, - which can be found in the articles 2:53 until 63j DCC, but also to the existing methods of financing cooperatives.

The concept of the cooperative and its successive legislation history is best understood against the background of its economic history, which is the subject of chapter 2. During the initial period of codification there was little consensus regarding how a cooperative should act. The extant of cooperative forms reflects the diversity in principles as enunciated in the Dutch codifications of 1876, 1925, 1976 and 1989. The early period articulated a series of legal principles including: the principle of 'one man, one vote', open membership, democratic control, administration of the cooperative by its members on the basis of expenses, and - with regard to cooperatives on the continent - unlimited liability of the members for any deficit of the cooperative in case of dissolution. These principles reflect the 'social' intentions of the early cooperators. The ideas of these early cooperators, classified respectively as the Socialist School, Solidary School and German School, fail to explain the manner cooperative enterprises should be operated, nor their financing. Yet, economic explanations can be located in the so-called 'economic-analytical theory of cooperation', which has generally been accepted by economists since the end of World War II.

The economical approach of this theory regards the cooperative as an enterprise that functions as an extension of the business activities of its members. The result is that the cooperative enterprise has no incentive itself to maximize profits. Its primary function, then, is to generate substantial income for its members by producing and marketing their products. The ideas of the economic-analytical theory of cooperation can also be found in recent legislation with regard to the taxation of cooperatives (see Wet Vennootschapsbelasting 1969), and in legislation with regard to the influence of employees on the appointment of the board of
directors (bestuur) and their supervisors (raad van commissarissen)(see Wet inzake de structuurregeling voor de grote coöperatie en de grote onderlinge waarborgmaatschappij 1989). The legislative position of the cooperative is conceptualized as an extension of the business units of its members.

Chapter 3 offers a description and analysis of the history of successive legislation of the legal form of the cooperative set forth in 1876, 1925, 1976, and 1989. Two important issues arise. The first concerns the differentiation of the cooperative of the legal form of the association (vereniging), and the legal form of the limited liability company (naamloze vennootschap). The second issue addressed concerns the question whether a cooperative should be allowed to supply services to non-members, without making an alteration in its legal form. During the period 1976 until 1989 the legislator chose to answer the question whether an organization should be classified as a cooperative by referring not to the way it was established, but rather to the satisfaction to the material features enumerated in the legal definition of the cooperative (see art. 2:53.1 DCC). In fact, the compelling legal requirement that any economic interaction between cooperative and its members (indicated in the thesis as zakelijk verkeer) must take place by means of separate contracts, gave way to legal uncertainty. Notwithstanding the fact that the legislator in 1989 returned to a distinguishing of the cooperative by reference to the way the organization was established, the attributional approach of the legal form of the cooperative was maintained. So for example, an organization established as a cooperative, which fails to satisfy the material features, could be dissolved by the Public Prosecutor (see art. 2:21.1 under c DCC). Yet, in 1989 the definition was enlarged to permit members to contract directly with subsidiaries of the cooperative. Since 1989 the cooperative is permitted to operate as a holding-corporation, on the condition that the compelled economic interaction with its members takes place via one of its subsidiaries (see art. 2:24b).

Chapter 4 assesses the regulation of the cooperative in light of the financial restrictions that derive from its legal nature. The legal nature of the cooperative is determined by four features. In the first place, the legal nature is determined by its legal aim. Art. 2:53.1 DCC states that a cooperative must supply in specific material interests of its members, which implies that the purpose of the cooperative is to produce earned income for its members and/or to save expenses. To this end the cooperative may operate and control one or more business activities that its members could pursue only on a less profitable basis. Yet, due to restrictions on its legal purpose, the cooperative is not empowered to pursue activities beyond the lines of business of its members, or maximize the profits of the investment capital of non-members. Such activities are likely to be contrary to the income generating purpose of the cooperative. This conflict arises when the annual
settlement of the economic nexus with its members is done on a cost-price basis. This tension is to be felt less, when the annual settlement of the economic nexus is calculated on a market price basis.

Secondly, the legal structure of a cooperative is based on the association (vereniging). The members of this form of association tend to have similar business interests, and therefore the cooperative is not considered as a capital owned corporation. On the basis of their membership, the members have an exclusive right - and in some cases also an obligation - to make use of the services the cooperative supplies. While this is not regulated by law, studies show that the rights and obligations of the members deriving from the membership are not accounted for by reference to the extent of capital invested, but rather to the extent that economic interaction has taken place in one or more financial years. Voting rights, but also financial claims and other obligations for members are fixed on the basis of proportionality. A limiting aspect, from a financial viewpoint, of the legal structure of the cooperative lies in the fact that its members have the freedom to terminate their membership. The financial participation of the members who have terminated their membership, diminishes in proportion to their reduction of the level of economic interaction with the cooperative. Art. 2:60 DCC opens the possibility to impose restrictions regarding the termination of the membership, based on the condition that such restrictions can be of economic importance for the continuation of the enterprise. Yet, art. 2:60 DCC also states that a restriction that may have the effect that any withdrawal could be virtually impossible, is not permissible. Furthermore, these restrictions might well be contrary to national and European anti-trust law, in particular to art. 85.1 EC Treaty and art. 6 Dutch Anti-trust Law Act. Cases of the Court of Justice of the EC show that in case of a cumulation of restrictions invoked by a cooperative, these restrictions were found to be null and void. A further disadvantage is the legal impossibility to exclude the right of members to withdraw from the cooperative. Pursuant to art. 2:36.1 DCC any member has the right to withdraw at the end of the year following the year in which the member withdrew his name from the cooperative. Difficulties may also arise in other situations (see, i.e., art. 2:36.3 DCC, containing the right to withdraw immediately in case of any increase of membership obligations or decrease of membership rights, or art. 2:36.4 DCC, containing the right to withdraw immediately in case of merger, conversion or demerger of the cooperative.

The legal nature of the cooperative is also determined by the compelling form in which the economic interaction between the cooperative and its members must take place. It has been determined that the legal requirement of separate contracts is to be deleted from the legal definition in art. 2:53.1 DCC, since in all cases the rights and obligations of the members in essence derive from the membership as such. Moreover, there are a range of similar regulations that should be deleted on grounds that they have no substantive meaning (i.e., art. 2:53.3 and 53.4 DCC,
which contains a prohibition for the cooperative to supply similar services as to its members to non-members, and art. 2:59 DCC, which states that a cooperative is not allowed to change the conditions of the separate contracts concerning the economic interaction by means of a mere decision of (the board of) the cooperative.

The fourth and final factor determining the legal nature of the cooperative is the fact that a cooperative must maintain a business for its members. To satisfy this criterion the business activities of the cooperative must stem from the economic activities of the members. In this regard, the members must have the possibility to benefit economically from the business activities of the cooperative. Regarding permissible business activities, members are allowed to enter into business transactions with a subsidiary of the cooperative that are related to the business interests of the cooperative. Such transactions may be achieved by separate contracts to which the subsidiary is obliged to enter, but can also be derived from the obligations of the membership. In these latter matters, it has been determined that a member may benefit economically, only if the cooperative is able to influence the policy-making of the subsidiary. More specifically, the required influence has been interpreted to mean that the cooperative can exercise the majority of the voting rights in the general meeting of the subsidiary. Having identified the problems of control over the subsidiary by the cooperative, the question is considered how employee participation in the appointment of supervisors affects the possibility for the cooperative to determine the policy of the subsidiary. The answer is that the cooperative is most effective in influencing the policy of the subsidiary in case the so-called structure regime (see articles 2:63f-63j DCC) is applied not on the level of the subsidiary, but on the level of the holding cooperative.

Chapter 5 considers the existing forms of financing for agricultural cooperatives. What has to be emphasized is that these forms of finance are best understood in terms of ‘self-financing’. In practice a cooperative depends only on its members for the supply of a sufficient flow of capital or creditworthiness. As noted earlier, the restrictive function of cooperatives precludes external sources of finance, and the cooperative must rely on internal capital or capital from its members. In this regard, members generally have an obligation to participate, whereas these member participations generally are related to the extent of the economic interaction taken place between the cooperative and the individual member.

As a general rule, the members must supply the cooperative with sufficient funds to satisfy any deficit in case of dissolution (see art. 2:55 DCC). In this way, each member has an obligation to pay his equal share in the deficit. The practice surrounding the so-called ‘W.A.’-regime (see art. 2:56 DCC) reflects that the members’ obligation to cover the cooperatives liabilities in case of bankruptcy is not so strong, and may be limited or excluded due to the significant level of risk involved in any particular undertaking. In the event a limited liability remains for
any deficit, this so-called ‘B.A.’-regime (see art. 2:56 DCC) can only be effective
to the extent that a cooperative succeeds in binding its members. There are a
number of approaches which are suitable for this purpose. In this chapter, I show
that a combination of statutory rules, as noted below, may be effective. A
cooperative may succeed in binding its members if it creates: 1) an obligation to
deliver in case of a selling cooperative, or an obligation to purchase in case of a
purchase cooperative; 2) an obligation to participate in its capital; 3) a restriction
to withdraw; 4) an obligation to pay a fee in case of withdrawal; and 5) the
‘confiscation’ of credits of the member to the cooperative in case of withdrawal.
We can see that the purpose of these rules is to create a stable economic
environment for the cooperative in order to retain the financial participation of
members. An essential point is that these methods to bind are likely to conflict
with the compelling right to withdraw from the cooperative, which derives form
the legal character of the cooperative as an association, as well as anti-trust law.

A positive contribution to the effect of the liability, as mentioned in art. 2:55
DCC, may arise also from the obligation of members to clear off any deficit
appearing on the annual balance or on the profit and loss account. What usually
occurs, if these rules are executed, is that the probability of dissolution on the
ground of bankruptcy diminishes. I move on to discuss the so-called leden-
schuldrekening. In case of such an account, members are obliged to place a part
of their share in the net proceeds at the disposal of the cooperative by way of a
loan, in proportion of their share in the extent of the economic interaction.
According to art. 2:55.5 DCC, a member is not allowed to compensate his debt
on account of any liability in case of dissolution with his right of payment against
the cooperative on account of the for mentioned loan. The effect of this rule has
been a virtual postponement of the claims of members in relation to other creditors,
and has led to an increase of creditworthiness. Furthermore, any financial addition
to this type of member account out of the net proceeds may be deducted, according
to art. 9.1 under h Company Tax Law 1969, from the company tax, to be paid by
the cooperative.

Much of the literature on cooperatives shows that they are more frequently
than not financed by reservation of the net proceeds by adding them to general
financial reserves, as well as to individualized financial reserve accounts. This
method of finance is regressive from a tax point of view since, in most cases,
members face double taxation (e.g., company tax to pay by the cooperative, income
tax to pay by its members at the time the profits are paid out). The reason for this
is that the for mentioned provision of art. 9.1 under h Company Tax Law 1969
is not applicable, if the net proceeds are added to any kind of financial reserve
of the cooperative. There is yet another shortcoming of raising investment capital
by reservation of net proceeds, which lies in the fact that the members, during their
membership, have few options to cash a contingent claim on the capital of the
cooperative and its growth. The reason is that these financial claims are not embodied in any transferable financial participation. In a rare case they might be embodied, as in the case of the different types of individualized financial reserve accounts. Yet, the transferability is virtually restricted to the circle of the members since these accounts generally oblige them to participate financially to the extent that economic interaction has taken place between the cooperative and its members.

Chapter 6 focuses on whether a cooperative can satisfy its requirement for external capital by allowing participation of non-members. Dutch civil law allows a cooperative to include the actions of investors that have a claim on (a share in) the net proceeds of the cooperative. Yet, recognition of the financial claims of investors may conflict with art. 2:53.1 DCC, which states, as noted earlier, that the business activities of the cooperative should generate substantial income for its members. Equally, the legal definition states that a cooperative must maintain an economic nexus with its members, which means that a cooperative should be an extension of the business activities of the members. However, according to current Dutch civil law the annual settlement of the economic nexus of members does not require cost-price accounting. Indeed, settlement on the basis of market prices is also permitted. Applying the later method, a cooperative could show a profit similar to non-cooperative enterprises. In this regard, members may benefit from the capital of the cooperative, and its potential growth, by the introduction of financial participation along the same terms as the external investors. The change in financial terms, as just stated, introduces a break between compensation for the delivery or purchase of goods by a member on the one hand, and compensation for capital invested by a member or non-member on the other hand. It is clear that the statutes of many cooperatives already award the members with a financial claim on its capital to the extent of the business transactions taken place between the cooperative and its members. If this is the case, the for mentioned break can be facilitated by conversion of these financial claims into freely transferable participations, as put forward over twenty five years ago in a 1973 report of the National Cooperative Council.

In case where external financial participation is introduced, the question of control poses a serious issue for the investor. Control rights are essential for any investor since they make it possible to influence the important legal and economic decisions of the cooperative, such as the determination of profits. This chapter shows that an external investor will normally be paid a fixed, preferential compensation in exchange for his investment. It will be shown that effective control can derive from the private regulation of the financial claims, which are located in the statutes of the cooperative. This regulation of financial claims in the statutes of the cooperative can only be altered or changed by the participants. I address the case when the determination of the profits awarded to participants depends
Summary on the decision-making in the general meeting. The basic idea is that exercise of voting rights is imperative for investors. Yet, problems may arise when non-members may want to exercise voting rights in a general meeting of an association, such as the cooperative. The analysis will show that, under Dutch law, only members who maintain business transactions, which are in line with the function of the cooperative, are entitled to voting rights, except for the provision in art. 2:38.3 DCC. This line of reasoning would lead to a restricted vision of the exercise of investor rights in cooperatives. Yet, it is clear that the demand for external investor participation cannot be limited by such provisions. In the next section I consider the legal techniques designed to enhance the legal participation of the external investor in the actions of the cooperative. I explore three major techniques that may adjudge, directly or indirectly, voting rights to the external investor. It is worth noting at this point that these techniques rely typically on the admittance of the external investor to a special membership of the cooperative.

The first technique, introduced by Bartman and Van der Meijden, allows investors to be admitted directly to a freely transferable membership in accordance with art. 2:34.1 DCC. In their view, this form of investor-membership could be viewed as a bearer membership. I argue that such a membership is permissible for a cooperative with a limited or excluded liability (see art. 2:56 DCC), since it imposes no liability on these members for any deficits in case of dissolution. In case of a limited liability pursuant to art. 2:56 DCC, only those members who can not be held liable for any deficits, are able to rely on this bearer membership form.

The second technique, described by Nillesen, relies on the concept of a ‘qualitative membership’. To put it simply, a special investor membership occurs by virtue of the mere possession of a financial participation in the cooperative. Here, every participant qualifies as a member and is ensured the right to vote in the general meeting in accordance with art. 2:38.1 DCC.

The third technique, introduced by Dortmond, proceeds, in contrast to the other two techniques, on the basis of a single special membership for the establishment of a trust, which occurs usually in the form of a foundation. The trust, which is the only special member of the cooperative, holds all financial participations emitted by the cooperative. The trust translates these holdings into bearer certificates in favour of the investor.

It is natural to assume that these techniques permit a special investor membership under Dutch civil law. In this case the assumption is false. I argue that the long-standing regulation of the cooperative shows that a cooperative should only have members that maintain business transactions with the cooperative in line with its function as described in its statutes. One implication of this theory is that the cooperative can be qualified as a ‘close corporation’ of associates with similar business interests and activities. This chapter develops a further argument
against a special investor membership approach. I argue that art. 2:38.3 DCC already gives an exclusive provision for the adjudication of voting rights. Art. 2:38.3 DCC states that the statutes may adjudge voting rights in the general meeting to persons who are member of any body of the cooperative other than the general meeting. Once one recognizes that the legal body referred to in art. 2:38.3 DCC does not necessarily have to be an existing body of the cooperative, then it is possible to create a vehicle of legal body which is legally acceptable. Knowing this, members will perceive little risk that the actions of the cooperative will be unduly influenced or subject to an increased level of risk. Indeed art. 2:38.3 DCC contains a limitation of voting rights to be adjudged to non-members. Note that non-members can only exercise voting rights to the maximum of the half of the voting rights of the members that have been exercised at the general meeting.

In all cases of adjudication of voting rights, either by means of a special investor membership or by means of application of art. 2:38.3 DCC, the direct influence of the outside investor in the general meeting of the cooperative can be altered by the certification of the financial participations. Consequently, the voting rights connected with the investments are exercised by a trust in the legal form of a foundation.

Chapter 6 also explores the question whether a subsidiary of the cooperative might attract external capital from investors by the issuance of shares. The analysis offered here suggests that if a subsidiary maintains business transactions with the members of the cooperative, so-called ‘first-line’ business activities, then problems could arise with regard to the determination and destination of the profits of the subsidiary, which are similar to the problems that may arise on the level of the cooperative. If the annual settlement of the economic nexus is done on a cost-price basis, these problems are resolved by awarding the investors a fixed, preferential compensation. But, if the annual settlement is calculated on a market price basis, the subsidiary will show profits that derive from the business transactions with members of the cooperative. Naturally, the cooperative itself, as a shareholder, is entitled to dividend. To be sure, the statutes of the subsidiary allow to award the cooperative with a fixed, preferential share in exchange for the capital invested. Likewise, the members of the cooperative would be entitled to receipt of a dividend, to the extent that their business transactions involved the cooperative. Members who finance the business ventures of the subsidiary, are compensated on the same basis as investors in the subsidiary.

Yet, the attempt to raise investment capital, via shares, at the subsidiary level may be limited. The implication is that issuing new shares will diminish relatively the voting rights of the cooperative. It is possible to understand that the cooperative eventually will be unable to influence the policy of its (former) subsidiary. Of course, this consequence might be precluded by application of art. 2:118.5 DCC.
Art. 2:118.5 DCC contains a provision that restricts the amount of voting rights that could be exercised based on the level of capital invested. This restriction may be combined with the possibility of the issuance of preferential shares to a ‘friendly’ party, or the certification of shares issued to the investors. By doing so, the rights of control of the subsidiary can be restricted in favour of the cooperative as a major shareholder. However, the last two techniques are, without any restrictions, only available in case of a private issuance of shares. If shares of the subsidiary are listed on the stock exchange, the restrictive rules of Appendix X of the Dutch Stock Regulation are applicable. The appendix contains restrictions on the subject of so-called beschermingsconstructies.

The complex problems regarding the determination and destination of the profits of the subsidiary may not occur where the subsidiary is involved in so-called 'second-line' business activities. These activities play no direct role with regard to the nexus of economic activities between the cooperative and its members. In this regard, the subsidiary will show profits that are similar to non-cooperative enterprises. Like any other investor, members can benefit directly by investing in shares of the subsidiary. It is essential that after issuance of shares that the cooperative retains the capacity to influence the policy of the subsidiary. In this regard, any further issuance of shares of the subsidiary should be issued to a trust, which then issues shares in bearer certificate form.

In the last section of this chapter, I explore a specific tax-construction that could limit the burden of a double taxation of the net proceeds. In this regard, I introduce the limited partnership construction which involves the following aspects: the business activities of the cooperative enterprise are undertaken in the legal person of a limited partnership, of which the cooperative/corporation is the only general partner. An investment company in the legal form of a limited liability company will be the only limited partner. Contingent investors will participate in the limited liability company by taking shares. According to current Dutch tax law, this construction would have the following consequence: any dividend paid out of the net proceeds to the members of the cooperative are deductible from a contingent company tax to pay by the cooperative, whereas a dividend paid out to the investors could be charged with taxes only once, at the level of the investor. The reason for this lies in the fact that by Dutch law a limited partnership is so-called ‘fiscally transparent’. In contrast, the investment company is charged with a tax rate of nil percent. The tax rules state also that any profits of the investment company must be paid out immediately as dividends to investors in or after the year the profits are made.