

Dr. Christa Jessel-Holst
Senior research associate, Max Planck Institute
for Comparative and International Private Law, Hamburg

Law of Cooperative Societies – European and recent German Experiences

I. Introduction

The general theme of this year's conference in Vrnjačka Banja, namely "Law and Investors Protection" offers a broad choice of interesting topics. Investment, be it domestic or abroad, is mostly associated with the activities of commercial companies. In this field of the law, the past decade has been one of intensive reforms, not only on the national scale. After a period of reflection, the European Union has accelerated the harmonization of company law as can be seen from recent directives (Directive 2004/25/EC of 21 April 2004 on takeover bids;¹⁾ Directive 2005/56/EC of 26 October 2005 on cross-border mergers of limited liability companies²⁾) as well as from a number of strategic papers and drafts like the Proposal of 5 January 2006 for a Directive on the exercise of voting rights by shareholders of companies having their registered office in a Member State and whose shares are admitted to trading on a regulated market and amending Directive 2004/109/EC.³⁾

In order to facilitate the doing of business on a Community scale, the Council adopted the Regulation (EEC) No 2137/85 on the European Economic Interest Grouping⁴⁾ and the Regulation (EC) No 2157/2001 establishing the legal form of the European Company.⁵⁾

1. OJ L 142, 30.4.2004, p. 12.
2. OJ L 310, 25.11.05, p. 1.
3. COM(2005) 685 final.
4. OJ L 199, 31.7.1985, p.1.
5. OJ L 294, 10.11.2001, p. 1.

Since the year of 2006, it is also possible to create cooperatives as supranational legal bodies, see Council Regulation (EC) No 1435/2003 of 22 July 2003 on the Statute for a European Cooperative Society (SCE).⁶⁾

This contribution focuses on the reaction of the German legislator to the SCE-Regulation and examines the recent developments. In Germany (as in other countries) for a considerable period of time a reform of the law of joint stock companies has had priority over other types of enterprises. The 2006 reform of the law on cooperative societies has been triggered by the SCE-Regulation, but also by general need for modernization in the field of cooperatives that has been obvious for some time. One highlight of the reform has been the admission of financial investors to membership in a cooperative. Emphasis is also put on corporate governance provisions which so far have largely been missing with respect to cooperatives. It is to be hoped that with these aspects, the criterion of "Law and Investors Protection" will be met.

II. The European Cooperative Society (SCE)

The European Cooperative Society is a new instrument for organizing business activities. SCE-s may be created by persons residing in different Member States or by legal entities established in different Member States. Main sources of law⁷⁾ are the above mentioned SCE-Regulation as well as the Council Directive 2003/72/EC of July 2003 supplementing the Statute for a European Cooperative Society with regard to the involvement of employees.⁸⁾

The SCE-Regulation went into force on 18 August 2006. As a regulation, it is directly applicable in all EU-Member States; it applies also in Norway, Iceland und Liechtenstein as members of the European Economic Area. However, even in the case of a regulation it is necessary to adopt provisions for the implementation (art. 78 EC-Treaty). The SCE-Regulation in a number of provisions refers to the law of the Member States (the State in which the SCE has its registered office). Therefore, the regulations on the European level are supplemented by a set of rules in the national law. For the latter, each national legislator will strive for making his national regime as attractive as possible, hoping that a large number of SCE-s will choose their registered office in that particular country.

By its very nature, the directives can only take effect through their transposition into the national laws of the Member States (art. 249 para. (3) EC-Treaty). The Directive 2003/72/EC has been implemented by about one half of the member states.⁹⁾

6. OJ L 207, 18.8.2003, p. 1 with corrigendum OJ L 49, 17.2.2007, p. 35. For a detailed presentation of the SCE, including a comparative legal survey which covers France, Italy, Germany and the United Kingdom, see *Schulze* (ed.), *Europäische Genossenschaft SCE. Handbuch* (Baden-Baden 2004), 269 pp.

7. See also the Communication from the Commission to the Council and the European Parliament, the European Economic and Social Committee and the Committee of the Regions of 23 February 2004 on the promotion of cooperative societies in Europe (COM(2004)18 final).

8. OJ L 207, 18.8.2003, p. 25-36.

9. State of implementation 16 November 2006.

III. The German Reform of the Law of Cooperative Societies of 2006

1. Introductory remark

Germany has used the opportunity of the adoption of its implementing provisions for the SCE-Regulation and of the transposition of the above mentioned Directive 2003/72/EC for a modernization of the domestic law of cooperative societies as well. Therefore, the Law on Introduction of the European Cooperative Society and for Amending the Law of cooperative societies¹⁰⁾ consists of several components, namely the Law implementing the SCE-Regulation¹¹⁾, the Law on involvement of employees in the SCE¹²⁾, Amendment to the Law on Trading and Industrial co-operatives¹³⁾ as well as amendments to other laws. By the way, a similar approach can be found e. g. in Hungary, which has recently enacted the Law LXIX/2006 on the European Cooperative Society¹⁴⁾ as well as the Law X/2006 on Cooperatives.¹⁵⁾

The German law implementing the SCE-Regulation in 36 §§ inter alia deals with the structure of the SCE, especially for the monistic system which is not applied for German national companies or cooperative societies. Similar to the European Company (SE), the European Cooperative Society shall comprise as its organs a general meeting and either a supervisory organ and a management organ (two-tier system) or an administrative organ (one-tier system) depending on the statutes (articles 36 et sequ. of the SCE-Regulation). It is therefore mandatory for each Member State to leave for SCE-s with the registered office in that particular State the free choice between the monistic and the dualistic system and to offer a set of rules for both systems.

The German law on Trading and Industrial co-operatives (GenG)¹⁶⁾ goes back to the year of 1889. The amendment from the year of 2006, which went into force on 18 August 2006, marks the first major change since 1973. The need for reform has been obvious, it suffices to point out that the total number of cooperative societies in Germany has in the last 30 years been cut in half, meaning that the total number of cooperatives has shrunk dramatically from 18. 260 in the year of 1970 to only 7. 927 cooperatives in the year of 2004. Many of the former cooperatives have undergone a change of legal form or a merger. On the other hand, in 2004 only 74 cooperatives have been founded.¹⁷⁾ Some main objects of the reform

10. Gesetz zur Einführung der Europäischen Genossenschaft und zur Änderung des Genossenschaftsrechts vom 14.8.2006 (EuroGenEinfG) (BGBl. I 2006 p. 1911).
11. Gesetz zur Ausführung der Verordnung (EG) Nr. 1435/2003 des Rates vom 22. Juli 2003 über das Statut der Europäischen Genossenschaft (SCE) (SCE-Ausführungsgesetz – SCEAG).
12. Gesetz über die Beteiligung der Arbeitnehmer und Arbeitnehmerinnen in einer Europäischen Genossenschaft (SCE-Beteiligungsgesetz SCEBG). In this context see *Kisker*, Unternehmerische Mitbestimmung in der Europäischen Gesellschaft, der Europäischen Genossenschaft und bei grenzüberschreitender Verschmelzung im Vergleich: Recht der Arbeit 2006, pp. 206-212.
13. Änderung des Gesetzes betreffend die Erwerbs- und Wirtschaftsgenossenschaften.
14. Magyar Közlöny 2006 no. 95 p. 7792.
15. Magyar Közlöny 2006 no. 1, p. 181. German and English translations of this law are to be found in: Hatályos Magyar jogszabályok/Gelende Ungarische Rechtsnormen/Hungarian rules of Law in Force No. XVII/21 (2006) p. 1635.
16. Gesetz betreffend die Erwerbs- und Wirtschaftsgenossenschaften (for the full text of this law as well as any other German piece of legislation see www.gesetze-im-internet.de). For the development of cooperative societies in Germany see *Karsten Schmidt*, Gesellschaftsrecht (4th ed. 2002) § 41 (pp. 1263-1277).
17. According to *Kessler*, Das neue Genossenschaftsrecht im Wettbewerb der Unternehmensformen – erleichteter Zugang auch für KMJ?: Der Betriebsberater 2006 pp. 1693-1698 (1694).

of 2006 have already been mentioned above. The reform has also aimed at facilitating the foundation of cooperative societies and to make their regime more flexible, especially for small cooperatives. Other measures concern the capital of the cooperative. The field of application of cooperatives has been enlarged. Finally, the terminology of the law, which went back even to the year of 1889, has been modernized.

This contribution does not deal with questions of the involvement of employees, because this is a topic in itself and would need more space. It shall therefore suffice here to state that the German Co-determination Act¹⁸⁾ applies also to cooperative societies (see § 1).

The registration of cooperative societies has been modernized following the Law on the electronic commercial register and the cooperative register and the enterprise register of 10 November 2006.¹⁹⁾

2. Recognition of non-profit cooperatives

Especially in France and in Romanic countries, the cooperative societies are traditionally not restricted to economic activities. Cooperatives in Germany have in the past de facto also fulfilled social and cultural purposes, although without a proper legal basis. As a clarification, the law now expressly allows the use of cooperatives for social and cultural purposes (§ 1 GenG) (the Hungarian law X/2006 speaks of "the objective of lending assistance to the members so as to satisfy their economic and other needs (cultural, educational, social and healthcare)"). The legislator had in mind school-, sport-, media-, theatre-, museum- and other cooperatives. Economically oriented cooperatives, as for example house-building cooperatives, may serve social and cultural purposes as a secondary object.

3. Simplified regime for small cooperatives

As in the case of associations, the founding of a cooperative until recently required a minimum of seven members. This threshold has been lowered considerably, it is now sufficient for the cooperative to have at least three members (§ 4 GenG). The founding of miniature size cooperative societies can be an interesting option e. g. for craftsmen or farmers. In this respect, the German law is more flexible than the SCE-Regulation which stipulates a legal minimum of five members (art. 2 para. (1)).

In case the cooperative has, in addition to the ordinary members, also investor members (see *infra* (6)), the investor members remain out of consideration for the determination of the legal minimum of three members (§ 80 GenG). This rule applies for the new foundation of cooperatives as well as for their dissolution for lack of the required number of members.

For cooperatives having no more than 20 members, a special regime has been introduced. Thus it is now possible to stipulate in the articles of association that the management board in such a cooperative society shall consist of only one person (§ 24 GenG). It may also be stipulated in the articles of association to do without a supervisory board and let the corresponding rights and duties be exercised by the general meeting instead (§ 9 GenG).

18. Gesetz über die Mitbestimmung der Arbeitnehmer (Mitbestimmungsgesetz – MitbestG), BGBl. 1976 I p. 1153. See also § 1 of the Gesetz über die Drittelbeteiligung der Arbeitnehmer im Aufsichtsrat (Drittelbeteiligungsgesetz-DrittelbG), BGBl. 2004 I p. 974.

19. BGBl. 2006 I p. 2553.

Cooperatives with a balance sheet total of no more than 1 Mio. Euros and a turnover of no more than 2 Mio. Euros are now privileged in the sense that their annual financial statements need no auditing. For them, an examination of the economic circumstances and of the regularity of the conduct of business in regular intervals (every two years for cooperatives with a balance sheet of up to 2 Mio. Euros, every year for cooperatives with a higher balance sheet) is sufficient (§ 53 GenG). Finally, the provisions on quality control for auditing associations (§§ 63e et sequ. GenG) do not apply to smaller cooperatives.

4. Formation of cooperative Societies on the basis of non-cash contributions

The new sub-clause (3) of § 7a GenG allows for the articles of association to provide also for contributions in kind as payment on the share. Cooperative societies have in this respect thus finally received equal treatment with commercial companies. Here again, especially smaller production cooperatives will profit from the change.

5. Introduction of a minimum capital

It is now possible (although not mandatory) to stipulate a minimum capital which is then determined in the articles of association (§ 8a GenG). The law does not say anything with respect to the amount of the minimum capital which is therefore left entirely to the articles of association. (Under the SCE-Regulation, the subscribed capital shall not be less than 30. 000 Euros²⁰). This part of the reform is meant to strengthen the equity position of the cooperative. Under the new regime, in the case of a termination of membership the back-payment of the membership shares may be suspended under referral to the existing minimum capital.

An alternative solution for the stabilization of the cooperative's capital has been opened by the new § 73 sub-clause (4) GenG. According to this provision, the articles of association may deviate from the general rule that in the case of a withdrawal the member share must be paid off within six month after the termination of the membership.²¹)

6. Admission of financial investors (= introduction of "investor members")

In contrast to commercial companies, the cooperatives have been conceived as a means of self-help of the members, through consumer-cooperatives, craftsmen's cooperatives, people's banks, cooperative housing societies, agricultural cooperatives etc. Thus German law declares as the overall objective of cooperative societies the promotion of the trade or the industry, or of other concerns of the members through common business operations (§ 1 GenG). Promotion of members is done not in a monetary form but in natura (although the members are also entitled to participate in the profits of the cooperative). However today, especially in bigger cooperatives the personal commitment of the members to their cooperative is often rather weak.

Starting from 2006, German law recognises two categories of membership in a cooperative. Following modern tendencies, which are also reflected in the SCE-Regulation, the

20. See art. 3 para. (2).

21. In this context see also §§ 67a, 76 GenG.

articles of association may now prescribe that investors may join the cooperative. The law defines the investor members as "persons, who do not come into consideration for the use or the production of the goods and for the use or supply of the services of the cooperative" (§ 8 GenG). Such persons however become investor members only if they have been admitted expressly to this kind of membership. (By this formal criterion, the investor members can be distinguished from the so-called sustaining members).

Adding to the ordinary members a second category of investor members is meant to facilitate the acquisition of capital (many cooperatives lack the cash for making investments). The investor members may pursue interests of their own that clash with the interests of the non-investor members. The perspective of investor members with a pure financial interest therefore poses some problems which the law tries to solve by establishing a special protective mechanism.

Thus an alteration of the articles of association which introduces the possibility of admitting investor members needs a 75 percent majority of the votes cast in the general meeting (§ 16 GenG).

Even where the articles of association provide for investor members, the admission of such members is only possible with the consent of the general meeting in every single case (the articles of association may transfer the competence for giving this consent to the supervisory board instead). By this, the ordinary members of the cooperative have the right to determine the number of investor members to be admitted to their cooperative.

Once an investor member has been admitted to the cooperative, he/she has the same membership rights as the ordinary members, including the right to vote in the general meeting and to withdraw from the cooperative. Investor members may also be elected to the management board or the supervisory board.

However, the articles of association must ensure through appropriate measures (like limitation of the voting right, or the requirement of a double majority of the ordinary members as well as of the investor members) that the influence of the investor members cannot surpass certain limits. This principle is expressly stated in the law (§ 8 GenG). In particular it must be ensured that the investor members can in no case vote down the ordinary members and that the investor members cannot prevent the adoption of a resolution of the general meeting which needs at least a three-fourth majority (which means that the law does not allow a blocking minority of the investor members for qualified decisions). For multiple voting rights see *infra* (7).

Finally, the total number of investor members in the supervisory board may not exceed 25 percent of all the members of the supervisory board.

Interestingly, there is no such restrictive provision with respect to the management board so that investor members may be elected to the management board like any ordinary member.

Like the ordinary members, the investor members have the legal right to withdraw from the cooperative. For ordinary members, such a withdrawal means at the same time that they will lose all the *de facto* advantages that come from their membership in the cooperative, whereas the investor members may simply take their money back and look for investment opportunities elsewhere, which makes their withdrawal more likely. Therefore the

threat to exercise the right of withdrawal of the investor members may in practice be used to influence the decision making process. Adequate conditions for the right of withdrawal that take into account the interests of the parties concerned may be stipulated in the articles of association (§ 65 GenG)²²⁾.

The annual surplus is distributed among the members in relation to their membership shares, unless otherwise provided for in the articles of association (§ 19 GenG). An equal distribution of the profits among the ordinary members and the investor members may lead to unfair results, since the ordinary members already have non-monetary advantages from their membership (e. g. use of favourable conditions) which the investor members do not have. The practice will have to develop mechanisms for a fair participation of investor members in the profit of the cooperative, through appropriate clauses in the articles of association²³⁾ which keep the proper balance between the interests of the ordinary members and the investor members. In this sense, the law for example allows for exceptions from the interdiction of the payment of interest on the membership shares (§ 21a GenG). Preferred dividends may also be granted.

In the case of a termination of the membership, the amount to be paid to the former member is tied not to the economic value of the share, but is calculated on the basis of the annual accounts; the former member does normally not participate in the reserves and the other assets of the cooperative (in detail see § 73 GenG) which means that he will namely not fully benefit from increase in the enterprise value.

7. Corporate governance provisions

The intensive discussions on corporate governance and the creation of a number of reform acts with regard to joint-stock companies – namely the so-called KonTraG²⁴⁾, NaStraG²⁵⁾, TransPuG²⁶⁾ and the UMAG²⁷⁾ - have finally had an impact also on the law on cooperative societies. In fact, it has been discussed for some years what should be the proper strategy for implementing corporate governance conceptions in the law of cooperative societies and how far the legislator should go in this respect, having in mind also the fundamental differences in comparison with the capital market-orientated joint-stock companies (shareholder-value versus membership-value)²⁸⁾.

In German cooperative societies the two tier system applies (for cooperative societies with a maximum of 20 members see supra 3). The management board is elected and dismissed by the general meeting; however, the articles of association may lay this matter into the competence of another body (typically: the supervisory board), see § 24 GenG. The mem-

22. In this context see *Pistorius*, Der Regierungsentwurf zur Änderung des Genossenschaftsrechts – Stärkung der Rechtsform eG?: Deutsches Steuerrecht 2006, pp. 278-284 (283).

23. See *Saenger/Merkelbach*, Die investierende Mitgliedschaft im deutschen Genossenschaftsrecht – eine interessante Beteiligungsmöglichkeit für Genossenschaften und Investoren?: Der Betriebs-Berater 2006, pp. 556-569.

24. Gesetz zur Kontrolle und Transparenz im Unternehmensbereich, BGBl. 1998 I p. 786.

25. Gesetz zur Namensaktie und zur Erleichterung der Stimmrechtsausübung, BGBl. 2001 I p. 123.

26. Gesetz zur weiteren Reform des Aktien- und Bilanzrechts, zu Transparenz und Publizität, BGBl. 2002 I p. 2681.

27. Gesetz zur Unternehmensintegrität und Modernisierung des Anfechtungsrechts, BGBl. 2005 I p. 2802.

28. For details see *Kessler*, Die Genossenschaftsreform im Lichte der CorporateGovernance-Debatte: Der Betriebs-Berater 2005, pp. 277-283.

bers of the supervisory board (normally three) are always elected by the general meeting (§ 36 GenG).

All members of the management board and of the supervisory board must be members of the cooperative society (for details see § 9 GenG). At least for the management board, this is a controversial regulation.

The management board represents the cooperative in and out of court. The duty of care and the liability of the members of the management board are regulated in § 34 GenG. It says there that the members of the management board shall apply the due care of a diligent and conscientious manager of a cooperative. In contrast to the law on joint stock companies (§ 93 AktG), § 34 GenG contains no business judgment rule. The omission has been criticised in the legal literature²⁹⁾ a clarification would certainly have been useful.

As in joint stock companies, the role of the supervisory board has been considerably strengthened. Namely, the individual members of the supervisory board have received the right to request information from the management board, which must however be given to the supervisory board as a whole and not to the individual member (§ 38 GenG). Besides this, the supervisory board has received the right of avoidance with respect to resolutions of the general meeting (§ 51 GenG). The position of the supervisory board vis-à-vis the management board has also been enhanced. Thus, the articles of association may transfer to the supervisory board the right not only to appoint, but also to dismiss the members of the management board (§ 24 GenG). The supervisory board has now received the right to represent the cooperative towards the members of the management board (§ 39 GenG). Therefore, the supervisory board may now on its own initiative bring suit against a member of the management board. However, the articles of association may provide that the general meeting decides on litigation against members of the management board.

Another corporate governance element can be seen in the enhanced role of the members of the cooperative society. Before the applicant declares the accession to the cooperative, he shall be provided with a copy of the actual version of the articles of association (§ 15 GenG). The members exercise their rights through the general meeting, unless the law provides otherwise. The articles of association can now permit for resolutions of the general meeting to be adopted in writing or in electronic form; it may also allow for members of the supervisory board to participate in the general meeting via picture or sound program transmission. It may also allow for picture or sound program transmission of the general meeting (§ 43 GenG).

Where a cooperative has more than 1500 members, the articles of association may provide for a meeting of delegates (Vertreterversammlung, § 43a GenG), in which case the general meeting consists of (at least fifty) delegates. It may now be stipulated in the articles of association that certain resolutions may only be adopted by the general meeting (that is, by the members themselves and not by the delegates). It is also made easier for the members of the cooperative to submit nominations for the election of delegates; this right is guaranteed to a (legal) minimum number of 150 persons. Besides this, it has been made easier to switch

29. *Kessler*, Die Genossenschaftsreform im Lichte des Regierungsentwurfs: Der Betriebs-Berater 2006, pp. 561-565.

back from the system of a meeting of delegates to general meetings held by the members of the cooperative. So far, the decision to abolish the meeting of delegates in favour of general meetings of the members had to be made by the meeting of delegates itself; understandably, practical examples of such decisions were extremely rare. Under the new law, ten percent of the members may request an immediate convening of the general meeting for deciding on the abolishment of the meeting of delegates; the articles of association may provide for an even smaller percentage. In case of non-compliance, the court may authorize the respective members to convene the general meeting themselves.

The general meeting, or as the case may be the meeting of delegates, shall be convened with all despatch at the request of one tenth of the members (the articles of association may stipulated a smaller percentage). In the same way members are entitled to put items on the agenda of the general meeting or of the meeting of delegates. In the case that the delegates' meeting has been convened on the request of members, those members who made this request have the right to be present in the delegates' meeting as well as the right to speak and the right of motion. Members on whose request items have been added to the agenda of the delegates' meeting enjoy the same right (§ 45 GenG).

The law stipulates no legal quorum for the passing of resolutions in the general meeting. The decisions of the general meeting are made with a simple majority of the votes cast, unless the law or the articles of association provide for a higher majority or additional requirements. Thus, the articles of association may only be changed with a 3/4 majority of the votes cast, and in certain situations an even higher majority is needed (§ 16 GenG).

The rather sensitive matter of multiple voting rights has been discussed in a controversial manner. The German government had the intention to abolish multiple voting rights altogether but had to face opposition especially from agricultural cooperatives. In the end, a compromise has been reached in the sense, that on principle, members particularly promoting the activities of the cooperative may hold up to three votes. However, their multiple voting rights cannot be exercised in the case of fundamental resolutions of the general meeting that need a 3/4 or a higher majority.

This limitation does not apply for cooperatives in which more than 75 percent of the members are entrepreneurs. In these cases, the law stipulates a legal limit of ten percent of the votes present in the general meeting per member, so that no single member may reach a dominating position³⁰). In the meeting of delegates, no multiple voting rights are allowed so that each delegate may cast only one vote.

The general meeting shall be convened at least two weeks before the day of the meeting; so far, one week has been sufficient. This will give the members more time to organise their participation in the meeting and to prepare themselves. Items may be put on the agenda no later than one week in advance of the meeting (until now, this was possible up to three days before the meeting). The whole agenda (and not only the "purpose" of the meeting) shall be announced to the members together with the convening of the general meeting (§ 46 GenG).

30. For details see § 43 GenG.

Information of the members about the meeting of delegates has also been improved considerably: The agenda of the meeting of delegates shall from 2006 on be announced to all members in the cooperative's designated journals or under the internet address of the cooperative or directly in written form (§ 46 GenG). The members are also entitled to receiving a copy of the minutes of the delegates' meeting on their request (§ 47 GenG).

Amendments in the section on auditing seek to guarantee the independence of the auditing (see §§ 53 et sequ.). All cooperatives are audited in regular intervals by an auditing association. Each member of the cooperative shall be entitled to inspection of the summarized results of the audit report (§ 59 GenG).

8. Transfer of membership shares

Each member has the right of withdrawal from the cooperative (§ 65 GenG). It may also terminate the membership by transferring its membership shares to another person. Since 2006 it is also possible to transfer not all, but only some of the membership shares and keep the rest (for details see § 76 GenG). In any case, the acquirer must be or must become a member of the cooperative.

IV. Final Remarks

It is too early yet for the evaluation of the practical results of the measures taken. German authors like to point out that reforms on the national level have been rather moderate so far. In any case the renewed interest in cooperative societies is certainly positive. One should also have in mind that the insolvency rate of cooperative societies is extremely low. It will be of special interest to watch whether investor members will become a reality and how the conflicts of interest between them and the ordinary members will be solved in practice.