

# Cooperative Law in Norway – Time for Codification?

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## 1 Introduction: A Lacuna in Norwegian Company Law

The Nordic countries differ in their regulatory approach to cooperatives. Finland (since 1909) and Sweden (since 1895) have for many years enacted laws on cooperatives. In Denmark and Norway proposals to enact laws on cooperatives have been rejected. In Norway, this situation may now change.

Prevailing Norwegian cooperative law is case-based, apart from two specific acts governing building societies and housing cooperatives.<sup>1</sup> A Governmental Law Commission was appointed in 1999 to consider the need for a general act on cooperatives and to work out a draft law. On March 5<sup>th</sup> 2002 The Norwegian Cooperative Law Commission handed over its report to the Minister of Justice (Norwegian Governmental Commission Report – NOU 2002: 6).<sup>2</sup> The commission unanimously recommended the adoption of an act. The commission report represents the fifth attempt in a century to adopt general cooperative legislation in Norway.

The report has been subject to a customary consultative procedure by the Ministry of Justice. During the consultative round, 47 organisations and individuals have submitted comments. A compilation of the comments made by the Ministry of Justice totals 168 pages. The great majority of the comments are in favour of adopting a law much like the one proposed by the law commission. The four previous attempts at proposing an act on cooperatives were unsuccessful, due to resistance from the cooperative sector. This time, the strongest objections have been voiced by three bodies representing competitors of the cooperative sector. They state that The Cooperative Law Commission has

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<sup>1</sup> Act 4<sup>th</sup> February 1960 No. 1 and Act 4<sup>th</sup> February 1960 No. 2. These acts will be replaced by two new acts on building societies and housing cooperatives: Act 6<sup>th</sup> June 2003 No. 38 and Act 6<sup>th</sup> June 2003 No. 39.

<sup>2</sup> The Internet version of the report is published at: “<http://www.odin.dep.no/jd/norsk/publ/utredninger>”.

not given enough importance to competitive conditions especially in the agricultural area. – This fifth time around, the cooperative sector itself appears to be, on the whole, rather strongly in favour of having the draft law adopted.

The mandate for the governmental law commission mentioned the four previous efforts to enact statutes on Norwegian cooperatives during the twentieth century. When the first Norwegian Corporation Act was prepared, a proposal on a Cooperatives Act was also put forward (Odelstingsproposisjon No. 28 1900-01). The proposal did not please Parliament. Another commission was set up in 1922 putting forward another proposal for a Cooperatives Act in 1925 – again to be rejected. The exercise was repeated with a commission set up in 1936, only to have its draft rejected in 1937. In 1953 a fourth commission was set up. This time the mandate was limited to discussing the need for an Act on Consumer Cooperatives. Nothing came of it.

After four fruitless tries within a period of 53 years, one may understand why it took another 46 years before a Norwegian government again thought it worthwhile to ask a commission to consider the need for a Cooperatives Act.

A new statute on cooperatives would fill a lacuna in Norwegian company law. During the last quarter of the twentieth century, most of the law in Norway concerning different legal persons and organisations was codified. In 1980 an act on foundations (stiftelsesloven 23<sup>rd</sup> May 1980 No. 11) was passed and in 1985 an act on partnerships and limited partnerships (selskapsloven 21<sup>st</sup> June 1985 No. 83). At present, non-profit associations and cooperatives constitute the uncodified area of the law on organisations. There is no indication that a law on non-profit associations is forthcoming. The case concerning cooperatives is quite different, as the cooperatives are much more of a player in the economic arena of Norwegian society.

Up to 2003, there was no EU legislation on cooperatives. Therefore, a model law on cooperatives has not been a part of the EEA agreement. The Agreement on the European Economic Area was signed in 1991 and entered into force January 1<sup>st</sup>, 1994. Three EFTA countries – Iceland, Liechtenstein and Norway – are now parties to the EEA agreement, in addition to the EC and the EU member states.

As of 22 July 2003, the legal situation concerning cooperatives within the EU has been somewhat changed as the EC Council adopted a Regulation on the Statute for a European Cooperative Society (SCE).<sup>3</sup> This Regulation on European Cooperatives attends cooperatives with members in at least two EU member states. It does not, however, make any requirements concerning purely national cooperatives. It is not clear at what time this SCE Regulation may become part of the EEA agreement.

In Norway the EEA agreement in 1997 resulted in the adoption of two new acts on corporations. If a law proposal on national cooperatives as recommended by the Norwegian Law Commission, is put forward to Parliament, there is no obligation under the EEA agreement to enact any law on cooperatives.

For many years, there have been acts on cooperatives in Sweden and Finland, but there is no act in Denmark. In Sweden, the act is called the Act on Economic Associations (lag 1987: 667 om ekonomiska föreningar). Sweden has been

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<sup>3</sup> Council Regulation (EC) No 1435/2003.

enacting acts on economic associations since the end of the nineteenth century. The first Finnish Act on cooperatives was enacted in 1909. The current Finnish Act was adopted December 28<sup>th</sup> 2001, and entered into force January 1<sup>st</sup> 2002. Denmark has twice had commissions drafting acts on cooperatives (1910 and 1986 – Betænkning No. 1071 1986), but no proposal for a law has been sent to Parliament. The resistance from the Danish cooperative sector has been considerable whenever the idea of a general law has been raised. There have also been comments in the Danish cooperative press being amazed at the need for a Norwegian report of 447 pages on the need for an extensive and detailed statute for a sector that may appear to function reasonably well on its own.

A main reason why the four foregoing efforts on cooperative legislation in Norway have failed seems to be, as already indicated, that an act has not been desired from the cooperative sector itself. Traditionally the cooperative sector in Norway has preferred to evolve without a restraining act. In a report published in 1997, the Norwegian Standing Committee on Co-operative Affairs (“Samvirkeutvalget”), which is a joint forum for cooperatives in the four largest sectors, seemed fairly sceptical as to the need for an act on cooperatives. When The Norwegian Cooperative Law Commission was appointed in 1999, it was not greeted with any notable enthusiasm from the cooperative sector. The consulting comments reflect that this attitude has changed or, at least, been greatly modified.

In this chapter, the main proposals of the Norwegian Cooperative Law Commission will be outlined. We will present some core features of the commission report, focusing in particular on two subjects: The discussion for and against legislation on cooperatives in Norway, and the draft law. To a large extent, the draft law proposals codify or clarify current unwritten law. A presentation of the draft law of the Cooperative Law Commission may serve as an introduction to the main principles of current cooperative law in Norway. Firstly we will, as a background, give a short description of the existence of cooperatives in Norway today.

## 2 Cooperatives in Norway Today

In Norway there are four big cooperative sectors: Agriculture, fishing, consumer and housing.<sup>4</sup> *The agricultural sector* consists of 15 national cooperatives governing refine, sale, purchase, breeding, credit and insurance. The agriculture cooperatives have approximately 60,000 members and 15,000 employees.<sup>5</sup> The annual turnover is approximately 36 billion NOK (4.6 billion Euro).

*The fishing area* consists of six sales-cooperatives with exclusive rights to first-hand sale of all kinds of fish and shellfish, except breeding fish. This sector has totally 13,000 members, and an annual turnover of approximately 10 billion

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<sup>4</sup> For further information about the four main cooperative sectors in Norway, see Review of International Co-operation Vol. 96 No. 1/2003 at 6-17 and “<http://www.samvirke.org/english>”.

<sup>5</sup> Norway has a population of 4,513,000.

NOK (1.3 billion Euro). Fishery, including the fish farming industry, is the second largest export industry in Norway after oil and gas.

There are 238 *consumer cooperatives* in Norway operating 1300 stores. The consumer cooperatives have more than 900,000 members and 18,000 employees. The annual turnover is approximately 27.5 billion NOK (3.5 billion Euro). The apex-organisation, Coop NKL BA, is a part of the Coop Nordic Group, which is the largest actor in retail food industry in Scandinavia.

*Housing* is a very important cooperative sector in Norway. There are a total of 4,400 building and housing cooperatives with 652,000 members and 256,000 dwellings. After World War II cooperatives became a notable instrument in the Norwegian housing sector by providing a lot of people with their own residence. On June 6<sup>th</sup> 2003 the Parliament adopted two new acts on building and housing-cooperatives, which will replace the current acts from 1960.

In addition to these four dominant areas, cooperatives are organized in many parts of economic and social life. There are business cooperatives such as transport cooperatives and energy supply cooperatives. Furthermore, there are smaller cooperative organisations in such areas as health-care and rehabilitation, school, local radio- and TV-production, library, laundry, cold store, bakery, water supply, museum, recreational facilities etc.

### **3 The Need for a General Act on Cooperatives in Norway**

The law commission emphasized that *there is a need for organisational structures that encourage active member participation in both economic enterprises and other parts of social life*. In a social perspective it is important that the cooperative form represents a real alternative as regards organising economic activity. At the same time, the law commission pointed out that the lack of a general act on cooperatives hampers the establishment of new cooperatives. The commission referred to statistics showing that only 0.4 % of all enterprises established in Norway in 2000 were cooperatives (building and housing cooperatives are not included in this figure). According to the commission, this indicates that the cooperative form is *too unfamiliar, too anonymous and too incomprehensible*. It may, however, appear uncertain how much weight is given by the established cooperatives to the argument that the cooperative organisational form may be too unclear to be applied by new enterprises.

It has been argued that there is no need for an act on cooperatives in Norway, because *Norwegian cooperatives for nearly 150 years have managed well without a general act*. The law commission found it difficult to evaluate the validity of such a contention. However, the commission referred to the fact that there are few start-up cooperatives, and that in some sectors there is a tendency towards conversion into other forms of organisations. New enterprises, even on a small scale and based on cooperative efforts by interested parties, most often choose to incorporate as joint-stock companies (“aksjeselskaper”). A reason for this may be the lack of a clear legal framework for cooperatives.

A basic question is *whether the current case-based law is satisfactory* compared to the situation with a written law. According to the commission,

prevailing cooperative law is characterized by 1) relatively great flexibility, 2) indistinctiveness and 3) incompleteness in the way that there are certain kinds of rules that cannot be developed on the basis of case law (rules about concerns, the co-determinations of the employees etc.). The opinion of the commission was that the current state of the law has some major weaknesses. The lack of clarity and accessibility was particularly stressed. During recent years in Norway, the costs of legal assistance have risen sharply with an extra increase of 24 % VAT due to the Norwegian 2001 VAT Reform. To the present authors it appears quite reasonable to assume that there will be some reluctance for small start-ups with limited resources in applying legal forms that are surrounded by a high degree of uncertainty due to the lack of explicit legislation.

Established cooperatives that may want to undergo mergers, divisions or other kinds of reorganisations, sometimes find that the current law is too unclear or makes such changes very hard. Under Norwegian tax law, mergers etc. may be taxable unless they may be considered to be executed in accordance with the company law (e.g. cooperative law). The result is that a cooperative wanting to merge, change organisational form etc. may be risking an uncertain, but considerable tax bill.

The law commission maintained that it is feasible to draw up a law, which imposes a *systematic and fairly complete "tailor-made" regulation of cooperatives* without restraining their flexibility in an unreasonable manner. The commission acknowledged that legislation in some respects might lead to limitations compared to the present situation. However, in the making of the draft law the commission underlined that any kind of limitation must be justified with reference to third party interests, minority member interests or the need to protect the cooperative identity. The provisions regarding mergers and liquidations also pay attention to the concerns of former members and other stakeholders, e.g. governmental agencies having provided grants, tax benefits etc. Moreover, the commission accentuated that an act on cooperatives also provides new possibilities in some respects (for instance the rules about mergers and divisions/de-mergers), where the current law is at best unclear and in some instances does not provide satisfactory options.

The commission pointed out that an act might *make it easier to organize new cooperatives in an expedient manner*. An act that lays down what the bylaws shall and may contain, may lead to a better quality of bylaws, and consequently, fewer conflicts. Furthermore, an act can also *serve as background rules of law*; the act might have a supplementary and reparatory function in relation to imperfect bylaws.

One question the commission considered during its deliberations, is *to what extent the flexibility of the current law may result in allowing for too much isomorphism whereby the cooperatives gradually start losing their cooperative identity*. In practice, the dilemma is to what degree the cooperatives may be moving closer to ordinary capital corporations where the participation is not personal and activity-related, but based on capital contributions and ownership rights.

Organisational theory indicates that the process of isomorphism is the natural outcome of external forces exercising their pressure on different kinds of organisational forms. Professional norms and copying stimulate the same erasing

of differences. Gradually, these organisational forms start moving closer together, resembling each other.<sup>6</sup> In an international business world with a strong focus on capital, it may be more likely that the transformation processes of cooperatives work in the direction of capital corporations, than movement in the opposite direction. The concept of customer loyalty, all kinds of rewards and membership schemes by different kinds of profit oriented retailer chains and service providers indicate, however, that the picture is not clear-cut. All the forces of isomorphism are not working in the same direction. Ordinary business is also learning from the cooperative loyalty and membership way of thinking.

In spite of the tendency towards isomorphism, it is easy to argue that organisations within a society fulfil multiple purposes. This diversity of functions requires a multiple of truly different organisational forms as organisational form and activity are related. If one wants society to be able to offer a cooperative structure that is truly genuine, legislative barriers against the process of isomorphism may be required. An act on cooperatives may be the most natural way of doing this. Codifying the law on cooperatives may be a means to maintaining distinctiveness.

If one ends up with one definition of cooperatives for tax purposes, one for banking purposes, one for registration purposes etc., the result may be a definition of cooperatives that is not truly grounded on a thorough knowledge of the cooperative field and principles. The banking-, tax-, and registration-considerations will be in the forefront.

An act on cooperatives may *harmonize with existing rules governing other kinds of organisations, persevering at the same time the cooperative identity*. If there is no reason to lay down a distinctive rule for cooperatives, one can choose the same rules as in the acts on corporations, partnerships or building and housing cooperatives. In this manner the proposed law on cooperatives might make for more coherent Norwegian legislation on organisations and corporations. In addition, it may be advantageous that case law and legal theory in connection with a provision in one act may be utilized when interpreting an identical provision in corresponding acts.

The law commission stressed that an act on cooperatives may *strengthen the legal protection of minority members and third party interests (creditors, contracting parties, employees etc.)*. Even today the courts may respond to evident violations against minority rights within cooperatives. However, for lack of a general law the minority protection in cooperatives may be weaker than in other enterprises. By the same token, employees in cooperatives – as opposed to employees in other enterprises – do not have any legal right to be represented on the boards of directors. - From anecdotal evidence, it appears that many of the conflicts in existing cooperatives are due to the fact that the protection of minority interests is quite unclear under current law. At times, it may appear rather weak.

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<sup>6</sup> Røkholt, Per Ove, *Strengths and weaknesses of the co-operative form: A Matter of Perspective and Opinion*. Paper presented at the ICA International Co-operative Research Conference, Quebec, 28-29<sup>th</sup> of August 1999.

## 4 Draft Law

### 4.1 General Remarks

The Cooperative Law Commission submitted a proposal on *one single law governing all kinds of cooperatives*, except building and housing cooperatives and mutual insurance associations. Even though there may be substantial differences concerning the character and size of the enterprises, the commission, after some deliberations, became convinced that it is possible to form an act that provides for a satisfactory regulation for all cooperatives regardless of size. With two acts, one for small and medium-size cooperatives, and one for large cooperatives, one might end up creating more problems than were solved.

In Norway, as in many other countries, there may be drawn a distinction between the traditional cooperative sector and new cooperatives. Some of the enterprises in the old cooperative sector are quite large, while the new cooperatives are often quite small and sometimes quite “private” in nature. Within the EU member states, there is a tradition that the regulation of corporations takes place through two parallel legislations. There is one act for large corporations that attract capital from external sources, and one for small corporations where a closed circle of investors holds the stock. Norway has adopted the same two-line way of legislating for corporations even though this is not expressly required neither by the EU directives nor the EEA agreement.

The law commission on cooperatives discussed whether one should adopt a similar two-tier structure for legislation on cooperatives. An independent act for small corporations might make the provisions more easily accessible to them. On the other hand, most modern acts invariably end up being reading materials for lawyers and experts that have to be “translated” to be useful for the layman. Having two parallel acts for cooperatives necessarily increases the number of articles, interpretation and coordination problems anybody interested in cooperatives have to deal with. There would have to be rules on transformation from small to large cooperatives, and vice versa. Regardless of the cooperative being large or small, the basic cooperative principles should be the same. Therefore, the need for a somewhat simpler regulatory scheme for small cooperatives might be taken care of through special exemptions for them as part of the general act. The content of the act might be made available for the small cooperatives through model statutes for different kinds of small cooperatives according to what line of services and business they are in. Accordingly, the commission found that the promotion of cooperatives would be most appropriate by one common act. After 100 years of unsuccessful attempts at legislation, the commission did not want to try to go “one bridge too far”.

The commission made an effort to draft an act that opens for *a great extent of flexibility*. Many of the provisions are therefore made non-mandatory. Also, when deciding what situations should at all be regulated, the commission gave priority to allowing the cooperatives a certain freedom.

The draft law *is based on the cooperative principles*, as adopted by The International Co-operative Alliance at its Centennial Congress in Manchester in 1995. The draft law neither lists nor expressly refers to the principles, but some of them are included in the legal definition of cooperatives, whilst others are

expressed in different provisions. They are also referred to in the report of the commission. In Norway, preparatory works, such as commission reports, may influence the courts when interpreting statutory provisions. Already, under the current law, the courts refer to the cooperative principles. This will, no doubt, also be the case in the future if the draft law is adopted.

Even though the draft law is based on the cooperative principles, the commission *also considered solutions laid down in current company law and in the proposals for the two new acts on building and housing cooperatives (enacted as Act Nos 38 and 39/2003 – not yet in force)*. The systematic structure of the proposed act on cooperatives has much in common with The Private Company Act. Furthermore, the provisions that state the procedure of formation, merger, division, conversion and liquidation are fairly similar to the corresponding provisions in The Private Company Act. Reading the proposed act on cooperatives, it is quite clear that the commission through its proposal wanted to fill the lacunae in Norwegian company law due to the fact that the cooperatives have no general legislation of their own.

The draft law has *159 sections spread over 13 chapters*. Below, we shall present some main features.

## **4.2 Scope and Definitions**

The draft law sets forth under § 1, second paragraph that its provisions govern:

enterprises whose main purpose is to promote the members' economic interests through their participation in the enterprise as buyers, suppliers or in other similar ways, and in which

1. the yield of the enterprise, except a normal interest on invested capital, either is kept in the enterprise, or is distributed among the members in proportion to the volume of their transactions with the enterprise, and in which
2. none of the members have personal liability for the debts of the enterprise.

According to this basic definition, there has to be some kind of economic transaction between the members and the cooperative. However, the commission neither in the wording of the law itself nor in the commentaries stated explicitly what percentage of the transactions of the enterprise should be with its members to qualify as a cooperative. Under current law the transactions with the members may not be insignificant. But one may probably not under the current law require, as a general and mechanical rule, that at least 50 per cent of the transactions of the enterprise be with the members.

In regard to cooperatives that are part of a vertical structure (groups and federatives) § 1 third paragraph contains an exemption: In vertical structures it is not an absolute prerequisite that the members enter into transactions with the cooperative of which they are members. Instead they may, on further conditions, enter into transactions with another enterprise that is part of the same vertical structure, e.g. a subsidiary of the cooperative.



§ 1 fourth paragraph states that the draft law does not apply to private or public companies, housing and building cooperatives and mutual insurance associations.

Both under current law and the draft law, each time a new cooperative is to register, the Norwegian Register of Business Enterprises has to decide whether the purported cooperative as judged from its statutes, qualifies as a cooperative. If it does not qualify, registration as a cooperative (company with limited liability – “selskap med begrenset ansvar BA”), will be denied. One of the most vocal proponents of a codification and clarification of the law on cooperatives has been the Enterprise Register. The spokespersons of the Register have pointed out that it has become increasingly difficult to decide whether a company qualifies as a cooperative. The Register has clearly favoured that an act be implemented in order to clarify the criteria regarding what kind of company should qualify as a cooperative. As the Register sees it, the classification problems are increasing partly due the cooperatives pursuing new areas of activity. There should be no doubt that the classification problems should be reduced under the draft law, regardless of the fact that not all the classification criteria are mechanical and without any need of discretionary judgements.

The legal definitions of federatives and groups are stated in §§ 4 and 5. According to the definition of federatives, the members of the second level cooperative have to be other cooperatives, or other cooperatives must at least have a determinant influence over the second level cooperative. The key element in the definition of a cooperative group is that a cooperative must have a determinant influence over another enterprise. The subsidiary cannot be a cooperative – it will typically be a private company.

§ 6 of the draft law lists the conditions for use of electronic communication between the cooperative and its members while sending messages and information according to the law. A cooperative may only communicate electronically in its dealings with a member that expressly has accepted this form of communication in advance. A member may send messages etc. by means of electronic communication to the e-mail address or in whichever way the cooperative has stated for the purpose.

### **4.3 Formation and Registration**

The formation of a cooperative requires that at least two persons date and sign a formation agreement (draft law § 8). The founders may be either natural or legal persons, and they may be either private or public bodies. – Art 2(1) of the EC Regulation on European Cooperative Societies requires that an SCE be formed by five persons.

After the signing of the formation agreement, the formation has to be notified to The Norwegian Register of Business Enterprises within three months. If this deadline is not kept, the formation agreement will be ineffective, and the cooperative cannot be registered.

In conformity with current Norwegian cooperative law, the draft law does not fix a minimum capital that has to be paid in connection with the formation. The commission found that any capital requirement might act as an impediment to

establishing small cooperatives. All cooperatives, however, have to respect the requirement that its funds should be adequate for its activities and obligations. As there are no fixed capital requirements, the proposed rules on formation are simpler and less extensive than the corresponding rules in the companies acts. – The EC Regulation on European Cooperative Societies art 3(2) requires a minimum capital of EUR 30,000. For a cooperative operating at a European level, this requirement may, however, appear quite moderate. It does not really reflect another basic attitude than the Norwegian proposal for no nominal capital requirements for domestic cooperatives.

#### **4.4 Membership in Cooperatives**

The cooperative principle on voluntary and open membership is expressed in the draft law §§ 15 and 23. The principal rule is that a cooperative must be open for all persons whose interests may be taken care of by the cooperative. Membership can only be denied on justifiable basis – there must be a relevant ground.

According to the draft law, the basic rule is that members can resign from a cooperative at any time. However, the bylaws may contain a time limit for withdrawal, which cannot exceed three months in primary cooperatives and 12 months in secondary and higher level cooperatives. Other kinds of withdrawal restrictions can only be laid down in the bylaws if there are weighty and reasonable grounds to do so.

The economic settlement in connection with a resignation may to some extent be regulated by the bylaws. The declaratory rule is that a resigning member has the right to have his capital investment reimbursed at nominal value. A limited interest on the investment can be paid if allowed by the bylaws. A resigning member has basically no right to a share of the cooperative's assets. However, in working cooperatives it is permitted to have bylaws that allow resigning members such a right.

Memberships in cooperatives are in general not transferable, but the bylaws may contain provisions providing that memberships may be transferred on approval from the board of directors, the manager or others (draft law § 21). The acquirer must accede to the former member's rights and obligations towards the cooperative. This also includes contractual positions connected with the membership. The former member may still be held responsible for his economic obligations, if something else is not laid down in the bylaws or a separate agreement with the cooperative.

A member may be excluded from a cooperative in case of a fundamental breach of his obligations (draft law § 24). Furthermore, the bylaws may establish that a member may be excluded if the member does not have any transactions with the cooperative for a period of at least one year. As a main rule the economic settlement is the same for an excluded member as for a voluntarily withdrawing member, but the bylaws may provide for other solutions.

The draft law operates with two kinds of sanctions in situations where the cooperative has violated the rights of a member: Right to immediate withdrawal irrespective of any restrictions in the bylaws, and right to release (draft law § 25). The right to immediate withdrawal presupposes a fundamental breach. The

right to release is, in addition, conditional on being not unreasonable to the cooperative. The conditions for release are meant to be very strict, partly because the amount of releasing is calculated according to the member's share of the cooperative's assets.

#### 4.5 Capital Formation and Distribution of Surplus

The draft law does not require the constitution of a reserve fund. The girder of the capital protection system is a requirement of *sufficient capital* in light of the risks and size of the enterprise, i.e. *a legal standard referring to prudent and good business practice*. This means that the draft law, as opposed to the acts on private and public companies, does not establish a distinction between free and tied up equity. Regarding private and public companies ("aksjeselskaper" and "allmennaksjeselskaper"), the Norwegian law has detailed requirements concerning what part of the capital that may be distributed. The proposed cooperative law deviates from this tradition in its simplifying emphasis on the requirement that there should be sufficient capital left after any distributions.

Today the capital formation in Norwegian cooperatives has four main sources: Members' investments, undistributed surplus, savings schemes for the members and external loan capital. The law commission discussed different kinds of external financing, e.g. transferable investment certificates. However, the commission concluded that the capital formation in Norwegian cooperatives should still be based on self-financing supplemented with the possibility for member investments/savings and external loans. The commission could not see that there was a substantial need for alternative capital instruments. The commission also emphasized that an introduction of such instruments might result in an invidious conflict between member interests and investor interests. This might threaten the cooperative principles, especially if external investors were granted voting rights in the cooperative. The proposed Norwegian law consequently differs from the Swedish act that allows for a kind of equity with limited voting powers from non-members (so-called "förlagsinsatser"). The Norwegian commission still felt that allowing for equity from non-members might violate the basic cooperative principle that only members should control voting powers.

The commission had many discussions on what restraints, if any, there should be on distributing retained surplus referring to earlier years. One of the reasons why the commission found it somewhat hard to decide upon the appropriate rules, might have been that it did not see that there were any clear guidance to be found neither in the cooperative principles nor in the cooperative law of other countries or in the international literature on the subject.

As a basic rule, the draft law states that the annual surplus should be credited the general equity of the cooperative (§ 28). The bylaws may contain four forms of alternative application of surplus:

- 1 Back pay in proportion to the volume of the members' transactions with the cooperative,

- 2 Allocation to “back pay-fund” (collective equity),
- 3 Allocation to member capital accounts (individual equity), and
- 4 Interest payment on the members’ investments and capital accounts.

These alternatives presuppose that there is a remaining surplus after the deduction of loss and, possibly, the deduction of surplus that should be allocated to funds due to the bylaws.

The “*back pay-fund*” is an innovation in Norwegian cooperative law. The objective of this construction is to stimulate consolidation – the members should not be forced to distribute the surplus directly to prevent that it becomes a part of the general equity. The fund, which cannot exceed 20 % of the balance sheet amount, can be spent on distributions to the members in accordance with the volume of their transactions with the cooperative for a period of at least one year. The balance of the fund may also be transferred to the members’ capital accounts or to the general equity of the cooperative. The requirement that the back pay-fund may not exceed 20 % of the balance sheet amount is founded on the idea that the cooperative should not risk having to distribute a large part of its capital at any given moment in time. Fixing the percentage at 20 % may to some extent be regarded as a kind of best estimate.

The system of *member capital accounts* also has a consolidation purpose. But opposed to the “pay back fund”, this is a kind of individualized equity. Allocations to the capital accounts have to be in conformity with the volume of the members’ transactions with the cooperative. The general assembly may decide that the credit balance of the individualized member capital accounts be paid to the members, but only if this option is laid down in the bylaws. Moreover, the members have the right to the capital on their account in case of withdrawal or in case of liquidation of the cooperative. In a situation of insolvency, creditors have priority over members. – Under the draft law, the members have no such rights regarding the back pay-fund that may be regarded more as distributable collective capital.

#### **4.6 *Organs and Management of the Cooperative***

According to the draft law, the general assembly and the board of directors are the only obligatory organs of a cooperative. Basically a cooperative should also have a manager, unless otherwise stated in the bylaws. If a cooperative does not have a manager, the board leader – or the board as such – carries out his functions. The draft law contains rules concerning two facultative organs: The board of representatives and the supervisory committee. While the supervisory committee is a unit that exclusively deals with control, the board of representatives may also have other functions under the bylaws.

The general assembly is the supreme decision making body of the cooperative (draft law § 37). Every member has the right to meet at the general assembly, either in person or through a legal representative. In cooperatives with more than 200 members, the bylaws may require that the general assembly be

composed of delegates. While a legal representative acts on behalf of one single member, a delegate acts on behalf of a group of members. Delegates can only be elected on the basis of geographical location, number of members in the group or the volume of the group's transactions with the cooperative.

In conformity with the cooperative principles, the draft law states as its basic rule that each member has one vote at the general assembly (draft law § 40). However, the bylaws may allow the members additional votes due to the volume of their transactions with the cooperative. In secondary cooperatives the bylaws may also specify that votes shall be distributed on the basis of the number of members or geographical location of the primary cooperative. According to the draft law, no member may by himself have the majority of the votes.

Decisions in the general assembly may be taken by simple majority, unless otherwise required by the bylaws or legal provisions (draft law § 55). Decisions amending the bylaws require a two third majority. Some amendments to the bylaws may only be enacted by an even more qualified majority (draft law § 56). This concerns substantial amendments to the objective of the cooperative, increasing the members' financial liability towards the cooperative or its creditors, the introduction of trading obligations or restrictions of the right to withdrawal. These decisions can only be made by unanimity, or by a three quarter majority at two subsequent general assemblies.

The rules on boards of directors and the manager are formed with The Private Company Act and The Public Company Act ("aksjeloven" and "allmennaksjeloven") as a pattern. These rules will not be described any further here. Nevertheless, it is worth mentioning that the draft law gives the employees the right to representation on the board of directors if the cooperative has more than 30 employees. According to current Norwegian law the employees in cooperatives, as opposed to employees in partnerships and companies, do not have a legally protected right to such codetermination. In practice, however, and under an agreement entered into by the large cooperatives and the nationwide unions, there has been employee representation on the boards of the most important Norwegian cooperatives for many years. The draft law makes this voluntary representation mandatory, under the same criteria and with the same number of representatives as under the laws on corporations, companies and economic foundations.

#### **4.7 Audit**

Under the draft law every cooperative must have an auditor. If the total annual turnover of the cooperative exceeds 5,000,000 NOK (ca. 690,000 Euro), the auditor has to be state authorized. Every financial year, the auditor's statement must be presented to the general assembly.

#### **4.8 Dissolution**

According to the draft law, the dissolution of a cooperative may either be voluntary or, in more extraordinary situations, compulsory. Dissolution may be

resolved by *the general assembly* with the same majority as for the amendment to bylaws (draft law § 129). Dissolution by *the court* is a sanction in instances where the cooperative has violated specific obligations of major importance, e.g. neglecting to submit the annual accounts or the auditor's annual statement to The Norwegian Register of Company Accounts (draft law § 143). Voluntary dissolutions follow the provisions in the act on cooperatives, whilst compulsory dissolutions are subject to the provisions of The Bankruptcy Act and The Creditors Security Act.

The main focus of the deliberations in the law commission concerned the distribution of assets in the case of voluntary dissolution. Much effort was put into establishing rules both in accordance with the cooperative principles and at the same time allowing for some kind of membership rights to the assets. Regarding the distribution of assets on dissolution, the draft law will allow for more flexibility as well as more certainty than under the current law.

The basic principle of the draft law is that the members on voluntary dissolution of the cooperative have the right to repayment of invested capital and any funds in their individualized member accounts, as long as the obligations towards the creditors are made up (draft law § 137). Any additional funds should be distributed to cooperative purposes or to public benefit purposes. Consequently, the main rule is that the members do not have any right to the net capital in the event of liquidation. The net capital, including undistributed profits and any remaining balance on the pay-back fund, apart from the individualized member accounts, is treated as a kind of collective cooperative capital not any more belonging to the cooperative under dissolution or its members. However, the bylaws may specify that on dissolution all or parts of the net capital should be distributed to the members – or even to former members – on the basis of the volume of their transactions with the cooperative during the last five years (possibly a shorter period if this is stated in the bylaws, but not shorter than one year). The net capital cannot be distributed to the members in any other way, e.g. under any other criteria than the volume of their transactions. The commission held that it would violate the cooperative principles to allow distributing the net capital of the cooperative on the basis of invested capital or any kind of stakeholder interest other than the volume of members' transactions with the cooperative.

Many of the present Norwegian cooperatives have bylaws stating that the net capital in case of liquidation shall be donated to cooperatives or to public benefit purposes. A crucial question is: Should it be possible to amend the bylaws so that the members get a right to the net capital? This question was discussed in depth by the law commission. The conclusion of the commission is that such amendments should be possible, but only under strict conditions: The decision has to be made with a three quarter majority at two subsequent general assemblies and there must be a reasonable ground for the decision. In addition the decision has to be approved by a public authority. This requirement is added in order to avoid situations where a membership majority may simply want to distribute funds among themselves – funds to which the present members may not in any way have made any significant contributions. It is not a matter of applying for a permit, but the controlling public authority that is suggested to be the supervisory body for foundations (“Stiftelsestilsynet”) should make up its

mind whether the reasons offered amending the bylaws and allowing distributing the liquidation proceeds to the members are legitimate.

#### **4.9 Merger and De-merger**

The law commission has drawn up rules on merger and de-merger (draft law chapter 8 and 9), which to some extent are identical to the corresponding provisions in The Private Company Act (“aksjeloven”). The primary objective of the provisions is to make it possible to accomplish these transactions in accordance with a continuity principle, i.e. that the legal positions of the transferring cooperative(s) continue in the absorbing cooperative. Thereby, the commission assumed that the mergers and de-mergers will be accepted as non-taxable events as long as the tax cost basis etc. are continued by the merged and de-merged cooperatives. This is how mergers and de-mergers of corporations are regulated for tax purposes. The same kind of continuity principle for tax purposes is also applied in the case of mergers and de-mergers of cooperatives under the current law. A new law on cooperatives will, however, make the situation clearer, both from a company law and tax law perspective.

The draft law operates with two main types of merger and de-merger: One where the absorbing cooperative(s) exist(s) in advance, and one where the absorbing cooperative(s) is/are founded as a part of the transaction. The provisions are in general applicable only when all the involved enterprises are cooperatives. There are two exemptions from this where a cooperative has subsidiaries organized as private companies. Both mergers between a cooperative and a subsidiary and mergers between the subsidiaries may in such cases be accomplished according to a simplified procedure.

Decisions on merger and de-merger can be made with the same majority as for amendment to the bylaws (normally a two third majority). If a merger or de-merger would result in the members of one of the involved cooperatives gaining increased access to the net capital in the event of liquidation, the draft law requires a three quarter majority at two subsequent general assemblies of the cooperative in question. In addition there must be a reasonable ground for the transaction, and a public authority must approve the decision. These conditions are the same as when the bylaws are amended so that the members get an increased right to the net capital in event of liquidation. The underlying rationale is also the same. The members should not be allowed to gain access to the net capital of the cooperative by way of a merger or de-merger if this alternative is blocked in the case of a direct liquidation.

As far as mergers are concerned, each member of the transferring cooperative has a right to membership in the absorbing cooperative. When it comes to de-mergers, there is one additional option if the transferring cooperative is meant to exist after the de-merger: Compensation by way of increased investments in this transferring cooperative, instead of or in addition to, membership in the absorbing cooperative. Compensation beyond a membership in an acquiring cooperative has to be yielded in accordance with the volume of the members' transactions with the cooperative for the last five years (possibly a shorter period

if it is stated in the bylaws, but not shorter than one year). Consequently, this rule is the same as in the case of liquidation.

#### ***4.10 Conversion to Private and Public Companies***

Pursuant to current Norwegian cooperative law, a cooperative may not convert into a private or public company without ceasing to be a body corporate. The law commission has proposed rules on conversion based on a continuity principle (draft law chapter 11). The objective of the rules is to facilitate restructuring processes and bring them into adequate forms.

Both the procedural and substantive provisions on conversion have much in common with the rules on merger and de-merger. It is, however, not necessary to send a notice to the creditors or to involve them in other ways. This is due to the fact that the rules on conversion refer to the rules on founding of private and public companies. Besides, in connection with a conversion, there is no cash outgoing to the (former) members of the cooperative. The members get their compensation by way of shares in the company on the basis of the volume of their transactions with the cooperative during a certain period previous to the conversion. Thus, the shares are not distributed to the members according to the size of their investment in the cooperative.

The rules of the draft law on liquidation, mergers, de-mergers and conversion will make the law on cooperatives more flexible with less lock-in effects and at the same time more certain than under the current Norwegian law. At present, it is not settled what rights the members of a cooperative may have to the net assets of a cooperative in case of dissolution. Also, the law is not quite clear as to under what conditions a cooperative may merge, de-merge or converse into either a private or public company. As certain tax law benefits (e.g. merging without being made taxable for unrealized gains) in Norway is linked to what is allowed under private law, much attention has been paid to these uncertainties.

The law commission may have hoped that the more flexible law on liquidation etc. would create a more favourable attitude towards the enactment of the first general Norwegian law on cooperatives.

#### ***4.11 Regulatory Body***

Under the current law, the governmental authority (apart from tax authorities etc.) all cooperatives will get in touch with is The Norwegian Register of Business Enterprises. This register has very limited functions. It is not to act as some kind of company – or cooperative – police. When a company or cooperative is set up, it has to register with the Enterprise Register. Changes in the registered data should also be submitted to the register. The register is passive until applications for primary registering or changes are received. Then the register scrutinizes whether the applications are in accordance with the law. But the register is not actively checking whether the day-to-day operations of the cooperative are run according to its own statutes and the cooperative principles. No other governmental authority in Norway is policing the daily operations of



the cooperative sector. Due to the requirements of some tax provisions allowing certain benefits for cooperatives, the tax assessment offices may some times look into the running of the cooperatives to check that the requirements of the tax law are fulfilled. The Enterprise Register appears uncomfortable regarding the lack of follow-up supervision of the cooperative sector.

The Cooperative Law Commission proposed that the new nationwide governmental authority supervising foundations (“Stiftelsestilsynet”), also be given supervisory functions regarding cooperatives. The commission found that the involvement of some kind of governmental authority was necessary to allow for more flexibility to avoid lock-in effects regarding out-dated bylaws, mergers, conversions etc.

#### ***4.12 Transitional Provisions***

Due to the experience of the last century with four unsuccessful attempts to legislate on cooperatives, the commission proposed flexible transitional rules. If a cooperative has been formed before the law is put into force, the law will not be mandatory before five years have passed. The cooperative itself may, however, decide that the law should apply by registering as a cooperative under the new law with The Enterprise Register.

Two or three years may pass before any law proposal is put forward to the Parliament. Then, if the proposal is adopted, it will take some time until the law is put into force.

In practice, any existing cooperative may have approx another 10 years to prepare itself for the new regulatory scheme proposed by the cooperative law commission in NOU 2002: 6. This liberal time frame should not be the reason why the proposals of the commission do not find their way into the Norwegian legislation.

#### ***4.13 Arbitration Procedures and Recommendations for Bylaws***

To promote the use of cooperatives the law commission also discussed whether there should be an institutionalised arbitration procedure or small-court rules in the case of disputes between members and the cooperative. One found, however, that such procedures should not be part of the legislation but rather be established, if need be, on a voluntary basis.

### **5 The Consultative Procedure and the Process Ahead**

In Norway, proposals from law commissions will normally be submitted to interested parties for comments. A total of 55 bodies responded to the commission report, of which 8 had no comments. Somewhat surprisingly taking the historical record of one hundred years of unsuccessful attempts at legislation, none of the responding organisations expressed any principled objection to a

statutory regulation of cooperatives. A large majority supported the draft law or requested only minor amendments.

Today is not yesterday. This time the cooperative sector itself does not seem to offer much opposition to the idea of codification. On the contrary, the most strongly voiced objections to the law on cooperatives have been offered by three bodies from outside the cooperative sector, representing competitors to some of the big agriculture cooperatives. The organisations in question have stated that substantial amendments must be made to the draft law before a bill should be presented to Parliament.

Another interesting observation is that the law proposal has been favoured not only by the big cooperatives and their organisations, but also by organisations representing the small ones. The organisations representing the big cooperatives, argue, *inter alia*, that an act on cooperatives is necessary in order to:

- strengthen the visibility of the cooperative form,
- preserve the distinctive character of the cooperative form,
- make the state of cooperative law clearer,
- make the cooperative form more accessible for entrepreneurs, and
- facilitate restructuring processes such as mergers and de-mergers.

Organisations representing small cooperatives and cooperatives in new areas, emphasize above all how difficult it is to establish and operate cooperatives without a written law.

A main reason why the cooperative sector this time is much more in favour of legislation than before, seems to be that the draft law opens for a great extent of flexibility. Another reason may be the uncertainty under present law. For instance, neither mergers nor de-mergers among cooperatives are subject to clear-cut rules. Also, the proposal by a Norwegian Governmental Commission on a ban on the establishment of new credit unions appears to have made the cooperative sector more sensitive to the fact that the lack of legislation may create much estrangement attending this organisational form outside the cooperative community itself. It may be quite illustrative that the only credit union in Norway, Landkreditt, is one of the strongest supporters of the legislation initiative.

As already mentioned, only three bodies have requested substantial amendments to the draft law. They state that The Cooperative Law Commission has not given enough importance to competitive conditions especially in the agricultural area. In their opinion there has to be made a detailed statement about the socio-economic consequences of the draft law with particular focus on competitive conditions. They assert that the draft law does not give members of cooperatives sufficient economic rights. They argue that no part of the capital should be the common property of the cooperative, and that the entire net capital should be subject to a hurdle rate fixed in the bylaws. The law should not contain any upper limit for interest payments on the members' investments.

Furthermore, in their opinion it should be possible to pay a resigning member a share of the cooperative's assets, and the basic rule should be that membership in cooperatives is transferable.

The remarks from these three bodies may be looked upon as an illustration of a conflict between two schools of thought in cooperative organisational theory: The classical cooperative paradigm and the neo-classic economic paradigm.<sup>7</sup> The draft law is, according to the mandate, based on the ICA statement on the cooperative identity including the cooperative principles. It seems as though the three bodies representing competitors to cooperatives, request an act on cooperatives that will make Norwegian cooperatives closer to "new generation cooperatives", as they are known from the US. The Norwegian cooperative sector itself has not expressed any need for an organisational structure that is more similar to companies.

At the moment the case about cooperative legislation in Norway is in the hands of The Ministry of Justice. Probably the Government will submit a bill either the autumn 2004 or the spring 2005. It can probably not be expected that an act will enter into force before January 1<sup>st</sup> 2006. However, the political process ahead is difficult to predict. There may also be a change of government after the parliamentary elections in 2005. A bill on cooperatives is not an important part of the general political agenda in Norway, but any election may make for some uncertainty regarding law proposals. The present proposal has no guarantee of success, even though the reactions on the whole have been positive.

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<sup>7</sup> Røkholt, Per Ove, *Strengths and weaknesses of the co-operative form: A Matter of Perspective and Opinion*. Paper presented at the ICA International Co-operative Research Conference, Quebec, 28-29<sup>th</sup> of August 1999.