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ITALIAN CO-OPERATIVE LAW REFORM AND CO-OPERATIVE PRINCIPLES

Antonio Fici*

ABSTRACT

A reform of Italian co-operative law was passed in 2003 and came into force in 2004. This paper presents the principal characteristics of the new Italian co-operative law and seeks to evaluate the relationship of some of its main provisions to traditional co-operative principles. From this perspective, the paper deals in particular with the definition of the Italian co-operative as a company with a "mutual purpose"; the distinction between "mainly mutual" co-operatives and "other" co-operatives (and the relationship between mutuality and profit-making in co-operatives); the regulation of voting in the assembly (the "one member, one vote" principle and its exceptions); the available governance systems ("tripartite", "dualistic", "monistic"); and co-operative finance solutions (investor members and financial instruments). Using the Italian reforms as a starting point for debate, this paper puts forth the possibility of generalising a modified approach to co-operative regulation and principles, taking into account efficiency issues, while preserving the co-operative identity.

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1. Introduction

This paper has an aim that might appear rather narrow, that is, to give a general overview of the new Italian co-operative law, by dwelling upon its most particular and innovative points pursuant to the reform of 2004.[1]

However, this is a task that is neither simple (since Italian co-operative law, even after the reform, remains difficult to understand and allows for different interpretations), nor trivial for two main reasons.

Firstly, it would be useful to create a global and integrated system of research in the co-operative field, reflecting the existing co-operative model of political representation and economic integration. The philosophy that inspires the 6th ICA principle ("co-operation among co-operatives") should apply to co-operative studies ("co-operation among co-operative scholars"), because the strengthening of the co-operative movement, which this ICA principle wishes to implement, would be highly favoured by the co-operation among scholars from different countries.[2]

This is particularly true for Europe, given that many questions which have arisen there, for example the controversy surrounding the legitimacy of tax benefits awarded to co-operatives by some Member States, such as Italy, and whether this special treatment is a state aid forbidden under art. 87, paragraph 1, of the EU Treaty,[3] require a unified approach. Common answers and shared thoughts as to the identity of a co-operative and its specific features compared to other forms of company (commercial or lucrative ones), especially in terms of its suitability to the production of socio-economic benefits for the community (what economists call "positive externalities") are necessary.

We should not take it for granted that the concept of a co-operative is self-evident or that the difference between co-operatives and for-profit companies is universally

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[1] Legislative decree 17 January 2003, n° 6, modified the section of the Italian civil code dealing with co-operatives and other companies. In Italy, the general regulation of companies, including co-operatives, is part of the civil code.

[2] "Co-operatives serve their members most effectively and strengthen the co-operative movement by working together through local, national, regional and international structures".

[3] In 2008 the European Commission asked the Italian government about tax privileges awarded to consumer co-operatives in banking and distribution sectors, with particular regard to their compatibility (in light of state aid prohibition) with the E.U. Treaty, when these privileges are awarded to consumer co-operatives (not "mutual" co-operatives or "social" ones), which are direct competitors of commercial enterprises. In the preliminary phase of this inquiry the Commission considered tax deduction from the co-operative's taxable income of profits earmarked for reserves incompatible with the Treaty if these profits come from the activity with non-members, unless earmarking is prescribed by law (mandatory reserves) or the co-operative is a small-medium enterprise; in addition, the Commission considered tax abatement on interest granted to members for loans to their co-operative incompatible, for in such cases members do not act as members but as third parties with respect to their co-operative; on the other hand, the Commission considered tax deduction from the co-operative's taxable income of profits awarded to members as "patronage refunds" to be compatible, to the extent that these profits stem from transactions with members: see letter E1/2008 in http://www.coopseurope.coop/spip.php?rubrique292. On this point, see the reaction of Co-operatives Europe: position paper, 6 October 2008, *ibidem*, where the argument of the relevance of the distinction between big and small-medium co-operatives (also with respect to the greater or smaller member participation to the governance of the co-operative) is substantially criticised, as well as that of the relevance of the exclusive or predominant mutuality principle, and it is argued that these measures are only compensatory for co-operatives; see also the papers presented at the international seminar "Co-operative enterprise between national taxations and European market", organised by Euricse, the 11-12th September 2008, in Trento, in http://www.euricse.eu/it/node/44.
Art. 87 of the EU Treaty stipulates: "Save as otherwise provided in this Treaty, any aid granted by a Member State, awarded by Member States or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market".

recognised. In fact, there is still a lack of visibility of the co-operative sector of the economy.

Therefore, the first step a researcher who aims to be part of such a network should take, would be to diffuse the knowledge of one's own national legislation (which, moreover, is in many countries, as in Italy, complex and scattered between general laws, sometimes integrated into civil codes, sometimes not, and special/sectorial laws; between civil laws and tax laws; etc.), and to introduce other researchers to its sources and main characteristics, thus making a comparative analysis possible.[4] Secondly, the new Italian co-operative law offers a good "test case" to discuss and evaluate the relationship between legislation and promotion of co-operatives. Recognising law as an instrument of policy, we may consider "does the law reinforce or hinder co-operatives?"; "does it take into account the benefits brought by co-operatives to the community?"; and so on.

Therefore, some features of the Italian legislation are suitable for this kind of analysis, and will be the main topics of this paper.

In particular, the paper will focus on:

- the definition of a co-operative under Italian law and the "mutual purpose" as the key element of this definition;
- the distinction between "mainly mutual" and "other" co-operatives (and the relationship between mutuality and profit-making);
- the regulation of voting in members' assemblies (the "one member, one vote" principle and its exceptions);
- the available governance systems ("tripartite", "dualistic", "monistic");
- co-operative finance solutions (investor members and financial instruments).

As for each of these issues, the paper also aims to evaluate their relationship with ICA co-operative principles and to understand whether and to what extent they divert from them; to identify the reasons for their adoption; and to determine whether such measures presuppose and introduce a new co-operative norm.

In presenting Italian law from the methodological perspective above, the paper will make comparative references to other national co-operative laws,[5] and to the SCE Regulation as well. Although this Regulation only creates a European cross-border form of company (the SCE) and hence, does not intend to harmonise Member States' co-operative laws, it is relevant due to the strong effect it has had on recent European national laws, as we shall see examining the Italian reform. As sought by the European Commission, this may therefore result in an indirect approximation of national laws with a view toward improving their quality.[6]

[4] Sharing this view, EURICSE, with two other European partners (Co-operatives Europe and the Spanish Ezai Foundation), is going to start a year-long research financed by the European Commission on the implementation of the European co-operative society ("SCE") Regulation in the 27 Member States (and 3 EEA countries: Iceland, Liechtenstein, Norway) by establishing a network of 30 national experts in co-operative law, coordinated by a scientific committee made up of six experts from different countries. Results are expected by the end of 2010.

[5] This comparison will be limited to the general co-operative laws of France, Spain, Portugal, Finland, Poland, Malta, Hungary and Norway.

[6] See COM(2004) 18, *On the promotion of co-operative societies in Europe*, p. 10.

2. The Italian (and European) context

Before going deeply into the legal analysis, it is useful to begin by offering some brief background data on Italian co-operatives. It is an unquestionable fact that co-operative law, as a consequence of its particular subject matter, reflects the historical, political, economic and social, as well as legal, context in which it exists, more than other company laws. We have evidence of this in the existing variation of co-operative legislation in European states.

We can begin by affirming that Italy is a country with a high concentration of co-operatives, as the tables annexed to this paper show. Italy is not characterised by a particular type of co-operation, as all its forms and patterns are present. There are worker co-operatives and consumer and production (among entrepreneurs) ones as well. Co-operatives operate in every sector of the economy (from agriculture to banking, with a strong presence in the sectors of commercial distribution, construction and services, especially social). There are both large and small co-operative models (where a consortium associating small co-operatives carries out particular entrepreneurial functions in their interest), with the latter prevailing over the former. There is a co-operation with Catholic origins (the so called "white" co-operation) and one derived from socialist inspiration (the so called "red" co-operation): both are headed by a representative organisation (commonly known as "*centrali cooperative*"), Confcooperative and Legacoop respectively. Other minor national organisations are AGCI, UNCI e UNICOOP. The province of Trentino is an exception, where only one representative organisation operates (the "Federazione Trentina delle cooperative").[7]

There are two main characteristics of Italian co-operation: a strong propensity to create and consolidate a (political and economic) connection among co-operatives (which, as we shall see, is recognised and sanctioned by law), and the consciousness of an existing link between co-operation and social utility (which is recognised in the Constitution of the Republic of Italy and has represented one of the reasons for the recourse by Italian legislators to the co-operative form in order to introduce the first legal form of social enterprise: the social co-operative).[8]

The second background datum is a legal-political one. It is important to highlight that in the Italian legal system co-operative enterprises are not on the same level as the other enterprises, as they are recognised in, and protected by, the Constitution, where the basic values of our community are acknowledged, safeguarded and promoted. The Italian Constitution deals expressly with the economy in article 41 ff. Article 41, after having affirmed that "private economic initiative is free", further qualifies it by saying that "it cannot be carried out against social utility or in a way that hinders security, freedom and human dignity".

On the other hand, with regard to the co-operative enterprise, article 45 states that "the Republic recognises the social function of co-operation with mutual character and without private speculation purposes. The law promotes and favours its growth with the most appropriate means, and ensures, with appropriate controls, its character and purposes".

[7] However, these organisations are not only political in the strict sense, as, through organisations controlled by them, they run the mutual funds for the growth and promotion of co-operation; these funds are variously nourished by the associated co-operatives (they are obliged to allocate 3% of the annual surplus to the funds; and their assets are allocated to the funds in the event of winding-up and transformation).

[8] See Law, 8 November 1991, n° 381.

Thus, in the Italian legal system, a possible conflict between the enterprise as a whole and social utility is acknowledged, while a social function is ascribed only to the co-operative enterprise. The co-operative is the only type of enterprise which, being under the constitutional umbrella, can never be obliterated (unless there is a Constitutional revision), and, moreover, must be favoured by Italian legislators. This is not an isolated case, as a reference to co-operatives is also present in the Constitutions of Spain, Portugal, and Hungary.[9]

The acknowledgment of co-operatives by the Italian Constitution is subject to two conditions: mutual character (a feature of Italian co-operative law discussed below) and the absence of private speculation purposes. Although art. 45 of the Constitution does not deal with governance issues, many Italian scholars hold that the constitutional acknowledgment of the co-operative form is due to the fact that it is an institution of economic democracy, representing "one of the ways to allow worker participation in the "economic organisation" of the country", and therefore in the "shaping of political life" and the "exercise of sovereignty."[10] In this way, the co-operative institution may contribute to the implementation of the social reform project Italian legislators envisaged and called for in art. 3, para. 2, of the Constitution.[11]

This interpretation is extremely topical from a political point of view, since the European Commission has also expressed its view that co-operatives contribute to the development of knowledge (being "schools of entrepreneurship and management" for the members, notably the workers, who take part in their activities),[12] and also that they are the most appropriate and least disruptive legal form for the transfer of an enterprise that has no hope of continuing in its present form. In these cases, the ownership of the company may be transferred to the workers, the very people who have a huge interest in its survival and good knowledge of the sector in which they operate, and who otherwise would not have the required financial means to acquire the enterprise but for the fact that they were organised within a co-operative.[13]

The last background datum is of political-institutional nature and relates to the European policy towards co-operatives. In communication COM(2004) 18, of 23 February 2004, *on the promotion of co-operative societies in Europe,* the European Commission maintains that "co-operatives are an excellent example of a company type which can simultaneously address entrepreneurial and social objectives in a mutually reinforcing way,"[14] and recognises their "increasingly important and positive roles… as vehicles for the implementation of many Community objectives in fields like employment policy, social integration, regional and local development, agriculture, etc."[15] Hence, the growth and promotion of co-operatives in Europe has become a European government policy, though, in light of this, the more recent expression of

[9] See Art. 61 of the Portuguese Constitution; art. 129 of the Spanish Constitution (expressly, as the Italian, obliging legislators to promote co-operatives), and art. 12 of the Hungarian Constitution.

[10] GALGANO, *sub* Art. 41, in *Commentario della Costituzione*, Branca (ed.), Rapporti economici, t. II, Bologna-Roma, 1982; see also NIGRO, *sub* art. 45, *ibidem*.

[11] "It is the responsibility of the Republic to remove the obstacles of an economic and social nature that, by limiting de facto the freedom and equality of the citizens, prevent the complete development of the human person and the effective participation of all workers in the political, economic and social organisation of the country". With great shrewdness and political-institutional awareness, Italian legislators were therefore conscious of the fact that the legislative recognition of formal equality and the prohibition of discrimination were not sufficient to guarantee the exercise of fundamental rights in the absence of the material means required to exercise these rights.

[12] See COM(2004) 18, cit., point 2.1.1.

[13] See COM(2004) 18, cit., point 2.3.1. These considerations should be taken into great account in this time of economic recession.

[14] See COM(2004) 18, cit., point 4.

[15] See COM(2004) 18, cit., point 1.2.

doubt by the Commission as to the compatibility with competition law of the national measures advantaging co-operatives seems contradictory.[16]

A co-operative is, therefore, at the European level as well, a legal form of company which may be distinguished from other enterprises by the fact of the combination of economic and social aspects, as clearly stated in the Italian Constitution, which specifically ascribes a social function to co-operatives.[17] The background set out above shows that in Italy, as well as in Europe, the co-operative assumes, among the various types of company, a particular role and position due to its social nature. The co-operative becomes an economic player which public institutions can or, rather, should refer to for the implementation of their general interest policies. Such an environment allows for a specific regulation of co-operatives that both recognises their specificity, and, precisely on these grounds, promotes and strengthens them.

3. "Mutual purpose" as the objective of the Italian co-operative

New art. 2511 of the civil code (hereinafter "c.c."), defines the co-operative as a company "with variable capital and mutual purpose". The variability of capital is a requirement which is embodied in almost all the legislation on co-operatives,[18] and represents the technical way to implement the 1st ICA principle ("voluntary and open membership").[19] In contrast, "mutual purpose" is a distinctive (not included, to the best of the author's knowledge, in any other laws) and traditional formula of Italian law (in the civil code since 1942 and in the Constitution of 1948).

However, even though the legislative formula is unique, the "mutual purpose" of the Italian co-operative is an objective not substantially dissimilar from that which other European national laws,[20] the SCE Regulation,[21] and ICA principles assign to co-

[16] n 3 above. However, to be more precise, one must point out that this doubt is not general, but regards only some measures and only those in favour of some types of co-operatives.

[17] It is known, moreover, that European institutions include co-operatives, together with associations, foundations and mutuals, in the category of the so-called "social economy organisations": see recently COM(2008) 412, of 2 July 2008, where co-operatives are more precisely qualified as "social economy enterprises".

[18] See, among others, art. 13, para. 1, French law n° 47/1775; articles 2, para. 1, and 18, para. 1, Portuguese co-operative code n° 51/96; chapter 1, sec. 2, of the Finnish law n° 1488/2001; chapter 1, sec. 7, of the Hungarian law of 2006; art. 1, para. 2, SCE Regulation: "the number of members and the capital of an SCE shall be variable"

[19] Admittance and exclusion of members do not determine a structural modification of the co-operative and therefore do not require any modification of the act of incorporation or the statute (the number of members may freely varies during the co-operative's existence). The 1st ICA principle states: "co-operatives are voluntary organisations, open to all persons able to use their services and willing to accept the responsibilities of membership, without gender, social, racial, political or religious discrimination".

[20] In some European national laws, the obligation for a co-operative to operate with its members arises *a contrario* from the express prohibition (which, moreover, has its exceptions) to operate with non-members, since in effect the prohibition to operate with non-members is the result of the obligation to operate with members, so implementing the mutual purpose: see for example art. 4, para. 1, Spanish law n° 27/99; art. 2, para. 2, Portuguese co-operative code; art. 3, para. 1, French law n° 1775/47, and also SCE Regulation at art. 1, para. 4: "An SCE may not extend the benefits of its activities to non-members or allow them to participate in its business except where its statute provide otherwise". For a positive definition, see the specific statement of sec. 56 of Hungarian law of 2006, which talks about "modes of personal involvement of members", specifying that this personal involvement may be realised "by way of production, processing products, and preparation for marketing, sales, consumption or by other means", and that "one mode of personal involvement … is the obligation to perform work". But see also the recent Norwegian Co-operatives Societies Act of 29 June 2007, at sec. 1, para. 2: "by a co-operative society is meant a group whose main objective is to promote the economic interest of its members by the members taking part in the societies as purchasers, suppliers or in some similar way". And sec. 2 of Finnish law n° 1488/2001: "the purpose of a co-operative shall be to promote the economic and business interests of its members by way of the pursuit of economic activity where the members make use of the services provided by the co-operative or services that the co-operative arranges through a subsidiary or otherwise. However it may be stipulated in the rules of the co-operative that its main purpose is the common achievement of an ideological goal".

operatives.[22] Under Italian law a co-operative is a type of company whose objective is to satisfy a common interest of its members by making contracts/transactions with them. These transactions are of diverse legal nature and subject matter, depending on the typology of the co-operative (employment contracts in worker co-operatives; exchange contracts in consumer or producer co-operatives).

In addition to the company relationship, there is a distinct, though related, mutual relationship (of work or exchange) through which the co-operative implements the imposed legal function, namely the mutual purpose. A member is, therefore, both member of the company, having subscribed its capital, and its counterpart within the mutual relationship (of work or exchange).

On the basis of several arguments, it is implicitly admitted by scholars that the purpose of a co-operative is not only to enter into a contract with its members, but also to make these contracts the most profitable for the members (that is, its counterparts), obviously as long as it is compatible with the economic equilibrium of the enterprise.[23] This "mutual" advantage may be awarded to members immediately at the time of contract or subsequently (once the company accounts have been approved and there is a surplus to allocate) as "patronage refunds". Scholars and courts, moreover, agree on the fact that members are not entitled to this mutual advantage. Their interest is only indirectly protected (through the power to substitute managers; sue them for liability, etc.). Italian law adds and specifies that in the establishment and execution of these mutual operations a co-operative shall guarantee the equal treatment of members (art. 2516, c.c.), and assign patronage refunds to members in proportion to the quantity and quality of mutual exchanges (art. 2545 *sexies*, para. 1, c.c.).

Having said this, the difference between co-operatives and for-profit companies (i.e. companies acting for a lucrative purpose, namely, with the end of first making and then distributing profits to shareholders in proportion to the subscribed capital) comes out clearly. The latter act for remunerating the capital subscribed by their members (and shareholders), and not to advantage them through (and in proportion to) exchanges.

However, in light of this, we cannot deny that a co-operative, like for-profit companies, is a company which acts in the interest of its members, and that the common interest of members might also be financial, even though technically non-lucrative (i.e., in the remuneration of the subscribed capital).[24] For this reason, some Italian scholars, thereby provoking at times the reaction of representatives of the co-operative movement, argue that the co-operative is an organisation pursuing a "selfish" or "internal" (in relation to members' interests), though non-lucrative, aim. This position, perhaps, ignores the fact that co-operatives are obliged, at least under

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[21] According to art. 1, para. 3, of the SCE Regulation, "an SCE shall have as its principal object the satisfaction of its members' needs and/or the development of their economic and social activities, in particular through the conclusion of agreements with them to supply goods or services or to execute work of the kind that the SCE carries out or commissions".

[22] In fact, in the 1st principle it is said that co-operatives are organisations open to all persons "able to use their services"; the 3rd principle allows, among the possible allocations of profit, a co-operative to benefit members "in proportion to their transactions with the co-operative".

[23] By way of contrast, this is explicitly stated in the opening of French law n° 1775/47, whose article 1 assigns to co-operatives the main purpose of reducing the price of goods and services sold to members and of improving the quality of goods and services offered to them (namely, to act in their interest).

[24] Accordingly, in defining a co-operative, a widespread formula in Europe, especially in the most recent laws, is that the co-operative is a company set up to satisfy members' economic, as well as social, cultural, or other needs: see sec. 7, Hungarian law of 2006; along this line also art. 3, loi sur les co-operatives of Québec.

Italian law, to allocate a great amount of the surplus (33%) to the satisfaction of interests unrelated to their members (see the regulation of reserves and other compulsory destinations), so that the pursued aim should be more correctly defined as both selfish and altruistic, internal and external.[25] At any rate, with regard to the aims pursued by an organisation, a difference between mutuality and solidarity must be drawn, as shown by the fact that a specific legislative measure (the law n° 381/91) was needed and enacted in order to allow co-operatives to act in the general interest.[26]

Indeed, even though the mutual purpose itself contains elements of sociality (as a co-operative does not seek to remunerate the subscribed capital, but to satisfy needs of a different nature, and even though at times these needs may appear financial, in reality they are predominantly social),[27] it would not be appropriate to identify this aim with the pure and exclusive "altruistic" purpose which characterises non-profit organisations and social enterprises (and social co-operatives within this latter category), and which relates to the satisfaction of the common interest and not of members' needs as such.

In this regard, it is worth underlining that the 5th and the 7th ICA principles are not followed by Italian law, which does not oblige co-operatives to allocate resources to the protection and promotion of members' human needs and to the sustainable development of the community.[28] The observance of these principles mostly takes place on a voluntary basis (namely, as a form of corporate social responsibility, as far as this concept presupposes the voluntary, therefore not compulsory, adoption of measures to sustain workers, the environment, and more generally the community).[29]

4. "Mainly mutual" and "other" co-operatives

Italian law not only ascribes a mutual purpose to the co-operative (art. 2511, c.c.) and states that transactions with non-members are allowed only if provided by the statute of the co-operative (art. 2521, para. 2, c.c.), but also determines the minimum quantity of mutual transactions, that is the minimum value of the ratio between transactions with members and transactions with non-members (if any).

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[25] This debate is topical at the European level, especially now that in many countries measures introducing "social enterprises" have been passed ("social enterprise" in Italy and in Finland; CIC in England; SFS in Belgium). What is the relationship between co-operative and social enterprises? What makes these two subjects different? In effect, there is a widespread worry in certain co-operative circles as to whether social enterprise might obfuscate in the eyes of public opinion the intrinsic sociality of the co-operative enterprise. On this point, see FICI, *Co-operative and social enterprises: comparative and legal profile*, *forthcoming* in Roelants (ed.), *Co-operatives and social enterprises. Governance and normative frameworks*, CECOP, 2009.

[26] Before Law 381/91, in fact, some Italian courts refused to register co-operatives whose declared aim was to act in the general interest of the community, and not in the interest of their members.

[27] For example a co-operative made up of small producers from developing countries; or of disadvantaged workers; etc. But also consider the role of the co-operative form in the transfer of (family or under financial crisis) enterprises, highlighted by the European Commission in the quoted communication of 2004.

[28] The 5th ICA principle, titled "Education, training and information" stipulates: "Co-operatives provide education and training for their members, elected representatives, managers, and employees so they can contribute effectively to the development of their co-operatives. They inform the general public - particularly young people and opinion leaders - about the nature and benefits of co-operation".
According to the 7th ICA principle, titled "Concern for community", "Co-operatives work for the sustainable development of their communities through policies approved by their members".

[29] See the Commission's definition in COM(2001) 366, *Promoting a European framework for Corporate Social Responsibility*: "a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis".

However, the question should not be put in this manner; it needs to be better articulated.

The reform has in fact introduced a distinction that makes the Italian legal system, to the best of the author's knowledge, unique in the world with regard to this profile.
It is the distinction, among co-operatives, between "mainly mutual" co-operatives and "other" co-operatives (that is, co-operatives which do not meet the requirements to be included in the first category and therefore are "other").

"Mainly mutual" co-operatives are characterised by two elements:

- they must operate predominantly with their members;
- they can remunerate the capital subscribed by members only to a certain extent.

"Other" co-operatives are not subject to these restraints: they can freely operate with non-members and they can freely remunerate the capital. Nonetheless, they remain "co-operatives", although, being "other", they are not eligible for tax benefits (though they are eligible for other benefits). The first restraint regards the business of the co-operative: the mainly mutual co-operative must operate (exclusively with, or at mimimum) predominantly with its members: workers, consumers or providers.

The condition of predominancy must be analytically documented in the "integrative note" to the balance sheet, by underlining the following parameters (see art. 2513, c.c.):

a) in consumer co-operatives, sale proceeds from members' consumption must be superior to 50% of total sale proceeds;
b) in worker co-operatives, labour costs for members' jobs must be superior to 50% of total labour costs;
c) in production co-operatives, manufacturing costs for goods and services provided by members must be superior to 50% of total manufacturing costs.

In agricultural co-operatives, the condition of predominancy exists when the quantity or the value of the products conferred by members is superior to 50% of total quantity or value of products.

Special types of co-operatives, as, for example, social co-operatives, are automatically considered "mainly mutual", leaving the condition of predominancy out of consideration (with the consequence that they are automatically eligible for tax benefits).

Ministerial decrees may introduce other exceptions to the condition of predominancy as provided by article 2513, c.c. As to the capital remuneration restraint, art. 2514, c.c., states that mainly mutual co-operatives:

- cannot distribute dividends on the subscribed capital superior to the maximum interest of postal bonds increased by 2.5 points;[30]

[30] This limit regards "dividends", that is, an amount provided as capital remuneration, but does not apply to "patronage refunds", namely, an amount provided as and in proportion to the transactions with the co-operative. Italian law does not set limits for the provision of patronage refunds, although: co-operatives should distribute patronage refunds only after deduction of the compulsory allocations (30% to the legal reserve, and 3% to mutual funds); only the surplus stemming from the business with members (and not that coming from the business with non-members) should be refunded; and some special laws could limit the payment of patronage refunds (this is the case of Italian law n° 142/2001 on worker co-operatives, which sets the limit of 30% of the salary). For the SCE regulation on this point, see articles 65-67. See also Art. 58, para. 4, of Spanish co-operative law and the 3rd ICA principle where the distinction between dividends and patronage refunds

- cannot distribute reserves to user-members (that is, co-operators);
- cannot remunerate the financial instruments subscribed by user-members more than the maximum interest of postal bonds increased by 4.5 points;
- shall return, in all cases of dissolution, all their assets, subtracting paid-up capital, to the mutual funds for the promotion and development of co-operation;
- can assign to withdrawing members only the paid-up capital, or a smaller amount in case of capital loss.

The mainly mutual co-operative image is that of a co-operative transacting with its members (even if only predominantly) and subject to a cap on the remuneration of the subscribed capital, and therefore substantially conforming to the 3rd ICA principle[31] and to other European national laws.[32] Though the SCE Regulation, on the other hand, provides that a return on subscribed capital and quasi-equity is allowed only after deduction of the allocation to the legal reserve (art. 65) and the payment of dividends (art. 66),[33] it does not set precise limits to the said return, giving the SCE's statute the power to regulate this issue (see art. 67)).

As already mentioned, the above-described restraints do not apply to "other" co-operatives, which are obliged neither to have a minimum number of transactions with members nor to limit the distribution of dividends on capital (this limit may be provided by the statute). Furthermore, they can distribute reserves and assets to withdrawing members and in the case of dissolution.[34]

Accordingly, "other" co-operatives, either due to the first aspect (transactions with members) or the second (limited remuneration of capital), are co-operatives which contrast with the co-operative norm stemming from ICA principles. This conclusion does not concern governance aspects, since, in this respect, no difference exists in the Italian regulation between mainly mutual and other co-operatives. The reasons for the legislative choice to create the category of "other" co-operatives are not clear.

Some scholars argue the only reason for this was to prevent many (normally large) co-operatives, which used to operate *de facto* without limit with non-members, from being excluded from co-operation after the reform came into force. As a result, the category is destined to exhaust itself, because no new "other" co-operatives will be set up.[35]

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emerges clearly when it states that "*limited compensation, if any, on capital subscribed*" and "*benefiting members in proportion to their transactions with the co-operatives*".

[31] "Members usually receive limited compensation, if any, on capital subscribed as a condition of membership".

[32] See, among others, Art. 48 para. 2, Spanish Law on co-operatives; art. 14, French Law on co-operatives.

[33] Although Art. 66 of SCE Regulation literally refers to "dividends", it emerges clearly from its contents that it is dealing with "patronage refunds".

[34] They can moreover convert into a for-profit type of company, which mainly mutual co-operatives are not allowed to do, unless they previously lost this quality (but in this case they are obliged to allocate their assets into indivisible reserves, although an opinion of the Central Commission for co-operatives, a consulting public body, affirms that in this case co-operatives shall devolve their assets to mutual funds) (see art. 2545 *octies*, c.c.). The mainly mutual co-operative loses its quality if it either does not comply with the requirements in articles 2513 for two financial years in succession or it modifies its statute removing non-lucrative clauses. In case of conversion, co-operatives shall devolve their assets, subtracting paid-up capital increased (if necessary) up to the minimum capital which Italian company law requires for the setting up of the legal form into which the co-operative converts (€ 120,000 in the case of an s.p.a., which is the maximum required) (see Art. 2545 *undecies*, c.c.).

[35] See BELVISO, 'Le co-operative a mutualità prevalente', in Abbadessa & Portale (eds.), *Il nuovo diritto delle società*, vol. 4, Torino, 2007, p. 653.

However, this issue has not yet been sufficiently explored by Italian scholars. Indeed, softening the rules of mutual purpose and limited distribution of profits can solve the biggest problem an ordinary co-operative faces, that is to say, undercapitalisation. If a co-operative can freely operate with non-members and remunerate the subscribed capital, the possibility to make profits for both the co-operative and for members multiplies, and the investment in a co-operative becomes more attractive.

Therefore, the reform makes a new legal form available, namely a new sub-type of co-operative, which is more market-oriented and can in theory survive by generating its own means without needing a preferential tax treatment (which, moreover, could not be awarded to "other" co-operatives given the constitutional provision of art. 45) or other specific financial measures. In this sense, "other" co-operatives lie in-between (mainly mutual) co-operatives and for-profit companies.

However, the following questions arise:

- whether this legislative option will be exploited: "other" co-operatives are, in fact, subject to the same governance rules as the mainly mutual ones ("one member, one vote"; public control; etc.), and, given this, one could ask what incentives there would be to set up a co-operative instead of an ordinary for-profit and investor-driven company; the point is that the co-operative type of governance makes sense (and is economically rational) only in the presence of a company with a mutual and non-lucrative purpose;
- whether the category of "other" co-operatives may threaten and undermine the image of co-operation: indeed, the force which drives "other" co-operatives is capital since they may not have user-members, but only investor-members, or at least members who are not interested in the activity itself, but in the remuneration of capital; but "other" co-operatives remain co-operatives, participate in the co-operative movement, and can receive public benefits different from tax benefits; thus the judgement on their behaviour might be extended to co-operation in general ("other" co-operatives are not obliged to act in a certain way, namely, in the interest of consumers, workers, producers, regardless of whether they are members or not: if they were obliged to do so, the judgement on their social function would be definitely positive, maybe even more positive than for "mainly mutual" co-operatives, which may act only in the interest of their members, preferring them to non-members).[36]

The reform of Italian law does not consider separately the case of a co-operative which does not operate predominantly with its members, is limited by a profit distribution restraint, and pursues the interests of its consumers, workers, counterparts. Yet, this type of co-operative might have a social impact even greater than the mainly mutual one, for it broadens the area of beneficiaries. But, given

[36] It is very significant in this regard what the president of the sub-commission for the reform of Italian co-operative law has affirmed after the reform approval: "it is very difficult to identify the social function (and the meritorious character) of a co-operative which does not act with and in favour of its members, and which has a dominantly, though imperfect, lucrative nature" (see BASSI, *Profili generali della riforma delle cooperative*, in *Il nuovo diritto delle società*, vol. 4, cit., p. 575). On the other hand, the same scholar points out elsewhere that "mutual purpose gives co-operatives a particular meritorious character when mutuality is direct to the implementation of particularly significant economic needs (making reference to the qualities of members or the type of services provided by the co-operative), as mutuality can be *neutral*, inexpressive, … or even speculative" (BASSI, sub art. 2511, in *Società cooperative*, Presti (ed.), Milano, 2006, p. 6), and moreover "pure mutuality does not necessarily correspond to social function. Pure mutuality … is not a sure index of sociality. The value of a co-operative lies in the activity it performs, in the economic conditions of the mutual exchange, in the needs it satisfies, in the categories of citizens and economic operators it sustains, in the diffuse welfare it promotes, and not in the rules on the governance of the organisation (equality, "open door") inspired by principles of democracy. By way of contrast, pure mutuality regards the containment of lucrative purpose, which has not a value *per se*, but at best as an index of a value placed elsewhere" (*ibid.*, p. 17).

Italian legislation, this type of co-operative, being not mainly mutual, would not be eligible for tax benefits.[37]

5. Voting rights. The principle "one member, one vote" and its exceptions

Under Italian law, "each member has a vote" in the co-operative assembly, regardless of the amount of the subscribed capital (art. 2538, para. 2, c.c.). Therefore, in a co-operative, voting is not linked to shares (as it is in the regulation of other forms of company), but membership *per se* on principle.

The traditional principle of co-operative democracy stemming from this rule has therefore been confirmed by the Italian reform of 2004. This principle is followed by other European national laws[38] and the SCE Regulation,[39] and of course included in ICA principles.[40]

The principle is directly related to the specific aim of the co-operative to satisfy the common interest of its members, and is one of the governance aspects determining the social function of co-operatives. Indeed, the social importance of the principle of democracy is evident if we consider that not only does this make the co-operative an instrument that satisfies people's needs and aspirations, rather than the interests of capitalists, but above all, it encourages the participation of everyone in the control and the running of the enterprise, making the co-operative the "school of entrepreneurship and management" referred to in the abovementioned European Commission Communication, or even the instrument of economic democracy alluded to in the Italian Constitution.

However, the Italian reform provides a few exceptions to the rule "one member, one vote" and in this sense, it goes beyond the ICA principles, where an exception is allowed only for secondary (second degree) co-operatives (co-operatives among co-operatives), though these must still maintain a democratic manner of organisation.[41] This is not surprising since almost all European national laws contain exceptions to the

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[37] Yet, one must notice that many of these co-operatives are social co-operatives under law n° 381 of 1991 and therefore automatically eligible for tax benefits.

[38] See, for example, Art. 9, para. 1, French law n° 1775/47: "*Chaque associé dispose d'une voix à l'assemblée générale*"; Art. 51, para. 1, Portuguese co-operative code, law n° 51/96: "*Na assembleias-gerais das cooperativas de primeiro grau, cada cooperador dispõe de um voto, qualquer que seja a sua participação no respectivo capital social*"; Art. 26, para. 1, Spanish law n° 27/99: "*En la asemblea general cada socio tendrá un voto*"; sec. 23, para. 1, Hungarian law n° X/2006: "Each member shall have one vote in the general meeting"; Sec. 38, para. 1, Norwegian law of 29 June 2007: "Each member has one vote at the annual meeting".
By way of contrast, other laws allow general exceptions to this principle, sometimes without indicating any criteria for the division of votes or limits; see chap. 4, sec. 7, Finnish law n° 1488/2001, which, after stating that "in the general meeting of the co-operative, one member shall have one vote in all matters to be considered by the general meeting", allows the statute to assign a multiple vote, but the number of votes of one member may be more than ten times the number of votes of another member only in a co-operative in whose rules it is stipulated that the majority of members are to be co-operatives or other legal persons. Even more general is the provision of Sec. 56, para. 1, Maltese law n° XXX/2001, stating that each member has a vote, unless the statute provides otherwise.

[39] See art. 59: "each member of an SCE shall have one vote, regardless of the number of shares he holds".

[40] The 2nd ICA principle ("Democratic member control") states that "Co-operatives are democratic organisations controlled by their members, who actively participate in setting their policies and making decisions. Men and women serving as elected representatives are accountable to the membership. In primary co-operatives members have equal voting rights (one member, one vote) and co-operatives at other levels are also organised in a democratic manner". The 4th ICA principle ("Autonomy and independence"), states that "Co-operatives are autonomous, self-help organisations controlled by their members. If they enter into agreements with other organisations, including governments, or raise capital from external sources, they do so on terms that ensure democratic control by their members and maintain their co-operative autonomy".

[41] According to the 2nd ICA principle: "In primary co-operatives members have equal voting rights (one member, one vote) and co-operatives at other levels are also organised in a democratic manner".

rule.[42] But on this point, as we shall see, Italian law seems to depart from other European national legislation as well as the SCE Regulation.
Firstly, the statute of an Italian law co-operative may assign more votes to a member that is a legal entity (a co-operative or other legal forms of organisation) , with a maximum of five, in relation to the capital held or the number of its members (art. 2538, para. 3, c.c.).[43]

This is not an unusual exception and can be easily explained by the need to adapt the democratic principle to secondary co-operation (even though, in Italian law, this exception could also apply to primary co-operatives comprising both individuals and co-operatives or other organisations), as already envisaged by the 4th ICA principle. Indeed, if a co-operative is formed of co-operatives (or other organisations) and one of them has more members than the others, it seems more democratic and conforms more closely to the principle "one member, one vote" that this co-operative is awarded extra-votes, even considering that the law limits them to five. It is more difficult, on the other hand, to justify the same rule when the statutory criterion for awarding more votes is not based on membership as above, but on the capital held, unless we assume (but this argument would be very weak) that the amount of capital is a sign of the size of the co-operative in terms of its members. In allowing the statutory use of this criterion of vote attribution, Italian law follows the SCE Regulation on this point.[44]

Secondly, the co-operative's statute may allocate and determine votes in proportion to the mutual exchange, that is, the transactions between the member and the co-operative. But this exception is possible only in co-operatives among entrepreneurs (art. 2538, para. 4, c.c.), regardless of whether they are legal entities or natural persons.[45]

This is a more significant exception, given that it is not limited to secondary co-operatives and meets a different limit: indeed, each member, to whom more votes have been assigned under this rule, cannot have more than 10% of the total votes in

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[42] Among the national laws on co-operatives examined in this paper, only Hungarian law does not present exceptions to this rule.

[43] Partially different provisions can be found in other European national laws. See Art. 9, para. 2, French law n° 1775/47, which provides that in a secondary co-operative a multiple vote can be assigned only on the basis of the number of the members of the comprising co-operative; Art. 26, para. 2, Spanish law n° 27/99, allows, in primary co-operatives, a multiple vote in favour of co-operatives, companies controlled by co-operatives and public entities: the multiple vote shall be assigned in proportion to the quantity of mutual activity and faces the limit of 1/3 of total votes; para. 6 of the same law deals, on the other hand, with voting in secondary co-operatives, providing that the statute may assign a vote proportional to the participation in mutual activity and/or the number of members of the comprising co-operative (with the limit of 1/3 of the total votes or 40% if the co-operative has only three members); Sec. 38, para. 2, Norwegian law of 29 June 2007, allows the statutes to stipulate, in a secondary co-operative, that the votes are to be divided according to membership figures or the geographical area to which the primary co-operative belongs, but one member may not have a majority of the votes in the enterprise; the Portuguese co-operative code, law n° 51/96, limits the rule "one member, one vote" to primary co-operatives.

[44] See Art. 59, para. 2, SCE Regulation: "In SCEs the majority of which are co-operatives, if the law of the Member State in which the SCE has its registered office so permits, the statutes may provide for the number of votes to be determined in accordance with the members' participation in the co-operative activity including participation in the capital of the SCE and/or the number of members of each comprising entity".

[45] Art. 26, para. 4, Spanish law n° 27/99, permits the multiple vote only in agricultural, service and transport co-operatives, in proportion to the quantity of mutual activity and with the limit of five votes or 1/3 of the total votes for each preferred member (but for multiple voting in co-operatives for land exploitation see art. 26, para. 5); Sec. 38, para. 2, Norwegian law of 29 June 2007, allows the statutes to stipulate that members may have several votes if the votes are divided among the members according to their trade with the enterprise (but one member may not have a majority of the votes in the enterprise).
For the SCE Regulation, see Art. 59, para. 2, according to which "if the law of the Member State in which the SCE has its registered office so permits, the statutes may provide for a member to have a number of votes determined by his/her participation in the co-operative activity other than by way of capital contribution. This attribution shall not exceed five votes or 30% of total voting rights, whichever is the lower".

each assembly, and all these preferred members together cannot have more than 1/3 of the total votes in each assembly.

Considering this exception, the democratic principle seems to have been reinterpreted by the Italian reform (at least with regard to co-operatives made up of entrepreneurs), in the sense that it only forbids the control of the co-operative by one member or a category of members, but does not prescribe that each member have equal voting rights. Voting is not linked to membership *per se* (pure personal criterion of vote assignment), but directly to the degree of the interest each member has in mutuality (mutualistic criterion of vote assignment).

Nevertheless, this evaluation has to take into account, on the one hand, that the greater voting power is linked to the member's interest in mutuality and not in the remuneration of capital, and on the other, that this exception applies only to co-operatives among entrepreneurs, where the need to connect the voice of each member to the financial risk she/he faces by participating in a co-operative may be more urgent.[46] In a co-operative where, for example, new investments are required, members facing this issue could show a positive or negative attitude towards investing, depending on the type and aim of their involvement in the activity of the co-operative. Therefore, distributing voting rights in relation and in proportion to the involvement of each member in the co-operative's business might be a way to prevent conflicts among members in co-operatives where membership is not homogenous (the alternative being either not setting up or dissolving a co-operative).

Thirdly, the co-operative's statute may determine voting rights in the election of the supervisory body in proportion either to the capital held or mutual exchanges (art. 2543, para. 2, c.c.).[47]

This is a different exception if compared to the previous, as:

- it does not apply only to co-operatives made up of entrepreneurs, but all co-operatives;
- it only applies to the appointment of the supervisory body;
- the criterion of determination may be capitalistic (the amount of the capital held).

Nevertheless, perhaps this exception has been provided for the same reasons as the previous. It can be a solution to the problems arising in co-operatives with unhomogenous membership, therefore being an incentive to set up a co-operative even under this condition. On the other hand, as to the capitalistic criterion of determination, the fact that the exception regards only the election of the supervisory body reduces the risk of undermining the social function of the co-operative structure, even though a departure from the principle of democracy is evident in this respect. Finally, the statute of a co-operative may assign a multiple vote to investor members: this point will be addressed later, when the paper discusses co-operative finance solutions.

Concluding on this point, it may be that the single vote is not only the main characteristic of co-operatives all over the world, but – as has been argued – "one member, one vote" can find an economic rationale by taking account of the typical

[46] However, other laws do not limit this exception to co-operatives among entrepreneurs: see Sec. 38, para. 2, Norwegian law of 29 June 2007, and Art. 59, para. 2, SCE Regulation.

[47] A similar provision cannot be found in other European national laws, but of course, if the law allows the statute to deviate from the rule "one member, one vote", then a statute could provide a rule like this.

aim of a co-operative. Indeed, the single vote "favours the objective of production and allocation of wealth to members […]. It eliminates transaction costs associated with the need to consider continuously what the contribution of each member to the common wealth is […]. It favours the manifestation of individual preferences, inasmuch as it favours the preferences of the average member, rather than those of the marginal member […]. In particular, it contributes to the implementation, so to speak, of an "internal" market, inasmuch as it favours and promotes mutual exchanges, rather than the remuneration of the subscribed capital."[48]

However, even though the provision of the single vote in co-operatives promotes mutual exchanges and therefore the fulfilment of their aim, it makes the creation of a "market of control" of a co-operative impossible, as the control cannot be acquired by those who value it more, given that the governance of the enterprise is based on the principle "one member, one vote."[49] In light of this, it may be appropriate and effective to depart from the main rule if the exception could ensure the best accomplishment of the co-operative aim (as in co-operatives with an unhomogenous membership, in terms of individual contribution to the co-operative's activity), preventing, at the same time, the co-operative from being controlled by only one member or category of members. This could be the case of the rule allowing voting rights to be linked to the quantity or quality of mutual exchanges between the member and its co-operative, but not that of allowing voting rights to be linked to the amount of the subscribed capital. It seems that this latter rule cannot be justified in light of co-operative principles, but only in light of the profit-making philosophy of commercial companies.

6. The co-operative governance structure: the three available systems of administration and control

We cannot understand the importance of the Italian reform on this point if we do not review the repealed provisions. Before the reform, a co-operative statute had limited, or rather, no freedom to determine the system of administration and control of the co-operative. Therefore, the co-operative structure could only conform with the so-called "tripartite" (or three-tier) system of administration and control. There was, furthermore, a strong insistence on the principle of co-operative self-management, to the extent that the law forbade a co-operative to appoint non-member directors (thus, the only way to employ professional managers was to admit them as technical members first).

In order to permit a more efficient and effective management of a co-operative, the recent reform enables co-operative statutes to choose among three different systems of administration and control: the so-called "tripartite" ("three-tier"), "dualistic" (two-tier") and "monistic" ("one-tier") systems. It is worth noting that these options are taken from the regulations governing the main Italian legal form of for-profit enterprise, namely, the "*società per azioni*" (limited shareholder company), with only a few adaptations to the co-operative form. In addition, the influence of the SCE Regulation is also evident, although Italian law models do not exactly correspond to those of the SCE Regulation. The default system is the traditional tripartite one, since the other methods must be expressly opted for by statutes. It is divided into three bodies: the member assembly, the board of directors and the board of supervisors.

[48] ZOPPINI, *Il nuovo diritto delle società cooperative: un'analisi economica*, in *Riv. dir. civ.*, 2004, II, p. 444.
[49] In this sense, ZOPPINI, *Il nuovo diritto delle società cooperative: un'analisi economica*, cit., p. 445.

Among its main ordinary functions, the member assembly appoints and removes directors and supervisors and approves annual accounts. Directors are in charge of the management of the company and they may perform all the acts necessary for the implementation of the social object (art. 2380 *bis*, para. 1, c.c.). At least a majority of them must be members (therefore, the other directors can be non-members) (art. 2542, para. 2, c.c.).

Supervisors verify the duties performed by directors, the observance of the legal and statutory rules governing their actions, as well as their general good faith. Only registered auditors, registered professionals (such as lawyers and notaries), and law or economics professors may be appointed as supervisors (although at least one supervisor must be a registered auditor).

A co-operative must also appoint at least one registered external auditor for the specific aim of auditing annual accounts unless the board of supervisors is entirely formed of registered auditors, in which case the board of auditors can also be in charge of this particular function.[50]

The one-tier ("monistic" in the Italian civil code) system is not substantially different from the three-tier one, except for the following points:

- supervisors are not directly appointed by the assembly, but by the board of directors from among its members; at least one supervisor must be a registered auditor; supervisors are non-operating members of the board of directors (they cannot manage the company) and all of them together constitute an internal body of the latter (named "auditing committee");
- the external audit of accounts is always required.

This system has been criticised by some Italian scholars, as supervisors are appointed by the very persons who have to be supervised. But this criticism is unpersuasive, since, after all, members identify supervisors, although indirectly, through their first appointment as directors. By way of contrast, this could be an effective administration system, because, on the one hand, it favours the circulation of information between administrators and supervisors, both being part of the same body, and on the other hand always requires an internal and external audit (which can be, however, absent in smaller co-operatives adopting the three-tier system).[51]

If compared to the corresponding provisions of the SCE, apart from nomenclature (the bodies of directors is called "administrative organ" there), we find an important difference, given the fact that in the SCE Regulation one-tier system the requirement for an internal auditing committee is absent.[52]

The two-tier ("dualistic" in the Italian civil code) system is divided into three bodies: the member assembly, the supervisory body and the management body. Under this system, the assembly of members has fewer functions than in both of the others. It does not appoint (not even indirectly) managers (as in the one-tier system), it does not approve annual accounts, nor is it in charge of other central issues, such as the

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[50] Under the three-tier system, smaller co-operatives (whose capital is not greater than € 120,000, and do not simultaneously go beyond two of the following limits: - statement of assets: € 4,400,000; - proceeds: € 8,800.000; - 50 employees on average, and do not issue "non-participative" financial instruments) are not obliged to appoint either a supervisory body or an external auditor (see Art. 2543, para. 1; 2477, para. 2, 3; 2435 *bis*, para. 1, c.c.).
One must note that an SCE could adopt a system similar to that of the Italian three-tier, by exercising the option laid down in art. 37, para. 2.

[51] n 48 above

[52] See PRESTI, *Le fonti della disciplina e l'organizzazione interna della società cooperative europea*, in FICI & GALLETTI (eds.), *La società cooperativa europea*, Trento, 2006, p. 84.

decision on the recourse advanced by third persons against the denial by administrators of their request to become members; the approval of general regulations on the mutual relationship between the co-operative and its members; etc.

The supervisory body is the central body of this system of administration. It is appointed by the assembly from among its members, is in charge of the election of managers, controls their conduct, approves annual accounts (and is in charge of those key decisions which we referred to before as not being under the responsibility of the assembly), and may also be given by statute the "high administrative" power to determine strategic, industrial and financial plans of the enterprise. The supervisory body is formed of at least three persons, one of whom must be a registered auditor. The management body is formed of at least two persons, also non- members of the co-operative. It manages the enterprise with the same powers as the body of directors under the three-tier system. Under this system the external audit of accounts is always required.

The Italian law two-tier system differs from that of the SCE Regulation in that pursuant to the latter, the assembly is not deprived of the power to make important decisions regarding the enterprise, as it is in the former in favour of the supervisory body.

The reason for this may be due to the fact that without making substantial modifications, Italian co-operative law on this point adopted a system of company administration provided by the civil code for a limited shareholder company more suited to widely held large companies (including listed) in which, furthermore, shareholders are not necessarily interested in the company business, but rather returns on investment. Thus, the two-tier system is the system which, more than the others, strongly divides property and control of the enterprise, in the sense that members do not control the enterprise, as control is in the hands of the members of the supervisory body and the managers.

Therefore, one should inquire whether the deprivation of assembly power and its concentration in the hands of few people (supervisors and managers) are compatible with co-operative principles, especially with regard to the governance of primary co-operatives. Indeed, according to the 2nd ICA principle ("Democratic member control"), "co-operatives are democratic organisations controlled by their members, who actively participate in setting their policies and making decisions", while the 4th ICA principle ("Autonomy and independence"), states that "co-operatives are autonomous, self-help organisations controlled by their members". In light of these principles, the answer would probably be negative.

Even the predictable objection that members in co-operatives with a large membership do not actually participate and exercise their power to control anyway, so the Italian two-tier system would not really undermine member participation, seems unsound. The fact remains that a co-operative facing this problem could adopt other governance means which would definitely be compatible with the co-operative principle of member participation, such as mail or electronic voting or separate assemblies, both provided for by Italian co-operative law.[53]

[53] See, respectively, Art. 2538, para. 6, and 2540, c.c.

It seems that the straightforward transplant of rules and solutions conceived for non-co-operative companies can only result in a loss of identity of the co-operative form of enterprise, which might be particularly dangerous if we consider that only on the basis of its particular features would it be possible to justify the special legal treatment reserved to the co-operative enterprise (otherwise unjustifiable and consequently unlawful under specific laws, such as European competition law). Instead, we should be seeking suitable co-operative solutions to the unique problems a co-operative faces (such as that of implementing and ensuring member participation, as well as that of undercapitalisation), and not passively imitating other company law patterns.

It is surprising how Italian co-operative law has moved from a point in which the principle of member control was absolutely mandatory (as mentioned, the law forbade the appointment of non-member managers) to a point where this principle is only optional (in a co-operative adopting the two-tier system, the only power a member has is to appoint supervisors). We may well ask why this has happened.

If we consider the dualistic system together with the above-described "other" co-operative model, the suspicion that for-profit competitors managed to align the co-operative enterprise to the for-profit commercial enterprise, thereby diluting the characteristics of the former, turns out to be legitimate.

7. Co-operative finance solutions

It is well and universally known that co-operatives face a problem of undercapitalisation, especially due to the irrelevancy of capital in governance (as an effect of the democratic principle) and its limited remunerability. At first glance, this problem might appear unsolvable, since limited remuneration and democracy are co-operative principles which identify and distinguish co-operatives among other types of companies. Therefore, their weakening could result in a loss of identity for the co-operative enterprise. The commitment should be to search for solutions that are compatible with the legal nature of a co-operative, without threatening its identity.

For this reason, one can criticise the choice of Italian legislators to allow the constitution of "other" co-operatives, because these organisations, though formally named "co-operatives", are not truly co-operatives in their substance if we identify a co-operative through ICA principles. This is not a proper answer to the problem of co-operative undercapitalisation, since it avoids the problem rather than solving it.

One must also consider that, if co-operatives do indeed encounter a problem of undercapitalisation, normally they do not face a problem of lack of assets (therefore, undercapitalisation constitutes a problem particularly in the starting-up phase of the enterprise). This is partly due to the legal obligation to direct part of their profits to reserves. Italian law obliges co-operatives to earmark 30% of total annual profits for the legal reserve, irregardless of the amount of the legal reserve.

The compulsory contribution to reserves is a solution to the undercapitalisation problem in line with co-operative principles, as it reinforces the non-distribution constraint and the solidarity aspect of a co-operative (solidarity among co-operators, from old co-operators toward new co-operators).

Another external solution is offered by the co-operative movement, in terms of co-operation among co-operatives (sometimes in Italy this is called "system mutuality").

Italian law co-operatives are obliged to allocate 3% of total annual profits to the mutual funds for the promotion and development of co-operation established (under article 11 of law n° 59/92) and headed by the representative organisations of the co-operative movement (the aforementioned five inter-sectorial organisations) with the aim of promoting and financing the development of new co-operatives in various manners, as well as through the participation in their capital as founders. In the event of dissolution of the co-operative enterprise, its assets have to be allocated to these funds, (except for "other" co-operatives).

This solution also conforms to co-operative principles, especially the 6th ICA principle ("co-operation among co-operatives"). It does not threaten the co-operative identity, but strengthens it, mostly in terms of its solidarity aspect. The solutions to the problem of undercapitalisation presented above are traditional solutions, as the first (compulsory contribution of profits to a legal reserve) was already present in the civil code of 1942 and the second (compulsory contribution of profits to mutual funds) was introduced in 1992.

The most recent reform of Italian law sought to reinforce co-operative finance by other new means. In this regard, the general rule is found in article 2526, para. 1, c.c., which states that "the statute may provide for the issue of financial instruments, in accordance with the regulation on limited shareholder companies".

The freedom given to co-operatives to draft their statutes accordingly is very wide. Indeed, statutes may define financial and administrative rights of financial instrument holders (art. 2526, para. 2, c.c.). As to the financial rights, even in "mainly mutual" co-operatives, financial instrument holders can be remunerated without limit (the only limit in "mainly mutual" co-operatives regards financial instruments held by user-members).[54] As to the administrative rights, the law only sets the limit that the category of financial instrument holders cannot have more than 1/3 of the total votes in the member assembly (art. 2526, para. 2, c.c.). The right to elect administrators could also be awarded to financial instrument holders, but with the maximum of 1/3 of total administrators (art. 2542, para. 4, c.c.).

Beyond this, the concrete characteristics of issued financial instruments will depend on the statute: a co-operative may issue equity-financial instruments (and therefore admit investor members), debt-financial instruments (as, for example, bonds), or hybrids (as, for example, participative bonds, that is, bonds related to the performance of the enterprise, or shares awarding a minimum return, regardless of the performance of the enterprise, but not voting rights).[55]

Perhaps, the most important case is that of investor (non-user) members. It is known that the opportunity for a co-operative to admit members who are only interested in the remuneration of the capital (and not in mutuality) has long been discussed.[56] The question is whether the presence of a non-user (investor) member can turn out to hinder the co-operative institutional "mutual purpose".

[54] But not using reserves, which are legally indivisible.

[55] Along this line, art. 64 of the SCE Regulation provides that "an SCE's statute may provide for the issue of securities other than shares, or debentures the holders of which are to have no voting rights", and whose acquisition does not confer the status of member. But for certain types of financial instruments already provided by the laws considered in this paper, see for example Italian "co-operative participative shares" (Art 5, Law 59/1992); French "*investiment co-operative certificates*" (Art 19-sexdecies, Law n° 1775/47); Portuguese "investment bonds" (Art. 26, Código Cooperativo); Spanish "*bonds*" and "*participative bonds*" (Art. 54, Law n° 27/99); and, more recently, Finnish "*supplementary shares*" (Chap. 11, Law n° 1488/2001).

[56] Not accidentally, Art. 14, para. 1, SCE Regulation, in regulating this point, refers back to national laws, stating that, in an SCE, investor members may be admitted only if the applicable national law so permits.

The author proposes that if the administrative rights of investor members are limited by mandatory provisions of the law (as under Italian law or the SCE Regulation),[57] then the presence of investor members will not undermine the co-operative aim. Nevertheless, this is not the key issue. Italy first introduced this type of finance solution, that is, investor members, in 1992 (art. 4, law n° 59/92), and since then (at least, according to the common understanding in the co-operative field) this option has not been exploited largely outside co-operative investors, such as mutual funds, that is to say, investors sharing the same view and ideas.[58] In other words, membership has not been attractive for potential investors who are not a part of the co-operative movement. This is understandable in light of the fact that potential investors in a co-operative do not have a degree of power (to control) proportionate to the amount of the investment and the financial risk. Insofar as they cannot control the co-operative, profit seeking investors act rationally if they prefer to invest in a non co-operative company.

Therefore, co-operative finance remains mostly dependent on the co-operative movement and its capacity to create and implement new solutions for co-operative finance. One of these might be the recourse to employee (whether members or not) financial participation plans (in the form of profit-sharing or especially share-ownership), which for many reasons might find fertile ground in a co-operative.[59]

8. Conclusions

The concept of "co-operative", which stems from the Italian reform of co-operative law is twofold, due to the distinction between "mainly mutual" and "other" co-operatives, this differentiation being the main characteristic of Italian co-operative law after the reform.

As a result, a company acting under the name of "co-operative" (both "mainly mutual" and "other") may:

- not operate with its members, but exclusively or predominantly with non-members;
- remunerate member capital and financial instruments without limits;
- distribute its reserves and assets to members;
- devolve its assets to members in the event of member withdrawal and co-operative dissolution.

The "other" co-operative "new form" or "sub-type" of co-operative – although it is subject to the same governance rules as the "mainly mutual" form and is not eligible for tax benefits – is an historical anomaly and can only be considered either as an improper solution to the financial weakness of co-operatives, or as a barrier to the conversion of existing non-mutual co-operatives into for-profit shareholder companies. As a solution to co-operative finance concerns, this would be an improper approach insofar as it avoids the problem of undercapitalisation rather than solving it. "Other" co-operatives, though formally named "co-operatives", are not truly co-operatives in their substance, at least if we identify a co-operative through ICA principles, as well as

[57] The SCE Regulation provides that investor members may not together have more than 25% of total voting rights.
[58] According to the common understanding in the co-operative sector, this conclusion is valid also for France and Spain, whose laws embody similar provisions on investor members.
[59] On this topic, see FICI, 'Financial participation by employees in co-operatives in Italy', (2004) *Journal of co-operative studies*, 16 ff.

the principles arising by other national laws (the only co-operative feature "other" co-operatives possess is governance).

Perhaps the concrete reason (the historical contingency) for this legislative choice was to prevent many (normally large) co-operatives, which used to operate *de facto* without limit with non-members, from being excluded from the co-operative sector after the reform came into force, particularly if we consider that "other" co-operatives may convert into a for-profit type of company (while "mainly mutual" co-operatives are not allowed to), but in this case are obliged to devolve their assets to the mutual funds.

If this holds true, one can question whether the "other" co-operative form may threaten and undermine the image of "real" co-operatives.[60] Nevertheless, perhaps this concern would not be completely relevant, as the category of "other" co-operatives is destined to exhaust itself. Generally speaking, it is doubtful that there are any incentives to set up new "other" co-operatives which would be subject to the same governance rules (including public control) as the "mainly mutual" ones, but not eligible for tax benefits. Co-operative governance rules make sense and are economically rational only in the presence of a company with a non-lucrative purpose. Therefore, persons interested in profit-making and not in mutuality can find more suitable legal forms than the co-operative for the establishment of their enterprise. The second main characteristic of the reform relates to the "one member, one vote" rule, that is, co-operative democracy.

Italian law has confirmed democracy as a general rule, but has provided a few exceptions to it. Some of them are easily understandable in light of the mutual aim of the co-operative and have an economic rationale. This holds true for the division of votes in proportion to the number of members of the comprising organisation, or to the volume of mutual exchanges (where voting is linked to the degree of the interest each member has in mutuality). In particular, when membership is not homogenous, distributing voting rights in proportion to the involvement of each member in the co-operative's business might be a way to prevent conflicts among members, avoiding that a new co-operative is not set up or that an existing one dissolves.[61]

On the other hand, other exceptions appear to be in contrast with the democratic principle, insofar as they adopt a capitalistic criterion for vote allocation (capital held as a criterion for awarding more votes).

Considering the overall regulation of voting, the democratic principle seems to have been reinterpreted by the Italian reform, in the sense that it only prevents a co-operative from being (formally) controlled by one member or one category of members, but it does not state that each member shall have a vote.

The reform has allowed co-operatives to adopt two other governance systems in addition to the traditional three-tier one (which remains the default system). The one-tier system can be considered an effective governance system, as, on the one hand, it

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[60] Recently, in the editorial of an important Italian review, it has been affirmed: "It is strongly unpopular to be said, but it is our convincement that having accepted the legal ratification of the distinction between mainly mutual co-operatives and non-mainly mutual co-operatives has been a great mistake, whose consequences are not been well considered yet" (see BONELLA, '*Orgoglio e pregiudizio'*, (2007) 4 *Rivista della cooperazione* 4).

[61] Nevertheless, this incentive structure of voting raises a question which cannot be dealt with in the paper, namely, whether by doing so the co-operative allows member interest to prevail over the co-operative interest, and individual utility over solidarity among co-operators. This point raises more general questions, namely, "what is the relationship between mutuality and solidarity", "in what does the social function of a co-operative consist?"

favours the circulation of information between administrators and supervisors, and on the other hand always requires an internal and external audit (which may be absent in the three-tier system).

By way of contrast, the two-tier system appears to contrast with co-operative principles, since it strongly divides property and control of the enterprise, limiting the power of the assembly of members. This holds true also in the case of large co-operatives where member participation is not effective. The two-tier system, again, avoids the problem rather than solving it, inasmuch as it cancels participation rather than promoting it. Other governance means are available for co-operatives, which not only are compatible with co-operative principles, but favour member participation as well, such as mail or electronic voting and separate assemblies, both provided by Italian co-operative law.

The finance issue in a co-operative is fundamental and topical. As has been opportunely pointed out, "co-operatives in Canada and around the world are not immune to the challenges of making their way in a global economy dominated by investor-owned companies … Inadequate provision for capital needs has driven some co-op businesses to convert to investor ownership."[62] This is definitely true and raises the question "Which co-operative finance?".

New Italian co-operative law allows co-operatives to issue financial instruments in the manner and with the characteristics (with regard to rights and obligations of the financial instrument holders) provided for by statute, with the only limitation being that investor members may not have more than 1/3 of the total votes in each assembly. Therefore the success of this new form of finance depends on the capacity of co-operatives to create adequate financial instruments.

The Italian experience of investor members ("*soci sovventori*") has shown that co-operative finance remains inside the co-operative movement, as mostly only mutual funds, co-operative banks, secondary and tertiary co-operatives have been investor members in co-operatives so far. Indeed, where control is possible, it is economically rational that non co-operative investors prefer to invest in a non co-operative enterprise. Therefore, finance solutions should be elaborated not only by the single co-operative, but by the co-operative system as well, and this increases the importance of a co-operative being part of such a system.

Italian law recognises and promotes in different ways the activity of mutual funds run by representative organisations of co-operatives with the specific aim to promote the setting up of new co-operatives. But more general and sophisticated solutions are needed, also by implementing the freedom given by the law to issue financial instruments and determining their contents. From this perspective, the establishment of a general stable system of employee financial participation schemes in co-operatives (in the form of profit-sharing or share-ownership) may be an opportunity for the development of co-operative finance which the co-operative movement might definitely consider.

[62] WEBB, 'Where is the Co-operative Economy, and Why Does it Need Education Programs?', (2005) *The Workplace Review* 30

APPENDIX

Tables and figure

Table 1 – Co-operatives enterprises in the ISTAT Census of 2001

Number	% on the total*	Jobs	% on the total*
53,393	1.2	935,239	5.8

Source: Zamagni-Zamagni, La cooperazione, Bologna, 2008, pp.85

Table 2 – Co-operative enterprises in 2005

Number	**% on the total**
70,397	1.38

Source: Unioncamere, Secondo rapporto sulle imprese co-operative, 2006

Table 3 – The Italian co-operative movement in 2005

	Number	**Turnover (billion €)**	**Members**	**Jobs**
Legacoop	15,200	50	7,500,000	414,000
Confcooperative	19,200	57	2,878,000	466,000
UNCI	7,825	3	558,000	129,000
AGCI	5,768	6	439,000	70,000
Unicoop	1,910	0.3	15,000	20,000
Non-members	21,561	3	100,000	150,000
TOTAL	71,464	119	11,490,000 (1 in 5 IT citizens)	1,249,000

Source: Zamagni-Zamagni, cit., pp.89

Table 4 – The co-operative register (data at 15th January 2006)

	Number	%
"Mainly mutual" co-ops (16.5 % social co-ops)	58,236	93.5
"Other" co-ops (31.2 % worker co-ops; 16.1 % housing co-ops)	3,821	6.2
Not subjected co-ops	196	0.3
TOTAL	62,253	100

Source: Unioncamere, Secondo rapporto sulle imprese cooperative, cit.

Table 5 – Co-operatives in Europe in 2008

Number	**Members**	**Jobs**
250,000	163,000,000 (1 in 3 EU Citizens)	5,400,000

Source: Co-operatives Europe, October, 2008, in www.coopseurope.coop

Table 6 – Mainly mutual and other co-operatives

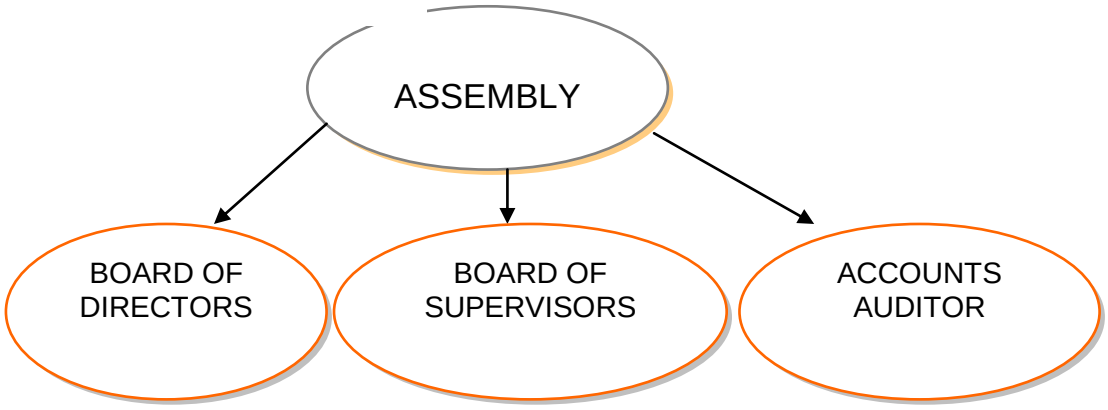
	Mainly mutual co-ops	Other co-ops
Minimum operations with members	yes	no
Limited remuneration on the capital (and on financial instruments) subscribed by members	yes	no
Distribution of reserves to user-members	no	yes
Devolution of assets to mutual funds in case of dissolution	yes	no
Conversion into a for-profit company	no	yes (but assets devolution to mutual funds)
Tax advantages	yes	no

Table 7 – Voting rights. Exceptions to the 'one member, one vote' rule

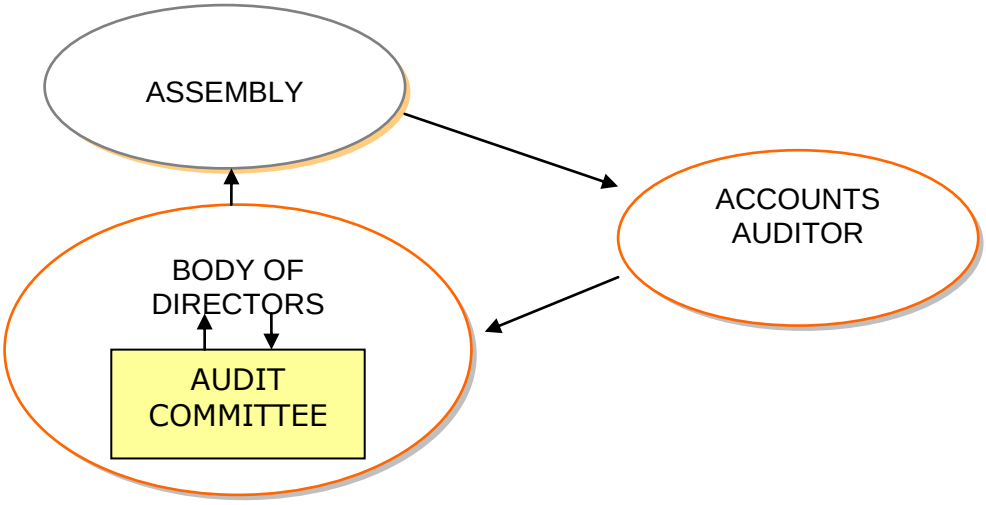
Exception	Beneficiary	Criterion	Limit
Art. 2538, para. 3, c.c.	Legal entity	- capital held - number of members	5 votes
Art. 2538, para. 4, c.c.	Members of a co-operative among entrepreneurs	In proportion to mutual exchanges	- each: 10% of the total votes - together: 1/3 of the total votes
Art. 2543, para. 2, c.c.	All members of all co-operatives	- capital held - mutual exchanges	appointment of the supervisory body
Art. 2526, para. 2, c.c.	Investor members	Law is silent on this point	each or together: 1/3 of the total votes

Figure 1 – Systems of administration and control

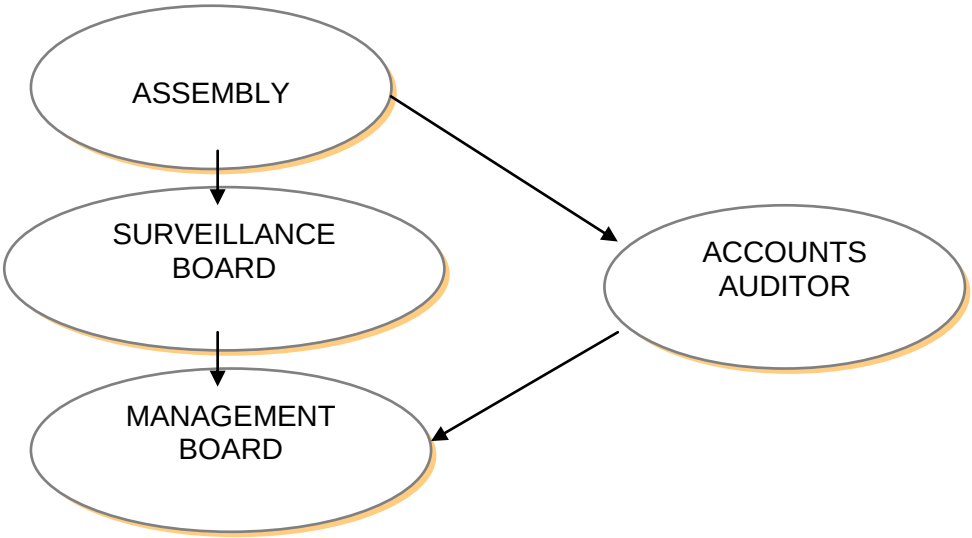
Three-tier/default system



One-tier system



Two-tier system



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