

## Guidance Note 3

**Issued:** September 2001

### Key topics

1. Co-operatives
2. Converted co-operatives
3. Shareholder limits
4. Founding shares
5. Mutual business entities
6. Entity structures
7. Tax issues
8. ASX discretion
9. ASX preferred model

### Listing Rules

1. Listing rule 1.1
2. Listing rule 6.9
3. Listing rule 6.10
4. Listing rule 6.12
5. Listing rule 6.18
6. Listing rule 7.1
7. Listing rule 19.12
8. Chapter 4 Listing Rules

### Cross-reference

1. Co-Operative Acts
2. Financial Institutions Code 1992

### Guidance Note History

Last Issued: 1/7/2000

## Co-operatives and Mutual Business Entities

### Introduction

1. This Guidance Note is published to explain the approach of Australian Stock Exchange Limited (ASX) to listing co-operatives, companies that were co-operatives but have converted to companies ('converted co-operatives'), companies limited by guarantee that have operated on co-operative principles, and mutual business entities. It would include, for example, entities in the following categories:
  - friendly societies;
  - co-operative housing societies;
  - credit unions;
  - rural and trading co-operatives; and
  - permanent building societies.

### Application of this Guidance Note

2. A significant number of co-operatives, converted co-operatives, companies limited by guarantee which operate on co-operative principles, and mutual business entities face special problems that prevent their complying with the Listing Rules dealing with control issues. Relevant listing rules include listing rule 1.1 condition 1, listing rule 6.9, listing rule 6.10 and listing rule 6.12.

**Guidance Note 3**  
**Co-operatives and Mutual Business Entities**

3. These entities have special historical characteristics and current requirements that make it difficult, if not impossible, for them to meet the standard listing requirements. ASX believes that there are advantages for the economy in having a transparent secondary market for these entities and is prepared to consider relief to allow a wider range of structures for them than it will allow for other listing applicants. However, ASX expects the entities to have regard to its preference for more orthodox structures and to move to such structures over time as they adjust to market circumstances.
4. While ASX is proposing a flexible approach to the listing of these entities to address control issues, ASX has a preferred model for listing. This is discussed further at paragraphs 44 and 45. If it is not proposed to adopt the ASX preferred model, the reasons for adopting a different structure need to be explained. Whatever the proposed structure, discussions at an early stage are encouraged.
5. The entities to which relief may be available can be identified by reference to many, or all, of the following characteristics.
  - Their history and evolution.
  - Their functioning in accordance with co-operative principles or mutual principles. For example, the co-operative principles have been incorporated in legislation (NSW Co-operatives Act, section 6).
  - Their regulation is or has been principally under special state legislation (eg. co-operatives legislation), not the Corporations Act.
  - Their membership (ownership) is limited to suppliers, producers or customers.
  - Taxation treatment is as a co-operative or mutual.
  - There are restrictions on the transfer of their securities.
  - Initial investment in them was divided over the initial membership according to a formula (eg. equal shares or according to patronage).

## **Co-operatives**

### **Shareholder limits**

6. Co-operatives legislation currently restricts the holding of shares to active members, and makes the transfer of shares subject to certain restrictions (eg. board approval). The legislation limits the scope for trading ownership interests. This is very likely to limit the availability of access to the market in relation to the equity of co-operatives subject to the co-operatives legislation.
7. However, if a mechanism were available to allow the quoting of shares in a co-operative, a question arises about limits on ownership. There may be a limit imposed by legislation on the number of shares that may be held by a member of a co-operative (eg. Victorian Co-operatives Act, section 174). Security holder limits in legislation often are accompanied by disenfranchisement and divestment. Listing rules 6.10 and 6.12 allow disenfranchisement and divestment to occur under Australian legislation.

8. Listing rule 6.10 restricts the circumstances in which voting rights and dividend rights can be changed or removed. However, listing rule 6.10.4 allows a security holder's right to vote or receive dividends to change in the following circumstances:

*The right is removed or changed under Australian legislation, or under a provision in the entity's constitution that must be included to comply with Australian legislation. Any provision must cease to operate once it is no longer necessary.*

9. Listing rule 6.12 restricts the divestment of equity securities. However, listing rule 6.12.1 allows divestment in the following circumstances:

*The divestment is under Australian legislation, and the mechanism the entity adopts for divesting the security is set out in the legislation, or is approved by ASX as appropriate and equitable. Any provision in the entity's constitution must cease to operate once it is no longer necessary.*

10. Thus, if shares in a co-operative can be quoted, the entity may be able to have a shareholder limit.

#### **One member - one vote**

11. Many co-operatives have one vote per member, reflecting the legislation under which they were formed, and their history and nature. ASX will consider waiving listing rule 6.9 (dealing with voting rights of equity securities) to allow 'one member - one vote' structures if it is required by the Co-operatives Act of the state regulating the co-operative.

#### **Building societies**

12. ASX has previously permitted 'one member - one vote' structures, and shareholder limits as set out in the Financial Institutions Code 1992 for building societies.

#### **'Wet' and 'dry' structures**

13. A 'wet' and 'dry' structure refers to the distinction often drawn (eg. in dairy co-operatives) between active members who trade with the co-operative ('wet' shareholders) and other members who tend to be suppliers of capital ('dry' shareholders). Under the current co-operatives legislation, there does not seem to be scope for the application of a 'wet' and 'dry' share structure in the context of the listing of a co-operative. This is because of limits in the law on the transfer of equity, and the requirement that shares be held by active members.

**Guidance Note 3**  
**Co-operatives and Mutual Business Entities**

14. In time this may change, making 'wet' and 'dry' structures an available option for co-operatives seeking listing. ASX does not necessarily regard such structures as unacceptable. It follows that divestment and disenfranchisement arrangements to support a 'wet' and 'dry' structure are mechanisms that might be explored with ASX. This is discussed further in the section dealing with converted co-operatives. Particular issues with 'wet' and 'dry' shares include whether the structure allows free transfers of 'wet' shares, and if it does, switching between classes and reporting the number of securities in each class from time to time. However, the ASX preferred model for listing provides protection for the interests of active members without complicating the structure of the listed entity. The preferred model is discussed further below at paragraphs 44 and 45.

**Quasi-equity**

15. Co-operatives Acts allow various types of quasi-equity instruments including, under New South Wales legislation, Co-operative Capital Units (CCUs).
16. Some of the instruments contemplated by the co-operatives legislation, including CCUs, may have characteristics of equity (eg. dividend participation). A structure that involves the issue of such quasi-equity may be acceptable to ASX, which will consider the particular characteristics of the instrument concerned on a case by case basis.
17. The Listing Rules allow ASX to classify an instrument as a debt security or an equity security for the purposes of the Listing Rules, refer definitions of 'debt security' and 'equity security' in listing rule 19.12. If ASX decides that quasi-equity is classified as a debt security, the entity may be admitted as an ASX Debt Listing. In this event, there are issues raised about the application of additional listing rules that have relevance to equity instruments (eg. periodic disclosure in Chapter 4). The Listing Rules for ASX Debt Listings are sufficiently flexible to allow ASX to apply additional rules under the debt-issuer regime if appropriate. A decision on the appropriate type of listing, and any additional listing rules applicable to an ASX Debt Listing, will be made on a case by case basis.

## **Converted co-operatives**

### **Shareholder limits**

18. Converted co-operatives are entities that have converted from structures governed by co-operatives legislation to structures governed by the Corporations Act. Being subject to the Corporations Act, these companies do not have the legislative restrictions on share ownership applicable to co-operatives. However, many converted co-operatives want to retain an aspect of their co-operative nature. Some seek to do so by imposing a limit on the number of shares that may be acquired. Usually the limit is not supported by legislation. Shareholder limits are often enforced by curtailing the voting rights of security holders whose holdings breach the limit set out in the constitution of the entity. There are usually also mechanisms for the forced disposal of securities above the limit. The limit was often a basis for conversion to a company from a traditional co-operative.
19. As noted in relation to co-operatives, listing rules 6.10 and 6.12 allow disenfranchisement and divestment to occur under Australian legislation. If there is no legislative limit, the Listing Rules allow divestment and disenfranchisement under a provision in the entity's constitution that ASX has approved as appropriate and equitable (listing rules 6.10.5 and 6.12.3).
20. Matters that ASX will have regard to when considering whether divestment and disenfranchisement provisions are appropriate and equitable include the following.
  - Whether the limit in the constitution of a converted co-operative is reasonable.
  - Whether the mechanisms to effect divestment and disenfranchisement are themselves appropriate and equitable (eg. only operating on shares in excess of the limit, not being unnecessarily onerous, operating in clearly defined circumstances, complying with the SCH Business Rules, divestment occurring only after adequate notice, etc.)
  - The benefit to the security holders as a whole.
  - The extent to which the provisions may entrench existing control.
21. Given the special considerations that may apply in the case of a converted co-operative, ASX will consider allowing a shareholder limit. Normally ASX would expect an entity to adopt a limit of not less than 10 per cent, but in exceptional circumstances ASX may accept a limit of not less than 5 per cent. Exceptional circumstances would include, for example, a statutory limit set at that level.
22. Another possibility that ASX would consider is for the constitution to impose voting restrictions and divestment at different levels (eg. a voting restriction on shares held above 10 per cent and divestment of shares held above, say, 15 per cent).

**Guidance Note 3**  
**Co-operatives and Mutual Business Entities**

23. Given ASX's view that converted co-operatives should move to more orthodox structures over time, ASX considers that the provision setting the limit should not initially operate for more than 5 years from listing, and its operation should be considered again no more than 5 years after the last reconsideration. The reconsideration may be either by a resolution to continue the provision's operation or a resolution to end its operation (the entity may decide which form it prefers for the provision). In either case, the vote may be by ordinary resolution. If the provision is framed to require a vote on whether to continue the limit, ASX is prepared to agree to a special resolution if the entity wants. However, a special resolution would not be acceptable if the provision requires a vote on whether to end the operation of the limit, because the entrenchment impact is too great.
24. In the process of preparing for listing, entities may need to seek the approval of members for various changes (eg. changes to articles). If there is a meeting of members at any stage of the planning for the listing, ASX will expect that the introduction of a shareholder limit is put to members as a separate matter for them to decide.
25. A vote on the introduction of the limit, and regular reconsiderations, gives members an opportunity to consider the advantages and disadvantages of a limit. ASX would expect adequate information concerning the advantages and disadvantages of the limit to be given to members at the time of any vote.
26. ASX would normally expect the existence of the limit to be conditional on the following.
  - There is no right to refuse to register transfers to enforce the limit, refer listing rule 8.10.
  - Divestment and disenfranchisement is by acceptable mechanisms, involving appropriate notice.
  - The limit can be removed at any time (ie. the provision is not entrenched and, for example, if it is in articles of association, could be removed by a special resolution of members).
  - Any other conditions that ASX decides are warranted given the structure.

**Founding shares**

27. Another way that control issues might be addressed is by the use of a special share, sometimes called a founding share or golden share. ASX will consider waiving listing rule 6.9 (dealing with voting rights of equity securities) to allow a founding share. However, ASX considers that its preferred model for listing delivers the protection for the interests of active members that a founding share can deliver, without complicating the structure of the listed entity. The preferred model is discussed below at paragraphs 44 and 45.

28. Consistent with shareholder limit structures, the introduction of a founding share structure should be considered by members as a separate matter if there is a meeting of members at any stage of the planning for the listing. The share should also be reconsidered no more than 5 years after listing and thereafter at least every 5 years (but subject to the comments below).
29. How the reconsideration of the provision is structured is a matter for the entity as it is in relation to a shareholder limit in paragraph 23, but ASX may regard a special resolution to continue the share's special voting rights as appropriate if the special rights attaching to the share are broader rather than narrower (ie. not merely reserve powers in the event of a change in control, refer paragraph 34).
30. The adoption of a structure that allows for reconsideration of the founding share is more complicated than for shareholder limit structures. This is because the passing of the resolution would need to be assessed disregarding any special vote that the founding share carried, but having regard to the interests of the members in the vehicle holding the founding share and the members of the listed entity.
31. One possibility would be to take a vote in the vehicle holding the founding share, and carrying the proportion of 'for' and 'against' votes through to the listed entity. In other words, the votes of the 'wet' interests (the members in the vehicle holding the founding share) are taken into account in the listed entity as if they were votes of ordinary shares in the listed entity. This gives all 'members' an opportunity to reconsider from time to time if they want to retain the founding share. Another possibility would be to entitle the founding share for this purpose to a number of votes in proportion to the amount of equity held by 'wet' interests at the date of listing. For example, if one quarter of the equity of the listed company was raised externally, and the total issued capital was 100 shares, the founding share would be entitled to a vote equal to 75 shares. Over time, as the amount of outside equity increased the influence of the founding share on the reconsideration would decrease.
32. The complexity of these sorts of mechanisms may make them impractical in a particular case. ASX would not necessarily regard a structure that did not include reconsideration of the founding share as unacceptable, but ASX may expect the dominant activities to be more rigidly entrenched. For example, there may be a provision that the founding share automatically lost its special voting rights if the vehicle ceased to be a special purpose vehicle.
33. In assessing requests for waivers, matters that ASX will take into account include whether the purpose of the founding share is to promote co-operative principles, and who owns the founding share.

**Guidance Note 3**  
**Co-operatives and Mutual Business Entities**

34. ASX would normally expect the existence of the founding share to be conditional on the following.
- The special rights attaching to the share must be, in ASX's opinion, appropriate and equitable (eg. reserve powers concerning control issues like changes in the articles, appointment of a number of directors, or takeover matters).
  - The founding share must not be transferable.
  - The founding share must be able to be redeemed, or converted to an ordinary share, by the holder at any time.
  - Any other conditions that ASX decides are warranted given the structure.

## **Mutual business entities**

### **Shareholder limits**

35. ASX's experience of mutual business entities is that when they convert to 'for profit' corporations, they normally adopt an orthodox structure. However, a long history as a mutual and the structural changes that conversion necessitates has led a number of mutual business entities to seek a shareholder limit to allow them to adjust more gradually to their new circumstances. Sometimes the limit is supported by legislation.
36. ASX may accept a limit on the holding of a shareholder similar to that for converted co-operatives, refer paragraph 21.

### **Other structures**

37. Co-operatives or converted co-operatives, in particular, might employ different types of structures (subject to any technical constraints - refer paragraph 42) involving the following.
- Preference shares.
  - Debentures (if these are the only securities quoted, the entity may qualify as a debt issuer).
  - CCUs in the case of a NSW co-operative (if these are the only securities quoted, the entity may qualify as an ASX Debt Listing, depending upon the terms of the CCUs).
  - Non-voting shares (but note that ASX regards fractional voting shares as undesirable).
38. To accommodate the variations between co-operatives legislation, financial institutions legislation, the Corporations Act, and the different structures of particular entities, ASX is prepared to consider relief so that an entity can maintain a structure which it has under its controlling legislation.

## **Other issues**

39. Depending on an entity's structure, there may be issues raised in relation to other listing rules, including the following.
- Listing rule 7.1, dealing with issues of ordinary securities exceeding 15 per cent of capital. Provisions in keeping with the special co-operative relationship between holders of the 'wet' class and the entity should prevent a large increase in the number of those securities. In that case listing rule 7.1 is unlikely to be an issue.
  - Price discovery in relation to securities in the quoted class. Unless the proportion of unquoted, transferable securities is too great compared to the quoted class, this is unlikely to be an issue.
  - Takeovers and the control mechanisms used to maintain the co-operative character of the entity. This is unlikely to be an issue if the control mechanism does not survive a significant change in the control of the entity that has the benefit of the mechanism.
40. While ASX has given an in-principle indication of its likely response to such issues, the position for a particular entity can only be considered at the time of its preparing to list, and ASX encourages early consultation.

## **ASX discretion**

41. ASX reserves a discretion in assessing the listing application and any relief. The matters that ASX may take into account include the following.
- The reasons why the structure is employed.
  - Whether additional rights could be extended to inactive members (eg. voting rights, right to board representation) or holders of other classes of securities.
  - Whether other similar entities in the same industry have employed the same, or similar structures.
  - Whether the structure is likely to allow market forces to push the entity towards a more orthodox structure over time.
42. Another issue for ASX is whether quotation is sought for 'securities' (as defined in ASX's articles of association) that can be traded on ASX, whether the securities are 'marketable securities' under the Corporations Act (eg. for transfer purposes), and whether National Guarantee Fund protection applies. In relation to New South Wales and the quotation of CCUs, a regulation has been passed which resolves the technical difficulties, subject to an Australian Securities and Investments Commission (ASIC) modification being granted in each case.

## **Tax issues**

43. ASX recognises the importance of an entity being a ‘co-operative company’ for tax purposes, but cannot become involved in tax issues. This is a matter for the entity to resolve.

## **ASX preferred model**

44. The ASX preferred model for listing co-operatives, companies that were co-operatives but have converted to companies, companies limited by guarantee that have operated on co-operative principles, and mutual business entities, has the following features.
- Members of the co-operative or mutual business entity receive shares both in the entity to be listed (listed entity), and a holding company for the listed entity (holding company).
  - The listed entity conducts the business of the co-operative or mutual business entity eg a business of bulk grain handling.
  - The listed entity has only one class of shares.
  - The holding company holds a percentage of the listed company which is acceptable to the members of the co-operative or mutual business entity (eg. 50%).
  - Ownership of shares in the holding company is restricted to members of the co-operative or mutual business entity (eg. active members of a rural co-operative).
  - Members of the co-operative or mutual business entity exercise control over the listed entity through a combination of their collective ownership of the holding company, and their individual ownership of shares in the listed entity.
  - The holding company is permitted to have “top-up” rights where there is a non-pro rata issue of new securities to enable its current percentage holding to be maintained. Such rights lapse when the percentage holding declines to, eg. 20%. A waiver from listing rule 6.18 will be required to accommodate “top-up” rights.
45. The ASX preferred model enables the members of a co-operative or mutual business entity to retain control of the listed entity in an orthodox way. Influence is exercised through a major holding in the listed entity, in the same way that any major holding confers a capacity to exert influence over any other listed entity. Further, the route to a completely normal structure is straightforward, if the holding company permits its percentage holding to decline.