PART VI – SHARES AND OTHER CAPITAL

6.1. Introduction

It is questionable whether the word "shares" is appropriate in the co-operative context since it is taken by many people to imply a claim on the ultimate surplus of the organisation and a right to vote according to the level of share holding. Since, in a co-operative, votes attach to membership and the distribution of any surplus remaining on solvent dissolution should, if it is permitted at all, apply on the basis of transactions, the word may mislead. However, since it has been used for so long and is used so widely to describe a member's holding in a co-operative, the Group concluded that it is not practicable to change the usage.

The Group considered the use actually made of share capital and other instruments by co-operatives in the various sectors. It was clear that in the consumer co-operative movement the reliance on share capital had declined and that retained earnings and institutional borrowings were the major sources of funding for most societies. In early 1994, the CWS had used the issue of listed loan securities as a source of funds.

In the worker's co-operative and agricultural co-operative sectors, a range of devices was used. In these and other sectors, share capital was not generally withdrawable – an attribute limited to consumer co-operatives. In Common Ownership Co-operatives, a "share" is usually no more than a token of membership, although a few "small enterprise" co-operatives grouping traders together to share services use redeemable I & P shares limited to par value and transferable only within the membership or to new members. The extensive use of registered companies as their constitutional vehicle by workers' and agricultural co-operatives rather than industrial and provident societies, means that they often use classes of shares or structures found among smaller companies. This includes loan or debenture stock which might be secured or unsecured and non-voting preference shares. These devices avoid excessive returns on capital and ensure that voting remains on the basis of membership rather than share holding. They would continue to be available under a new Co-operatives Act.

Some co-operatives are involved in schemes for the part ownership of another business vehicle (such as a company) with which it also enjoys a contractual relationship. Thus a workers' co-operative might own a proportion of the equity of a PLC and contract its worker members to provide services to the PLC. This allows the possibility of a gradual buy out by the co-operative. ESOP structure also offer possibilities of tax benefits for forms of employee ownership or investment in existing co-operatives.

In the agricultural sector a similar range of devices including loan and share capital and companies both private and public are used.

The key issues affecting the approach to capital are the scope and application of the Co-operative principles. The idea that votes should, in primary societies, attach to membership and not the ownership of shares is clear and can generally be applied without difficulty, although flexibility may be required in co-operatives of businesses, such as federals, where voting rights on the basis of transactions with the society may apply within limits. However, those taking up preference shares may demand voting rights in the event of a failure to honour their rights. Similarly, holders of loan capital may in reality have considerably more influence on the co-operative and its decision making than the members who vote in general meetings. This is simply the result of the pressures of the market.

The concept of a limited return on capital and the related concept applicable to surplus distribution are more complex. If the return on capital is to be related to market rates (sufficient to retain and attract capital and no more) then the amount paid must vary with the level of risk perceived at the time of

agreeing the contract under which the capital is provided. It is important that the system operated under a new Co-operatives Act succeeds in maintaining the distinguishing features of co-operatives without importing undue rigidity. We would see the role of the Commissioner in monitoring the application of Co-operative principles in the rules of co-operatives to ensure the primacy of the members and normally to avoid the payment of any ultimate surplus on the basis of capital holdings. This would be particularly important in the case of a capital surplus on the solvent dissolution of a co-operative.

Within these limits and subject to the application, where relevant, of the Financial Services Act 1986 to investments (other than co-operative shares and other exempt securities) offered to the public, co-operatives, by virtue of their legal personality would be able to employ a full range of contractual devices to attract and retain capital. It is not desirable that the Co-operatives Act should list or devise specific capital instruments. That is better left to co-operatives and their advisers.

The results of the research commissioned by the UKCC in 1995 from the Plunkett Foundation on capital raising and tax policy in connection with co-operatives may provide considerable assistance in developing practices in this area. The proposed Co-operatives Act simply provides the framework within which such practices and initiatives can evolve.

The Commissioner would police the genuinely co-operative nature of the share capital of co-operatives when approving rules and rule amendments. Unlike private companies, the status of registered societies does not (and should not) prevent them from seeking investment from the public. A de minimus rule should exempt co-operatives operating on a small scale and appealing for loan capital to a limited group such as members or other co-operatives which belong to the same secondary organisation from any obligation to draft a prospectus or equivalent document. This would also be limited to raising a maximum amount. The general exclusion of co-operative share capital from these requirements is based on its status as a token of membership which makes the right to take it up open ended for those people who are or might become members. In the case of e.g. consumer co-operatives the principle of open membership would allow any member of the public to become a member and thus to be offered shares. For these reasons shares in co-operatives should continue to be excluded from the definition of "investment" in the Financial Services Act and the present position on non-transferable securities should be retained.

The acceptance of deposits is currently regulated under the Banking Act and industrial and provident societies are exempt only on the basis of membership of the current Co–operative Deposit Protection Scheme. Under a new Co–operatives Act, the Commissioner should be involved in approving a new or continued consumer protection scheme which gives co-operatives exemption from Banking regulation in return for a guaranteed level of protection for consumers. Any deposits or loans covered by such a scheme should be exempt from the prospectus requirements of the Financial Services Act 1986. These problems only relate to co-operatives which choose to use withdrawable share capital which amounts, in effect, to a deposit.

The Group believes that co-operatives with entrenched rules which prevent any distribution of residual assets on a solvent winding up and which limit the distribution of surplus to members as a going concern should be regarded as having an indivisible reserve at the core of the business. This ensures that there is a fund available for business development and in the interests of future generations. It is protected by those rules from distribution to the current generation of co–operators. Such arrangements are clearly defined and fixed. This makes them an appropriate basis for tax or other concessions aimed only at those co-operatives that prevent distribution. The 1995 ICA principle on Member Economic Participation notes the importance of that part of the property of a co-operative that is its common property (see Appendix I).

6.2. Maximum Shareholding in a Co-operative

There has traditionally been a maximum limit on the shareholding of individual members of industrial and provident societies. It currently stands at £20,000, having been raised from £10,000 as part of the Deregulation Initiative of 1994. This does not apply to members which are registered societies or who hold their shares under specified provisions applying to certain housing associations or agricultural co-operatives.

The justification for such a rule could be argued to be prudential in the case of co-operatives with withdrawable share capital in which a single member with a large shareholding might threaten the co-operative's viability if the shares were withdrawn. Another justification would be the disproportionate influence on decision making of members holding large amounts of share capital.

One might also note that so long as the holders of withdrawable share capital are to be protected by a deposit protection scheme (currently the Co-operative Union Scheme), a limit on the maximum share holding entitled to that protection is necessary. It does not follow that such a figure should also constitute a limit on the level of share holding. Bank deposits are protected by such a scheme up to a maximum level of £20,000 but there is no such limit on the amount that may be held in an account.

In each case the argument points to a limit on share holding relating to the proportion of shares held rather then the monetary amount that they represent. It is the express or implied threat to withdraw a large proportion of the society's capital that is dangerous. In some co-operatives this could be as little as £5000. In others only amounts of several hundred thousand pounds would have this effect. In societies without withdrawable share capital the threat is more distant and limited in any event. One might add that the absence of any such rule applicable to loan capital undermines the principle - if the concern is with the dominance of the co-operative by certain members it might be applied to the proportion of loan capital that they hold or their combined holding of loan and share capital.

If this rule is to be maintained, the Act should provide for the Commissioner to fix, by order, a maximum percentage of total issued share capital that could be held by an individual member of a co-operative. The rule would not apply to federals, secondary or tertiary co–operatives or co–operatives of businesses. The Commissioner would fix a sliding scale relating the proportion of share capital held to actual figures with a maximum of one third for all but two member co-operatives. The scale would be intended to ensure that no one individual or small group of individuals could dominate the co-operative or threaten its liquidity by the proportion of shares that they held.

It might be necessary to introduce rules in the statute providing for the aggregation of holdings by different individuals or by nominees and, indeed, by related people or corporate bodies. These provisions would be intended to prevent avoidance of the maximum holding rule by the use of such devices. They could be modelled on the "concert party" definitions and rules to be found in the Companies Act.

6.3. Nature of Shares According to Co-operative's Rules

Co-operatives would be free to attach to their shares whatever terms seemed most appropriate to raise the necessary capital or otherwise serve their needs so long as rules intended to preserve the Co-operative nature of the organisation were not broken.

To protect the key defining principles applicable to co-operatives, the Act would confer on the Commissioner the power to approve rules or rule amendments concerned with rights attached to share capital and the voting rights of members. The Act would require co-operative rules to address that

issue. The conditions attached to shares by the rules would vary between Common Ownership Co-operatives and other Co-operatives.

The general principle would be one member one vote. The income return allowed to shares would be limited to the amount necessary to attract and retain capital.

In the case of a Common Ownership Co-operative no distribution of surplus to members would be permitted on solvent dissolution. Other co-operatives could provide for such distribution by a provision in the rules approved by the Commissioner setting out details of the distribution or, if the rules were silent or so provided, by a scheme devised before dissolution and approved by the Commissioner and by the co-operative's members. Such a scheme would normally be expected to allow for distribution to members in accordance with the proportion that the value of their transactions bore to the value of all the co-operative's transactions in a given time period ending on dissolution. The Commissioner would have regard to fairness and equity in approving such a provision by considering, for example, whether a longer or shorter period would radically alter the proportions of surplus to be received by particular members or groups of members and whether this was fair and reasonable.

In cases in which the Commissioner was satisfied that a distribution according to transactions with the co-operative was impractical (e.g. because there were no records from which transactions could be ascertained) or unfair (e.g. because of the legitimate expectations of the members or the circumstances in which the co-operative was established) he or she could approve a scheme for distribution on some other basis. This would involve the use of one or more of the following criteria: equal distribution to all members, length of membership or, in very exceptional cases in which no other method of distribution was considered to be equitable, the level of shareholding. This provision would allow the Commissioner to police this important aspect of the application of Co-operative principles and would leave the present fall back provision for distribution according to shareholdings in the absence of any rule on the subject to be used only in marginal cases in which fairness demanded it.

Subject to the protection of the nature of the organisation as a co-operative by the provisions already outlined, the Act would permit the widest possible range of terms to be attached to shares and would thus encourage the imaginative use of a range of securities tailored to meet particular needs. Thus rights to interest or the repayment of capital and the priority of those rights could be determined by the terms of the shares. This would allow shares of different classes such as preference shares or deferred shares.

Shares, as at present, would be withdrawable, transferable, or redeemable. The Act might limit transferability to the death, bankruptcy or mental illness of a member or the dissolution of a corporate member and cases in which the board of the co-operative approved a transfer to an existing or potential new member. The Commissioner might use his or her power to approve rules and rule amendments to regulate the circumstances in which an internal market in the shares among existing or potential members was permitted. This would not be appropriate in the case of consumer co-operatives which operated a system of open membership and withdrawable share capital on the basis of par value of shares but it might be helpful in the case of workers' co-operatives in which new members could buy out existing members.

6.4. Issues of Shares and Securities

6.4.1. Issues at a Discount or Premium

The Act should prevent the issue of shares at a discount to avoid risks to creditors and existing shareholders from the process of crediting more as paid up on shares than was in fact the case. This is to be distinguished from the possibility of issuing partly paid shares. This is acceptable as it leaves shareholders liable for the amount as yet unpaid. However, the Act might require that a minimum proportion (say 25% on the model of PLC's) of the amount due for a share should be paid up. This would ensure that a minimum proportion of the co-operative's issued share capital was represented by assets.

If issues at a discount were to be expressly forbidden, it might also be appropriate to require the valuation of non-cash assets provided to the co-operative in return for shares. There is no evidence that these issues have created problems under the present law but new legislation should expressly deal with them.

If shares were issued at a premium, the Act would provide for the aggregate amounts of any premiums to be transferred to a share premium account which would be regarded as paid up share capital and could be used for bonus shares, the distribution of surplus in the form of shares, writing off preliminary expenses or providing a premium payable on the withdrawal of withdrawable shares or the redemption of redeemable shares. In many sectors issues at a premium would be inappropriate (e.g. consumer co-operatives with withdrawable shares, par value share capital and fluctuating capital accounts).

6.4.2. Par Value Vs. Capital Appreciation

The Act would specify that the shares of a co-operative would have a par value, the amount being fixed in the rules. However, the Act should allow revaluation of the shares on the basis of annual changes in the state of the balance sheet or the RPI (whichever was lesser) for societies other than those using rules which give them Common Ownership status. This would retain the concept of a limited return while facilitating more imaginative means of raising capital. Common Ownership Co-operatives would not use this method for shares although they might apply it to loan stock. Only co-operatives with a commitment in the rules to par value shares would retain the tax treatment of the interest paid on share capital as a deduction before calculating profits. Such benefits would be lost where capital gains were permitted.

In the case of withdrawable capital, the share account would reflect the current amount held by the member and would grow as interest or dividend was credited to it and shrink as a member withdrew capital. The Commissioner would be given statutory responsibility to ensure that the rules of a co-operative dealt with the possible problem of a run on capital in a responsible manner without unduly restricting the rights of members who held such shares.

6.4.3. Voting Rights Attached to Shares

The Group does not favour conferring voting rights on non-participants or allowing shares with normal voting rights to be held by non-participants. Only a limited group of former participants would be given membership status and that would be on the basis, as at present, of limited membership rights. However, strictly limited voting rights designed only to protect the legitimate interests of certain classes of shareholder could be permitted. This would apply to decisions to change the rights already conferred on the holders of a certain class of shares. In such cases, the consent by special majority of

both the class members and the co-operative members as a whole could be required.

It is only after careful consideration of the possibilities that we have retained this position after the consultation exercise on our 1994 paper. Although we have expressed our willingness to accept the concept of non-user investor members in the context of the Proposed European Co-operative Statute, we are not convinced of the desirability of such a category of members in domestic law. The central importance of the concept of membership to the nature of a co-operative leads us to the view that this status should not be available to people whose only role in a co-operative is as investors. A range of financial and other rights might attach to such investments and votes might be provided to deal with changes in the class rights attached to the securities issued to the investor but general voting rights of the kind available to the holders of equity shares in a company are not appropriate in the case of co-operatives under the regime that we recommend. Other considerations apply to an optional structure which is to have common features recognisable in a range of member states of the European Union.

6.4.4. Prospectus

Currently co-operatives are excluded from the prospectus requirements of the Financial Services Act 1986 in respect of issues of shares or other securities since other means of consumer protection are in place. In addition, non-transferable securities are exempt from more recent regulations based on the EC Second Banking Directive. It is important that these exemptions are retained so that co-operatives are not placed at a disadvantage in raising capital.

It is particularly important to provide a de minimus exception from the usual rules on prospectuses for issues below a certain value by co-operatives falling below a certain turnover threshold. This would acknowledge the fact that problems of co-operatives as small businesses and of housing co-operatives in particular as organisations needing large amounts of capital despite their modest turnover.

In cases in which a co-operative issued loan securities to be listed on the Stock Market the normal Listing rules would apply. No co-operative would be permitted to issue listed share capital as the fluctuation in value and the free transferability of share capital could not be reconciled with the defining principles of a co-operative.

6.4.5. Bonus Shares

The Act would empower co-operatives to issue bonus shares subject to two conditions. First this would only be permitted out of distributable surplus or share premium account and, second, the co-operative's rules would have to permit the issue of such shares. The Commissioner, in approving the rules allowing such issues, would have to satisfy itself that the basis on which surplus was to be distributed by bonus share issues was in accordance with the principle of distribution on the basis of transactions rather than of shareholding.

The Act would follow the Companies Act 1985 by providing that distributions by way of dividend or bonus shares could only take place out of a surplus available for distribution or the share premium account. This would put good practice in statutory form following Part VII of the Companies Act. However, the Act would permit an additional exception in the case of co-operatives with withdrawable share capital to the extent that a distribution amounted to no more than a payment to a member in accordance with the rules applicable to such shares. Subject to that the detail of these rules would seek to achieve broad parity with the Companies Act provisions.

6.4.6. Special Distributions

The Act would also provide that distributable surplus need not be distributed at all. If distribution were to take place, it should normally be only in the form of a dividend on transactions with or participation by the co-operative, as interest on shares, or, if the rules so permit, for any charitable purpose or purpose promoting Co-operative principles. In exceptional cases, the Commissioner could approve rules allowing, within limits, distribution in some other way such as an additional profit related distribution to certain classes of share. The Act would state that a distribution might be made by issuing fully paid shares, crediting monies to a share account, by leaving the dividend on loan to the co-operative or by the provision of some other security (such as loan stock) in the co-operative.

6.4.7. Register of Members

The Act would provide for each co-operative to maintain a register of members which would include details of the value of the shareholding or other property of each member in the co-operative as well as the member's name and address, the date that person was entered on the register, and details of the officers of the society. It would follow the present Industrial and Provident Societies Act 1965 in allowing public inspection of all details except the level of shareholding held. Since the level of shareholding does not affect the control of the society, it is not necessary to make that information public.

The register would be prima facie evidence of the information that it contained.

6.5. Power to Raise Money

This power will, in general flow from the status of the co-operative as a corporate body and the powers conferred on it by its rules. Where it was involved in the banking business it would be regulated by the regime set up by the Banking Act. Involvement in investment business would result in regulation under the system set up by the Financial Services Act 1986. As noted above there would be an exception for withdrawable share capital in a society and the definition of the banking and investment businesses would exclude the co-operative where it was dealing only with its own shares or loan securities.

The Group questions the need to retain the provision of sections 12 and 21 of the Industrial and Provident Societies Act 1965 which prevent societies from providing unsecured loans to their members unless they are duly registered to operate a banking business and lend in the course of that business or fall within an exception applying to certain agricultural co-operatives. Presumably the provision was intended to protect creditors or others from improvident loans granted to members by these organisations that are under the control of the same members. It is difficult to see why co-operatives should be under any greater restriction in this respect than other trading organisations such as companies. The next Part will deal with transactions between directors or senior managers and a co-operative. There would seem to be no reason for imposing restrictions on loans by co-operatives to their members.

The prohibition on societies with withdrawable share capital engaging in banking would seem to be prudent and should be retained. The exception applicable to small deposits (at present a limit of £400 applies) is, as far as we are aware, used by no societies. It should be abolished.

6.6. Charges

The Act would provide for the system of registering charges granted by co-operatives over their property as security for borrowing. Those rules should be identical to those applicable to companies except that the Central Office would continue to be the body responsible for registration. We

recommend that the rules introduced for companies under the Companies Act 1989 should be applied to co-operatives when it is implemented. This would permit a late registration or the correction of an error out of time without the need to apply to the court for permission to register or alter the details but would limit the protection of the lender against those acquiring interests in the meantime. It would seem that the list of registrable charges applicable to companies is applicable to co-operatives.

The key principle here would be to retain consistency between the two systems and the Act would provide for amendment by statutory instrument to ensure that the rules applicable to co-operatives stayed in line with those applying to companies in this respect. The recent limited changes to the rules applicable to societies under the Deregulation initiative are welcome but full consistency with the rules applicable to companies is desirable and when the provisions of the 1989 Companies Act are brought fully into effect the same rules should apply to co-operatives.

PART VII – MANAGEMENT, ADMINISTRATION, MEETINGS AND VOTING

7.1. Introduction

The Act would seek to set a minimum framework of corporate governance for co-operatives. Its aims would be to reinforce their democratic structure and, within those limits, to allow maximum flexibility so as to accommodate the range in size and type. It would, therefore, deal with issues surrounding meetings, voting and directors. This is an area in which the range and variety of co-operatives demands self regulation by federal and promotional bodies. The Act would serve two purposes. One is to ensure that the Commissioner, by exercising his or her power to decide whether to register rules or amendments to rules, could insist that registered co-operatives operated on a system of democratic control by members in line with co-operative principles. The other is to bring the statutory provisions on self dealing by directors and senior managers into line with the equivalent protection conferred on the members of companies, friendly societies and building societies.

7.2. Voting

The Act would lay down that normally each member of a primary co-operative has one vote only and that voting rights are personal and not attached to shares. Joint members would be entitled to only one vote to be exercised by the person present or the one named first in the register of members unless the rules of a particular co-operative laid down some other procedure. Such members would have the right to determine whose name was to appear first in the register.

Primary societies would be permitted to have a tiered structure in which voting in elections or at general meetings was carried out on a delegate basis providing the voting system contained in the rules was regarded by the Commissioner as fairly reflecting the rights of members. This might permit voting by regions or groupings on the basis of their membership or a combination of membership and turnover. The Commissioner would have to be satisfied that a departure from a straightforward system of one member one vote was justified in the context of the particular co-operative and the relative size of its membership would normally be a substantial element in the voting rights exercised by a region or other groupings within the society.

The Act would allow for proxy voting by one member for another only if the rules allowed it and would limit the number of members on whose behalf one person could hold proxies to five on any one occasion.

In the case of secondary and tertiary co-operatives or federals, voting rights would be in accordance with the rules but the Commissioner would only approve provisions which determined voting rights in an equitable manner. This might be according to the relative size of the membership of different member bodies, their transactions with the secondary or federal co-operative or on some other fair basis accepted by the Commissioner.

A co-operative would be entitled to appoint one of its members as a representative to exercise all its rights (including voting) as a member of any other corporate body of which the co-operative was a member. That person would be stated to be entitled to receive all notices of meetings, to vote and to be elected to the board of the other corporate body despite not personally being a member of it.

7.3. Meetings

The Act would provide that every co-operative must hold an annual general meeting every year and that no more than fifteen months should elapse between such meetings. However, so long as a co-operative held its first annual general meeting within eighteen months of its incorporation it need not hold another one in the calendar year of its incorporation or the following year. A notice calling the meeting would specify the nature of the meeting and give details of any resolution properly submitted for discussion at the meeting. Failure to hold an annual general meeting would be an offence and the Commissioner would have power to direct that a meeting be called if the members and directors were unable or unwilling to call one.

The Act would lay down a minimum period of 14 days for notice to be given of general meetings but would allow for longer notice in the rules. The rules would determine the manner of giving notice. With the agreement of all members a co-operative could dispense with notice, which would assist small co-operatives to operate without unnecessary formality.

The Act could provide for a system of elective resolutions along the lines permitted by the Companies Act 1989 to avoid the need for annual general meetings and the re appointment of auditors. This would apply only with the agreement of all members who would have to sign the necessary resolution and would therefore only be likely to apply to small co-operatives. The purpose of such rules would be to remove unnecessary bureaucratic procedures without limiting the rights of members or preventing proper democratic control.

The Commissioner would police restrictions in the rules of a co-operative on the right of members to vote if liabilities or debts were due to the co-operative from the member, such provisions would only be allowed if the Commissioner considered them fair and appropriate.

The Act would protect the right of not more than twenty members (or a smaller number specified in the co-operative's rules) to call for a poll at any general meeting on any question other than the election of the chairman or the adjournment of the meeting. The Commissioner might insist on the rules of smaller societies having a lower figure. The Group suggest a figure of twenty in the Act to avoid problems for co-operatives with a very large membership.

The rules of all co-operatives would be required to permit a proportion of members (fixed at not more than 10% of the total membership or 100 members, whichever is the smaller, but never less than two members) to requisition a general meeting to require a particular resolution to appear on the agenda of an annual general meeting. In the case of co-operatives organised on a federal basis or operating with general meetings attended by delegates, the proportion entitled to exercise these rights would be agreed by the Commissioner when the co-operative's rules were approved but would never be more than the number representing 10% of the co-operative's members.

All resolutions to be considered by a meeting of a co-operative or a postal ballot would be defined as either ordinary resolutions or special resolutions. An ordinary resolution would require only a simple majority of those entitled to vote and voting in person or by proxy.

A special resolution would require a three quarters majority under the Act. Unless the Act or the rules specified the contrary in respect of a particular resolution, this would be a majority of those members entitled to vote and voting in person or by proxy on a poll, at a meeting or in a postal ballot. A special resolution would also have to require at least 14 days notice (or such longer period in the rules). The notice would state that the resolution was a special resolution and could not be passed without the particular majority applicable to the resolution which was the subject of the notice. It would be personally provided to each member or advertised in the same way as notices of general meetings.

7.4. The Board

Whilst the Industrial and Provident Societies Acts use the term committee of management and committee member, the Group suggest that the opportunity be taken to give statutory force to the terms "board" and "director" now commonly in use.

The Act would provide that a co-operative that was not operating as a collective had to have at least one director elected by the members in accordance with its rules. A co-operative which wished to operate as a collective would, by rule, confer all powers of decision-making on its general meeting of members so that it carried out all the functions normally divided between the board and the general meeting.

7.4.1. Age Limits

The minimum age for a director would be 18 as the age at which full legal capacity is obtained. The question of any maximum age for directors should be left entirely to the rules of each co-operative. Any maximum age limit in legislation is an inhibition on the democratic process.

7.4.2. Co–option

The Act, like the present legislation, would allow the power of co-option in rules of a limited number of directors whether or not they were members. However, the right of co-operatives to co-opt directors would be limited by the Act in a number of ways. The Board would have to consider the co-opted director to be a fit and proper person to be a director and the number of unelected directors would be limited to a minority of the board.

7.4.3. Employee Directors

At present, the question of the number of employees that serve on the board of co-operatives other than worker co-operatives is regarded as a question of member control and the status of the organisation as a bona fide co-operative. If an excessive proportion of the board consists of employees, there is a danger that they will make decisions in the interests of employees rather than of members. At present the Registry requires the number of employee board members to be limited to the number which would remain a minority at a barely quorate board meeting. We recommend that this approach continues and that the Commissioner deal with this issue as part of his or her remit to ensure that the rules of a co-operative retain their co-operative nature. This would emphasise the key issue of member control and would leave discretion to deal with cases such as community co-operatives with employees, volunteers and users on their boards.

7.4.4. Term of Office

The Act would lay down a maximum of five years (or a shorter period contained in the rules) as the term of office of an elected director. This would not prevent the re–election of the same person at the end of that period and for as many terms as the members chose but it would ensure that elections took place at least once every five years in respect of all members of the board.

7.4.5. Secretary

Every co-operative would be required to have a secretary (who could be a director) who would bear the primary responsibility for statutory returns. It is not necessary for the Act to stipulate that every society must have a chief executive. Many smaller societies do not operate in this way and the considerations that make this necessary in the case of financial institutions such as building societies and friendly societies do not apply to co-operatives. The better analogy is with companies where no such requirement is laid down in the legislation.

7.4.6. Qualifications for Office

The rules of a co-operative would be expressly permitted to lay down conditions as to length of membership, value of transactions with the co-operative or level of shareholding as qualifications for directors. The Commissioner would vet such requirements in rules with particular regard to the importance of maintaining democratic control by members.

The Act would provide for the acts of a director to be valid despite any defect later discovered in his or her appointment or qualification. This would be without prejudice to the general protection given to those dealing with the co-operative elsewhere in the Act.

It would lay down that a person who was an undischarged bankrupt or who was subject to a disqualification order preventing him or her from acting as a director of a company would also be prevented from acting as a director of a co-operative.

The Act would also apply the provisions of the Company Directors Disqualification Act 1986 to the directors of co-operatives so as to permit a court to make an order disqualifying a person from acting as a director of a company or a co-operative if they had been convicted of certain offences such as fraud or, in the case of an insolvent co-operative, were found, because of their past conduct to be unfit to act as a director.

7.5. Directors and Officers Dealings

The Co–operative Union Working Group Report on Corporate Governance highlighted a number of issues surrounding the acts of directors and chief officials and that report's recommendations have been taken into account in this section. The Report represents an example of self regulation and the Act would leave most matters in this field to that system. However it would set a minimum threshold of standards to limit and regulate "self dealing" between the co-operative and its directors or senior managers.

These statutory rules are modelled on the equivalent provisions found in the Building Societies Act 1986 and the Friendly Societies Act 1992 which in turn draw on Part X of the Companies Act 1985. These provisions assume the existence of the Common Law obligations of directors and senior managers to act in good faith in what they perceive to be the interests of the organisation, to avoid conflicts between their duty to the co-operative and their personal interest, to observe the duty of

confidentiality, to avoid exploiting property or business opportunities of the co-operative for personal gain, and to exercise reasonable care and skill in carrying out their office. The liability of directors and senior managers to the co-operative for breach of these duties would remain as it is now. The following provisions apply to co-operatives the same minimum statutory standards that apply to companies, building societies and friendly societies. Beyond that, corporate governance is a matter best left to self regulation by the various co-operative sectors.

The concept of a shadow director (natural or corporate) would apply . A shadow director is a person in accordance with whose directions or instructions the directors of a co-operative are accustomed to act but an exclusion would apply to a person who would fall into the category only because the directors act on advice given in a professional capacity. This is based on section 741 of the Companies Act 1985. In addition to this provision, the Act would apply its self dealing rules to a person who acted as Chief Executive, Managing Director, or in a similar capacity in relation to a co-operative whether or not that person was a member of its board. This is important because such officers have at least as much power and influence as the elected directors and more opportunities for abuse. The Act could either be drafted to apply particular provisions of other legislation by reference (see Friendly Societies Act 1992 Schedule 11 Part II) or it could set them out (Building Societies Act 1986 sections 62 to 68 or Companies Act 1985 Part X).

7.5.1. Prohibition of Tax Free Payments

A co-operative would be prohibited from paying a director, shadow director, Chief Executive or equivalent manager remuneration (whether as a director or otherwise) free of income tax or otherwise calculated by reference to or varying with the amount of his or her income tax. Rules, resolutions or contractual provisions violating this rule would be read as if the amount to be paid as the net amount was the gross amount to be paid before tax. The purpose of this provision is to ensure that members have full information about the exact amount paid to directors rather than being given a figure on top of which the co-operative has to meet a tax liability. Equivalent provisions apply to companies, building societies and friendly societies. In cases in which a co-operative paid another co-operative for the services of one of its officers as a director or paid a fee to a self employed person, the provision would require the full amount payable by the co-operative for those services to be known with certainty. The fact that the tax was not organised on a PAYE basis would be irrelevant.

7.5.2. Payments to Directors for Loss of Office

It would be unlawful for a co-operative to pay any amount to a director, shadow director, Chief Executive or equivalent manager as compensation for loss of office or as consideration for or in connection with retirement without details (including the amount of any proposed payment) being disclosed to and approved by the members of the co-operative. This provision places co-operatives in the same position as companies on this question and the exception applicable to companies which covers bona fide payment of damages for breach of contract or by way of pension for past services would also be applied to co-operatives.

7.5.3. Disclosure of Interest in Contracts and Other Transactions

This provision would make it a criminal offence for a director or Chief Executive to fail to declare any direct or indirect personal interest in any contract or proposed contract with the co-operative. This would have to be done at the board meeting at which the proposed contract was to be discussed or at the first board meeting after the director became interested in the contract if that was later. A general notice given to the directors that he or she is interested in contracts with specified persons that are connected with him or her or by a specified company or firm of which he or she is a member would

serve as the necessary declaration for all later contracts. The director need not attend the meeting to declare his or her interest so long as he or she ensures that it is brought to the attention of the meeting by being read to it. The section would apply to transactions and arrangements as well as contracts - including loans to directors and persons connected with them. It would not apply to transactions with the co-operative in the normal course of business in the capacity of a member of the co-operative i.e. the normal employment contract of the member of a workers' co-operative, the sale contract of a farmer member with a marketing co-operative etc.

7.5.4. Substantial Property Transactions Involving Directors and Connected Persons

This provision would require the approval of the co-operative's general meeting for any transaction between the co-operative and a director or Chief Executive or equivalent manager or person connected with them where one or more non-cash assets of the value laid down were to be acquired by that person from the co-operative or by the co-operative from that person. The level at which the value of a transaction would trigger the application of this rule would be varied by regulations and would be kept at the level applicable to companies, building societies and friendly societies (currently at least £2000 or 10% of the company's net asset value (whichever is greater) or, if that comes to more than £100,000, then £100,000).

A transaction entered into in violation of this provision would be voidable at the behest of the co-operative subject to exceptions where restitution is impossible or property has passed to a third party acting in good faith or the co-operative has affirmed the transaction with full knowledge of the circumstances. The persons involved in the transaction would also be obliged to hand over to the co-operative any gain they made and to indemnify it for any loss or damage it suffered. Ignorance of the circumstances constituting a contravention would be a defence.

7.5.5. Restrictions on Loans to Directors and Persons Connected with them

This provision would follow the one applicable to companies, building societies and friendly societies. It would prevent loans, guarantees, the provision of security or the leasing or hiring of property by the co-operative to directors, Chief Executive or equivalent managers or connected persons. It would prevent indirect arrangements whereby the co-operative provided a benefit to some other person who had provided such facilities to the director or connected person.

Exceptions would exist for:

a) "small" loans below a level varied to keep in line with companies, building societies etc. (currently £5,000);

b) loans in the normal course of business (if lending is the co-operative's business) on no more favourable terms than are normal;

c) loans of up to £100,000 to a director who is also an employee to buy or improve a house if such loans are normally provided to the co-operative's employees;

d) loans of not more than £20,000 in aggregate approved by the general meeting (before or after being made) with full information provided to it to provide the director or Chief Executive with funds to meet expenditure incurred or to be incurred by him or her for the co-operative's purposes or so as to carry out his or her duties as a director or Chief Executive;

e) leases or hirings of value of not more than £10,000 or made in the ordinary course of business on no more favourable terms than normal.

Transactions covered by this provision or the previous one and approved by the general meeting or within one of the exceptions listed above would be recorded in a register kept for the purpose. A statement of the information in the register for the last financial year would be available for the inspection of members at the annual general meeting and for fifteen days before it and would be sent to the Commissioner and lodged on the public file at the Central Office. The register would show transactions in the current financial year and the previous ten. An exception from the duty to include transactions on the statement (but they would still have to be shown in the register) would be provided for small scale loans (e.g. £3000 or less) and the Commissioner would have power to make regulations varying the limit for such exemptions. This applies the rule which building societies and friendly societies follow.

An interpretation provision would define "connected persons" and would include companies or other corporate bodies with which the director or Chief Executive was to be regarded as associated. This would be limited to personal interests beyond that of being an employee of the company in question so that employees of primary co-operatives serving on the boards of federals such as CWS would not be affected.

The sanctions for breach of these rules would be the same as those applicable to substantial property transactions.

7.5.6. Prohibition on Exemption from Liability

The Act would prevent the terms of either the rules of a co-operative or any contract between the co-operative and a director or officer (including a Chief Executive) from exempting such persons (or auditors) from any liability by any rule of law for negligence, default, breach of duty or breach of trust for which he or she might be liable or indemnifying them against such liability. Exceptions would apply to permit a co-operative to insure its directors and officers against such liability and to allow indemnification of a person for legal costs if they were acquitted or in which judgement is given in their favour. In addition, the court would be given power under section 727 of the Companies Act 1985 to grant relief to directors or officers for honest and reasonable breaches of duty.

This provisions places co-operatives in the same position as friendly societies, building societies and companies.

7.5.7. Service Contracts

The Act would provide that the service contract of any director, shadow director, Chief Executive or equivalent manager should be open to inspection by any member of the co-operative free of charge at its registered office or principal place of business and that the location of the copy of the written contract or the memorandum containing the full terms of a contract not made in writing should be notified to the central office and the Commissioner. This provision is based on section 318 of the Companies Act 1985. Like that section, it would not apply to a contract which would terminate within twelve months without a right on the part of the director etc. to renew or when it could be terminated without compensation by the co-operative within the next twelve months.

The Cadbury Report and the existing section 319 of the Companies Act 1985 would be reflected by a requirement that any service contract provided for a Chief Executive or equivalent manager or for any director which required (in effect) three or more years' notice for the co-operative to terminate it without proving any specific circumstances would only be valid after approval by a majority of members voting at a general meeting of the co-operative or by postal ballot.

7.6. Major Transactions

The Act would require the rules of co-operatives to state whether the approval of the members in general meeting (or by other means) for transactions which represent more than a specified percentage of the net asset value of the co-operative or of its stream of profits and whether any circulation of information to members might be required at a lower threshold.

This approach is modelled on the rules applicable to listed companies and would, if a co-operative chose to give its members this right in its rules, ensure that the board could not use the extensive powers conferred on it by the co-operative's rules, acquire or dispose of assets of very great value without the knowledge or the approval of the members. This provision would dovetail with the provisions applicable to transfers of engagements and conversions. No co-operative would be obliged to adopt a rule giving its members such rights but, if it did not do so, its rules would contain a statement to that effect. This would ensure that the question was addressed at the time of formation.

PART VIII – ACCOUNTS AND AUDITS

8.1. Introduction

On these questions co-operatives should enjoy a level playing field with companies. The interests of members, creditors, employees and the public at large in having accounting information that is transparent and accessible is the same whether a business is formed as a co-operative or a company. The differences in the accounting and audit rules applicable to industrial and provident societies rather than companies are the result of a failure to update legislation for co-operatives rather than an acknowledgement that they have different needs.

Nevertheless, there are some areas of co-operative accounts that will necessarily be different from those of conventional companies - mainly those relating to share capital (especially when it is withdrawable) and those applying to a dividend given to members on their transactions with the co-operative. There is also the issue of the "indivisible reserve" referred to earlier. For these reasons, we tend to the view that while the machinery of the Accounting Standards Board and the Financial Reporting Council which set company accounting standards should apply to co-operatives, input should be available to deal with the special features of co-operatives. The current Co-operative Union Committee on Co-operative Accounting Standards might be helpful in this connection.

The statutory provisions to be found in this part of our proposal are drawn, in the main, from the equivalent parts of the Friendly Societies Act 1992, the Building Societies Act 1986 and the Companies Act 1985.

8.2. Records and Systems

The Act would require all co-operatives to cause accounting records to be kept and to establish and maintain systems of control of its business and records and of inspection and report.

The Accounting Records would be required to be sufficient:

(i) to show and explain the transactions of the co-operative;
(ii) to disclose at any time the financial position of the co-operative at that time;
(iii) to enable the directors (or members in the case of a collective) to carry out their function of direction of the affairs of the co-operative; and

(iv) to enable both the directors (or collective) and the co-operative properly to discharge the duties imposed on them under the Act.

They would have to be kept in an orderly manner and their content would have to include, in particular:

(a) entries from day to day of all sums paid or received by the co-operative and the matters in respect of which they were paid or received;

(b) day-to-day entries of all transactions likely to give rise to assets or liabilities of the co-operative other than insignificant assets or liabilities in respect of the management of the co-operative;

(c) a record of the assets and liabilities of the co-operative; and

(d) if the co-operative's business involves dealing in goods, statements of stock held at the end of the financial year, of stocktaking from which the statements were obtained and statements of all goods sold and purchased, other than by way of ordinary retail trade, showing details of the buyers and sellers.

The provisions as to accounting records would apply to subsidiaries. The records would have to be kept at the co-operative's registered office or such other place as the board decided and would be open to inspection by the board at any time. They would have to be preserved for six years.

The System of Control and of Inspection and Report would be required to control the activities of the co-operative in accordance with the Act and the decisions of the board as well as accounting and other records and to inspect and report on the operation of the system to the board. Such systems would be required to operate to a standard that ensured that the board and the co-operative could carry out their duties under the Act and, in the case of the board, its duty to direct the society. A detailed written statement of the system currently in operation would have to be available to the board at all times.

In more specific terms, these systems would be required to ensure that the activities of the co-operative were so conducted and its records so kept that accurate information was available sufficiently regularly and promptly to enable the board to carry out its functions.

8.3. Annual Accounts

The board of a co-operative would be under a duty to prepare a balance sheet and an income and expenditure account for each financial year - including group accounts if it had subsidiaries or jointly owned businesses.

The detailed requirements as to the content and possibly the format of those accounts would be laid down by regulations. The Act would require that they give a true and fair view of the position of the society and include the notes and supplementary information laid down in regulations made by the Commissioner with treasury consent. This would include reference to accounting principles and rules, corresponding information for the previous year, remuneration, compensation for loss of office and financial interests of directors and officers. However, the "true and fair view" requirement would override the provisions of the regulation.

Subject to the duty to have accounts which meet the needs of the co-operative, exemptions (based on the criteria that apply to companies) would be available from the obligation to provide detailed accounting information in accounts submitted to the Commissioner and the Central Office. These

would apply to small and medium sized co-operatives with a more generous level of exemption for small co-operatives than for medium sized ones. The criteria for these exemptions would be changed to keep in line with those applicable to companies. This would currently mean that a co-operative would have to meet two or more of three criteria; namely that there is less than £2 million turnover, less than £975,000 Balance sheet total and less than 50 employees for a "small" co-operative and for a "medium" co-operative £8 million turnover, £3.9 million balance sheet total and 250 employees.

8.4. Annual Report

The board of a co-operative would be obliged to prepare an annual report on the activities of the co-operative for presentation to the annual general meeting. This would be required to contain a fair review of the activities of the co-operative during the year in question. Normally there would be an obligation to send a copy to every member and holder of a debenture or other loan stock but, in cases in which this was impractical, the Act would permit other forms of distribution such as making them available in places of business or at the annual general meeting. The Act would confer a right on all members and holders of loan stock to demand a copy of the report and accounts free of charge at any time of the year.

8.5. Audits

In this area compatibility with the rules applicable to companies is also desirable. The Act would provide detailed rules as to the appointment, tenure, remuneration and qualifications of auditors which would be similar to those applicable to companies. Appointment would be a matter for the board until the co-operative's first annual meeting and thereafter would be for the general meeting. The possibility of a unanimously agreed elective resolution to dispense with the need to reappoint the auditor would also assist in reducing the amount of unnecessary bureaucracy required This would place co-operatives in the same position as companies.

As at present, eligibility for appointment would, in general, be identical to the rule applicable to company auditors. However, to acknowledge the problems of small co-operatives, the Act would include the Deregulation provision introduced in 1994 for companies which abolishes the need for an audit at all if turnover is less than £90,000 and allows for a limited audit where turnover is less than £350,000.

The present procedures for the removal or resignation of auditors would apply with the right of the outgoing auditor to address and submit written comments to the general meeting. The general meeting would fix the remuneration of the auditors as at present and that information would appear in the annual report.

The auditors would, as at present, submit a signed report to the annual general meeting as to whether proper records have been kept, and whether satisfactory systems of control inspection and report exist and whether the annual accounts agree with the accounting records. They will also report any failure to get access to documents or information and will report on the directors' annual report. They will deal with whether the annual accounts have been properly prepared and give a true and fair view of the co-operative's affairs in accordance with the Act.

In order to carry out their duties the auditors would be given power to obtain books, documents and information and to attend and speak at meetings. It would be an offence for an officer or director to deny these rights.

Auditors would be required by the Act to furnish information to the Commissioner on the conduct of the co-operative or its business if the Commissioner requested such information regardless of any obligation of confidentiality to the co-operative. If the auditors were satisfied that it was appropriate to do so in the interests of the members of the co-operative they would be empowered to provide information to the Commissioner on their own initiative.

8.6. Laying and Furnishing Accounts and Reports

The Act would impose a duty on the board of a co-operative to lay copies of the annual accounts, the directors' report and the auditors' report before the annual general meeting each year and, fourteen days before the meeting, to send a copy of those documents to the Commissioner and the Central Office. At that time, the duty to make those documents available to members would also arise. Again these requirements would be based largely on company law practice with adaptations to deal with the problems some co-operatives would have with the cost and practicality of the process of sending the annual accounts and report to all members. The Act would create offences to enforce these obligations. Liability would fall on co-operatives and their directors and officers for failure to comply subject to appropriate defences of ignorance of the fact that the offence was committed or reasonable efforts to comply.

PART IX – SUPERVISION AND PROTECTION OF CO-OPERATIVES

9.1. Introduction

This Part of the Act would deal with the function and role of the Co-operatives Commissioner. The powers conferred on the Commissioner would be used for the central purpose of ensuring that all co-operatives conformed to the requirements of the Act as to adherence to Co-operative principles. Where a co-operative was proposing to convert into or transfer its engagements to a company, the Commissioner would have to approve the arrangement in accordance with Part XI. In relation to credit unions which would continue to be governed by their own legislation, the Commissioner would carry out the regulatory function currently performed by the Registry of Friendly Societies.

The role of promoting co-operatives and ensuring that information about the co-operative system of business was disseminated to the public would be a matter for the promotional and federal bodies of the various co-operative sectors as it is now with UKCC or its successor operating as an umbrella body. It was evident from the consultation process on our original proposal of November 1994 that the promotion of co-operatives is not seen as an appropriate function for a state body.

The Central Office of the Registry of Friendly Societies would operate as a registration body under the supervision of the Commissioner. This builds on the existing system and uses the specialist expertise that has been built up over the years while establishing a clear and separate co-operative identity with its own legal regime.

9.2. Regulation of Co-operatives

The function of ensuring that rules and amendments to them conform with co-operative principles would, in large part, be carried out on registration or on amendment of rules. However, the Act would also lay down the Commissioner's role of overseeing the adherence of co-operatives adhere to Co-operative principles as expressed in their own rules - especially when he or she received complaints from members or others.

If the Commissioner was satisfied that a co-operative was not operating in accordance with its own rules, the Act or Co-operative principles he or she could make an order under the next section to correct the matter. Those powers would allow the Commissioner to correct specific problems without taking the drastic measure of suspending or terminating the registration of a society or petitioning for it to be wound up. Only after a failure to comply with such an order and where the interests of the members or of the public required such action would the Commissioner have power to seek a winding up order or to suspend or terminate the registration of the co-operative. The Commissioner, in making an order, would take into account the particular concerns of common ownership co-operatives on the use of residual assets and any other relevant features of the co-operative in question.

9.3. Powers of the Co-operatives Commissioner and Appeals in Connection with a Co-operative's Compliance with Its Rules and the Act

The Commissioner, on his or her own initiative, could, after investigating the matter, order a co-operative to take specific steps to remedy a failure to comply with its rules or with the provisions of the Act. He or she would only be entitled to do this after being satisfied that there was a breach and that it would not be remedied unless an order was made. The order might require rule amendment, particular procedures in an election or a meeting or the admission of people within a particular group into membership.

After considering the question of appeals from the decisions of the Commissioner very carefully, we concluded that the question of whether a co-operative met the "bona fide" co-operative requirement of the legislation should not be subject to appeal. The guidance published by the Commissioner after considering the ICA Statement to be found in the schedule to the Act would, in our view, provide sufficient certainty about the rules to be applied. The statutory requirement that the Commissioner consult the main representative bodies of the various co-operative sectors should ensure that those criteria set out in the guidelines are acceptable.

On considering the powers of the Commissioner we were convinced of the desirability of building on the present remedies open to the Registry without importing sweeping new regulatory powers. For relatively minor infractions of the Act, the present system of prosecution with a fine on conviction would continue. In addition, the Commissioner would have the powers to gather information and to establish inspections or investigations that are suggested in section 9.4. This might assist in the use of the Commissioner's power or in the work of the police and other prosecution agencies if breaches of the general law were involved. Under Part X members could use the lower civil courts or arbitration or mediation systems to deal with their disputes. Beyond this, the ultimate remedy against a co-operative for persistent breaches of the Act would be the withdrawal of the privilege of registration under the Act with, if necessary, a court supervised liquidation of its operations.

The Commissioner would be empowered to petition for the winding up of a co-operative for persistent failure to comply with its own rules or the Act but only if this was in the interests of the co-operative's members or the public interest. Orders made by the Commissioner would be indications of his or her view that the co-operative had failed in this respect combined with a statement of the steps to be taken to rectify the situation. If a co-operative failed to comply with the orders, the ultimate sanction would be either the suspension and ultimate termination of its registration or an application to the court for an order that it be wound up. In each case a court would be involved in the decision. In the case of a winding up order it would only make the order if convinced of the persistent breach of rules or the Act. In the case of the termination of registration it would hear any appeal against the order of the Commissioner while the registration of the co-operative continued pending the hearing of the appeal.

The choice between the two courses of action would depend on the circumstances of the co-operative. A winding up order would be sought where the co-operative had assets and where re-registration

under other legislation was inappropriate but its absence would lead to the existence of an unregistered group unable to operate lawfully as a partnership because of excessive numbers or for some other reason. If the co-operative had no assets, or could be re-registered, for example as a company, in a way which did not defeat its members' legitimate expectations, or could lawfully operate as a partnership after its registration was terminated, the Commissioner would terminate its registration.

9.4. Inspections and Investigations

The Commissioner's powers to gather information and to investigate the affairs of a co-operative would be modelled on the existing rules. The result of such investigations might lead to orders under the earlier provisions or might simply give the members the possibility of dealing with the situation at a meeting convened by the Commissioner. The use of the power to make orders would not be limited to cases in which such inspections or investigations had taken place but would apply where the Commissioner was satisfied that there had been a breach of the Act or of the co-operative's own rules which required such a remedy.

The Act would provide a new power for the Commissioner to gather information, documents or other material and explanations relating to the activities or planned future activities of the co-operative or a subsidiary of the co-operative or body jointly controlled by it which the Commissioner considered that it needed for the purposes of the proper discharge of any of its functions under the Act. This would be exercised by the service of notice on the co-operative or other body and/or on any employee, director, officer or agent of the co-operative or other body. It would also apply, in relation to documents or other material, to any person who appeared to the Commissioner to have the document or material in his or her possession or under his or her control. As with equivalent powers in similar legislation this would be without prejudice to a lien someone held over the property in question and subject to legal privilege. Failure to produce the information, material and explanations required would be an offence by the person or body on whom notice was served. The provision of false or misleading information, material or explanations would be a more serious offence. This power would be geared to the investigation of whether a co-operative was complying with the Act and its own rules so as to operate as a co-operative.

On the model of the Companies Act 1985, the Building Societies Act 1985 and the Friendly Societies Act 1992, there would be provision for:

(a) The appointment of an inspector to gather information on behalf of the Commissioner. There would be duty on the officers, directors, employees and agents of the co-operative under investigation to provide records, books and papers, to attend and answer questions and to give all assistance that they could reasonably provide to the inspector. Failure to do so would be an offence. This would result in a report to the Commissioner on the state and conduct of the co-operative's activities or any aspect of them. This power can be exercised without notice but does not give the inspector a right to examine anyone on oath or to go to the High Court to have a refusal to answer questions treated as contempt of Court. This is a more routine power of information gathering.

(b) A power, if the Commissioner is of the opinion that an investigation into the affairs of a co-operative should be held and/or that a special members' meeting should be held to consider its affairs, to do those things. This power would also be capable of being exercised at the request of 100 members or 10% of the co-operative's members, whichever is more, so long as the Commissioner was satisfied that the request was not frivolous or vexatious and subject to the applicants providing any security for costs that the Commissioner may require. This would allow investigation where there was widespread disquiet in a large co-operative. In smaller co-operatives, complaints from fewer than 100 members may result in an investigation or the calling

of a meeting at the Commission's own initiative. The Commissioner could require the co-operative, or the applicants or members, officers, employees or former members, officers or employees to defray all or part of the cost of the investigation. The co-operative would be entitled to have notice of the use of this power and the reasons that it was to be used and fourteen days to reply. As suggested above, the powers of the inspector under this section would be wider and would include the right to insist on replies under oath with the threat of taking a person who refuses to reply to the High Court for contempt. the resulting report could be published and would be admissible as evidence in legal proceedings. This would be in addition to the powers conferred under (a) above.

This model would place the Co-operative Commissioner in a directly analogous position to the DTI when it is investigating companies. In practice, only major crises in large co-operatives would be subject to the full scale investigation in (b). The key special issue confronted by the Co-operatives Commissioner would be whether a co-operative was in fact operating as such in accordance with its rules and the Act. However, these powers of inspection and investigation and calling meetings are an updated version of those to be found in the Industrial and Provident Societies Act and might be used in cases of suspected fraud or financial irregularity.

The confidentiality of information obtained under the Act would be guaranteed subject to exemptions for information that was already public and in relation to legal proceedings and other regulators. (see Friendly Societies Act 1992 sections 63 & 64).

9.5. Records, Notices, Forms and Fees

This section of the Act would deal with the role of the Central Office which retains its role as a registry but operates under the supervision of the Co-operatives Commissioner. There would be provision for the Office to prepare and maintain a "public file" relating to each co-operative. This would be open to public inspection and would contain copies of the co-operative's rules, annual accounts and reports, registered charges and other information specified in the Act. Details of the requirements for the keeping of the records of co-operatives and of the requirements for the service of notices and of the power to lay down Registry fees and forms by regulation would also be found here. The legislation should facilitate the use of electronic systems for the storage and retrieval of information.

PART X – COMPLAINTS AND DISPUTES

The Act should recognise the importance of straightforward, cheap and informal methods of resolving disputes involving a co-operative and its members. Historically this was done by the encouragement of arbitration, provision for the use of the lower courts and (until 1992) the possibility of using the Registry to arbitrate on disputes.

While we accept that the Registry has stepped back from its role as arbitrator in resolving disputes, we would expect the Act and the Commissioner to encourage co-operatives to have provisions in their rules to provide for arbitration. This might be by an arbitrator chosen from a panel set up by the general meeting or the use of a secondary or sponsoring body such as ICOM or the Co-operative Union. The Act and the Commissioner could encourage the use of alternative dispute resolution processes such as mediation and conciliation before arbitration is used. There might also be a role for a Co–operative ombudsman scheme to be set up by the promotional and federal bodies as part of their self regulatory function. Should conciliation, mediation or an ombudsman fail, the member parties could agree to use the County Court or Sheriff's Court and if the member failed to obtain a decision to deal with the matter by arbitration under the rules for a period of forty days there would be a right to use the County Court or Sheriff's Court.

PART XI – AMALGAMATION TRANSFER OF ENGAGEMENTS CONVERSION AND RECONSTRUCTION

This Part of the Act would deal with the familiar possibilities of the amalgamation of co-operatives or the transfer of engagements from one to another or from a co-operative to a company. It would also deal with the conversion of a co-operative into a company. These matters are central to the concern of the Act to protect the co-operative nature of the bodies registered under it. The availability of the possibility of entrenching provisions in the rules of a co-operative to create a common ownership co-operative allows for a change out of such a structure to be treated similarly.

Although our proposal seeks to minimise the extent and cost of the regulation to be introduced, we make an exception for situations in which the co-operative is to become a non co-operative business. Such is the anxiety about that process throughout all co-operative sectors that we would wish to see protection both by requiring special majorities to achieve such change and by ensuring that the Commissioner has power to vet such changes.

Conversion into, amalgamation with, or transfer of engagements to a body not registered under the Co-operatives Act by a co-operative would require the prior approval of the Commissioner as well as a three quarters majority of members voting at a general meeting or by postal ballot. The required majority would also have to constitute more than 50% of the total membership of the co-operative (along the lines of the Building Societies Act 1986). The Commissioner would consider the terms and conditions of the proposed transaction and the plans for providing information to members and for obtaining their agreement. He or she would ensure that the members had all the information that was reasonably necessary to make a decision and that they had sufficient time to consider the matter. The Commissioner would also consider the proposed distribution of shares in the company to members to consider whether it was fair and equitable. He or she would have power to determine the most suitable way of ascertaining the views of the members and might insist on a postal ballot in certain cases.

In the case of a transfer of engagements to or amalgamation with another co-operative of the same type (i.e. from one Co-operative Society to another or from one Common Ownership Co-operative to another) the focus would be on ensuring that the procedures laid down in the Act were correctly followed. For this purpose the existing requirement of a two thirds majority of those voting would be sufficient. In the case of common ownership co-operatives, their rules would permit only a transfer of engagements to another common ownership co-operative or amalgamation with another co-operative so as to create a common ownership co-operative.

If our proposal in paragraph 7.6. leads co-operatives to require member approval for major transaction, this would ensure that transactions likely to undermine the mutual nature of a co-operative without formal conversion would require member approval. Otherwise, we are satisfied that the power of the Commissioner to approve rules and rule amendments is sufficient protection when combined with the need for special majorities to achieve amalgamations, transfers of engagements or conversion into a company.

The purpose of the Act would be to ensure that members were fully informed when making vital decisions of this kind; to ensure that legitimate expectations about the nature of the organisation were fulfilled and not frustrated.

The Act would provide for the formal processes of transfer of engagements, amalgamation and conversion and would furnish the Commissioner with the regulatory powers referred to above.

PART XII – INSOLVENCY, WINDING UP AND DISSOLUTION

This Part of the Act would bring about important and long awaited reforms. However, its drafting is relatively straightforward. The two routes to dissolution currently found in the Industrial and Provident Societies Act 1965 would be retained. The use of the Instrument of Dissolution signed by 75% of the total membership would remain available in those cases in which the scale of the membership and the solvency of the co-operative made it practicable.

The alternative of using a winding up order or resolution under the Insolvency Act 1986 would also remain. However, the Act would also make available to co-operatives the full panoply of rules and provisions contained in that Act concerning Administration Orders which permit a court controlled procedure to confer the advantage of a debt moratorium on a business of doubtful solvency; the provisions concerning administrative receivership which determine the role, powers and duties of the receiver; and the order of payment of debts and the provisions allowing for voluntary arrangements agreed by a majority under the Insolvency Act. In other words, all insolvency regimes would be open to co-operatives as they are to companies on the same terms and with the same consequences.

Additional provisions would allow the Commissioner to petition for the winding up of a co-operative in the public interest if it was no longer operating as a co-operative, refused to comply with directions from the Commissioner to rectify that position and if the members or general public would not be adversely affected by its liquidation.

Provisions would be included to allow the court to declare the dissolution of a co-operative void within 12 years. This would be used if someone had suffered injustice or loss as a result of the dissolution - for example where new assets are found or a plaintiff wishes to sue the co-operative and insurance cover or other assets would be available if it is restored to the register. This would mirror the equivalent provisions applicable to companies, friendly societies and building societies.

The Act would lay down the provisions envisaged above about the distribution of any ultimate surplus on a solvent dissolution. That would be only in accordance with the rules of a co-operative that had entrenched rules on this question and would have to be equitable in the case of all co-operatives. In the latter case, that would normally be according to transactions but if that was impracticable might be by length of membership, equally or, if no other method were fair, according to shareholdings. In any event, the distribution would have to be in accordance with the rules of the co-operative (previously approved by the Commissioner) or, if the rules were silent on the question because a co-operative had been registered before the Act came into force and no provision had been added to its rules, according to a Scheme of Distribution agreed between the co-operative and the Commissioner and having been approved by a majority of the co-operative's members. Unless one of these alternatives applied no distribution would be allowed to take place.

PART XIII – OFFENCES AND PROCEEDINGS

This Part of the Act would provide for criminal offences on the part of co-operatives and their officers and directors to enforce the Act. There would be a defence of due diligence for directors and officers and details of the courts in which prosecution was to take place, the service of process etc. This Part would deal with the status of information on a co-operative's public file and the contents of the register kept by a co-operative as prima facie evidence. It would lay down a time limit for proceedings.

PART XIV – MISCELLANEOUS AND TRANSITIONAL PROVISIONS

This Part would deal with transitional provisions, definitions and interpretation and the making of orders and regulations. It would allow for the amendment of provisions of the Act by statutory instrument to assimilate the Act's provisions to those of company law as the latter changed.

The transitional provisions could provide that all industrial and provident societies registered as bona fide co-operatives under the IPSA 1965 would be deemed to be registered under the Co-operatives Act. Those with rules restricting the distribution of surplus along common ownership lines would be able to use the Act's provisions to entrench that position. The rules of new societies registering after the Act was in force would have to address the issue of distribution of assets on solvent dissolution.

Existing companies that either had the word "co-operative" in their name or who chose to do so, would be allowed to register as co-operatives under the Act free of charge within two years after the commencement date. They would have to satisfy the Commissioner that their rules complied with the Act.

From the end of that two year period no company would be allowed to use the word "co-operative" in its name unless it had the permission of the Commissioner. That permission would be granted if the company was a subsidiary of a registered co-operative (e.g. The Co-operative Bank plc) or if the word described the function rather than the structure of the organisation (e.g. Co-operative Development Agency Ltd). The result of this position would be that a company could have a co-operative constitution if it chose but could not use the word "co-operative" in its title for that reason without registering under the Act as a co-operative.

Existing industrial and provident societies that had automatically been deemed to be registered as co-operatives under the Act would have ten years from the commencement date to introduce necessary rule changes to conform with the Act. Failure to do so within that period would lead to them being struck off the register after a series of notices of the intention to do this had received no reply or no satisfactory reply. This would clear "dead" societies off the register. There would be provision for reinstatement.

APPENDIX I

International Co-operative Alliance Statement on the Co-operative Identity

Definition

A co-operative is an autonomous association of persons united voluntarily to meet their common economic social and cultural needs and aspirations through a jointly–owned and democratically–controlled enterprise.

Values

Co-operatives are based on the values of self–help, self-responsibility, democracy, equality, equity and solidarity. In the tradition of their founders co-operative members believe in the ethical values of honesty, openness, social responsibility and caring for others.

Principles

The co-operative principles are guidelines by which co-operatives put their values into practice.

1st Principle: Voluntary and Open Membership

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.

2nd Principle: Democratic Member Control

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.

3rd Principle: Member Economic Participation

Members contribute equitably to, and democratically control, the capital of their co-operative. At least a part of that capital is usually the common property of the co-operative. Members usually receive limited compensation, if any, on capital subscribed as a condition of membership. Members allocate surpluses for any of the following purposes: developing their co-operative, possibly by setting up reserves, part of which at least would be indivisible; benefiting members in proportion to their transactions with the co-operative; and supporting other activities approved by the membership.

4th Principle: Autonomy and Independence

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.

5th Principle: Education, Training and Information

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.

6th Principle: Co–operation among Co-operatives.

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

7th Principle Concern for Community

Co-operatives work for the sustainable development of their communities through policies approved by their members.

Manchester, United Kingdom, 23rd September 1995.

APPENDIX II

SCHEDULE OF MATTERS FOR WHICH THE RULES MUST MAKE PROVISION

(a) The name of the co–operative and whether it is situated in England and Wales, Wales, Northern Ireland or Scotland.

(b) Objects and powers of the co-operative and whether business is to be carried out outside the United Kingdom.

(c) Whether the Co-operative is registered as unlimited, limited by guarantee or limited by shares.

(d) Terms of admission of members whether by acquisition of shares, provision of a guarantee, (with or without the payment of an annual subscription) or otherwise and, if the co-operative is to have mutual status, any terms necessary to establish that status.

(e) Whether any preferential, deferred or other classes of shares are to be issued and, if so, within what limits.

(f) Whether the co-operative is to have an indivisible reserve and, if so, the limitations on its use and requirements as to building and maintaining it.

(g) The manner in which disputes between members or persons claiming through members and the co-operative or its officers are to be settled.

(h) Terms on which any natural or legal person may invest in the co-operative.

(i) The calling and holding of members' meetings and, in particular –

  (i) The right of the members to requisition meetings and to move resolutions at meetings;
  (ii) The manner in which notice of any resolutions to be moved at meetings is to be given to members and the quorum for such meetings;
  (iii) The form of notice for convening a meeting and the manner of its service;
  (iv) The voting rights of members, the right to demand a poll and the manner in which a poll is to be taken;
  (v) The election, removal, powers and duties of delegates elected to attend meetings on behalf of members where the general meeting of the co-operative is a delegate meeting;
  (vi) The role of members' meetings where the general meeting of the co-operative is a delegate meeting.

(j) The powers and functions of the board of directors except in the case of co-operatives operating as a collective in which all functions of the board will be conducted by the co-operative's general meeting.

(k) As respects directors (except in the case of a co-operative operating as a collective) and officers:

  (i) The number of directors, the period for which they hold office, whether they retire by rotation or otherwise and any circumstances which will disqualify a person from being elected or continuing to serve as a director;

  (ii) The manner of electing and removing directors or appointing or electing and dismissing or

removing senior officers and of filling vacancies and whether or not directors can be co–opted;

(iii) Any conditions which must be satisfied with regard to the holding of shares in, the level of trading with, or the length of membership of, the co-operative or otherwise if person is to become or remain a director.

(iv) The manner of remunerating directors and senior officers.

(v) Directors would be defined to include those carrying out that function by whatever name they may be known in a particular co-operative.

(l) Determination of maximum shareholding of any individual member (if any).

(m) Interest to be paid on money borrowed or deposited.

(n) Whether any shares are transferable and, if so, the form of transfer and its registration and of the consent of the board to the transfer. Whether shares are withdrawable and, if so, the mode of withdrawal and of repayment of members withdrawing from the co-operative.

(o) Provision for audit of accounts, appointment, removal, powers, duties and remuneration of auditors.

(p) Determination whether and, if so, how members can withdraw and other means whereby membership may cease such as expulsion or suspension, death or the dissolution of a corporate body which is a member.

(q) Provisions as to claims of personal representatives of deceased members, trustees of bankrupt members or, in Scotland, members whose estate has sequestered and for the payment of nominees.

(r) Mode of application of profits of the co-operative in accordance with Co-operative principle.

(s) Provision regarding the co-operative's seal (if any).

(t) Provision as to the distribution or destination of any surplus assets remaining on the solvent dissolution of the co-operative after the payments to creditors and the repayment of the nominal value on any shares issued by the co-operative on the winding up or dissolution by consent of the co-operative. In the case of a Common Ownership Co-operative, this would prohibit any distribution to members and provide for a surplus to pass to another Common Ownership body, a body established to promote Common Ownership Co-operatives, or a charity. In the case of a Co-operative Society, the provision would require distribution to members on a fair and reasonable basis in line with Co-operative principles and approved by the Co-operative Commissioner.

(u) The procedure for altering the co-operative's rules and whether certain rules are to be unalterable – subject to the provisions of the Act about circumstances in which rules can only be altered with the approval of the Co-operative Commissioner.

(v) Which (if any) acquisitions and disposals of assets or other major transactions by the co-operative will require either approval by the members (whether in general meeting or otherwise) or advance notification to them of the transaction; the majority required to approve those transactions (if any) that require approval and the nature of any information to which members are entitled under the rules.