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TRICKS AND TRAPS OF THE CO-OPS ACT

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THE NAME "TRAP"

- a proposed name for a co-operative can be reserved for 90 days before incorporation
- if you don't incorporate within 90 days, you cannot reserve the proposed name or a similar name again for 1 year thereafter

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THE CERTIFICATE OF STATUS "TRAP"

- a certificate of status verifies an entity exists
- Business Corporations Act corporation records are online and a certificate of status can be issued instantaneously
- Financial Services Commission of Ontario maintains records for co-operatives; the records are not online; it usually takes a week to 2 weeks to get a certificate of status

Why is this a problem and what can be done about this?

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THE FINANCIAL ASSISTANCE "TRAP"

- Section 17(1) of the Co-operative Corporations Act (the "Act") states:
- "A co-operative shall not make loans to any of its members, directors or employees or give directly or indirectly by means of a loan, guarantee, the provision of security or otherwise, any financial assistance to any member, director or employee, except in the course of transactions of a type available to all members of the co-operative."
- directors and officers who authorize or consent to making a loan or giving financial assistance are liable to the co-operative and its creditors for any loss to the co-operative together with interest at the rate of 6% per year.

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What is financial assistance?

What can you do to avoid this trap?

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THE COMPENSATING DIRECTORS WITHOUT APPROVAL "TRAP"

- compensation of directors must be specifically authorized by by-law.
- no by-law is effective until it is:
  - (i) passed by the directors; and
  - (ii) confirmed with or without variation by at least 2/3 of the votes cast at a general meeting of the members or such greater proportion of the votes cast as the articles of the co-operative provide
- before compensating directors always ask:
  1. do you have a by-law that allows for this?; and
  2. is the contemplated compensation explicitly authorized in the by-law?

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A TRICK AND A TRAP – DISCLOSURE BY DIRECTORS OF AN INTEREST IN CONTRACTS WITH THE CO-OPERATIVE

- the “trap” is that if a director does not disclose their interest in a contract, they can be accountable to the co-operative for profits made
- the “trick” is that if the disclosure is made properly, the director is not accountable so long as they acted honestly and in good faith and it was in the best interest of the co-operative
- Section 98(1) of the Act provides that every director who “directly or indirectly has an interest in a contract or transaction to which the co-operative or a subsidiary thereof is … a party,”, the director shall declare their interest at the directors’ meeting, shall not vote and shall not be counted in the quorum

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- Section 98(2) of the Act provides that disclosure of a conflict of interest under Section 98(1) of the Act is not required unless:
  1. the interest in the contract or transaction is material; or
  2. the subject of the contract is of a type not available to all members
- Section 98(4) of the Act provides that if a director has made a disclosure of their interest in a contract and does not vote at the directors' meeting, the director, if they were acting honestly and in good faith at the time the contract or transaction was entered into, is not accountable for any profit or gain realized if it was in the best interest of the co-operative at the time the contract or transaction was entered into

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The cure all?:

- Section 98(5) of the Act provides that despite anything in Section 98, a director, if acting honestly and in good faith, is not accountable for any profit or gain if it was in the best interest of the co-operative at the time it was entered into and (i) the contract was confirmed by at least 2/3 of the votes cast at a meeting of the members called for the purpose and (ii) the director's interest in the contract is declared and disclosed in reasonable detail in the notice calling the meeting.

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THE "TRICK" TO RAISING MONEY WITHOUT REQUIRING AN OFFERING STATEMENT

- Section 34(1) of the Act provides:

> "No co-operative or a person shall sell, dispose of or accept, directly or indirectly, any consideration for securities of the co-operative that has more than the prescribed number of security holders or where the sale or disposition of or acceptance of consideration for securities would have the effect of increasing the number of security holders in the co-operative to more than the prescribed number, unless the co-operative has filed with the Superintendent an offering statement and has obtained a receipt for it."

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- Section 34(2) of the Act provides that Section 34(1) of the Act does not apply to:

(a) the conversion of patronage returns to shares or debt;

(b) if a prospectus under the *Securities Act* is filed instead of an offering statement;

(c) the issue of shares or debt as may be prescribed.

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- with regards (c) above, the regulations to the Act have 14 exceptions, they include:
  - securities issued to a bank, the Business Development Bank of Canada, a trust company, a credit union or an insurance company;
  - to a dealer registered under the Ontario *Securities Act* as a broker, investment dealer or securities dealer;
  - securities issued by the co-operative to its members, if the offering does not result in the co-operative having more than $200,000.00 of securities;
  - securities issued to members if the value of such an issue does not exceed $1,000.00 per member in a year and does not exceed an aggregate value of $10,000.00 per member

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How then can you raise money without an offering statement?

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THE "MATERIAL CHANGE" TRAP

- Co-operatives have an obligation to update their offering statement if there has been a "material change".
- "material change" is defined in Section 35(6) of the Act to mean "a change in the business, operations, assets or liabilities of the co-operative that would reasonably be expected to have a significant adverse impact on the financial position of the co-operative or that might prevent the co-operative from achieving the purpose of an offering, but does not include a change that is prescribed by the regulations as not a material change".

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- Section 12.1 of the Regulations to the Act states the following changes are not material changes:
    1. A change that affects the co-operative's gross revenue or gross sales by less than $20,000.00;
    2. A change that affects the co-operative's net income or loss by less than $10,000.00.
- So what then is a material change? If there has been a material change, a co-operative cannot offer securities for sale without filing a statement of material change because the offering statement does not meet the "full true and plain disclosure of all material facts" test mandated by Section 35 of the Act.

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Would the directors be exposed to personal liability in this situation?

What should you do?

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ACQUIRING SECURITY OVER A MEMBER'S SHARE "TRICK"

Section 43 of the Act provides:

> "Where a member is indebted to the co-operative for goods or services, and where the articles or by-laws so provide, the co-operative has a lien to the extent of the debt on the shares registered in the name of the member".

- consider including such a provision in your articles or by-laws, particularly if your co-operative is going to be issuing preference shares having considerable value.

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THE "TRICK" TO BUYING A MEMBER'S SHARES FOR LESS THAN THEIR PAR VALUE

- Section 32.1(1) of the Act provides "the articles of a co-operative may provide that shares may be purchased for cancellation or redeemed at a price determined in accordance with a formula set out in the articles that is less than the price otherwise determined if:

  (a) the co-operative is otherwise required to purchase for cancellation or redeem the shares; and

  (b) the board of directors determines, by resolution, that it is necessary for the long-term financial well being of the co-operative."

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- formula could be based on retained earnings
- useful where the co-operative is having financial issues and members decide they want to get out rather than weather the storm

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THE "TRICK" TO REMOVING DISGRUNTLED MEMBERS

- Section 66(1) of the Act provides a member may be expelled by resolution passed by the Board duly called for that purpose not later than 30 days prior to the annual general meeting

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- Section 66(2) of the Act provides a resolution under Section 66(1) is not valid unless:

  (a) prior written notice is given to the member setting forth the grounds to expel;

  (b) the notice is given to the member 10 days or more before the date of the directors' meeting called to consider the expulsion resolution; and

  (c) an opportunity is given the member to appear, either personally or through a lawyer, to make submissions at the directors' meeting called to consider the expulsion resolution.

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- Section 66(4) of the Act provides where the resolution expelling a member is passed, the member may appeal the decision at the next annual or general meeting of members and the members may, by a majority vote, confirm, vary or set aside the resolution;
- Section 66(6) of the Act provides the co-operative shall purchase from an expelled member, within 1 year after the member's expulsion becomes final, all of the member's shares, other than prescribed shares, at par value together with any premium and unpaid dividends and shall pay out:

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(a) all amounts held to the member's credit together with any interest; and

(b) any amount outstanding on loans made to the co-operative that are repayable on demand together with accrued interest.

- an alternative: try to exercise Section 32(1)(a) of the Act: the purchase of shares with the member's consent.

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THE "TRICK" TO HANDLING THE WITHDRAWAL OF A MEMBER

- Section 64(1) of the Act provides:
- "Subject to Section 67, a member may withdraw from a co-operative by giving to the secretary of the co-operative 6 months' notice of the member's intention to withdraw or such shorter notice as is established by by-law."
- Sections 64(3)(a) and (b) of the Act provide that where a member has given notice to withdraw, the co-operative will, within 6 months, purchase for an amount equal to par value together with any premium and unpaid dividends or a lesser amount agreed to by the co-operative and the member or the member's personal representative, all shares in the co-operative held by the member, other than prescribed shares; and

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- pay to the member or the member's personal representative all amounts held to the member's credit, excluding term loans, together with any interest accrued and the amount outstanding on loans made by the member that are repayable on demand together with accrued interest.
- Section 64(6) of the Act provides that if in the directors' opinion payments would not be in the best interest of the co-operative, the directors may by resolution extend such payments over a period of not more than 5 years and pay in each year not less than 20% of the amount to be repaid.

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- 67(1) of the Act provides the co-operative shall not exercise its powers under Section 64 if:
    - (a) the co-operative is insolvent or
    - (b) the exercise of its powers would be detrimental to the financial stability of the co-operative

- the Act provides for considerable room for negotiation between the co-operative and a member: “lesser amount”; extension of payments over 5 years and “detrimental to financial stability”

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THE MEMBER'S RIGHTS "TRAPS"

The Act has numerous sections giving members rights to do a variety of things:

1. Section 16(2) – a member may apply to a court for an order to restrain the co-operative from doing any act or transferring or receiving the transfer of real or personal property on the grounds the co-operative lacks capacity or power for the purpose.

Ask yourself – do the articles or by-laws contain restrictions on the powers of the directors to do certain things.

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2. Section 68(1) – member may maintain an action in a representative capacity for the member and all other members on behalf of the co-operative to enforce any right, duty or obligation owed to the co-operative.

3. Section 69(1) – if at a members' meeting a resolution is passed:

(a) authorizing the sale, lease, exchange or other disposition of all or substantially all the property of the co-operative,

(b) an amalgamation of the co-operative,

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(c) the conversion of the co-operative into a *Business Corporations Act* corporation,

(d) converting the co-operative from a share capital co-operative to a non-share capital co-operative or vice versa, or

(e) to transfer the co-operative out of Ontario,

- any member who has voted against the resolution may, within 10 days after the date of the meeting, give notice in writing to the co-operative requiring it to purchase the member's shares or refund the amount outstanding on loans.

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4. Section 70(1) – 10% of the members of a co-operative may requisition the members to call a meeting of the directors for the purpose of passing any by-law or resolution that may be passed at a meeting of the directors.

- if the directors do not, within 21 days, call and hold such meeting and pass such a by-law or resolution or call a general meeting of the members, then the members may call the meeting for the purpose of passing such by-law or resolution.

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5. Section 71(1) – on requisition of 5% of the members, the directors shall give the members entitled to notice at the next members' meeting, notice of any resolution that may be properly moved and is intended to be moved at the meeting or circulate to the members entitled to vote at the next meeting, a statement of not more than 1,000 words with respect to the matter referred to in a proposed resolution or with respect to the business to be dealt with at the meeting.

6. Section 79(1) – 5% of the members of a co-operative may requisition the directors to call a general meeting of the members for any purpose that is connected with the affairs of the co-operative; if the directors do not, within 30 days, call and hold the meeting, any of the requisitionists may call the meeting.

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7. Section 80 – a member may apply to the court for an order that the directors call a meeting of the members for any purpose that is connected with the affairs of the co-operative and is not inconsistent with the Act.

8. Section 119(1) – records of the co-operative consisting of its articles, by-laws, register of members and security holders, directors and registers of transfers shall, during normal business hours of the co-operative, be open to examination by the members and creditors or their agent to review and make extracts therefrom.

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9. Section 127(13) – any member may, by notice in writing given 5 days or more before any members' meeting, require the attendance of the auditor.

10. Section 146(1) – a member may make an application to the court to appoint an inspector to investigate the affairs and management of the co-operative and to audit the accounts and records of the co-operative.

What can be done to avoid these "traps"?

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THE "TRICK" TO SAVING MONEY AT YOUR ANNUAL GENERAL MEETINGS

- Section 172(1)(b) of the Act provides:

  "Except in circumstances as may be prescribed, (notice) may be sent electronically to him or her in accordance with the *Electronic Commerce Act*, 2000 and on such conditions as may be prescribed under this Act."

- give notice of members electronically pursuant to this Section of the Act to save money.

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- provide member with the option of opting out of receiving financial statements. Section 140(3) of the Act provides the requirement to deliver financial statements to members does not apply to a member who has given written notice to the co-operative that the member does not wish to receive the financial statements and auditors reports.

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THE BUSINESS WITH MEMBERS OR "50% RULE". IS IT A TRAP?

- Section 144(1) of the Act provides:

  "Where the Minister is of the opinion that a co-operative has, for a period of 3 years or longer, conducted 50% or more of its business with non-members of that co-operative, the Minister may, after giving the co-operative an opportunity to be heard, issue a certificate of amendment changing the co-operative into a … *Business Corporations Act* … or *Corporations Act* (not-for-profit) corporation."

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- Section 144(2) of the Act provides:

  "The amount of business conducted by a co-operative with a non-member means the value of goods or products acquired, marketed, handled, dealt in or sold or services rendered by the co-operative on behalf of or for the benefit of non-members expressed as a percentage of the total value of goods or products acquired, marketed, handled, dealt in or sold or services rendered by the co-operative from, or on behalf of, or for all customers during the year."

Please note that the Minister may change the co-operative into a *Business Corporations Act* or *Corporations Act* corporation.

Has this ever occurred?

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Thank you.