

# Regulatory Proposals

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# Canada Cooperatives Regulations

## Description

The Canada Cooperatives Act (the “Coops Act”) which received Royal Assent on March 31, 1998 replaces the Canada Cooperative Associations Act, R.S.C. 1970, c. C-40. The Coops Act modernizes the corporate governance rules relating to cooperatives and is largely modelled on the Canada Business Corporations Act, R.S.C. 1985, c. C-44 (the “CBCA”).

While no regulations were enacted under the former Act, regulations are required under the Coops Act primarily because of the new provisions borrowed from the CBCA. Specifically, the Coops Act allows cooperatives to issue investment shares to non-members if authorized by members. It also permits cooperatives to constrain investment shares. Consequently, the Coops Act Regulations are similar to the Canada Business Corporations Regulations SOR/79-316, as amended (the “CBCR”). The Regulations are divided into eight parts according to subject area.

Part 1, Electronic Transmission: The Regulation establishes the regulatory framework for electronic transmission of documents, notices and other information for the purposes of the Act. This includes transmission of information by and to a cooperative. Specifically, the Regulations describe the conditions that must apply if information is to be transmitted electronically. For example, the recipient must ask or consent to receive the information electronically and the method chosen for sending it allows the recipient to access the information and to retain it in a permanent form. The Regulation also permits electronic filing and electronic issuance of documents required to be sent to or issued by the Director appointed under the Coops Act.

The provisions respecting electronic filing and electronic issuance of documents required to be sent to or issued by the Director were not included when the Regulations were pre-published in the Canada Gazette, Part I, on July 25, 1998. However, these provisions do not introduce a substantive or material change to the Regulations; they prescribe an additional means of filing a document or issuing a certificate. Moreover, electronic filing provisions were included in the Regulations on which consultations were held with Coops Act stakeholders. No stakeholders voiced any concerns.

Part 2, Corporate Names: The Coops Act does not allow cooperatives to be incorporated with names that are prohibited. These Regulations describe names that are prohibited as cooperative names. For example, a proposed name that is confusing with an existing tradename or trade-mark is prohibited.

Part 3, Proxies and Proxy Solicitation: These Regulations establish the content and form of the proxy, and the content of the management proxy circular and the dissident's proxy circular required by the Coops Act to be sent to shareholders when soliciting proxies. Proxy documents must be sent to the investment shareholders before an investment shareholders' meeting and must be filed with the Director. Investment shareholders are holders of shares in the capital of a cooperative which are not membership shares. These documents must provide sufficient information to allow investment shareholders to make an informed decision at the meeting, must include the name of any director of the cooperative who intends to oppose any proposed action and must include the name of any person who controls, directly or indirectly, more than 10% of the voting investment shares.

Part 4, Financial Disclosure: These Regulations list the financial statements that must be sent to members and shareholders and, if required, filed with the Director. The financial statements must at least include (a) a balance sheet, (b) a statement of retained earnings, (c) an income statement and (d) a statement of changes in financial position. Cooperatives distributing investment shares to non-members must prepare their financial statements in accordance with the generally accepted accounting principles as set out in the Handbook of the Canadian Institute of Chartered Accountants.

Part 5, Constrained Share Cooperatives: The Coops Act permits cooperatives to constrain or restrict the issue, transfer or ownership of investment shares to persons who are not resident in Canada in order to comply with any prescribed law to receive a benefit, such as a licence, permit or grant. These Regulations establish disclosure requirements, issue and transfer restrictions, and voting rights related to constrained investment shares. They also prescribe the laws under which a cooperative can constrain investment shares.

Part 6, Rules of Procedure for Applications for Exemptions: The Coops Act allows cooperatives and other interested parties to apply for an exemption from complying with certain provisions. For example, the Director can exempt a cooperative from sending a form of proxy and proxy circular to shareholders and can authorize a cooperative to dispense with an audit committee. The Regulations set out the application procedure and the rights of the applicant.

Part 7, Prescribed Fees: Schedule I of the Regulations sets out the prescribed fees related to any action that the Director is required or authorized to take under the Coops Act. These actions include: the issuance of certificates on receipt of articles of incorporation, amalgamation, amendment, etc.; the examination of applications for exemptions; and providing any person with a copy or certified copy of a document required by the Act or Regulations to be filed with the Director. Fees are also prescribed for the filing of annual returns. Since the administrative responsibilities given to the Director under the Coops Act and the CBCA are similar, the processing of applications under the Coops Act require at least the same amount of resources as under the CBCA. For this reason, the fees to be prescribed under the Coops Act will be the same as those under the CBCA.

Part 8, Prescribed Interest: Under the Coops Act, the directors of the cooperative determine if payment to a dissenting member would adversely affect the financial wellbeing of the cooperative. In such cases, payment of the value of those members' membership shares may be made over a period of not more than ten years. The Regulations prescribe the rate of interest that these payments must bear. The Regulation sets the interest payable at the Bank of Canada rate plus three percent to reflect prevailing economic conditions.

## Alternatives

In order for the Coops Act to be implemented in an effective and workable manner, the Coops Act requires regulations to be made. The Coops Act, itself, refers to the need for these Regulations in requiring certain rules or procedures to be prescribed. For example, the Coops Act requires management proxy circulars to follow a prescribed form. The Regulations set out the contents of these documents and are consistent, where applicable, with disclosure requirements under the various securities legislation in Canada.

## Costs and Benefits

Since the Regulations are similar to the CBCR, the benefits and costs are also similar. The changes that are brought by the Coops Act and these Regulations will impose certain costs on the cooperatives. However, some of these costs were imposed by the previous legislation and are continuing, rather than new, costs. Currently, there are approximately 50 federal cooperatives. With the new Coops Act, the expected rate of incorporation is five per year. The rate of incorporation under the former Act is two per year. Since the requirement that a cooperative must carry on business in more than one province is maintained under the new Act, we do not expect a large number of cooperatives to incorporate federally. Larger cooperatives wanting to operate under a corporate framework which is similar to the corporation model are likely to be attracted to the new Act. The Regulations, therefore, will affect a small percentage of Canadian non-financial cooperatives of which there are more than 7,300.

The Regulations dealing with corporate names will impose costs on the incorporators and cooperatives since they must pay \$75 to a private firm for a name search report. This cost is a continuing one since cooperatives are required to file a name search report under the former Act. Given the importance of a cooperative name, the cooperatives benefit from the name regulations to the extent that their names are protected from any future registration of a similar and confusing name by another business entity. In addition, the cooperative has the right to use its name throughout Canada. Given the expected small increase in the rate of incorporation, the impact on government resources required to make name decisions is minimal, amounting to less than 1% of one staff member's time per year.

The Regulations requiring disclosure of information will impose costs on cooperatives incorporated under the Coops Act. The costs arise from the collection, presentation and distribution of information. The main beneficiaries are members and investment shareholders. Overall, however, accessible and adequate information contributes to the integrity of the marketplace. With respect to constrained investment shares, disclosure of the constraints is necessary, particularly where a cooperative is allowed to sell these shares without the investment shareholders' approval.

The costs related to financial disclosure are continuing costs since the former legislation also required financial disclosure. The Regulations dealing with proxy solicitation and constrained shares will have little impact on the existing federal cooperatives, as only a few have issued investment shares and none engage in an activity that would require constraints on shares.

Cooperatives would also bear the costs of applying for exemptions from certain provisions of the Coops Act. Under the CBCA the application fee for most exemptions is \$250. This cost is minimal and is outweighed by the benefit of a flexible legislation and, where the exemption is granted, the benefit of the exemption. Less than 0.01% of CBCA corporations apply for exemptions. Therefore, given the number of existing cooperatives, few exemption applications are expected. Consequently, the demand on government resources is minimal.

## Consultation

The cooperatives sector through the two national cooperatives associations, the Canadian Cooperative Association (CCA) and Conseil Canadien de la Coopération (CCC), contributed greatly to the modernization of the federal coops legislation. They were also significant participants in the development of these Regulations. The two associations along with the Cooperatives Secretariat of Agriculture and Agri-Food Canada assisted in ensuring that the proposed Regulations package was distributed as extensively as the Coops Act was when it was introduced as a bill. The proposed Regulations were sent to a considerable number of cooperatives, including the 50 federally-incorporated cooperatives, cooperative federations, credit unions, professional associations, academics, provincial registrars and other officials responsible for cooperatives, and provincial securities regulators. Each recipient was asked to submit written comments within the 60-day consultation period.

Many of the submissions proposed minor drafting suggestions or made comments with respect to the Coops Act which was still in bill form. Three regulatory issues, however, emerged from the responses.

The first issue related to the use of an individual's name in the cooperative name. The proposed Regulations required that in order to use an individual's name, the individual's written consent must be submitted with the incorporation documents and, in addition, the individual must have a material interest in the cooperative.

A comment stated that some cooperatives may want to use the name of a leader of the cooperative movement to identify their objectives with the philosophies attached to that person rather than to suggest that that person has material interest in the cooperative. The Regulations have been revised to allow for the use of a recognized cooperative leader in a cooperative name without that person having material interest in the cooperative.

The second issue relates to the requirement under the proposed Regulations that financial statements be prepared in accordance with the generally accepted accounting principles (GAAP) as set out in the Handbook of the Canadian Institute of Chartered Accountants (CICA Handbook). While they accept that reference should be made to the CICA Handbook, CCC and its members, supported by CCA, submitted that cooperatives should be exempted from certain generally accepted accounting principles with respect to the treatment of patronage allocations and membership shares. Instead, they propose that the Regulations set out alternative disclosure rules similar to those found in the Quebec cooperatives legislation on how patronage allocations and membership shares should be disclosed in the financial statements. The CICA also commented on the Regulations during consultations. It submitted that it is appropriate that the proposed Regulations refer to GAAP and that alternate disclosure rules should not be prescribed in the Regulations.

In trying to balance the cooperatives sector's need for flexibility in preparing financial statements and CICA's concern for consistency, the Regulations have been revised to require only those cooperatives that distribute investment shares to non-members ("distributing cooperatives") to comply with the CICA Handbook. We agree with CICA that alternate disclosure rules are not the answer. Instead, limiting the requirement to distributing cooperatives provides the flexibility cooperatives want while protecting investors' interests. Users of financial statements of non-distributing cooperatives will continue to be protected since all financial statements must be audited in accordance with the auditing standards set out in the CICA Handbook.

The third issue deals with the prescribed interest rate for payments made to dissenting members. A submission was made that the rate was too high since most cooperatives have the ability to borrow funds at lower rates. It was also submitted that, rather than a variable rate, a rate based on the 10-year Canada bond yield represented a reasonable and balanced interest rate. It was argued that a fixed rate would recognize the unique nature of member equity as being a commitment to the cooperative and not simply an investment vehicle for the member. The Regulations have been revised to lower the prescribed interest rate from 3.5 to 3 percent plus the Bank of Canada rate but will continue to be a variable rate. While member equity is unique, it must be recognized that a member who has exercised dissent rights is no longer a member of the cooperative. The certainty of a fixed rate may be appealing to a cooperative but it may not serve the interests of the former member. A variable interest rate, on the other hand, achieves a better balance between the interests of the former member and those of the cooperative.

The Regulations were pre-published in the Canada Gazette, Part I on July 25, 1998. The only substantive comment received was from CCC indicating that its position with respect to how a cooperative's financial statements are to be prepared remains the same.

## **Compliance and Enforcement**

Under the Coops Act, the Director appointed under the legislation is given the authority to take such enforcement action as is required to ensure equity and fairness in the cooperative environment. This authority extends to the Regulations enacted under the Coops Act. The Coops Act is, however, intended to be primarily self-enforcing, meaning that it provides aggrieved parties direct access to remedial actions. Generally, only in extraordinary circumstances where the public interest is affected will the Director be likely to intervene.

With respect to mandatory filings and the requirement to include certain information in documents sent to the shareholders and the Director, the Director already has systems in place for the processing of similar requirements under the CBCA. For example, the Director has in place mechanisms to deal with applications for exemptions, the filing of financial statements, and the handling of complaints made by shareholders and members of improper conduct by a cooperative. Minor changes to internal policies and standardized documents will be required to reflect the new Coops Act and Regulations. Because of the small number of cooperatives (there are currently 50 federal cooperatives compared to 111,365 CBCA corporations; no more than 5 new cooperatives are expected to incorporate per year), there should be minimal impact on compliance and enforcement activities.

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