CWCF & CoopZone: Investment Shares in Co-ops

Presented by

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Introduction

- General approach to share design common to all share corporations
- Law may apply elsewhere, but limitations:
  - Brian: Ontario
  - Laird: Alberta
- Questions – anytime

General Theory and Background

- Laird Hunter

What Are Shares?

- Only share capital co-ops have shares – non-profits (generally) do not.
- Share suggests a share of the ownership of the business.
- Traditional common shares in business corporations demonstrate that: if 100 common shares are issued, and you hold ten, on dissolution, you would be entitled to 10% of the net assets of the corporation.

Raising Capital

- Businesses, including co-operatives, obtain capital by borrowing or from investors by issuing shares.
- Debt pays interest, is repayable. Once repaid, the creditor has no further interest in business.
- Shares: dividends indefinitely, net assets on dissolution.

Share Value

- In a business corporation, the share value = market value as reflected in anticipated value of net assets on dissolution
- As its fortunes ebb and flow (assuming a market), share price fluctuates.
- In co-operatives (Ontario?) share value is fixed at its par value, normally the price paid to purchase the share. No market to determine “value”.
- Can be a problem where market value higher or lower than par value

Co-operative Capital is Different

- In ordinary business, the shareholders' interest - maximizing return on investment
- A co-operative is different: members primarily interested in obtaining its goods or services
- Acquiring capital is a necessary, but secondary goal.
- In an ordinary business, the investor entitled to the net surplus generated
- In a co-operative, member shares in the net surplus, after paying the cost of capital, proportionate to business with the co-operative

Membership and Preference Shares

- Co-op shares either membership shares or preference (investment) shares.
- Membership share - one vote at members' meetings. Dividends limited to bank prime +2%. Often nominal par value, issued to grant democratic rights to members.
- Co-op preference shares are designed for investment - the means by which members and community supporters of the co-op financially support the co-operative.

Preference Shares

- Votes attached to shares in the business corporations. In a co-operative, vote follows from the status of being a member. Holders of preference shares almost never vote.
- Different types – classes or series.
- Outside investors will normally have preference for dividend payment and on dissolution over members' preference shares.

Designing Co-operative Capital

- Directors decide what particular preferences, rights and privileges will likely suffice to raise the required amount of capital.
- Helps to already have some knowledge of what prospective members/investors are likely to find attractive.
- Not easy to change once marketing has begun – could be oversubscribed, or not raise the money needed.

Preference Share Rights

- Membership shares usually can’t have any preference, right, or other constraint save a restriction on their issue or transfer.
- Preference shares are normally required to have attached to them a preference or right over membership shares.
- Common preferences attached to preference shares:
    - Preference on Dissolution
    - Payment of Dividends

Dividends

- Either
  - a fixed percentage of par value
  - tied to an outside rate, such as bank prime, or
  - payable in the discretion of the board of directors
- Renewable energy, new generation co-operatives dividends reflect financial success of the co-operative.
- Investors may be attracted to a fixed percentage dividend if the right to a dividend is cumulative. Otherwise, if not declared, dividend right is extinguished
- Dividend in preference to other share classes

Redemption

- The right to redeem preference shares without the consent of the preference shareholder.
- While the co-operative and a shareholder can always agree to a sale of a share back to the co-operative, the right of redemption permits the co-operative to acquire shares by simply tendering the par value, and any accumulated unpaid dividends, to the shareholder.

Variable Redemption Price

- Co-operative may redeem preference shares for less than par value, where the co-operative has suffered a loss (Ontario only?)
- The formula for reduced price is inserted in the share provisions in the Articles.
- Articles may contain the right to a premium on purchase or redemption to reflect the increased value of the co-operative's business.
- The amount of the premium is calculated according to a formula stated in the articles, may not exceed the greater of:
  - 10% of the share's par value per annum compounded annually or
  - The increase in the Consumer Price Index over the period that the share was outstanding

Retraction

- Preference shareholder may wish to have the right to require the co-operative to redeem their shares on notice to the co-operative.
- This right is dangerous: preference share will be treated as a liability, and not equity, for accounting purposes, making it harder to obtain bank financing – looks more like debt.

Partial Redemption/Retraction

- Where only part of the outstanding preference shares are to be redeemed or retracted, select:
  - By lot,
  - In proportion to the number of shares of that class held by each preference shareholder,
  - As determined by the Board of Directors, with consent by all the holders of those preference shares or 95% of the holders holding at least 95% of the issued shares of that class, or
  - If issued in series, by date of issuance, within the series, from the earliest date to the latest

Prescribed Shares

- Exception to the usual obligation to purchase all the outstanding shares held by a person who ceases to be a co-operative member (only Ontario?).
- Prescribed shares defined: “preference shares that provide that the co-operative is not obliged to redeem the shares”.
- Provides greater assurance that preference shares will be treated as equity for accounting purposes
- Harder to market

RRSP-Eligible Shares

- Specified co-operative corporations include co-operatives which market their members' natural products (and process them incidentally to, or in connection with, the marketing of those products), which purchase supplies, equipment or household necessaries for or to be sold to its members or customers or which perform services for its members or customers, hold out the prospect of patronage dividends, permit each member to exercise only one vote, and have, as members at least 90% who are
  - individuals
  - other co-operative corporations, or
  - other corporations or partnerships that carry on the business of farming.
- Qualifying shares in such co-operatives are eligible for RRSPs.

Qualifying Shares?

- Ownership of these shares
  - can't be required as a condition of membership, and
  - patronage dividends can't be paid by the co-operative to the holder of such shares in respect of <u>consumer</u> goods or services.
- Shareholder can't be a "connected" shareholder - that is defined, essentially, as someone who owns 10% or more of any class of outstanding shares of the co-operative.

Series within a Class

- Cumbersome to call and hold members' meeting to approve new class of shares. Business corporations often empower the directors to create a new series of shares within a class, without seeking the approval of shareholders.
- In Ontario, the Act was amended in 2004 to allow the Board of a co-operative to create a series of shares, if the articles authorize them to do so.
- All the shares in any series of a class must have same priority for dividends and return of capital on event of dissolution as any other shares in that class.

Approval of Changes to Rights

- Act prohibits any amendment to the Articles to delete or vary a preference attaching to preference shares without the approval of at least two thirds of the votes cast at a meeting of the shareholders.
- Only time vote given