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Session 6 - Sale of business or major asset - legal considerations for a co-operative

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Are you aware of the unusual requirements of the Act? Find out before you do the wrong thing.

INTRODUCTION

This paper discusses:

1 the acquisition and disposal of assets by a co-operative – Part 10 section 285;
2 mergers and transfers of engagement – Part 12; and
3 arrangements and reconstructions – Part 13.

Acquisitions and Disposal of Assets

It is commonplace for a co-operative, like any other business, from time to time to seek to dispose of some or all of its assets or undertaking. The benefits of doing so may be many-fold, but the ultimate objective is likely to be fund raising or cost saving.

Publicly listed companies are required to comply with ASX Listing Rules in respect of changes to their activities or disposal of their main undertakings, including obtaining approval of shareholders.

Non-publicly listed companies are not subject to special requirements, but shareholder approval may often be sought in order to avoid falling foul of the oppressive conduct provisions of the *Corporations Act*.

Co-operatives are subject to their own unique statutory requirements which involve ensuring that the primary activities of the co-operative are not violated as a result of the disposal unless member approval in a special postal ballot is achieved. The required majority in a special postal ballot is 75% of those who participate in the voting process.

Mergers between Co-operatives

Also, sometimes the boards of two or more co-operatives can see benefits to the members of all the co-operatives involved if their businesses and assets are amalgamated into one co-operative. Co-operatives have several methods of achieving such a merger under the *Co-operatives Act 1992* (**Act**) without the need to obtain court approval and free of stamp duty. Such mergers are binding on third parties without the need to obtain the consent of the third party. This is no equivalent for mergers between companies.

Arrangements and Reconstructions

Finally, co-operatives can do what companies can do in the realm of arrangements and reconstructions, for example, with court approval make an arrangement to top hat a co-operative; that is put another entity (new entity) above the co-operative so that the members become members of the new entity and the old co-operative becomes a subsidiary of the new entity. This new entity could itself be a co-operative. This step is sometimes taken to enable the old co-operative to more easily sell some or all of its assets or business whilst preserving shareholding and membership in the top hat new entity.

The object of this presentation is to give you an outline of *some* of the ways in which a co-operative might acquire or dispose of assets, merge or restructure its assets and undertakings and the regulatory hurdles which present themselves in doing so.

1 ACQUISITION AND DISPOSAL OF ASSETS/UNDERTAKING

Co-operatives are subject to stringent rules and procedures in the acquisition or disposal of even relatively minor percentages of their assets where those assets relate to its primary activities.

Section 285(1) of the Act provides that a co-operative must not do any of the following things *except* as approved by *special resolution* by means of a *special postal ballot*:

(a) sell or lease as a going concern, the undertaking of the co-operative or a part of the undertaking that relates to its primary activities the value of which represents 5% or more of the total value of the undertaking;

(b) acquire from or dispose to a director or employee of the co-operative, or a relative (within the meaning of the *Corporations Act*) of such a director or employee or of the spouse of such a director or employee, of any property the value of which represents 5% or more of the total value of all the assets of the co-operative that relate to its primary activities;

(c) acquire an asset the value of which exceeds 5% or more of the assets of the co-operative if the acquisition would result in the co-operative commencing to carry on an activity that is not one of its primary activities;

(d) dispose of an asset if the disposal would result in the co-operative ceasing to carry on any primary activity of the co-operative, or in the ability of the co-operative to carry on any primary activity of the co-operative being substantially impaired either generally or in a particular geographical region.

The Co-operatives Council *may* exempt (conditionally or unconditionally) a co-operative from compliance with all or specified provisions of section 285 and section 194 (which governs special postal ballots) but such exemptions are (we suggest) rarely applied for or granted. An example of an exemption of which we are aware was granted to a South Coast co-operative who persuaded the Registrar (acting as a delegate of the Co-operative Council) to agree that member approval could be gained at a meeting where more than 90% of members attended the meeting rather than in a special postal ballot, provided that three quarters of the voters voted in favour.

Contravention of section 285 by a co-operative results in each director of the co-operative being guilty of an offence unless the director satisfies the Court that he or she used all due diligence to prevent the contravention by the co-operative. The maximum penalty is currently $6,600 (or 60 penalty units).

Special Resolutions by means of Special Postal Ballots

It is a common theme of the Act to require co-operatives to put important decisions (such as the disposal of assets under section 285) to members for approval by *special resolution* by means of a *special postal ballot*.

Section 189(1)(c) of the Act provides that a special resolution by means of special postal ballot must be passed by a three-quarters majority in a special postal ballot of members. For the purposes of a special postal ballot, the majority is calculated as being the majority of the members of the co-operative who, being entitled to do so, cast formal votes in the special postal ballot vote in favour of the resolution (section 190(2) of the Act).

Schedule 2 of the *Co-operatives Regulation 2005* (**Regulation**) prescribes in detail how special postal ballots are to be conducted.

Section 194 of the Act provides that:

(a) not less than 21 days notice of the ballot is to be given to members to enable sufficient time for a meeting to discuss the proposal that is the subject of the ballot to be convened and held (whether by the board or on the requisition of members) (section 194(2));

(b) the co-operative must send to each member (along with any other material required to be sent in connection with the postal ballot) a *disclosure statement* approved by the Registrar and containing information concerning:

  (i) the financial position of the co-operative;

  (ii) the interests of the directors of the co-operative in the proposal with which the ballot is concerned, including any interests of the directors in another organisation concerned in the proposal;

  (iii) any compensation or consideration to be paid to officers or members of the co-operative in connection with the proposal; and

  (iv) such other matters as the Registrar directs (section 194(3));

(c) if the Registrar so requires, the *disclosure statement* is to be accompanied by a report made by an independent person approved by the Registrar concerning such matters as the Registrar directs (section 194(4)).

Sections 17 and 28A of the Act should also be read in conjunction with section 194 in relation to the approval of a *disclosure statement*.

Needless to say, the requirements to produce a sufficiently detailed disclosure statement (and, if necessary an independent expert's report) to provide to members to enable them to make an informed decision in respect of a proposed transaction can be onerous and time consuming. However, our experience is that the Registry can be an extremely helpful aide in the preparation of disclosure statements and co-operatives should consider early consultation with the Registry to assist in the process.

2 MERGERS OR TRANSFERS OF ENGAGEMENTS OF NSW CO-OPERATIVES

Part 12 of the Act (inter alia) covers mergers and transfers of engagements between NSW co-operatives. Part 12 does not apply to a merger or transfer of engagements to which Part 13A applies – which deals with cross border mergers or mergers with foreign co-operatives or transfers of engagements involving foreign co-operatives.

Section 310 of the Act permits any 2 or more co-operatives to consolidate all or any of their assets, liabilities and undertakings by way of merger or transfer of engagements approved by the Registrar under Part 12, Division 1 of the Act.

A merger involves the existing co-operatives ceasing and a new co-operative replacing them with a new set of rules. A transfer of engagements involves one co-operative transferring all its assets and contracts and business to another co-operative. Quite often, the receiving co-operative will, at the same time, amend its rules and change its name to reflect the fact that it now caters for both its old and new members. Tax considerations will generally determine whether the merging co-operative should amalgamate pursuant to a merger or transfer its engagements to another co-operative or whether there is a better way for example, a straight sale.

Before co-operatives can apply for approval of a merger or transfer of engagements, the proposed merger or transfer must have been approved by each of the co-operatives by:

(a) a special resolution passed by means of a special postal ballot, or

(b) if permitted by subsection (2) - a resolution of the board of the co-operative (section 311(1)).

Under section 311(2), the proposed merger or transfer of engagements may be approved by resolution of the board of a co-operative if the Registrar consents to that procedure applying in the particular case.

Consideration should be given as to whether circumstances exist which would persuade the Registrar to give such consent, for example, where each member of the co-operative has representation on the board.

Similarly with the case of an acquisition or disposal under section 285, section 311A(1) provides that a resolution of a co-operative under section 311(1)(a) is not effective unless (inter alia) section 194 (2) and (4) (see above) and the following have been complied with.

Each co-operative must send to each of its members a disclosure statement approved by the Registrar specifying:

(a) the financial position of each co-operative concerned in the proposed merger or transfer of engagements as shown in financial statements that have been prepared as at a date that is not more than 6 months before the date of the statement, and

(b) any interest that any officer of each co-operative has in the proposed merger or transfer of engagements, and

(c) any compensation or other consideration proposed to be paid, or any other incentive proposed to be given, to any officer or member of each co-operative in relation to the proposed merger or transfer of engagements, and

(d) whether the proposal is a merger or transfer of engagements and the reason for the merger or transfer of engagements, and

(e) in the case of a transfer of engagements, whether it is a total or partial transfer of engagements, and

(f) any other information that the Registrar directs (section 311A(2)).

Again, we recommend early consultation with the Registry in respect of the approval process for such a disclosure statement.

The disclosure statement must be sent to the members of each co-operative so that it will in the ordinary course of post reach each member who is entitled to vote on the special resolution not later 21 days before the day on which the ballot commences (section 311A(3)).

Once members or the board (as appropriate) have approved a merger or transfer of engagements, an application for approval of the merger or transfer of engagements must be made to the Registrar in the manner and form required by the Registrar (section 311B(1)).

An application for approval of a merger must be accompanied by 2 copies of the proposed rules of the merged co-operative and any other particulars required by the Registrar (section 311B(2)).

Section 311C describes the approval process for a merger to be undertaken by the Registrar and a merger takes effect on the issue of the certificate of registration for the merged co-operative (section 311C(3)).

The Co-operatives Council may exempt a co-operative from compliance with all or specified provisions in relation to any matter concerning mergers and may grant such an exemption unconditionally or subject to conditions (section 312(1)). However, again we would suggest that such exemptions are rarely applied for or granted.

Section 313 describes the approval process for a transfer of engagements to be undertaken by the Registrar and a transfer of engagements takes effect on the day specified in the approval of the Registrar (section 313(2)).

A very important aspect of a merger or a transfer of engagements between co-operatives pursuant to the Act, is that a third party who has a contract with one of the co-operatives cannot penetrate the will of the members to merge. Assignment of assets, rights, liabilities and contracts do not require the third party's approval, which may otherwise be the case in the event of a straight sale between co-operatives (Part 12, Division 7).

Furthermore, a document or an instrument executed or registered for or with respect to a transfer of any property pursuant to a merger or transfer of engagements pursuant to the Act is not liable to stamp duty or to any fee chargeable under any Act for registration.

Relief from payment of stamp duty may also be available when assets or undertakings are transferred between co-operatives and companies within the same "group" (section 281 of the *Duties Act 1997 (NSW)*).

3 ARRANGEMENTS AND RECONSTRUCTIONS

Court approved arrangements and reconstructions are more complex and expensive to complete by nature and are more common in larger, complicated transactions. For example, the recent sale of Dairy Farmers to National Foods included not less than three court approved schemes of arrangement between 2004 and 2009 involving Australian Co-operative Foods and Dairy Farmers Milk Co-operative.

General Requirements

A compromise or arrangement is binding if and only if it is approved by order of the Court and it is agreed to:

(a) if the compromise or arrangement is between the co-operative and any of its creditors - at a court ordered meeting by a majority in number of the creditors concerned who are present and voting (in person or by proxy), being a majority whose debts or claims against the co-operative amount to at least 75% of the total of the debts and claims of all those creditors who are present and voting (in person or by proxy), or

(b) if the compromise or arrangement is between the co-operative and any of its members - by the members concerned, by special resolution passed by means of a special postal ballot (section 344(1)).

For the purposes of this presentation, paragraph (b) is the relevant provision of section 344(1). Paragraph (a) deals with a compromise between a co-operative and its creditors. We are here interested in an arrangement between the co-operative and its members, for example where a new entity is introduced so paragraph (b) applies.

The Court is not to make an order under this Division unless:

(a) at least 14 days' notice of the hearing of the application for the order, (or such shorter period of notice as the Court or the Registrar permits) has been given to the Registrar, and

(b) the Court is satisfied that the Registrar has had a reasonable opportunity to examine the terms of and make submissions to the Court in relation to the proposed compromise or arrangement concerned and a draft explanatory statement relating to it (section 346(1)).

The **"draft explanatory statement"** referred to in subsection (1) is a statement:

(a) explaining the effect of the proposed compromise or arrangement and, in particular, stating any material interests of the directors of the co-operative, whether as directors, as members or creditors of the co-operative or otherwise, and the effect on those interests of the proposed compromise or arrangement in so far as that effect is different from the effect on the like interests of other persons, and

(b) setting out such information as is prescribed and any other information that is material to the making of a decision by a member of the co-operative whether or not to agree to the proposed compromise or arrangement, being information that is within the knowledge of the directors of the co-operative and has not previously been disclosed to the members of the co-operative (section 346(1)).

It is important to note that the Court now takes the approach that it is not the Court's role to vet or approve the draft explanatory statement and that this is the role of the Registrar.

An explanatory statement must be as approved by the Registrar (section 355(1)).

If the compromise or arrangement affects the rights of debenture holders, the explanatory statement must specify any material interests of the trustees for the debenture holders, whether as such trustees, as members or creditors of the co-operative or otherwise, and the effect on those interests of the compromise or arrangement in so far as that effect is different from the effect on the like interests of other persons (section 355(2)).

If a notice given by advertisement includes a notification that copies of the explanatory statement can be obtained in a particular manner, every creditor or member entitled to attend the meeting or vote in the ballot is, on making application in that manner, to be furnished by the co-operative free of charge with a copy of the statement (section 355(3)).

Each person who is a director or trustee for debenture holders must give notice to the co-operative of such matters relating to the person as are required to be included in the explanatory statement (section 355(4)).

The explanatory statement must accompany every notice that is sent to a member of a co-operative for the purpose of the conduct of the special postal ballot to obtain agreement to the compromise or arrangement (section 354(1)b)).

When a compromise or arrangement (whether or not for the purposes of or in connection with a scheme for the reconstruction of a co-operative or the merger of any 2 or more co-operatives) has been proposed, the directors of the co-operative must:

(a) if a meeting of the members of the co-operative by resolution so directs--instruct such accountants or Australian legal practitioners or both as are named in the resolution to report on the proposals and send their report or reports to the directors as soon as practicable, and

(b) make any report or reports so obtained available at the registered office of the co-operative for inspection by the members of the co-operative at least 7 days before the day of the holding of the special postal ballot (section 351(1)). If this section is not complied with, each director of the co-operative concerned is guilty of an offence (maximum penalty currently $2,200 (or 20 penalty units)).

The Court need not approve a compromise or arrangement unless there is produced to the Court a statement in writing by the Registrar stating that the Registrar has no objection to the compromise or arrangement (section 353(1)(b)).

CONCLUSION

This presentation is intended to show some of the options available to co-operatives considering the acquisition, disposal, merger or reconstruction of their assets or undertakings. It is important to consider whether the straight sale or acquisition of an asset or undertaking is the most advantageous option available to a co-operative. Equally important is to take sound accounting and legal advice, and liaise with the Registry from an early stage. Doing so can help identify suitable options available to a co-operative, and identify any pitfalls and cost-savings.