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TO: THE PORTFOLIO COMMITTEE ON TRADE AND INDUSTRY

PARLIAMENT OF THE REPUBLIC OF SOUTH AFRICA

3 October 2012

OPINION 6

CO-OPERATIVES AMENDMENT BILL [B17 – 2012]

COMMENTS ON CERTAIN ASPECTS OF THE CURRENT WORKING DRAFT OF THE CONSOLIDATED CO-OPERATIVES AMENDMENT BILL (040612nb)

1. COMMENTS ON CLAUSES 1 & 29 – 53 OF THE BILL

My comments on clauses 1 and 30 – 53 are set out in my earlier Opinions 1 - 4

2. DRAFTING COMMENTS ON CLAUSES 2 -29 & 54 TO THE END OF THE BILL

I refer to my Opinion 5 dated 1 October 2012 together with its attached draft of the Bill (marked 'F-KI-PURPLE') which set out my purely drafting suggestions and comments on clauses 2 – 29 & 54 to the end of the Bill.

(Those only raised points of clarity, style, terminology, grammar and other drafting issues but do not impact on the substantive meaning or import of the provisions to which they relate. Given their purely 'formal' nature, these need not be debated by the Committee and can be finalised between myself and the other lawyers on the sub-committee.)

3. SUBSTANTIVE COMMENTS ON THE DEFINITION OF 'TRUST', CLAUSES 2-29 & CLAUSES 54 TO THE END OF THE BILL

These raise issues of law, principle and/or policy and will require the Committee's consideration.

1. The clause 1 definitions of 'juristic person' and 'trust' (s1 of the principal Act)

The revised clause 1 definition of a 'juristic person' expressly includes 'trusts'.

It is therefore now necessary to include a definition of a 'trust. Adv. Van der Merwe has suggested that we use the definition contained in the Trust Property Control Act. I have no difficulty with that suggestion.

There is however one further issue that the Committee may wish to consider. The reference to trusts in the Companies Act 2008 (which appears in its definition of 'juristic person') expressly includes any trust 'irrespective of whether or not it was established within or outside of the Republic'.

Assuming that trusts formed outside South Africa may become members of South African co-operatives (in the spirit of international co-operation, regional co-ordination and development and the fulfilment of the other co-operative ideals), the inclusion of a similar statement would be useful in confirming the possibility of non-South African trust participation in South African co-operatives.

2. Clause 3 (s3 of the principal Act)

The draft sub-clauses 3(c) and (d) provide for members of category C primary co-operatives, secondary co-operatives and national apex co-operatives to have different percentage voting rights (up to certain specified maximum percentages) in certain circumstances.

I am concerned that these provisions may result in situations where, due to member voting apathy or the formation of voting alliances, two members could effectively exercise absolute control over a co-operative. If that consequence is acceptable to the Committee, I would suggest that consideration be given to the inclusion of provisions providing minority members with protection against oppressive and unfairly discriminatory conduct, along the lines of that provided by s163 of the Companies Act 2008.

Even in the absence of any concern about the provisions of clause 3, the inclusion of such a general 'minority protection provision' would be a useful and desirable addition to the Act.

3. Clause 8 (s9 of the principal Act)

3.1 The provisions of this clause (as read with s 9 of the principal Act) dealing with pre-incorporation contracts does not cover all the scenarios that may arise in circumstances where a contract is entered into for the benefit of a co-operative that has not yet been formed.

For example, it does not cater for the possibility that:

(a) the pre-incorporation contract might be entered into by more than one person;

(b) the contract might be entered into orally, which could result in uncertainty or disputes regarding its terms ;

(c) the co-operative may wish or attempt to ratify only part of the contract by 'picking and choosing' between its terms; and

(d) the co-operative may, instead of ratifying the pre-incorporation contract, decide to enter into a separate agreement with the same third party and on substantially the same terms as the pre-incorporation contract. This would prejudice the persons who entered into the pre-incorporation contract for the co-operative (perhaps deliberately) by leaving them personally bound by the pre-incorporation contract. It would also mean that the third party would be bound by and able to enforce two essentially 'duplicate' contracts.

3.2 In order to avoid the potential difficulties associated with such possibilities, I would recommend that, as in s 21 of the Companies Act 2008, the following additional provisions be included:

(a) A requirement that the contract be a written one

(b) A provision expressly stating that where the contract is entered into by more than one person and unless the contract provides otherwise, all of those persons will be personally jointly and severally liable under the contract in the event that it is not ratified by the subsequently incorporated co-operative.

(c) A provision stating that where the co-operative wishes to ratify the pre-incorporation contract, it must ratify the whole contract and all of its terms. (The Companies Act allows for 'partial ratification'. I do not recommend that as it invites

confusion as to who is then liable under the contract, the terms for which they are respectively liable and because it could unduly prejudice the persons who entered into the contract for the co-operative by leaving them personally bound by the less favourable terms of the contract that the co-operative does not want. I mention it however so that the Committee is aware of all the possible provisions.)

(d) The inclusion of a provision similar to s 21(3) of the Companies Act which (with the necessary changes to terminology) would read:

> 'If, after its incorporation, a co-operative enters into a contract on the same terms as, or in place of, a contract contemplated in sub-section (1), the liability of the person or persons who entered into the sub-section (1) contract in the name of or on behalf of the co-operative shall be discharged.'

3.3 For the purposes of completeness, I also draw the Committee's attention to s 21(5) of the Companies Act. That section contains a 'deeming provision' which says that if a company does not expressly ratify or reject a pre-incorporation contract within 3 months of its incorporation (by just 'doing nothing'), it will be deemed to have ratified that contract.

This deeming provision is designed to protect the person(s) who entered into the contract for the company but it does place the onus on the co-operative to become aware of the contract and to actively decide whether or not to ratify it. Whether a similar provision should be included in the Bill requires a policy decision on where the 'risk' and the 'protection' should lie.

4. Clause 9(a) (s10 of the principal Act)

This clause is very confusing on which co-operatives can use the abbreviations 'co-op' and 'ltd'. It is also confusing on when they must use those abbreviations.

I recommend a re-draft to clarify the meaning of and intention behind these provisions.

5. Clause 10 (s12 of the principal Act)

This clause renders it an offence for any 'entity' to improperly use the words 'co-operative limited' or its abbreviations.

There are two problems with this:

(a) The term 'entity' has no recognised or particular legal meaning and should be replaced with 'juristic person' (which the Bill now defines as including trusts).

This change needs to be made to both clause 10(c) of the Bill and s12(1) of the principal Act.

(b) It is just as likely that natural persons (acting individually or in association with others but not through a legal structure that is recognised as juristic person) may improperly use the 'co-operative' words. Clause 10(c) should therefore be amended to refer to improper use by both natural and juristic persons.

6. Clause 12 (s14 of the principal Act)

6.1 Clause 12(e)

Given the potentially far-reaching financial implications for dependents of deceased members, I would suggest that this clause stipulate a maximum period for which the repayment of the nominal value of a deceased member may be postponed. In the absence of an express limitation, it would be possible for repayment to be postponed indefinitely.

6.2 Clause 12(f)

This clause deletes s14(1)(cc) of the Act (which says that a co-operative's constitution must include provisions setting out the procedures for requests for the calling of general meetings).

Why is this deletion being made? The ability of members to requisition meetings is an important mechanism for their protection and a key aspect of a democratic corporate structure.

6.3 Clause 12(g)

6.3.1 Which 'role players' are being referred to in sub-paragraph (j)?

6.3.2 This clause (which permits the appointment of 'non-executive independent directors') conflicts with the existing s14(1)(dd) of the Act which says that 'only members may be appointed as directors'.

If the intention is to permit co-operatives to have both executive and non-executive directors, the Bill should expressly refer to and permit non-executive director appointments. In addition, s14(1)(dd) would need to be amended to provide that only members may be appointed as executive directors.

7. Clause 21 (s24 of the principal Act)

The intention behind this clause is not clear.

Section 24(1) of the Act currently provides that 'if a co-operative determines that the repayment of a member's shares would adversely affect its financial well-being, the co-operative may direct that the repayment be deferred for a period not exceeding two years after the effective date of the notice of withdrawal' of a member's membership.

In my opinion there is nothing in this provision that should be changed. If the intention is simply to require co-operatives to indicate in their constitutions whether they may postpone repayment for the maximum permissible two year period or whether they will operate on some shorter maximum postponement period, then this clause needs to be re-drafted to make that clear.

8. Clause 29 (s38 of the principal Act)

8.1 This clause records the common law fiduciary duty of directors and others in positions of trust not to make any personal profit from their position.

However, like that common law duty, it should be qualified so as to permit personal gain in circumstances where it has been fully disclosed to the co-operative and the co-operative has consented to it.

8.2 The term 'manager' has no defined or particular legal meaning. Managers are included within the broader concept of 'employee'. As such, they need not be separately referred to and all references to 'managers' in this clause (and throughout the Bill) should be deleted.

9. Clause 56 (s72 of the principal Act)

Why are sections 72(1)(a) and (b) of the principal Act (which provide for winding-up of a co-operative by a court on the grounds of insolvency) being deleted?

This is an inherent power of the court and an important protection for creditors.

10. Clause 57 (s72 of the principal Act)

The proposed new s72B(a) allows the registrar or the Tribunal to wind a co-operative up in various circumstances, including where it or its directors have been convicted of an offence under s19(4) and where it has failed to operate according to the Act's co-operative principles.

Whilst I appreciate the intention of taking a 'firm position' to secure compliance with the Act's requirements, this is in my opinion an unduly harsh provision.

The offences concerned are of a relatively 'technical' nature and it is likely that they may be transgressed without deliberate intent. The directors responsible for these transgressions are already subject to criminal liability, as is the co-operative itself. This is in my view a sufficient deterrent without the need to for the threat of a winding-up, which is likely to have more of an adverse and acute effect on the members and creditors of the co-operative than the errant directors.

On a literal reading, the clause also permits the registrar or the Tribunal to wind a co-operative up where it has failed to 'carry out its objectives according to co-operative principles as required by [the] Act'. The co-operative principles record moral and business values rather than 'hard and fast' requirements. Assessment of whether they have been complied with is difficult and will inevitably be, at least to some extent, a subjective assessment. In addition, there is no indication of the extent or degree of non-compliance necessary to permit a winding-up. Again, given the 'final' nature of a winding-up and its implications for members and creditors, this is in my view too extreme a provision.

I am also concerned about conferring such a wide-reaching legal power on the registrar and the Tribunal. Generally, it is a court that has the power to wind-up juristic persons, and then subject to certain procedures that are designed to protect interested parties such as members and creditors.

I therefore recommend the deletion of this clause.

11. Clause 58 (ss73-76 of the principal Act)

I understand that s73 of the Act is being deleted because of the (problematic) transferral of the winding-up power from the Minister to the registrar and the Tribunal.

It is not however clear why the other sections (72, 74, 75 and 76) which set out general winding-up procedures and requirements are also being deleted.

12. Clause 59 (s77 of the principal Act)

I would suggest that the proposed new s77(2) refer to the time period that must elapse before a co-operative can be placed under judicial management.

13. Clause 61 (s82 of the principal Act)

The various subsections of this clause as read with s82 of the Act all refer to 'information'. It is not clear whether they are all referring to the same information or, if not, what the differences are.

I have suggested some drafting changes to the wording (in my Opinion 5 and its attached Bill 'F-KI-PURPLE) but, since I am unclear on the intention behind the different sub-clauses, am not sure that they express the intended meaning.

14. Clause 6 (s 91M of the principal Act)

This clause should indicate:

(a) The period of the term of office of members of the Tribunal

(b) The maximum number (if any) of terms they may serve

(c) The consequences of the Tribunal's failure to meet.

15. Clause 66 (s 91Q of the principal Act)

In principle, the proceedings before the Tribunal should be open to the public unless the Tribunal has good grounds for excluding all or certain persons from being present.

16. Clause 66 (s 91BB of the principal Act)

The proposed new s91BB(3)(b)(ii) allows for a compromise agreement between a co-operative that is in insolvent circumstances and its creditors to make provision for the creditors' claims to be converted into equity in the co-operative or another co-operative.

In my view this is not desirable. The resulting potential 'take-over' of co-operatives by creditors (who could be anyone) seems out of line with the community and social ideals and spirit on which the co-operative concept is based.

I would recommend the deletion of this provision or, at the very least, an expression of the maximum membership share (rather than 'equity') that creditors can collectively hold.

17. Clause 66 (s 91GG of the principal Act)

This clause should indicate:

(a) The term of office of the members of the Inter-Provincial Co-ordination Committee

(b) The maximum number (if any) of terms they may serve

(c) The consequences if the Committee fails to meet.

18. Clause 66 (s 91HH of the principal Act)

Have the structures referred to in this clause already been established? If they have, is this clause necessary or correctly worded (in terms of tense)?

I will see the sub-committee at its meetings on Thursday 4 October 2012 and Friday 5 October 2012 to discuss my drafting comments in my Opinion 5, the above comments and any other matters required by the sub-committee.

Yours sincerely

Kathy Idensohn