CO-OPERATIVES UK

Handbook of Co-operative and Community Benefit Society Law

2nd Edition

Editor
Ian Snaith

Co-operative enterprises build a better world

JORDAN PUBLISHING

Published in association with Jordan Publishing

Handbook of Co-operative and Community Benefit Society Law

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Handbook of Co-operative and Community Benefit Society Law

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Ian Snaith

Published by Co-operatives UK
in association with Jordan Publishing Ltd

Published by
Jordan Publishing Limited
21 St Thomas Street
Bristol BS1 6JS

British Library Cataloguing-in-Publication Data

A catalogue record for this book is available from the British Library.

ISBN 978 1 78473 0 130

Typeset by Letterpart Limited, Caterham on the Hill, Surrey CR3 5XL

Printed in Great Britain by Hobbs the Printers Limited, Totton, Hampshire SO40 3WX

For Judith,
without whose support
this book would not have appeared

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PREFACE

Important legal changes affecting co-operative and community benefit societies (formerly industrial and provident societies) came into force in 2014. The Co-operative and Community Benefit Societies Act 2014 consolidated most of the law for England, Scotland and Wales. A number of statutory instruments made important changes to the powers of the Financial Conduct Authority (FCA) as registrar of societies, applied insolvency rescue procedures and director disqualification to societies, increased permitted holdings of share capital, and eased electronic communication with the FCA. That followed the 2012 replacement of the FSA by the PRA and FCA which particularly affected creit unions. Those developments meant that it was time to provide an up-to-date legal text in the area. Co-operatives UK decided to do that and this is the result.

This book offers a full treatment of the law on co-operative and community benefit societies based on the 2014 consolidation and the reforms. It is intended to be authoritative and provides detailed and up-to-date legal references that the reader can follow up. It is aimed at lawyers, accountants and co-operative development workers as well as directors, secretaries, and active members of housing associations, co-operatives and community benefit societies. The book offers a resource for societies of every size across all sectors. It may also be of interest to historians, policy-makers, researchers, and commentators.

Professionals such as accountants, business advisers and lawyers need to increase their awareness of these societies as an alternative to the registered company. Undergraduate and postgraduate students and academics need a reference book in this area and perhaps the availability of this text will encourage law and business courses at all levels to widen their coverage beyond companies.

The updating project has been a truly co-operative effort. The Co-operatives UK legal team, particularly Helen Barber and Linda Barlow, have made this happen by virtue of their hard work and insight. They had the full support of Ed Mayo, the Secretary General and the Co-operatives UK board. A business plan was devised by Nick Money. Cliff Mills was heavily involved in promoting and encouraging the project from the beginning and Mike Gaskell rallied the Trowers' troops to assist.

It has been a privilege to work on this project with a team of legal practitioners highly experienced in the field. We worked on updating my original text for chapters or sections of chapters as follows:

- **David Alcock** of Anthony Collins Solicitors LLP – Section **9.1.**, and **Chapter 11**;
- **Diego Ballon-Ossio** of General Counsels Division, Financial Conduct Authority – Sections **3.1.** to **3.7.**, **9.3.** and **9.4.**;
- **Sam Coward** of Trowers and Hamlins LLP – **Chapter 10**;
- **Ian Davis** of Trowers and Hamlins LLP – **Chapter 8**;
- **Mike Gaskell** of Trowers and Hamlins LLP – Sections **3.8.** to **3.12.**;
- **Cliff Mills** of Capsticks Solicitors LLP – **Chapters 2** and **5**;
- **Jo Savage** of Croftons Solicitors LLP – **Chapter 6**;
- **Abbie Shelton** of ABCUL, Association of British Credit Unions Limited – **Chapter 13**;
- **Catherine Simpson** of Trowers and Hamlins LLP – **Chapter 7**;
- **Ian Snaith** of the University of Leicester and DWF LLP – **Chapter 1**, Section **9.2.**, and Sections **12.6.** to **12.8.**; and
- Sharron Webster of Trowers and Hamlins LLP – **Chapter 4** and Sections **12.1.** to **12.5**.

As editor, I co-ordinated all the work and finalised the whole text, including rewriting or reordering some chapters in the light of more recent developments and experience.

This edition updates the text of the 1993 version of the *Handbook of Industrial and Provident Society Law* which was published as a looseleaf volume by Holyoake Books, an imprint of the Co-operative Union (now part of Co-operatives UK). That volume drew on the work of previous Co-operative Union authors who produced earlier versions between 1894 and 1980. Particular tribute is due to Bill Chappenden, who produced the version on the 1965 Act, and to Paul Rose and Ian Swinney who updated that volume. The 1993 edition also drew on my own Law of Co-operatives which was published in 1984 by Waterlow Publishers. My work on the 1993 volume resulted from the encouragement of Arthur Pemberton and John Butler of the Institute of Co-operative Directors and its production and marketing were enthusiastically supported by Iain Williamson and Gillian Lonergan, both then of the Co-operative Union. In that sense, the book is the fruit of the co-operation of many over a period of 120 years.

The format has changed to reflect developments in the last 20 years. The former looseleaf format allowed updates from time to time but those loose page updates had to be filed in and the format was expensive to produce. For that reason, this book is in hardback format with a version in ebook form for those who prefer that. It seems that the law may be settled at least for a while now so a new edition may not be needed for a few years.

Because online access to legislation is now freely available at www.legislation.gov.uk, the 1993 appendices containing statutes and statutory instruments have been dropped. Similarly, the Co-operatives UK Corporate Governance Codes are available online at http://www.uk.coop, along with many other helpful legal and business materials. The provisions of some society model rules have been used to illustrate the choices open to societies in some chapters of this edition but, to avoid a having to sell the book at an even higher price, the full text of the Model Rules has not been included.

The process of preparing the text for production and publication has been ably and efficiently carried out by Kate Hather of Jordan Publishing and Julian Roskams of Etica Press Ltd.

I take full responsibility for the final product and particularly for any errors or inaccuracies in it. As far as possible, the law is stated as it stood on 1 August 2014.

Ian Snaith,

Leicestershire,
August 2014.

FOREWORD

At the beginning of 2012, the year dedicated by the United Nations to be the International Year of Co-operatives, the Coalition Government committed itself to update and consolidate the legislation for co-operatives registered as industrial and provident societies in the United Kingdom. This was a welcome moment for the sector.

Two years on, that commitment has been realised with the coming into law of the Co-operative and Community Benefit Societies Act 2014.

Co-operatives UK has been at the heart of the campaign for reforms and consolidation of the law relating to co-operatives for the last two or three decades. To complement the new Act, Co-operatives UK has published this updated handbook of co-operative and community benefit society law, an essential guide for societies and their advisors.

Ian Snaith, the *Handbook*'s editor, is the UK's foremost specialist in co-operative legislation, and part of a wider European and global resource on the application into law of co-operative principles and values.

Together, the authors have a wealth of experience in providing advice to societies, turning the *Handbook of Co-operative and Community Benefit Society Law* into an essential and authoritative publication.

Dame Pauline Green

International Co-operative Alliance

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TABLE OF STATUTES

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TABLE OF STATUTORY INSTRUMENTS

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LIST OF ABBREVIATIONS

1996 Deregulation Order	Deregulation (Industrial and Provident Societies) Order 1996 SI 1996/1738
2003 RRO	The Regulatory Reform (Credit Unions) Order 2003, SI 2003/256
2014 Investigations Regs	Co-operative and Community Benefit Societies and Credit Unions (Investigations) Regulations 2014, SI 2014/574
AA 1996	Arbitration Act 1996
ABCUL	Association of British Credit Unions Ltd
ACE	ACE Credit Union Services
AGM	Annual General Meeting
ARA Order	Industrial and Provident Societies and Credit Unions (Arrangements, Reconstructions and Administration) Order 2014, SI 2014/229
Art	article
Asset Lock Regulations	Community Benefit Societies (Restriction on Use of Assets) Regulations 2006, SI 2006/264
BIS	Department for Business Innovation and Skills
BSA 1986	Building Societies Act 1986
CA 1985	Companies Act 1985
CA 2006	Companies Act 2006
C(AICE)A 2004	Companies (Audit Inspections and Community Enterprise) Act 2004
CATP 2002	Financial Services and Markets Act 2000 (Consequential Amendments and Transitional Provisions) (Credit Unions) Order 2002, SI 2002/1501
CCBSA 2003	Co-operatives and Community Benefit Societies Act 2003
CCBSA 2014	Co-operative and Community Benefit Societies Act 2014
CCBSACUA 2010	Co-operative and Community Benefit Societies and Credit Unions Act 2010
CDDA 1986	Company Director Disqualification Act 1986
CDS	The Co-operative Development Society Limited – Co-operative Service Housing Agency
ChA 2011	Charities Act 2011
CIC	Community Interest Company

CIO	Charitable Incorporated Organisation
CIU	Clubs and Institutes Union
CLT	Community Land Trust
CUA 1979	Credit Unions Act 1979
CRD	Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 on credit institutions
CREDS	Credit Unions New Sourcebook (http://fshandbook.info/FS/html/handbook/CREDS)
CUK Bencom Model Rules	Co-operatives UK Society for the Benefit of the Community Model Rules
CUK Code 2013	Co-operatives UK, Corporate Governance Code for Consumer Co-operative Societies (November 2013)
CUK Consumer Model Rules	Co-operatives UK 12th Edition Model Rules
CUK Worker Code	Co-operatives UK, The Worker Co-operative Code, 2011/2012
CUK Worker Model Rules	Co-operatives UK Worker Co-operative Model Rules
CVA	Creditors' Voluntary Arrangement
DETINI	Department of Enterprise Trade and Investment Northern Ireland
EEA	European Economic Area
EGM	Extraordinary General Meeting
Electronic Communications 2011	Mutual Societies (Electronic Communications) Order 2011, SI 2011/2687
EU	European Union
FCA	Financial Conduct Authority
FEES	Fees Module of the FCA Handbook
Financial Promotion Order	Financial Services and Markets Act 2000 (Financial Promotion) Order 2005, SI 2005/1529
FrndSocA 1974	Friendly Societies Act 1974
FrndSocA 1992	Friendly Societies Act 1992
FSA	Financial Services Authority
FSA 2012	Financial Services Act 2012
FSMA 2000	Financial Services and Markets Act 2000
Group Accounts Regulations	Industrial and Provident Societies (Group Accounts) Regulations 1969, SI 1969/1037
HCA	Housing and Communities Agency
HMRC	Her Majesty's Revenue and Customs
HMT	Her Majesty's Treasury
IA 1986	Insolvency Act 1986
ICA	International Co-operative Alliance
ICOM	Industrial Common Ownership Movement
IPNEDs	Independent Professional Non-executive Directors
INEDs	Independent Non-executive Directors
IPSA 1893	Industrial and Provident Societies Act 1893

IPSA 1965	Industrial and Provident Societies Act 1965
IPSA 2002	Industrial and Provident Societies Act 2002
Investigation Regulations	Co-operative and Community Benefit Societies and Credit Unions (Investigations) Regulations 2014, SI 2014/574
JMLSG	Joint Money Laundering Steering Group
LLP	Limited Liability Partnership
LLPA 2000	Limited Liability Partnerships Act 2000
LP	Limited Partnership
LRO 2011	Legislative Reform (Industrial and Provident Societies and Credit Unions) Order 2011, SI 2011/2687
LSE	London Stock Exchange
MCOB	Mortgages and Home Finance Conduct of Business Sourcebook of the FCA
Mutual Societies Order 2001	Financial Services and Markets Act 2000 (Mutual Societies) Order 2001, SI 2001/2617
Mutual Societies Order 2013	Financial Services Act 2012 (Mutual Societies) Order 2013, SI 2013/496
NHF Version 2 Model	National Housing Federation Model Rules 2011 (version 2)
PA 1890	Partnership Act 1890
PLC	Public Limited Company
PMS	Presbyterian Mutual Society
PRA	Prudential Regulation Authority
Reg	regulation
Regulated Activities Order	Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, SI 2001/544
SAOS	Scottish Agricultural Organisation Society
Sch	Schedule
SGM	Special General Meeting
SHR	Scottish Housing Regulator
SLCU	Scottish League of Credit Unions
SUP	Supervisory Provisions of the FCA and PRA Handbooks
SYSC	Senior Management Arrangements, Systems and Controls module of the FCA and PRA Handbooks
UK Corporate Governance Code	Financial Reporting Council, The UK Corporate Governance Code, September 2012.
UKCU	UK Credit Unions Ltd
UKLA	UK Listing Authority

CHAPTER 1

CO-OPERATIVE AND COMMUNITY BENEFIT SOCIETIES IN THEIR LEGAL CONTEXT

1.1. INTRODUCTION

After an introductory outline of some of the legal requirements of co-operative and community benefit orientated businesses in Section **1.1.**, Section **1.2.** of this chapter sketches the legal context of co-operative and community benefit societies by comparing them with other legal structures available for business. Section **1.3.** deals with the protection of organisational purpose in legal structures and Section **1.4.** deals with the key legislative changes made to co-operative and community benefit society law in 2014.

1.1.1. The range of choice

The legal definition of a co-operative or community benefit society has at its core the requirement that it is 'a society for carrying on any industry business or trade (including dealings of any description with land), whether wholesale or retail' and that it registers as either a 'bona fide co-operative society' or a society conducting or intending to conduct its business 'for the benefit of the community'.[1]

Both types of society are business structures with particular practices or objectives. So where do co-operatives and community benefit societies fit in the wider picture of legal structures available for business in the UK?

Unlike many other legal systems, the UK jurisdictions do not generally require businesses of a particular type to use particular legal structures. Instead, they allow a wide choice of legal form to anyone starting a business. Business owners and founders also have a wide choice about the detailed rules in the organisation's constitution.

As a result, co-operative and community benefit societies might be said to be 'in competition' with other legal structures, such as companies and partnerships, from the point of view of people choosing between them. The special purposes or practices involved in being either a bona fide co-operative or a community benefit society also raise issues about the availability of other legal mechanisms or structures, such as trusts, charities, building societies or friendly societies, intended to achieve a similar outcome. That raises questions about locking assets into the purpose and how easy or difficult it is to demutualise the structure and turn the co-operative or community benefit society into an investor-owned company.

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1 CCBSA 2014, s 2(1) and (2).

This chapter briefly compares available structures with that perspective in mind. **Chapter 2** examines the history of co-operative and community benefit society legislation and the range of societies in existence today and **Chapter 3**, dealing with the registration of societies, looks at the key features of organisations that qualify as co-operatives or community benefit societies.

For an excellent practical analysis of the range of legal structures available for co-operative and other 'third sector' organisations, consult Co-operatives UK's *Simply Legal*.[2] It is particularly helpful in analysing the types of organisations against the available legal forms, the advantages and disadvantages of incorporation, ownership issues, and charitable status.

1.1.2. Some key issues for co-operatives and community benefit business organisations

Both types of business share some of the needs of other businesses. They include:

Capital: This can only come from reinvested profits (reserves), shares, and debts. For organisations committed to giving a lower priority and return and fewer rights to investors, this can be particularly problematic. However, a legal structure that permits shares and loan securities of one kind or another to be issued is useful for some businesses.

Contracting and property ownership: This is necessary for any business. A sole trader can do this as an individual and so can the partners in an unregistered general partnership. However, for this purpose, corporate personality is particularly helpful.

Corporate personality: In a corporate body such as a co-operative or community benefit society, a company or a limited liability partnership, the entity contracts and holds property separately from its members. Similarly it sues and is sued and continues in existence until it is dissolved regardless of changes in membership or ownership.

Limited liability: This is linked to, but separate from, corporate personality. This feature means that the liability of members or business owners for the debts of the business, even if it becomes insolvent, are limited to an amount they have paid in or, sometimes, an amount they have agreed to pay. This usually takes the form of the amount paid or due on the shares in the corporate body but in the case of a company limited by guarantee is an amount pledged when the member joins but paid on insolvency.

Governance and decision-making: These matters have to be dealt with in every structure but they are affected by the particular legal structure used. They can vary from a flat structure in which all owners participate in all decisions, for example in small workers' co-operatives or small partnerships to complex tiered structures. However, the classic system involves a general meeting of members and a committee or board elected by them.

Distribution and level of risk: Some unincorporated structures distribute risks and liability unevenly. This is due to the absence of both corporate personality and limited liability and the variable effects of contract and agency law on the liability of members

[2] 2nd edn, 2009.

or committee members. Corporate bodies with limited liability generally equalise underlying risk, sometimes subject to personal guarantee contracts by some members with business creditors and possible liability on insolvency for decision-makers in the business.

Privacy or transparency: Broadly, greater public disclosure of business information and of the identity of members or board or committee members comes with incorporation and limited liability for debts. If creditors are to take the risk of being able to hold only the corporate body liable, they are thought to be entitled to information to assist them in assessing the level of risk. However, this is often mitigated for small businesses by exceptions and permission to file abbreviated accounts.

Administration costs: The costs attached to the registration of a business as a corporate body and the ongoing costs of filing returns are often seen as an extra cost of incorporation. However, anyone seriously embarking on a business venture would be well advised to ensure that the governing documents for the organisation meet its needs, whether or not the business is to be incorporated.

Co-operatives and community benefit societies have extra requirements that define them. For co-operatives that revolves around the ICA Statement of Co-operative Identity, Values and Principles. For community benefit societies, it means operating in the interests of a group other than the society's members, with or without an asset lock, charitable status, or stakeholder control of decision-making.[3] Registration under CCBSA 2014 involves compliance with those values as a condition of registration, enforced by the FCA.

This chapter considers a range of business structures in the light of these needs. Section **1.2.1.** deals with unincorporated business structures, Section **1.2.2.** considers incorporated business structures and Section **1.2.3.** looks at the role of structures not usually used for business.

1.2. AVAILABLE LEGAL STRUCTURES

1.2.1. Unincorporated business structures

1.2.1.1. Sole trader

This 'structure' barely deserves that name. It simply recognises that any human being with legal capacity can make contracts and so can conduct business. Legal capacity will depend on the individual being of age (at least 18 years old) and not suffering from mental incapacity so as to be unable conduct his or her affairs. Given this level of legal capacity, the individual can borrow, lend, buy, sell, employ others and otherwise make any legally binding contract needed to conduct business.

No special rules about the relationship between the different owners of the business are needed since the owner is one individual acting as such. Similarly, an individual can

[3] See Section **1.3.** below.

make a declaration of trust in respect of property or enter a contractual arrangement that may lead to a legally binding obligation to pursue a charitable or other altruistic objective.

The sole trader will have unlimited liability for business debts to the full extent of their wealth. The business will be conducted through contracts made by the individual sole trader with or without the use of agents in accordance with agency law. Assets will be held by or on behalf of the individual sole trader.

BIS estimates that, at the beginning of 2013, there were a total of 3.1 million sole traders, of whom only 231,000 had employees.[4]

1.2.1.2. Unregistered general partnership

Three different forms of partnership are possible:

- unregistered general partnerships, governed by Partnership Act 1890 is dealt with briefly here;
- for Limited Partnership under Limited Partnership Act 1907, see 1.2.2.4 below; and
- for Limited Liability Partnership (LLP) under the Limited Liability Partnerships Act 2000, see 1.2.2.1 below

Unregistered general partnerships and LLPs are commonly used by a range of businesses. Limited partnerships are used only for specialised purposes.[5]

Across the three types of partnership, almost 500,000 businesses use the partnership structure and the vast majority of them are unregistered general partnerships.[6]

General unregistered partnerships within the definition to be found in the Partnership Act 1890 (PA 1890) were the earliest form of partnership. They are governed by rules developed by the common law and equity and codified in the 1890 Act. These partnerships are predominantly governed by rules from the law of contract, the law of trusts, agency law, and those equitable rules that govern fiduciary relationships. The key features of this business structure are, in England and Wales, the absence of any separate legal personality on the part of the enterprise, and, in all the UK jurisdictions, the unlimited personal liability of the individual partners for the debts accrued by the business, with the ability of each partner to act as agent for the partnership.

These features are drawbacks to the use of the structure but lead, as a matter of public policy, to the absence of any public disclosure of accounting and financial information about the business. A partnership of this kind can be formed without first registering it with any public authority. Since the full personal wealth of the partners is available to meet business debts, those dealing with the business do not have the right to gain access to financial information unless they contract with the partners to have that right.

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4 See BIS Business Population estimates for the UK and Regions 2013, p 6.

5 For more information on partnerships consult: Geoffrey Morse *Partnership Law* (Oxford University Press, 7th edn, 2010) or Roderick I Banks *Lindley and Banks on Partnership* (Sweet and Maxwell, 19th rev edn 2010).

6 See BIS Business Population estimates for the UK and Regions 2013, p 7.

Similarly, since there is no separate corporate personality in the case of an 1890 Act partnership (other than in Scotland) there is no need to register founding documents to allow a registrar to confer such corporate personality on the entity. It is enough that the identities of the partners are made known in the course of business so that process can be served on them.[7] This transparency of the business form is also reflected in the tax treatment of unregistered general partnerships, which are not subject to corporation tax on the business profits but in which the individual partners pay income tax on their share of those profits.

The absence of corporate personality means that property is held by individual partners on trust for the whole firm and that ownership of it may need to be transferred as partners join and leave. Unless the contrary is agreed between the partners, the partnership is dissolved and a new one formed whenever a partner resigns or a new one joins.[8] This is cumbersome and is an important reason to have a properly drafted written partnership agreement from the beginning.

A partnership exists if the relationships between those involved in the operation of a business amount to 'the relation which subsists between persons carrying on a business in common with a view of profit'.[9] As a result, partnerships can be formed unintentionally. The test of whether a partnership exists is based on any evidence of the intention of the parties about whether they were carrying on business in common with a view to profit or had some other business or commercial relationship. Section 2 of the PA 1890 and later case law provide guidance on deciding the nature of the relationship. Limited partnerships and LLPs can only be formed deliberately as they have to be created by registration.

The courts consider all the circumstances of the arrangement to decide whether it amounts to a partnership. The judges try to establish the real agreement of the parties. A statement in an agreement that they are, or are not, partners will not decide the matter if the circumstances do not bear it out. If the reality of the agreement and relationship indicates that they are borrower and lender, employer and employee, employer and independent contractor, or buyer and seller of a business and the goodwill in it, they will not be regarded as partners. If, on the other hand, they are sharing management and ownership of a common enterprise, seeking profits or contemplating losses that are to be shared, and so have a community of benefit rather than an opposition of interests, they will probably be partners.[10]

All partnerships need a minimum of two partners but the word 'persons' used in s 1(2) PA 1890 includes corporate bodies. As a result, any of the three types of partnership can be formed by any combination of individual people or corporate entities, such as companies or co-operative and community benefit societies societies, so long as the corporate body's constitution permits it to be a member of a partnership.[11]

Since 21 December 2002 there has been no maximum permitted number of partners.[12]

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7 CA 2006, ss 1200–1204.
8 PA 1890, ss 32–33.
9 PA 1890, s 1(2).
10 PA 1890, ss 1(1), 2 and 3 and the excellent discussion in Chapter 2 of Geoffrey Morse *Partnership Law* (Oxford University Press, 7th edn, 2010).
11 *Newstead (Inspector of Taxes) v Frost* [1980] 1 WLR 135.
12 Regulatory Reform (Removal of 20 Member Limit in Partnerships etc) Order 2002, SI 2002/3203.

An unregistered general partnership does not limit the partners' liability for debts and each partner is jointly and severally liable for the business debts.[13] In addition, any partner can contract as agent for all the partners and their acts and contracts carrying on the kind of business the partnership does in the usual way will usually bind all the partners.[14]

Internally, arrangements between the partners are governed by contract and their arrangements can always be changed by consent either expressly or by a course of dealings over time.[15] Property of any kind originally brought into the firm by partners or acquired since on behalf of the firm or for the purpose of its business is 'partnership property' held on trust for the purposes of the business.[16]

Other key features of the default provisions in the absence of agreement to the contrary are:

- Profits and losses are shared equally between partners.[17]
- Partners are not entitled to interest on capital or remuneration before profits are calculated.[18]
- Every partner has a right to take part in the management of the business.[19]
- Decisions are made by simple majority of the partners except admitting a new partner or changing the nature of the firm's business which both need unanimous agreement.[20]
- All partners to have access to the firm's books and accounts at any time.[21]
- There is no power to expel a partner unless expressly agreed.[22]
- The partnership must indemnify any partner for payments made and personal liabilities incurred in the ordinary and proper conduct of the partnership business or in doing anything necessary to preserve of the partnership's business or property.[23]
- If a partner, without the consent of their partners, carries on any business competing with the partnership, she must pay all profits to the partnership.[24]
- Each partner must account to her partners for any benefit she derives, without their consent, from any transaction concerning the partnership, or from any use by her of the partnership name or any partnership property or business connections.[25]

If a group has objectives involving the use of its resources for altruistic purposes and no intention to distribute any profits to the members of the group, it will want to avoid these default rules. Similarly, in a partnership the default position is that each partner has agency authority to bind all the other partners. In an unincorporated association, in the absence of explicit agreement in the association's rules or otherwise, only the

13 PA 1890, s 9.
14 PA 1890, s 5.
15 PA 1890, s 19.
16 PA1890, s 20.
17 PA1890, s 24(1).
18 PA 1890, s 24(4) and (6).
19 PA 1890, s 24(5).
20 PA 1890, s 24(7) and (8).
21 PA 1890, s 24(9).
22 PA 1890, s 25.
23 PA 1890, s 24(2).
24 PA 1890, s 30.
25 PA 1890, s 29(1).

committee members and officers are likely to be bound by contracts and the other members will be free of the contractual obligation and any other liability beyond the duty to pay any annual subscription.[26] Since neither legal form confers limited liability for the debts of the organisation, this is an important issue. Likewise, the rules applicable to a partnership under s 24(1) of the PA 1890 would give the members an equal share in profits or losses, in the absence of agreement to the contrary.

This highlights the importance of clarity at the beginning about the arrangements intended to apply to the organisation and care about ensuring that the legal structure being used will facilitate the aims of the group. If a group intend to establish a partnership under the PA 1890, they should use a written partnership agreement (or partnership deed) to set out their intention to operate as a partnership and the detailed rules they want to apply. That document establishes the business structure and modifies various provisions that would otherwise apply. Legal advice should be taken on this.

As a contractual arrangement, a partnership does not legally have to be created in writing and its existence can be proved by a course of conduct establishing the appropriate relationship. As a result, a failure to decide on the legal structure will amount to a decision by default, leaving the courts to decide on the parties' intention in the light of such evidence as is available and to deduce on that basis, the applicable legal rules as indicated above.

This apparently simple structure can be tailored to the needs of the partners by the free use of contract to establish their own structure. The PA 1890 default rules only operate in the absence of agreement to the contrary. The division of profits or losses among the partners, the level of reward for capital, the governance structure and the decision-making processes can all be created specifically to fit the needs of those using the structure. Since corporate bodies can be members of a general unregistered partnership, the structure can be tailored to confer limited liability on individuals by the use of that method.

BIS estimated that, at the beginning of 2013, a total of 434,000 of these 'general partnerships' existed and that 145,000 of them had employees.[27]

1.2.1.3. Unincorporated friendly society

Friendly societies were an original form of mutual insurance society out of which co-operative and community benefit societies grew. They are member-owned mutuals that operate on the basis of one member one vote and share surplus among their members by way of benefits without investor shareholders.

Until 1993 all friendly societies were registered but unincorporated. They can now be either incorporated or unincorporated. The Friendly Societies Act 1974 (FrndSocA 1974) governs unincorporated societies but since February 1993 no new societies have been able to register under that Act.[28] So this is a legacy business structure. For a brief outline of the incorporated friendly society structure that remains available for new registrations see Section **1.2.2.5.** below.

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[26] *Wise v Perpetual Trustee Co* [1903] AC 139.
[27] See BIS Business Population estimates for the UK and Regions 2013, p 7.
[28] FrndSocA 1992, s 93.

Existing unincorporated societies registered under FrndSocA 1974 as friendly societies can remain registered or incorporate under the 1992 Act.[29]

Other societies, such as cattle insurance societies and certain benevolent societies, registered under the FrndSocA 1974 but not as friendly societies can convert into co-operative or community benefit societies.[30]

The key feature of the friendly society business structure, whether it is incorporated or not, is that it can only be used for a strictly limited range of activities. In that respect it resembles a building society or a credit union. In Section **1.3.5.1.** that mechanism is examined as a way of protecting corporate purpose.

1.2.1.4. Co-operative and community benefit societies compared

A co-operative or community benefit society, unlike an unregistered general partnership, has corporate personality and gives its members the benefit of limited liability for business debts.

Unlike an unincorporated friendly society, it can pursue any form of business it chooses and is not confined to a particular type of business, such as insurance. However, it must operate as a co-operative or benefit the community as a condition of initial and continued registration.

1.2.2. Incorporated business structures

1.2.2.1. Registered company

The Companies Act 2006 (CA 2006) has consolidated most of the rules of company law, has changed some, and applies across the whole UK. It has been fully in force since October 2009. Like the previous legislation, it provides for the creation of a number of different types of company, the key features of which are outlined here. The Community Interest Company (CIC), which will be discussed more fully in Section **1.2.2.2.** of this chapter, was introduced and continues to be governed by the Companies (Audit, Investigations and Community Enterprises) Act 2004 (C(AICE)A2004).[31]

The company is the most popular form of corporate body for business activity in the UK. 2,778,400 were 'effectively' on the register across the UK on 31 March 2013. 2,771,400, were private limited companies, and only 7,000 were PLCs. This contrasts with a total of 7,578 industrial and provident societies (excluding those registered in Northern Ireland) on the register at the same date.[32]

The key feature shared by all companies registered under the CA 2006 or earlier legislation is corporate personality.[33] Any such company (like an LLP or a co-operative

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[29] FrndSocA 1992, ss 6 and 93 and Sch 4.

[30] FrndSocA 1974, s 84A and Sch 6A inserted by the Friendly Societies Act 1992 and see Section **3.11.** below.

[31] For more information on company law see: *Boyle and Birds' Company Law* (Jordan Publishing, 9th edn, 2014) or Lord Millett and Alistair Alcock (eds) *Gore-Browne on Companies* (Jordan Publishing, 45th edn, looseleaf updated service).

[32] Companies' House, Statistical Tables on Registration Activities 2012/2013 (September 2013).

[33] CA 2006, s 16(2) and (3).

or community benefit society society) is regarded as a separate person at law. As a result it can own assets (legally or beneficially) in its own name, can sue and be sued, can make contracts and appoint agents, and enjoys continued existence until dissolved despite frequent changes in its membership or management. This contrasts with the unregistered general partnership,[34] which has no separate existence for legal purposes (in England and Wales) and so amounts to no more than the individual personalities of the partners. Similarly, the unincorporated association has no corporate personality.[35]

Most registered companies confer limited liability on their members for the debts of the business but it is possible to register an unlimited company.[36] They have to be registered and enjoy separate corporate personality but their members have unlimited liability for business debts. They are not required to make their accounts public and so this structure may be attractive to those seeking privacy.[37]

Limited companies can either be registered as limited by shares or limited by guarantee. A company limited by shares defines the limit on the liability of a member for the business debts by reference to the amount due and not yet paid on the shares held by the member at the point when the company is wound up.[38] In the case of a company limited by guarantee the liability of the member is limited to an amount stated in the company's constitution as payable by each member if the company is wound up and no shares can be issued.[39] Companies limited by guarantee are usually used for social, charitable or other non-commercial purposes and commercial businesses are usually registered as companies limited by shares so that capital may be raised by the issue of shares. This, however, is a matter of practice and the CA 2006 does not lay down any restrictions on the use that can be made of a company based on its status as limited by shares, or by guarantee, or unlimited.

Another key division between types of company relates to the way they raise capital. All companies are classed as either public or private. A public company (PLC) is a company limited by shares whose certificate of incorporation states that it is a PLC and that was registered or re-registered as a public company in accordance with CA 2006.[40] Every other company is a private company.[41] A company need only have one member.[42]

A public company must comply with a minimum capital requirement before it is allowed to do business and is permitted to offer its shares and other securities to the public. A private company is subject to no minimum capital requirement and is prohibited from offering its securities to the public.[43] A public company must end its name with 'public limited company', or 'PLC'.[44] A private company, unless it gains exemption, must end its name with 'limited' or 'Ltd'.[45] A PLC also registered as a CIC must use 'community

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34 See Section **1.2.1.2.**
35 See Section **1.2.3.1**.
36 CA 2006, s 3(4).
37 CA 2006, s 448.
38 CA 2006, s 3(2).
39 CA 2006, ss 3(3) and 5.
40 CA 2006, s 4(2) and (3).
41 CA 2006, s 4(1).
42 CA 2006, s 7(1).
43 CA 2006, ss 755–767.
44 CA 2006, s 58.
45 CA 2006, ss 59–60.

interest PLC' or 'community interest public limited company' while a private company also registered as a CIC must use 'community interest company' or 'cic'.[46]

While all PLCs are allowed to raise capital by a public offering of shares or other securities, only some PLCs choose to do so. Of those, only some have securities traded on a public market and even fewer have securities listed on the London Stock Exchange. Thus within the category of PLCs only some are 'quoted companies' with equity shares officially listed on the LSE, in another EEA member state, or on the New York Stock Exchange or Nasdaq.[47] The level of regulation applicable to companies broadly increases with the move from private company to PLC and on to 'quoted company'.

In the absence of objections by a certain proportion of shareholders, private companies can use written resolution procedures rather than calling meetings for members' decisions and need not hold an AGM. They can also benefit from more relaxed rules about the preparation of publicly available accounts and on audits if they qualify as small or medium-sized private companies. However, there is usually some requirement, even for a private company, to submit an annual accounts and reports to the registrar of companies. Parts 13, 15 and 16 of CA 2006 set out the detail of these rules and the exemptions.

The Listing Rules, applicable to companies with securities admitted to trading on a regulated market, impose even more onerous requirements about publicity of information, shareholder involvement in decision-making, and corporate governance.[48]

The precise rights and duties of company members, whether shareholders in a company limited by shares or simply members of a company limited by guarantee, are defined in the company's articles of association. Since October 2009, this is the only governing document for a company but for companies already registered at that date, the provisions of the memorandum of association which was formerly required are read as part of the articles.[49]

While most companies limited by shares will confer votes according to the number of shares held by the member, that is not legally required and one member one vote could be laid down as the rule in the articles as it normally is in a company limited by guarantee.[50] However, anyone using a company limited by shares for a co-operative or community benefit business would probably be concerned to entrench key provisions of the articles to prevent or restrict change by later members (see Section **1.3.4.** below).

Companies usually have a board of directors and a members' general meeting as the core of their governance structure and this is assumed in Parts 8 and 10 of the Companies Act 2006. However, it is possible within the limits of the mandatory requirements of the Act, for the company's articles of association to vary the allocation of powers to the different organs of the company and even to vary the number of organs.

A company can be used either to carry on a business or for some other purpose. In practice, it is common for a company limited by guarantee to be used where the purpose

46 C(AICE) Act 2004, s 33.
47 CA 2006, s 385.
48 See *FCA Handbook, Listing Rules* at http://fshandbook.info/FS/html/handbook/LR/ (last visited 22 April 2014).
49 CA 2006, s 28.
50 CA 2006, s 284.

is not commercial but this is not a legal requirement. As is noted below, the CIC is specifically intended for use for non-charitable and non-political community benefit purposes and such a company can be a PLC or a private company. If private, a CIC can be limited either by shares or by guarantee.

So the Companies Act 2006 provides one route for the incorporation of an association formed to pursue a non-commercial purpose whether as a members' club, a religious, political or social campaigning organisation, or for charitable objects.[51]

1.2.2.2. CIC

A Community Interest Company (CIC) is a company limited by shares (PLC or private company) or by guarantee that is either formed as or becomes a CIC in accordance with Part 2 of the C(AICE)A 2004. The Companies Act 2006 applies to CICs but subject to Part 2 of the 2004 Act.[52]

The key feature of a CIC is that it must satisfy additional registration conditions that seek to lock its assets in to serving its non-charitable and non political community benefit objective. A CIC's compliance with the C(AICE)A 2004 and the Regulations made under it is policed by the CIC Regulator who operates within the Department for Business Innovation and Skills (BIS).

The key sources of legal rules governing CIC's over and above Part 2 of the C(AICE)A 2004 are the Community Interest Companies Regulations 2005, SI 2005/1778 as amended in 2009 and 2012 by SI 2009/1942 and SI 2012/2335 respectively. In addition, extensive guidance has been published by the regulator on its website.[53]

To register as a CIC a company must, in addition to satisfying the other requirements for registration as a company, obtain the approval of the CIC Regulator.[54] That approval will depend on the Regulator being satisfied that the company meets the 'community interest test' and is not an 'excluded' company.[55]

The community interest test is laid down in s 35(2) of C(AICE)A 2004 and requires that 'a reasonable person might consider that its activities are being carried on for the benefit of the community'. SI 2005/1778 elaborates the test by excluding activities that a reasonable person might consider to promote or oppose changes to the law or to public policy, support a political party or political campaigning organisation or influence voters unless that activity can be seen as incidental to other activities for the benefit of the community. Equally, an activity that only benefits members or employees of a particular body will not qualify.[56]

Excluded companies include political parties or political campaigning organisations and their subsidiaries.[57]

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[51] For a detailed analysis of companies Limited by Guarantee see: M Mullen and J Lewison *Companies Ltd by Guarantee* (Jordan Publishing Ltd, 3rd edn, 2011). On CICs see Section **1.2.2.2.** below.

[52] CA 2006, s 6.

[53] See https://www.gov.uk/government/publications/community-interest-companies-how-to-form-a-cic.

[54] C(AICE)A 2004, s 36.

[55] C(AICE)A 2004, s 36(5).

[56] SI 2005/1778, regs 3 and 4.

[57] SI 2005/1778, reg 6.

While a CIC may have charitable objects, it will not be regarded as a charity for legal purposes and so cannot register with the Charity Commission or enjoy any of the tax or other advantages that flow from that status.[58]

As part of securing the 'asset lock' on a CIC, the legislation caps distributions to members of dividend on any shares and the payment of interest.[59] Distributions of assets on any winding up and conversions of a CIC into another type of corporate body are also restricted and regulated.[60]

The annual report that must be made to the CIC Regulator is intended to provide an indication of how far a CIC may have deviated from activities within its objectives or breached limits on dividends, interest and remuneration. It must include details of directors' remuneration, dividends paid on shares, interest paid on capped loans and information on community benefit and stakeholder involvement in the CIC.[61]

The CIC regulator has extensive powers to supervise, investigate, change directors, manage CIC property, bring civil proceedings and petition to wind up a CIC.[62]

In December 2013 there were a total of 8,784 CICs approved and regulated by the CIC Regulator.[63]

1.2.2.3. Limited liability partnerships (LLPs)

LLP's were introduced by the Limited Liability Partnerships Act 2000 (LLPA 2000). This business structure is popular with many professionals such as solicitors and accountants. It shares the main features of the general unregistered partnership such as the assumption that all partners will take part in management, the other main default rules to be found in the 1890 Act model and the freedom of the partners to agree their own rules.

However, the LLP has a corporate personality separate from that of its members and the partners enjoy limited liability for the business debts other than for liabilities arising from their own torts. As a result, an LLP can be created only by registration and the disclosure rules about company accounts and financial information broadly apply to the LLP. In effect, this structure offers most of the features of a limited company except the use of share capital. However, the default model for its governance is that found in the PA 1890. The LLP is taxed in the same way as an unregistered general partnership rather than as a company.[64]

The LLP provides the organisational flexibility of a partnership without the drawback of unlimited liability for partners (called members in an LLP) and provides a corporate entity that can hold property, sue and be sued and continue to exist despite changes of membership. The law applicable to LLP's is mainly to be found in a great swathe of

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58 C(AICE)A 2004, s 26(3).
59 C(AICE)A 2004, s 30 and SI 2005/1778, regs 17 to 25.
60 C(AICE)A 2004, ss 31 and 52–56 and SI 2005/1778, regs 7 and 8 and para 1 of Schs 1 and 2 as amended.
61 C(AICE)A 2004, s 34 and SI 2005/1778, regs 26 to 29 as amended.
62 C(AICE)A 2004, ss 41–51 and SI 2005/1778, regs 30–33 of as amended.
63 Regulator of Community Interest Companies, Third Quarter Report, p 11 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/279580/CIC14605-community-interest-companies-operational-_report-_third-_quarter-_2013–14.pdf.
64 Corporation Tax Act 2010, ss 59–61.

statutory instruments as the LLPA 2000 provides only an outline of the structure and leaves most detailed rules to be created by secondary legislation.

An LLP is a corporate body separate from its members with unlimited capacity.[65] Its debts are not those of its members. Members have limited liability for the LLP's debts.[66] They are, however, personally liable for their own torts (including negligence) on the basis of a court's analysis of whether the tort was committed by the member or the LLP.[67]

Members can be liable to contribute on the winding up of an LLP on the basis of wrongful or fraudulent trading as applied to LLP's.[68] In addition, they can be liable to do so on the basis of an agreement between LLP members or between a member and the LLP.[69]

An LLP is formed by filing an incorporation document with the Registrar of Companies signed by two or more persons 'associated for carrying on a lawful business with a view to profit'.[70] The document must state the name of the LLP with the suffix LLP or Welsh equivalent, the address of its registered office, details of the initial LLP members and which of them are 'designated members'.[71] Designated members are responsible for signing and delivering accounts, appointing an auditor and similar statutory roles and any change to the designated members must be registered.[72]

In addition, the members must have an express or implied agreement about the mutual rights and duties of LLP members and their rights and duties in respect of the LLP but there is no requirement to make that document public by registration.[73]

Like partners in a general unregistered partnership, members are agents for the LLP, so they can make contracts that are binding on the LLP as a corporate body.[74] However, because the LLP has corporate personality and members enjoy limited liability this will have fewer potentially adverse consequences for other partners.

After incorporation, the LLP, like a company, must notify the registrar of changes of name, registered office or members, file accounts and register any charge over its assets.[75] The duties to file annual returns and other accounting information are similar to those applicable to companies and are mainly dealt with in the LLP (Accounts and Audit) (Application of Companies Act 2006) Regulations 2008 SI 2008/1911.

The other question about LLPs is how their internal governance and relationships work. Essentially that is a matter for the LLP agreement and its provisions will prevail. The mutual rights and duties both of the LLP members to each other and of each of them to

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65 LLPA 2000, s 1.
66 LLPA 2000, s 1(4) and (5).
67 See *Williams v Natural Life Health Foods Ltd* [1998] 1 WLR 830 HL on the similar position of company directors.
68 Insolvency Act 1986, s 214A.
69 Insolvency Act 1986, s 74 as applied by LLP Regulations 2001, SI 2001/1090, Sch 3.
70 LLPA 2000, s 2(1).
71 LLPA 2000, s 2(2).
72 LLPA 2000, s 6.
73 LLP Regulations 2001, SI 2001/1090, reg 2.
74 LLPA 2000, s 6.
75 See generally LLP (Application of Companies Act 2006) Regulations 2009, SI 2009/1804.

the LLP as a corporate body are as they have been agreed.[76] However, as in the case of an unregistered general partnership, there are certain default provisions which apply in the absence of agreement to the contrary. They are set out in LLP Regulations 2001, SI 2001/1090 and are similar to those applicable under the Partnership Act 1890:

- profits and losses are shared equally between members;[77]
- members are not entitled to remuneration before profits are calculated;[78]
- every member has a right to take part in the management of the business;[79]
- decisions are made by simple majority of the members except admitting a new member or changing the nature of the firm's business which both need unanimous agreement;[80]
- every member must share accounts and full information about anything affecting the limited liability partnership with any other member or her legal representatives;[81]
- the limited liability partnership must indemnify any member for payments made and personal liabilities incurred in the ordinary and proper conduct of the LLP's business or in doing anything necessary to preserve of the LLP's business or property;[82]
- if a member, without the consent of the LLP, carries on any business competing with the LLP, she must pay all profits to the limited liability partnership;[83]
- every member must account to the LLP for any benefit she derives, without the consent of the limited liability partnership, from any transaction concerning the limited liability partnership, or from any use by her of the LLP's property, name or business connections;[84]
- there is no power to expel a member unless expressly agreed;[85]
- all members can access to the firm's books and accounts at any time.[86]

An LLP is subject to company insolvency rules and procedures such as administration, winding up, and creditors' voluntary arrangements. The Company Directors Disqualification Act 1986 also applies.[87]

On 31 March 2013 there were 53,583 LLPs registered under the LLP Act 2000 on the register across the whole United Kingdom.[88]

1.2.2.4. Limited partnerships (LPs)

LP's have existed since the Limited Partnerships Act 1907 became law. The structure is little used except as an investment vehicle. It is particularly favoured by private equity

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76 LLPA 2000, s 5(1).
77 SI 2001/1090, reg 7(1).
78 SI 2001/1090, reg 7(4).
79 SI 2001/1090, reg 7(3).
80 SI 2001/1090, reg 7(5) and (6).
81 SI 2001/1090, reg 7(8).
82 SI 2001/1090, reg 7(2).
83 SI 2001/1090, reg 7(9).
84 SI 2001/1090, reg 7(10).
85 SI 2001/1090, reg 8.
86 SI 2001/1090, reg 7(7).
87 LLP Regulations 2001, SI 2001/1090, regs 4(2) and 5.
88 Companies' House, Statistical Tables on Registration Activities 2012/2013, September 2013.

funds and other venture capitalists. Before 2003, the structure was also frequently used to hold agricultural tenancies in Scotland, where LPs have corporate personality (see generally Morse *Partnership Law* Chapter 9).

A limited partnership is created by registration with the registrar of companies but does not have corporate personality in England and Wales. It must have at least one general partner who has unlimited liability for the debts of the partnership as is the case in an unregistered general partnership but may also have one or more limited partners who are not liable for the business debts beyond the amount that they contributed to the firm at the time of joining it. If a limited partner takes part in the management of the partnership business (beyond gaining information about the state and prospects of its business and discussing that with the other partners) he or she is liable in the same way as the general partners for any debts incurred during the time of his or her participation in management.

It is important to note that, because corporate bodies can be partners in any kind of partnership, the unlimited partners in a limited partnership could be companies or societies. No human being would then be faced with unlimited liability.

Apart from those special features, the rules governing limited partnerships are generally those that govern unregistered general partnerships. In 2009, the Legislative Reform (Limited Partnerships) Order 2009, SI 2009/1940 amended the 1907 Act to impose formal requirements about both the permitted use of names by LP's and the registration process. SI 2009/2160 prescribed forms to be used in that process.

On 31 March 2013 there were 23,828 LPs under the Limited Partnerships Act 1907 on the register across the whole United Kingdom.[89]

1.2.2.5. Incorporated friendly society

Friendly societies are member owned mutuals without investor shareholders which operate on the basis of one member one vote and share surplus among their members by way of benefits. From the 1980s onwards, the deregulation of the market in financial services and the changing structures for the regulation of the banking and insurance industries at both EU and UK level led to legislative reform for friendly societies with the Friendly Societies Act 1992 (FrndSocA 1992*)*. This permits larger friendly societies to incorporate and so use subsidiaries to carry on a wider range of business activities than those that remain unincorporated.

Registration under the 1992 Act is possible either for those establishing a new society or for existing unincorporated friendly societies registered under the Friendly Societies Act 1974. Like registration under the 1974 Act before that possibility was removed, registration under the 1992 Act is permitted only if the society is to be limited by its constitution to carrying on business within a limited range of activities: offering insurance and other discretionary benefits to members and those connected with them.[90]

Registration is with the FCA as registrar and that process and the structure of societies as well as their governance, amalgamation or reorganisation, the content and alteration

[89] Companies' House, Statistical Tables on Registration Activities 2012/2013, September 2013.
[90] FrndSocA 1992, s 1(2) and Schs 2 and 5.

of society rules, limited liability of members, name, registered office, contractual capacity, winding up and dissolution are all governed by the Friendly Societies Act 1992.

As insurers, friendly societies are also subject to prudential regulation by the PRA and the FCA under the Financial Services and Markets Act 2000 and Financial Services Act 2012. They are subject to similar regulatory requirements to other insurers and, at the time of writing, particular applications of those rules could be found in the Interim Prudential Sourcebook for Friendly Societies.[91]

1.2.2.6. Building society

Building societies are member-owned mutuals that operate on the basis of one member one vote and share surplus among their members by way of benefits. They developed from societies formed to assist people in building their own homes but most building societies now lend to members to permit them to buy homes and have two classes of member: savers and borrowers. They are registered under the Building Societies Act 1986 (BSA 1986), which lays down a full regime for them.

Like friendly societies, building societies must limit themselves to certain particular types of business, principally making loans secured on residential property and funded by their members.[92] They are subject to statutory funding and lending limits and limits on their powers to engage in various trading activities.[93]

For building societies their incorporation, constitution, governance, amalgamation or reorganisation, the content and alteration of their rules, the limited liability of members, the society's name, registered office, contractual capacity, and winding up and dissolution are all governed by the Building Societies Acts 1986 and 1997.

In addition, building societies are regulated by the PRA under the banking regulation regime and the FCA in respect of consumer protection under the Financial Services and Markets Act 2000 and the Financial Services Act 2012. At the time of writing the main specialist source book applying regulatory rules to building societies was the Building Societies Sourcebook BSOCS[94] which focuses on prudential issues. Building Societies are also subject to FCA regulation on issues about business standards and aspects of regulated mortgage lending.[95]

1.2.2.7. Co-operative and community benefit societies compared

A co-operative or community benefit society, like other incorporated structures, enjoys the benefit of corporate personality and gives its members the benefit of limited liability for business debts.

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91 See http://media.fshandbook.info/Handbook/IPRU-FSOC_Full_20140101.pdf.
92 BSA 1986, s 5(1).
93 BSA 1986, ss 6 to 9.
94 http://fshandbook.info/FS/html/handbook/BSOCS/1/1.
95 See Mortgages and Home Finance Conduct of Business Sourcebook MCOB at http://fshandbook.info/FS/html/handbook/MCOB.

Like companies limited by share, but unlike the LLPs, LPs and companies limited by guarantee, co-operative and community benefit societies can issue share capital providing the return to holders of shares is limited.[96]

They share the feature of limited returns to investors with CICs. However, unlike CICs, co-operative or community benefit societies can issue withdrawable shares and enjoy certain exemptions from the regulation of share issues.[97]

The CIC structure, like community benefit societies, can only be used for altruistic purposes and a community benefit society can choose to subject itself to an 'asset lock', which resembles some of the rules that apply to all CICs.[98] A co-operative society, on the other hand, is typically set up to pursue the interests of its members.

Unlike incorporated friendly societies and building societies, co-operatives and community benefit societies can pursue any form of business they choose providing a society that has withdrawable shares does not carry on the business of banking.[99] Co-operatives and community benefit societies other than credit unions (see **Chapter 13**) are not confined to a particular type of business, such as insurance or financial services.

The key feature of co-operatives and community benefit societies is the obligation to meet the registration requirements that define them.[100] Failure to do so empowers the FCA: to refuse to register the society; to refuse to register a rule amendment; or to cancel the society's registration.[101]

1.2.3. Structures not mainly used for businesses

1.2.3.1. Unincorporated association

An unincorporated association is an association set up by a group of people for some purpose other than carrying on a business. It is not incorporated either as a company or under any other legislation and so has no legal personality separate from its members. Like an unregistered general partnership, an association is governed by the law of contract, trust law and agency law. The rules of the association will define the rights and duties of the members between themselves and agency law will determine who has authority to make contracts and whether this is done on behalf of all the members or only on behalf of the committee or officers of the association.

This has been expressed judicially by Lawton LJ in *Conservative and Unionist Central Office v Burrell*:[102]

> 'two or more persons bound together for one or more common purposes, not being business purposes, by mutual undertakings each having mutual duties and obligations, in an organisation which has rules which identify in whom control of it and its funds rest and on what terms and which can be left or joined at will.'

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96 See Section **3.4.** and **Chapter 8** below.
97 See **Chapter 8** below.
98 See Sections **1.2.2.2.**
99 CCBSA 2014, s 67.
100 See **Chapter 3**.
101 **Chapters 3**, **4** and **12** below.
102 [1982] 1 WLR 522 at p 525 quoted by Warburton (below) at p 2.

It is by the use of the rules of the association, analysis of the facts of the particular case and the application of agency rules about express or implied agency authority that the possible liability of members, committee members or officers on contracts is determined. In the absence of explicit agreement, only the committee members and officers are likely to be bound by contracts and the other members will be free of the contractual obligation.[103] A similar process, with the application of principles such as vicarious liability linked to the rules defining individual status as a tortfeasor, will determine tort liability.

Since the association can have no corporate personality, property will either be held by individuals or corporate bodies. It may be held on trust for the membership or the association's purposes or directly by the members, depending on the evidence about contractual arrangements and intentions of the parties, the application of property law rules, and whether or not any trust, charitable or otherwise, is found to exist on the facts.[104]

Many practical issues can arise if this legal structure is used, especially if there is no express or implied agreement among the members about them. If there are clear agreed rules in a constitution they will be followed. In their absence and without evidence of agreement among the members on an issue the default position will be determined by case law.

For example, the objects of an association are important to the relationship between members as a member using assets outside their scope could be liable to the other members to repay funds misspent.[105] A member contracting beyond the objects with an outsider will be personally liable on the contract as she acted without the authority of the other members and so was not their agent. Similarly, unanimous agreement by all members will be needed to change the rules or constitution unless a procedure for amendment by a majority has been agreed in the rules and there is no power to expel a member unless that has been explicitly agreed. Contracts of employment, with all the potential liabilities they can cause, may be with all members, or the committee, or individual members depending on the application of the agreement between the members and the law of agency.

For these reasons, it is vital to consider the use of an unincorporated association carefully and to ensure that a clear, comprehensive, and well-drafted set of rules is agreed and regularly reviewed. For those reasons, this is only an appropriate legal structure for simple organisations with few potential risks and liabilities.[106]

1.2.3.2. Trust

Trusts are not normally seen as business structures and are not usually associated with organisational structures of any other kind. The trust device often operates in an unincorporated structure so that property held in the name of certain people or corporate bodies is held on behalf of others. Some of the partners in an unregistered

[103] *Wise v Perpetual Trustee Co* [1903] AC 139.
[104] See, for example, *Hanchette-Stamford v A-G* [2008] EWHC 330 (Ch).
[105] *Taylor v NUM* [1985] BCLC 237.
[106] For more information on the law of unincorporated associations, see Jean Warburton *Unincorporated Associations: Law and Practice* (Sweet and Maxwell, 2nd edn, 1992) and David Ashton and Paul W Reid *Ashton and Reid on Clubs and Associations* (Jordan Publishing, 2nd edn, 2011).

general partnership or some members of an unincorporated association may be registered as legal owners of property but in fact hold it on trust for all the partners or members. In those circumstances, the person holding the legal title to the property is a trustee and all the partners or members are beneficiaries of the trust. The terms of the trust define the rights of the beneficiaries on the basis of express or implied agreement between the partners or members and the underlying rules and principles of the law of trusts and equity. It is outside the scope of this book to examine those rules in any detail.

However, in some circumstances, the trust device can be used alone or in conjunction with other legal devices to dedicate assets, including the ownership of an ongoing business, to a particular purpose or the benefit of a particular group of people. In those cases the trust device is being used to achieve similar results to the registration of a co-operative or community benefit society.

This may be illustrated most clearly by considering two organisations that use this technique: Guardian Newspapers Ltd and The John Lewis Partnership, the UK's best-known employee-owned business.

1.2.3.2.1. The Scott Trust and the Guardian

From 1872 to 1929 CP Scott served as editor of the *Guardian* newspaper. From 1907 he owned it. After his death his surviving son John inherited the newspaper, and transferred all the assets to the Scott Trust. He intended to ensure continuity of purpose and editorial independence. Until 2008, the Trust operated under a deed of 1948. It owned the Guardian Media Group plc, a multimedia holding company created in 1993 as successor to the Guardian and Manchester Evening News plc. Thus the trust structure was used to own the PLC that ran the business and ensure that it was run so as to further the trust's objectives: 'To secure the financial and editorial independence of the Guardian in perpetuity; as a quality national newspaper without party affiliation; remaining faithful to its liberal tradition; as a profit-seeking enterprise managed in an efficient and cost-effective manner.'[107]

In 2008, the Scott Trust incorporated but its corporate constitution enshrines the values and purpose of the Guardian and The Scott Trust Limited is the parent of GMG, the operating company. The core purpose of The Scott Trust Limited cannot be altered or amended. The company is not permitted to pay dividends, and its constitution has been drafted to ensure that no individual can ever personally benefit from the arrangements. In the event of winding up, the assets of the company would be transferred to some other entity which has a similar purpose.[108]

This use of a combination of corporate and trust structures seeks to ensure the continuation of a commercially viable business dedicated to a particular purpose. There is an obvious parallel with the nature of a community benefit society or a CIC but, instead of using an available 'off-the-shelf' structure, a bespoke arrangement has been designed.

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[107] http://www.theguardian.com/newsroom/story/0,11718,658482,00.html.

[108] See http://www.pressgazette.co.uk/node/42189 and http://www.gmgplcco.uk/the-scott-trust/.

1.2.3.2.2. The John Lewis Partnership

This well-known UK retail business uses a combination of a trust mechanism and corporate structures to establish a subtle and finely balanced governance system which seeks to combine business efficiency in the market place with democratic employee involvement and financial benefit. Basic information on the John Lewis Partnership structure can be found at http://www.johnlewispartnership.co.uk/about/the-partnership.html on which this account of them is based. The business is not a partnership in the technical legal sense of the word but rather a collaborative relationship among the employee co-owners in their joint interests. The partners, as they are known, enjoy bonuses of a proportion of salary depending on the performance of the business.

The structure was established when the owner of the business decided to hand it over to the employees in the 1920s and created a trust to do so. Currently, the John Lewis Partnership Trust Ltd, a private company formed in 1950, whose objects are to uphold the partnership constitution and the employee benefit objectives of the trust, controls the PLC carrying on the business. The voting rights attached to the only two classes of voting shares in the company, ensure that a majority of votes on crucial decisions are held by trustees who are bound to exercise their votes in pursuit of the trust objectives and maintenance of the partnership constitution. Crucial decisions include changing the voting rights or winding the company up, and all decisions made by the company general meeting during an interregnum after the removal of a chairman by the Partnership Council – a key mechanism backing up the Chairman's accountability to the employee partners.[109]

The governance practice of the Partnership, within this legal framework follows the Listing and Disclosure and Transparency Rules and the UK Corporate Governance Code applicable to listed companies, despite the fact that the Partnership's companies are not listed or bound to follow those rules. The Partnership constitution consists of principles and rules that respectively set out its purpose and policies. The duty to uphold it is a key element in the objects of the trust company.[110]

The key top-level governing bodies are the Partnership Council, the Partnership Board and the chairman. The council is 80% elected by secret ballot every three years by the partners, all of whom can vote in the elections or stand for election. The elections are based on one or two representatives from each local constituency, the detail being decided by the trustees. Remaining council members are appointed by the chairman, often from people holding posts such as director of communications, director of legal services or company secretary. The intention is to provide the council with specialist knowledge but their presence, together with that of the board members who are automatically council members, also ensures full participation by senior management. The council meets at least four times a year and the chairman attends and reports to it twice a year. It is the council that has the power to remove the chairman. There are also divisional regional and local democratic bodies composed of partners. Together, these bodies are intended to hold management to account.

The Partnership Board manages commercial activities. Its members include the chairman, five directors appointed by him or her, five elected by the Partnership Council

[109] Articles of Association of John Lewis Partnership Trust Ltd.
[110] http://www.johnlewispartnership.co.uk/about/our-constitution.html.

and three non-executive directors. It is thus linked to the Partnership Council, partly by a partners' counsellor whose remit is to uphold the values, ethics and integrity of the business as set out in the constitution. The counsellor sits on the partnership board and convenes meetings of the elected directors from which executive directors are excluded as appropriate and at least once a year.

The Chairman's Committee consists of the chairman and the board members appointed by him or her plus the partners' counsellor. It meets frequently and informally to develop strategy, business plans and budgets and to review operational and management issues including results, forecasts and proposals.

Separate divisions such as John Lewis and Waitrose are managed day to day by divisional management boards, which are accountable to the chairman for performance but are also held to account by their own divisional partners' councils.

This structure illustrates the use of the trust mechanism and also represents an intricate set of organs that have separate roles of democratic representation and business management but that link together both at the apex (in the Partnership Board) and at divisional level with the divisional councils.

The values and purposes enshrined in the constitution and the trust objectives are fully legally secured and worked out institutionally. In addition, the partnership councils are forums for questions and concerns from the employee owners and the whole organisation is served by the *Gazette*, an internal newspaper where partners can raise issues and suggest ideas. At the time of writing, the organisation enjoys significant commercial success while maintaining its identity as a values-based employee-owned business.

1.2.3.3. Charitable incorporated organisation (CIO)

CIOs are governed by Part 11 of the Charities Act 2011 (ChA 2011) and the Charitable Incorporated Organisation (General) Regulations 2012, SI 2012/3012 and have been available for use since 2 January 2013. Full information about this new legal structure can be found on the Charity Commission website.[111]

A CIO is registered with the Charity Commission as a charity and also a body corporate with a constitution (which includes its name and purpose) and a principal office in England and Wales.[112] At the moment of registration any property held by the applicants on trust for the CIO's charitable purposes vests in it and it gains corporate personality under the name stated in the constitution with the applicants for registration as its first members.[113] This provides the key advantage of this structure. There is no need for filings with two bodies, such as the Registrar of Companies and the Charity Commission. Both functions are carried out by the Charity Commission. The benefits of corporate personality and limited liability are gained. In a CIO the obligations of charity trustees and the dedication of the assets to charitable objects are both secured.

[111] https://www.charitycommission.gov.uk/frequently-asked-questions/faqs-about-charitable-incorporated-organisations-(cios)/cios-general-information/.
[112] ChA 2011, s 205.
[113] ChA 2011, s 210.

Provision is made in the legislation for the conversion of charitable companies, CICs and community benefit societies into CIOs but this does not apply to a company with any unpaid share capital or to any company or society that is an exempt charity.[114] However, the time of writing (April 2014) no regulations had been made to deal with these conversions and so the conversion procedures were not yet available.

It is possible for CIOs to amalgamate with each other to create a new CIO or to transfer their undertakings to an existing CIO.[115] These reorganisation decisions can all be made by resolution but also require the approval of the Charity Commission.

The constitution of a CIO must deal with other matters and meet the requirements laid down in Part 3 of SI 2012/3012. Amendments to the constitution require either a 75% majority at a meeting of members or unanimity in the absence of a meeting. They do not become effective until registered by the Charity Commission, which may refuse to register them if they violate any legislative requirement, mean that the CIO ceases to be a charity, or are, in the Commission's opinion, otherwise beyond the powers of the CIO. Registration will also be refused if the CIO's name is to be changed to one for which permission would be refused on an initial registration. Constitutional amendments that alter the CIO's purposes or the application of its surplus on dissolution, or provide for some direct or indirect benefit to its trustees require advance authorisation by the Charity Commission.[116]

Requirements about publicity for the name of the CIO and a requirement to make clear that the entity is a CIO by using that description are laid down in ss 211–215 of the ChA 2011.

The CIO can have one or more members and they can either have no liability to contribute to the CIO's assets on its winding up or limited liability up to a maximum amount as defined in its constitution.[117] The constitution will also lay down rules about eligibility for membership of the CIO and the selection and qualifications of trustees, whether or not the trustees must or can be members and whether or not the trustees and membership are to be identical.[118] This indicates the possible use of the CIO structure as a 'foundation' with perhaps a single corporate or individual member or a 'membership' model with many members and trustees who may be elected by them. In each case the CIO can only operate within the limits imposed by its charitable objects, its constitution, and the requirements of charity law.

The constitution must state how the CIO's property is to be applied if it is dissolved.[119] Other rules about the winding up, insolvency, and dissolution of a CIO are laid down in SI 2012/3013 made under s 245 ChA 2011, which applies a modified version of the Insolvency regime to be found in the Insolvency Act 1986 and empowers the Charity Commission and the Official Custodian to deal appropriately with the CIO's property. They also deal with the restoration of a CIO to the register.

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[114] ChA 2011, ss 228–234.
[115] ChA 2011, ss 235–244.
[116] ChA 2011, ss 224–227.
[117] ChA 2011, s 205.
[118] ChA 2011, s 206.
[119] ChA 2011, s 206(2)(c).

1.2.3.4. Co-operative and community benefit societies compared

Co-operative and community benefit societies differ from the structures discussed in this section by being intended for use in business and generally being used in that way.[120] That distinguishes both co-operatives and benefit of the community societies from unincorporated associations which by definition have no business purpose.[121] It also distinguishes them from trusts, which are classically not used for business but which can be combined with other corporate structures as in the examples of The Scott Trust and the John Lewis Partnership. The HMRC trading rules applicable to charities, including charitable trusts, CIO's, community benefit societies, and charitable companies restrict trading within the charitable entity.[122]

Community benefit societies can operate as charities, as the CIO does and there is some resemblance between community benefit societies, whether or not they have an asset lock or charitable status, and a trust that dedicates assets to particular purposes or the benefit of particular people.

Co-operative societies can be established and operate to benefit only their members providing they do so as co-operatives. However, societies registered under CCBSA 2014 can generally be converted into companies without continuing their co-operative or community benefit identity if the necessary statutory procedures are followed.[123] The societies whose freedom to convert and lose their identity is restricted are community benefit societies with an asset lock or charitable status and credit unions.[124]

1.3. PROTECTING PURPOSE

1.3.1. Charitable status

A number of tax benefits and regulatory controls apply to bodies which pursue charitable purposes. These apply regardless of the legal form of the body concerned. In addition, the legislation dealing with charities provides the charitable incorporated organisation (CIO), a separate legal structure that can be used by charities as an alternative to the use of the structures referred to above.[125]

A charity in England and Wales is defined in the ChA 2011 as an institution that is established for charitable purposes only and is subject to the charity jurisdiction of the High Court.[126] Section 2 of the Act defines charitable purposes as ones which both fall within a specific list and are for the public benefit. The purposes listed in s 3(1) are:

> '(a) the prevention or relief of poverty;
> (b) the advancement of education;
> (c) the advancement of religion;
> (d) the advancement of health or the saving of lives;
> (e) the advancement of citizenship or community development;

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120 CCBSA 2014, s 2(1).
121 *Conservative and Unionist Central Office* [1982] 1 WLR 522.
122 *HMRC Guidance CC35*.
123 See Section **12.4**. below.
124 See respectively: CCBSA 2014, s 29 and SI 2006/264 and CCBSA 2014, s 151 and Sch 5, para 5; Finance Act 2010, s 30 and Sch 6; and CUA 1979, s 22.
125 See Section **1.2.3.(c)** above.
126 ChA 2011, s 1(1).

(f) the advancement of the arts, culture, heritage or science;
(g) the advancement of amateur sport;
(h) the advancement of human rights, conflict resolution or reconciliation or the promotion of religious or racial harmony or equality and diversity;
(i) the advancement of environmental protection or improvement;
(j) the relief of those in need by reason of youth, age, ill-health, disability, financial hardship or other disadvantage;
(k) the advancement of animal welfare;
(l) the promotion of the efficiency of the armed forces of the Crown, or of the efficiency of the police, fire and rescue services or ambulance services;'

The list also includes any purpose regarded as charitable by the law as it was before the Charities Act 2006 became effective on 1 April 2008 and any purpose that might reasonably be regarded as analogous to or within the spirit of any of the above purposes.[127]

The public benefit requirement cannot be presumed to be satisfied just because one of the detailed purposes applies and the Charity Commission must publish guidance on what will be regarded as being for the public benefit.[128] The guidance is to be considered by the trustees of charities when exercising their powers or duties.

The Charity Commission maintains a register of charities on which every charity must be registered if it has a gross income exceeding £5000 a year and is neither exempted by nor excepted by the Charity Commission or by regulations made by the Secretary of State.[129] Exempt charities are broadly those that are regulated by a body which performs the same function as would be carried out by the charity commission (a 'principal regulator'). Examples include universities and other educational institutions.

Co-operative societies are unlikely to be charities as they benefit their members. Community benefit societies may be charities. All registered societies were previously exempt charities by virtue of being registered under the Industrial and Provident Societies Acts and so regulated by the FCA. That meant that the key advantages of charitable status depended on HMRC recognition of that status without registration with the Charity Commission.

From a date yet to be fixed, charitable community benefit societies (other than registered social landlords[130]) may have to register with the Charity Commission in the same way as is required for a charitable trust, company, or unincorporated association. The logic of this change would be to provide consistent regulation to charities whether they are companies, trusts, unincorporated associations or community benefit societies. The exclusion of registered social landlords from the change ensures that housing associations with charitable objectives only need to comply with the regulatory controls imposed by the housing regulator and the basic registration requirements of the FCA under CCBSA 2014 without also having to meet Charity Commission requirements. This means that, like a company or any other charitable society, they only have to file returns to two bodies.

At the time of writing the position as stated on the Charity Commission website on community benefit societies is:

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[127] ChA 2011, s 3(1)(m).
[128] Ch A 2011, ss 4(2) and 17(1).
[129] ChA 2011, ss 22–33 and Sch 3.
[130] ChA 2011, Sch 3, paras 26 and 27.

> **'Industrial and Provident (Community Benefit) and Friendly Societies including social housing providers:**
>
> This category includes any of the following types of organisations that have exclusively charitable purposes for the public benefit:
> - registered friendly societies
> - industrial and provident societies (community benefit societies)
>
> These organisations are registered with the Financial Conduct Authority (FCA). Many of them are also social housing providers registered with, and regulated by, the housing regulator …
> - no firm decision has been made on the future regulation of community benefit societies and friendly societies as charities. One possibility is that those which are registered social housing providers may remain exempt whilst others may lose their exemption if no suitable principal regulator can be found.'[131]

The Charity Commission has extensive powers of investigation and enforcement and can remove a charity from the register so that it ceases to be entitled to any of the tax benefits available to charities and will no longer be able to refer to itself as a registered charity when trying to raise funds or engaging in any other activities. The Commission can remove charity trustees and, after an investigation, has a wide power to give specific directions to charities about what they are to do. The Commission can order anyone holding the property of the charity to apply it for the charity's purposes and the Commission can grant or deny a certificate authorising an organisation to undertake a charitable collection in a public place or house to house. Local authorities decide whether to grant a permit for a particular collection in a public place. The role of the Charity Commission is intended to ensure the proper use of charitable funds and to provide transparency about the financial affairs of charities so as to maintain public confidence in the sector.[132]

Organisations register as charities partly to be able to raise funds more readily from donors who will have confidence that the assets are to be dedicated to charitable purposes. The role and powers of the Charity Commission give some assurance on that point. However, the tax concessions available to registered charities provide a further incentive for registration. Charities are exempt from tax on most income and gains from investments, estates, land and property. They can arrange to receive bank interest, income from land and royalties paid gross, before tax is deducted and can reclaim tax paid on other investment gains or income. On 'Gift Aided' donations, charities can claim back tax that has been paid by the donor.[133]

VAT need not usually be paid on a charity's fund raising events.[134] In addition, some trading activities carried on by a charity enjoy exemption from income tax or corporation tax. Trading that is part of, or ancillary to, the charity's primary purpose, trading by the charity's beneficiaries and trading with a sales turnover of 25% or less of the charity's total gross income from all sources are exempt.[135] However, many charities set up a separate trading subsidiary to operate a business and pass all its profits to the

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131 Charity Commission Guidance CC23 'Exempt Charities' http://www.charitycommission.gov.uk/detailed-guidance/registering-a-charity/exempt-charities-cc23/ last visited 12 May 2014.

132 The Charity Commission's own outline of its role can be found at http://www.charity-commission.gov.uk/spr/regstance.asp and see Parts 5 and 6 of ChA 2011.

133 See generally http://www.hmrc.gov.uk/charities/tax/advantages.htm.

134 http://www.hmrc.gov.uk/charities/fund-raising-events.htm.

135 http://www.hmrc.gov.uk/charities/trading/tax-exemptions.htm.

charity as a donor. This allows the charity to trade on a more substantial basis purely for fund raising purposes and still gain a tax advantages in respect of the profits.[136]

1.3.2. Trusts

This ancient and elaborate legal mechanism permits assets to be held by one person for the benefit of one or more others and allows for the enforcement by the beneficiaries of the obligations of the trustees who hold the property. Charitable trusts are a variety of trust in which the assets are held for charitable objects rather than specific persons and the objects are enforceable. Such a trust is one way of establishing a charity and so achieving charitable status.[137]

As noted in Section **1.2.3.2.** above, this mechanism can also be used, together with other business structures such as registered companies, to protect a purpose while pursuing a business. In addition to structures of the kind discussed there, a common combination is for a registered charity to hold all the shares in a subsidiary trading company which covenants all its profits up to the owning charity. This overcomes the restrictions placed by the Charity Commission on trading by charities, locks all profits from the trading company in to the charitable purpose and gains the tax advantages of charitable status for the trading operation. This structure is used for the retail shops, commonly known as 'charity shops', that are an important feature of UK High Streets.[138]

1.3.3. Asset locks

The concept of an 'asset lock' is a way of describing a set of legal rules or mechanisms that restrict the uses to which the assets of an organisation can be put both while it is in operation and on its dissolution or transformation into a different legal form. Three types of asset lock are relevant to this book:

- community interest companies;
- community benefit societies; and
- charities.

In each case, the term 'asset lock' is misleading. The assets such as land, goods, or money, can generally be sold, exchanged or otherwise converted freely (subject to the need for prior Charity Commission permission for some assets in the case of charities). However, the obligations of the directors of the CIC or community benefit society or the charity trustees require them to seek to benefit the company, society or charity in such transactions and not to deliberately or negligently dispose of assets at a significant undervalue. This means that it is *the value* rather than the assets that the law seeks to 'lock in'. In each case, the value is locked in to an altruistic purpose. For CICs and community benefit societies, that is 'community benefit'. For charities it is the particular charitable objects listed in the trust deed or corporate constitution.

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[136] For more information on charity law, see Hubert Picarda *The Law Relating to Charities* (Bloomsbury Professional, 4th rev edn, 2010) or Con Alexander *Charity Governance* (Jordan Publishing Ltd, 2nd edn, 2014).

[137] See Section **1.3.1.** above.

[138] For more information on this, see Charity Commission Guidance CC35 at http://www.charitycommission.gov.uk/detailed-guidance/fundraising/trustees-trading-and-tax-how-charities-may-lawfully-trade-cc35/#d1 (last visited 12 May 2014).

All CICs and registered charities are 'asset locked'. In the case of community benefit societies, that is a choice made either on registration of the society or later by amendment of its rules. In a community benefit society without an asset lock, conversion into a co-operative or a company remains possible. Once an asset lock is included in the rules, that is no longer possible unless the community benefit purpose will continue to be served after the conversion, amalgamation or transfer of engagements.[139]

1.3.4. Entrenchment in constitution

1.3.4.1. What is 'entrenchment'?

Asset locks provide assistance from statutory provisions or trust law to limit the possibility of changes to move the organisation away from its founders' intentions. Another technique is to use the constitution of the organisation itself, without that support, to 'entrench' certain provisions. That amounts to an attempt to prevent or make difficult the amendment of the articles of a company or the rules of a co-operative or community benefit society.

There are a number of ways to achieve that including specific provisions in the corporate constitution making parts of it impossible or difficult to change. It is important that the provision that seeks to achieve that is itself entrenched. Techniques of entrenchment include requiring special majorities or the agreement of a particular person (human or corporate) to the change and special procedural requirements. For example, an exceptionally high turnout or a very high majority may be needed for a decision to change certain provisions. The scope for such entrenching provisions may be limited by the legislation governing the particular structure. This section looks briefly at the rules surrounding entrenchment in the constitutions of companies and co-operative and community benefit societies.

A trust mechanism can also be used to support entrenchment in a very legally effective way.[140]

1.3.4.2. Entrenchment in companies

Company articles of association can generally be amended by a special resolution subject, in the case of a charitable company, to the permission of the charity commission for certain changes that might threaten the charitable nature of the company.[141] A special resolution needs a 75% majority of the votes cast.[142]

However, a company's articles can contain a 'provision for entrenchment' to the effect that specified provisions of the articles may be amended or repealed only if certain

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[139] For more detail on these asset locks look in the following places: Community benefit society asset lock: see Sections **4.3**. and **12.6.1**. below; CIC asset lock: see the caps on distributions to members of dividend on any shares and the payment of interest: C(AICE)A 2004, s 30 and SI 2005/1778, regs 17 to 25. The rules on distributions of assets on any winding up and conversions of a CIC into another type of corporate body can be found in C(AICE)A 2004, ss 31 and 52–56 and SI 2005/1778, regs 7 and 8 and para 1 of Sch 1 and 2 as amended; charities: are asset locked by their objects, the duties of their trustees, and the powers of the Charity Commission under ChA 2011, Parts 6 to 10 and 13. In addition, for the CIO asset lock: see ChA 2011, Part 11 and, on dissolution, SI 2012/3013 made under ChA 2011, s 245.

[140] See, for example, the discussion of the John Lewis Partnership in **Section 1.2.3.2.(ii)** above.

[141] CA 2006, s 21.

[142] CA 2006, s 283.

conditions are met or procedures followed that are more restrictive than is the case for a special resolution[143] That includes a condition that the consent of all members is required for a change but not one preventing change by the agreement of all the members or when a court orders a change.[144] Companies House must be notified of the introduction or removal of such a provision and, while the provision is in place, compliance with the provision must be confirmed to Companies House whenever the articles are amended.[145]

If a group wished to fully entrench a provision using those sections, it could add to the permitted entrenchment provision a suitable trust mechanism to effectively prevent change due to the obligation placed on someone whose consent to change was required.

1.3.4.3. Entrenchment in co-operative and community benefit societies

CCBSA 2014 leaves the procedure for changing society rules to those rules but requires them to contain such a provision.[146] Most society rules require a special majority of two-thirds or three-quarters of the members voting in person or by proxy for a rule amendment.[147]

This suggests that there is considerable freedom to entrench particular provisions by requiring certain conditions to be met or procedures to be followed before certain rule amendments are possible. That reflects the contractual nature of society rules and societies' freedom under the legislation to decide their own rules. That freedom is always subject to the FCA's duty to ensure that the society is and remains a co-operative or a community benefit society.

However, for certain decisions, such as transfers of engagements, amalgamations and conversions of societies, CCBSA 2014 lays down statutory requirements about the procedure to be followed, including the majorities required. Society rules cannot change those legal requirements[148]

Subject to those statutory limits on the right to amend society rules, the law generally implements the rules as they are drafted, including any rules making particular amendments difficult or impossible to change or remove. Some further judge made rules may also be relevant. A court may interpret certain rules as so fundamental to the intentions of the founders of the society that they cannot be changed. In addition, members voting on amendments must do so honestly in what they believe to be the interests of the society as a whole.[149]

1.3.5. Limited business capacity

One way of seeking to protect the particular purpose or identity of an organisation is to restrict its activities or the way it carries them out. In some cases legislation effectively

[143] CA 2006, s 22(1).
[144] CA 2006, s 22(3).
[145] CA 2006, ss 23 and 24.
[146] CCBSA 2014, s 14(5).
[147] See Section **4.6** below.
[148] See Sections **12.2 to 12.5**.
[149] See Section **4.4.6**. below.

achieves that. In others, the legal rules governing the capacity of the organisation to contract or act in other ways and the obligation of directors and employees to remain within such limits may assist. This section looks briefly at each approach.

1.3.5.1. Restriction by the law establishing structure

In the context of mutuals, the main examples of this practice are to be found in the financial services sector. Sections **1.2.1.3.**, and **1.2.2.5.** and **1.2.2.6.** outline the position of building societies and friendly societies. **Chapter 13** deals with credit unions at greater length.

This technique, in each case, mandates the organisations using the structure to maintain their mutual character and to limit their activities to transactions with members either wholly or in part. Since 2001 all three types of organisation have been subjected to the regulatory regime applicable to equivalent financial services businesses. Before that, the Building Society and Friendly Society Commissions carried out the regulatory role specifically for those societies, alongside the registration function. Credit unions have, since the 2001 abolition of the Registrar of Friendly Societies, experienced the removal of specific rules and limitations from the CUA 1979 and their replacement with more flexible principles expressed in rules and guidance from, first, the FSA and, since 2013, the PRA in the CRED and then CREDS sections of their Handbooks.

1.3.5.2. Corporate capacity generally

Historically, corporate bodies were restricted to carrying on activities mentioned in the objects clause of the corporate constitution. This represented the Victorian judges' attempt to ensure that resources were devoted only to activities envisaged by founders.[150] However, during the twentieth century a combination of drafting techniques applied by those writing constitutions and gradual law reform made this 'ultra vires approach' almost wholly ineffective outside the public sector where it could have serious consequences.[151]

In the case of registered companies, the modern law gives non-charitable companies unrestricted objects unless the constitution specifically restricts them.[152] Co-operative and community benefit societies are still required to state their objects in their rules.[153] However, the validity of acts of non-charitable companies with restricted objects and non-charitable societies cannot be called into question on the ground of lack of capacity because of any provision in the constitution.[154] A violation of restrictions in the corporate constitution can, however, result in liability on the part of directors or committee members.[155] **Chapter 11** deals with this issue for societies and similar rules apply to building societies.[156] The protection for those dealing with incorporated friendly societies is more limited but they are protected from the full rigour of the nineteenth century ultra vires doctrine.[157]

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[150] *Ashbury Railway Carriage Company v Riche* (1875) LR 7 HL 653.
[151] See *Hazell v Hammersmith and Fulham LBC* [1992] 2 AC 1.
[152] CA 2006, s 31(1).
[153] CCBSA 2014, s 14 para. 2.
[154] CA 2006, s 39 and CCBSA 2014, s 43(1).
[155] CA 2006, ss 40 and 41 and CCBSA 2014, ss 43–49.
[156] BSA 1986, s 5(8) and Sch 2, paras 16–18.
[157] FrndSocA 1992, s 8.

The result of this legal position is that, outside the area of charities, the enforcement mechanisms available for actions outside restricted corporate objects are usually wholly internal and will not generally be available to set aside acts involving outsiders who had no knowledge of the violation of the corporate constitution.

In the case of partnerships, the question of corporate capacity does not arise because general unregistered partnerships and limited partnerships are not corporate bodies and LLPs have unrestricted objects.[158]

1.3.6. FCA role for co-operative and community benefit societies

Sections 3.4. and **12.7.** explain that, for co-operative and community benefit societies, the key restraints on acting outside the corporate purpose are the registration requirements and the power of the FCA to refuse or cancel registration.

1.4. CO-OPERATIVE AND COMMUNITY BENEFIT SOCIETY LEGISLATION IN 2014

The main subject matter of this book is co-operative and community benefit society law. This short section outlines the main sources of the current law and deals briefly with their commencement dates, territorial extent and some of the transitional provisions.

1.4.1. Sources of law

The main legislation is the Co-operative and Community Benefit Societies Act 2014 (CCBSA 2014).

That Act repealed and consolidated most of the legislation that governed societies before CCBSA 2014 came into effect. The Consolidating Bill was produced by the Law Commission which also produced a memorandum justifying the few substantive changes and a table of derivations.[159]

Main Statutes consolidated:

- Industrial and Provident Societies Act 1965
- Industrial and Provident Societies Act 1967
- Friendly and Industrial and Provident Societies Act 1968
- Industrial and Provident Societies Act 1975
- Industrial and Provident Societies Act 1978
- Industrial and Provident Societies Act 2002
- Co-operative and Community Benefit Societies Act 2003
- Co-operative and Community Benefit Societies and Credit Unions Act 2010, ss 1, 2 and 4.

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[158] LLPA 2000, s 1(3).

[159] General information on the consolidation process is available at http://lawcommission.justice.gov.uk/areas/consolidation.htm. For more specific information on the Co-operative and Community Benefit Societies Bill visit: http://lawcommission.justice.gov.uk/areas/co-operative_community_benefit_societies_bill.htm.

Main statutory instruments consolidated:

- Industrial and Provident Societies (Increase in Deposittaking Limits) Order 1981, SI 1981/394
- Deregulation (Industrial and Provident Societies) Order 1996, SI 1996/1738, arts 3 to 5, 7 to 9 and 12
- Financial Services and Markets Act 2000 (Mutual Societies) Order 2001, SI 2001/2617, Sch 3, paras 214 to 263
- Friendly and Industrial and Provident Societies Act 1968 (Audit Exemption (Amendment) Order 2006, SI 2006/265
- Mutual Societies (Electronic Communications) Order 2011, SI 2011/593, arts 22 and 24
- Legislative Reform (Industrial and Provident Societies and Credit Unions) Order 2011, SI 2011/2687, arts 3 to 7, 8(1), 9 and 10
- Financial Services Act 2012 (Mutual Societies) Order 2013, SI 2013/496, Schs 2 to 4.
- Industrial and Provident Societies and Credit Unions (Electronic Communications) Order 2014, SI 2014/184
- Industrial and Provident Societies (Increase in Shareholding Limit) Order 2014, SI 2014/210.

Remaining legislation that was not consolidated at the time of writing consists of statutory instruments changing the law applicable to societies from 6 April 2014:

- Industrial and Provident Societies and Credit Unions (Arrangements, Reconstructions and Administration) Order 2014, SI 2014/229 made under s 255 of the Enterprise Act 2002 (now replaced by s 118 of CCBSA 2014) applying insolvency rescue procedures and schemes of arrangement to societies; and
- Industrial and Provident Societies and Credit Unions (Investigations) Order 2014, SI 2014/574 made under ss 4, 6 and 7 of CCBSCUA 2010 (now ss 135 & 136 CCBSA 2014) giving the FCA the Companies Act 1985 investigation powers in relation to societies that have long been available to BIS for companies.
- Section 151 and paras 1 and 5 of Sch 5 of CCBSA 2014 continue such SI's in force as if they had been made under the powers now contained in CCBSA 2014.
- Societies registered or treated as registered under the IPSA 1965 are included in any reference in CCBSA 2014 to societies registered under CCBSA 2014 subject to detailed transitional provisions in Sch 3 of CCBSA 2014.[160]

It is important note that such 'pre-commencement societies' are registered as co-operative and community benefit societies while those registered on or after 1 August 2014 are registered specifically as either co-operative or community benefit societies.[161]

[160] CCBSA 2014, s 150(1).
[161] CCBSA 2014, ss 1 and 2 and Sections **3.3.** and **3.4.** below.

1.4.2. Commencement dates

The CCBSA 2014 came into force on 1 August 2014, immediately after s 1 of the CCBSCUA 2010 which was commenced so as to be consolidated by CCBSA 2014. From 1 August 2014 societies had to be registered as either co-operative societies or community benefit societies.[162]

The application of insolvency rescue procedures and schemes of arrangement to societies by SI 2014/229 and the additional investigation powers conferred on the FCA by SI 2014/574 both came into force on 6 April 2014.

1.4.3. Territorial extent

Most of the provisions of CCBSA 2014 apply to Great Britain ie England, Scotland and Wales.[163] Section 142 of CCBSA 2014 applies relevant provisions of the Act to any Northern Ireland societies that choose to record their rules with the FCA so as to conduct business in Great Britain. Those CCBSA 2014 provisions only apply to acts or omissions by such societies in Great Britain and not to anything done or left undone in Northern Ireland.[164]

CCBSA 2014 provisions, like those of legislation it consolidated, can be applied by Order in Council to the Channel Islands and no repeals in CCBSA 2014 affect any existing Order so applying them.[165]

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[162] See **Chapter 3**.
[163] CCBSA 2014, s 153.
[164] See Section **3.9.** below and s 142(3) for the full list of CCBSA 2014 provisions that apply to Northern Ireland societies in that way.
[165] CCBSA 2014, ss 152 and 153(6).

CHAPTER 2

LEGISLATIVE HISTORY AND MODERN SOCIETIES

2.1. LEGISLATIVE HISTORY

The term 'co-operative and community benefit society law' is new, and the result of the Co-operative and Community Benefit Societies Act 2014 and Credit Unions Act 2010. The previous terminology (industrial and provident society law) had been in use since the origin of this area of law in 1852, but had become redundant for any legal purpose some time ago. The new terminology reflects the two types of society now capable of registration under this legislation, though the terms 'co-operative' and 'community benefit' were only introduced into legislation in 1939 (see further below).

Co-operative societies (as we would recognise them today) were being registered from 1844 onwards, starting with the well-known Rochdale Equitable Pioneers Society, but at that point the only legislation under which they could be established was the Friendly Societies Acts. This legislation, since the Friendly Societies Act 1793, had encouraged the establishment of friendly societies for the purpose of raising funds for the mutual relief of members in sickness, old age and infirmity. This was at a time when forming associations (or 'combinations') was generally restricted by legislation following the French Revolution of 1789, due to suspicion about the real underlying intent of any collective endeavour. Over the following decades, the scope of friendly societies was extended to broaden the categories of those protected and the risks covered, and in the Act of 1834 the purpose of such societies was broadened to include 'any other purpose that was not illegal'. There was still no express mention of trading, though the Rochdale Equitable Pioneers Society and others that followed were clearly established for that specific purpose.

Although the Friendly Societies Acts therefore allowed the registration of trading societies, the legislation was not designed for them and contained many defects from their point of view. For example: societies could trade only with their own members, which left the position of productive societies (collectives of artisans or craftsmen) in doubt; they could not own land and could own other property only through trustees; societies could not federate and could invest in only limited ways. These were all indications of the need for a separate legislative framework for co-operative societies. By this time it had already become possible to incorporate trading companies under the Joint Stock Companies Act 1844.

2.1.1. The 1852 Act

In 1852 the first Industrial and Provident Societies Act became law. The Act provided that societies could be established for 'carrying on or exercising in common any labour,

trade or handicraft, except the working of mines, minerals or quarries beyond the limits of the United Kingdom and except the business of banking whether in the United Kingdom or not'. The Act required the rules to provide for a number of things including: whether or not loans could be contracted and on what terms (which could not include a rate of interest exceeding 6%, and could not exceed four times the amount of paid-up subscriptions); for the receipt of subscriptions from members and the payment of dividends to them not exceeding 5%; how the proceeds of trade after payment of expenses were to be treated including an increase of capital, 'provident purposes' authorised by the law for friendly societies, and division among the members; the appointment of managers and officers; and referring all disputes to arbitration. Members' subscriptions were to be withdrawable but not transferable.

The Act conferred neither limited liability on members nor corporate status on the society (property had to be held through trustees) but a member's liability ceased two years after his or her withdrawal from membership. The absence of limited liability is hardly surprising since the concept was not introduced for registered companies until the passage, after considerable controversy, of the Limited Liability Act 1855.

The Friendly Societies Acts continued to apply to societies registered under the 1852 Act except where they were inconsistent with that Act, so that societies retained the protection of the former Acts, through the law courts, for their funds and against the frauds of their officers, a vital provision to encourage individuals to trust others with their money. The 1852 Act was amended in minor respects in both 1854 and 1856. The former amendment relieved trustees of some of their liabilities and the latter dealt with the question of legal proceedings against registered societies.

2.1.2. The 1862 Act

The Industrial and Provident Societies Act 1862 was the model for all later substantial legislation dealing with societies. This Act repealed the three previous Industrial and Provident Societies Acts, re-enacted many of their principal features and gave societies further wide powers and privileges.

For the first time societies were given corporate status. Thus, they achieved a legal personality with perpetual succession, separate from the personality of their members; they could sue and be sued in their own name; and they could own property without trustees.

The Act also conferred limited liability in the modern sense of the term. For the future members were not to be liable for the debts of the society beyond the amount unpaid on their shares and their liability ceased altogether a year after their withdrawal from the society.

The permissible objects of societies were widened in one respect in that the words 'whether wholesale or retail' were added to the words 'any trade, labour or handicraft' but narrowed in another in that the business of mining might no longer be carried on whether in the United Kingdom or not.

The maximum shareholding was increased to £200, shares were allowed to be withdrawable or transferable, the rate of interest was allowed to be fixed by the rules of a society and, in a provision vital to the development of federal societies, one society was

allowed to invest up to £200 in the shares of another. For the first time, the legislation included the power of a member to 'nominate' another to whom their interest would be transferred on death. The statutory restrictions on the rate of interest on loans to a society and on the amount that a society might borrow were removed and these matters were left to be fixed by the rules of the society. The Act removed the restriction on the power of a society to own land.

The Friendly Societies Acts continued to apply to industrial and provident societies except where inconsistent with the Industrial and Provident Societies Act, and the privileges of exemption from stamp duty and income tax granted to friendly societies in 1853 were declared to apply to industrial and provident societies.

In return for these privileges the Act imposed duties. Every society was required to have a registered office, to provide a copy of the rules to any person who demanded it, to permit the inspection of certain books and registers by members and persons with an interest in its funds and to make an annual return to the Registrar.

The Act of 1862 was amended by the Act of 1867 in important respects. The latter Act removed the restrictions on the working of mines and quarries by societies, permitted one registered society to hold more than £200 in the shares of another and made express provision for the making of nominations by members up to £50. The Act also began the practice of listing in the legislation matters to be dealt with in the rules of societies, provided for the registration of amendments to the rules and fixed a date for the submission of an annual return. The Act withdrew the exemption of societies from income tax except under Schedules C and D and gave societies the power to buy and sell land.

In 1871 following a disagreement between the societies and the Registrar about the powers of societies to deal with land, a further amending Act was passed. It laid down that the rules of a society might provide for the erection of buildings and their alteration and management, the laying out of estates and the leasing of property, the disposal and sale of property whether to members or others, and for the advancing of money to members on the security of real and other property.

2.1.3. The 1876 consolidation

In 1876 a great consolidating Act was passed, which gave to industrial and provident societies an independent and almost self-contained code of law. With the exception of provisions relating to the appointments and duties of the Chief and other Registrars, industrial and provident societies ceased to be subject to any provisions of the Friendly Societies Acts. In addition to consolidating the law, the 1876 Act also allowed societies with no withdrawable share capital to undertake the business of banking and all societies to receive small saving deposits from members of up to £20 in instalments of not more than 5 shillings at any one time. Although there have been many amendments on many occasions since, the framework of the legislation was mainly secured by the 1876 Act.

In 1880 the Customs and Inland Revenue Act provided that societies were not to be chargeable with income tax under Schedules C and D unless they sold to non-members. In 1883 the Provident Nominations and Small Intestacies Act extended the limit of nominations by members to £100 and allowed nominations to apply to the deposits and

loans of members as well as their shareholding. It also required boards to see a certificate from the Inland Revenue authorities that death duties had been paid or were not payable before making payment of a nominated sum over £80.

2.1.4. The 1893 consolidation

The Act of 1893 consolidated the Acts governing registered societies once again and brought in minor changes. It modified the right of members to inspect the books of a society, increased the amounts that could be received in small savings deposits to £20 and the maximum single deposit to 10 shillings, gave societies wider powers to recover debts from members, widened the range of investments open to societies and allowed societies to convert themselves into companies. This Act stood as the principal Industrial and Provident Societies Act for 72 years and in May 2014 is still an important element in the legislation governing societies in the Republic of Ireland.

Minor amendments to the Act were made in 1894 on appeals from refusal by the Registrar to register a society and in 1895 on investments by societies in the island of Jersey.

The amending Act of 1913 required societies to submit their accounts annually to a public auditor for audit, permitted the establishment of a society consisting of only two registered societies, introduced new dates by which annual returns had to be made and required societies to make a triennial return to the Registrar showing the holding, in loans and shares, of each holder. It also required the submission of a certificate that a society had no assets before it could be dissolved to prevent a repetition of the facts of *Re Ruddington Land*[1] which involved the dissolution of a society under an instrument of dissolution before its assets had been dealt with.[2]

The Act of 1913 also made changes to the law governing nominations. Before 1 January 1914 a nomination was ineffective if a member had a holding above £100 when he or she made the nomination, passed only the amount held at the date the nomination was made and (probably) was not revoked by the marriage of the nominator. Nominations made on or after 1 January 1914 were declared not to be invalid if the nominator had a holding greater than £100 at the date he made the nomination, to pass to the nominees the amount held at the date of the nominator's death provided that this was not above £100 and to be revoked by the marriage of the nominator.

In 1928, an Act was passed with the single provision that no person was bound by an amendment of the rules, passed after he or she became a member and after 28 March 1928, which required the member to increase his or her holding of shares in the society or otherwise increased his or her liability unless the member consented in writing. This legislation dealt with the issue that arose in the case of *Re Wiltshire and Somerset Farmers Ltd*,[3] which was known as *Hole v Garnsey*[4] when it reached the House of Lords on appeal. The case is still important 80 years later for the statements made at House of Lords level on the general principle of changes to the rules of societies.

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1 [1909] 1 Ch 70.
2 See nowCCBSA 2014, s 126.
3 [1928] Ch 809.
4 [1930] AC 472.

2.1.5. Bona fide co-operatives and community benefit societies

In 1939, developments took place that ultimately led to the establishment of co-operative and community benefit societies as the two types of society that can now be registered. From the earliest times companies were required to issue a prospectus when offering shares to the public and the Directors' Liability Act 1890 introduced civil liability for negligent misstatements in a prospectus. The Companies Act 1900 required companies to file a prospectus with the registrar of companies when raising money from the public. To avoid these early regulatory requirements, the unscrupulous were registering industrial and provident societies, that did not require a prospectus, and indulging in what became known as 'share pushing'. Dealing with this problem required a re-examination of the criteria on which societies could be registered, which at this stage included no requirement about what we would today call corporate purpose.

The Prevention of Fraud (Investments) Act 1939 limited the range of organisations that could register under the Industrial and Provident Societies Act to 'bona fide co-operative societies', 'societies for improving the conditions and social well-being of members of the working classes' and 'societies for the benefit of the community generally'. The phrase 'bona fide co-operative' was not, and never has been defined. However, the 1939 Act introduced a provision that gives some guidance to its definition by providing that 'co-operative society' does not include a society that carries on business with the object of making profits mainly for the payment of interest, dividends or bonuses on money invested in, deposited with or lent to the society.

For the first time, the legislation for industrial and provident societies was effectively seeking to create a distinction between a society and company. This was now becoming important as the increasing use of incorporation became open to abuse, and the statutory regimes for societies and companies were evolving differently to suit their respective purposes. The chief provisions of the 1939 Act were re-enacted in the Prevention of Fraud (Investments) Act 1958.

The Societies (Miscellaneous Provisions) Act 1940 relaxed, for the duration of the emergency declared as a result of the Second World War, certain requirements of the 1893 Act on meetings, appointments of officers and amendments to rules. It also made provisions for a special membership of societies for the sole purpose of the purchase of government securities and allowed resolutions of the management committee for the setting up of special funds for such purposes to take effect as a change of rule. The 'emergency' was declared to be at an end on 30 June 1948 but the power of the board to set up special funds was removed only by the 1965 Act.

The Industrial Assurance and Friendly Societies Act 1948 changed the designation of auditors to whom societies must submit their books from 'public auditors' to 'approved auditors' and prescribed their qualifications. The law on estate duty was brought into conformity with the Finance Act 1946 with the effect that only when a nomination exceeded £80 and the holding of the nominator exceeded £200 was it necessary for the society to require a certificate that the death duty had been paid or was not payable. The Act also made it clear that while societies are permitted to invest in the Post Office and Trustee Savings Banks, the authorities were under no obligation to accept such deposits.

The limits on holdings in shares and deposits in a society were changed by the Industrial and Provident Societies Act 1952. For the future members were allowed to hold up to

£500 in the shares of a society or such lower figure as was fixed by rules. Depositors were allowed to have small savings up to £50 and the maximum single deposit was increased to £2. The board of directors was given power to authorise the increased limits and the authorisation took effect as a temporary change of rule.

The Industrial and Provident Societies (Amendment) Act 1954 made important changes to the law. Members were allowed by nominations made on or after 5 August 1954 to nominate up to £200 of their holdings. The choice of names by societies was limited by the provision that no name might be registered which was 'undesirable' in the opinion of the Registrar and the full name of the society was required to appear on all its business letters. The name of the society could be changed by a simple resolution of the general meeting instead of by special resolution as hitherto. The Registrar was given power in the case of societies existing for wholly charitable or benevolent purposes to allow the registration of names in which the word 'limited' did not appear.

The Act gave a discretion to the Registrar as to the date to which annual returns must be made up and required that all published balance sheets should be audited. New provisions were made on the form and inspection of societies' registers of members. The need to make a triennial return to the Registrar was abolished. Amalgamations and transfers of engagements between societies were facilitated by the Act, which provided that the special resolution for these purposes would need only a two-thirds, instead of a three-fourths, majority and that on a transfer of engagements the assets of the transferor society should vest automatically in the transferee society without other conveyance. The Act also made some minor changes in the law relating to criminal proceedings and the price of rule books, and withdrew the authority of a society to require evidence that the estate of a deceased member did not exceed £100.

The Corporate Bodies' Contracts Act 1960 brought English societies into line with other corporate bodies on the form of their contracts.

The Industrial and Provident Societies Act 1961 increased the maximum permitted holding of a member in the shares of a society to £1,000 and allowed a board resolution to take advantage of the increased limit to take effect as a temporary change of rule. The Act also gave power to agricultural, horticultural and forestry societies to make advances to members without security.

2.1.6. The 1965 consolidation to Credit Unions Act 1979

The Industrial and Provident Societies Act 1965 brought together in one statute all the legislation from 1893 to 1965 but made very few changes to the law. The Act reduced the range of societies that may register under it to bona fide co operative societies and societies for the benefit of the community and repealed the little used section relating to the transfer of stock at the Bank of England. It clarified a number of matters where there had been thought to be ambiguity. It introduced different terminology for English and Scottish societies but usually produced the same effect in both legal systems.

The Administration of Estates (Small Payments) Act 1965 amended the Industrial and Provident Societies Act to increase the amount that a member might nominate to £500 and to make a similar increase in the amount that could be distributed by societies without letters of administration or a grant of probate in the event of a member's death.

The Industrial and Provident Societies Act 1967 was passed to permit societies to borrow against the security of a floating charge. Before the Act English societies were unable to give such charges because of the decision in *Great Northern Railway Company v Coal Co-operative Society*[5] that the exemption in the Bills of Sale Acts for companies was inapplicable to societies. This meant that for a purely technical reason a society, unlike a company, was unable to give security over an asset that would be sold in the course of business (such as stock). In Scotland, the concept of the floating charge was not recognised at all; consequently societies could not provide that form of security. The 1967 Act cured this deficiency in the law by providing a system of registration for societies in both jurisdictions – in England by disapplying the Bills of Sale Acts on the basis of the registration of a document creating a floating charge and in Scotland by incorporating the provisions of the Companies (Floating Charges) (Scotland) Act 1961. The text in **Chapter 8** deals with the current position that exists as a result of successive amendments to the law governing Scottish floating charges.

The Friendly and Industrial and Provident Societies Act 1968 established new rules governing the accounts that societies are required to prepare (including rules as to group accounts), the submission of annual returns and the qualifications and rights of auditors. At the time of its passage the Act brought the law on these matters broadly into line with the law applicable to companies.

The Industrial and Provident Societies Act 1975 increased the limit on the size of a member's shareholding from £1,000 to £5,000 and allowed changes to the limit in the rules of societies to be introduced by resolution of the board during a transitional period. More significantly, this Act gave the Registrar power to amend the limit upwards in the future by statutory instrument so that primary legislation would no longer be necessary to keep the figure in line with inflation. That power has been used to establish the present limit of £100,000.[6] The Industrial and Provident Societies Act 1978 made similar provision for the amounts that societies are allowed to receive by way of deposit – both increasing the current limits with power to directors to amend society rules during a limited transitional period and allowing for future changes to the statutory maxima by statutory instrument. The limit was raised by the Act to allow deposits of £10 at any one time to a total of £250 from any one depositor. Both figures currently stand at £400 but this power is seldom used.[7]

The Industrial Common Ownership Act 1976 affected societies set up as worker co-operatives. Such societies could be certified by the Chief Registrar (now the Financial Conduct Authority) as common ownership enterprises or by the Secretary of State as co-operative enterprises. A common ownership enterprise had to have a constitution providing for only employees to be members, equal voting rights for members and control by the majority of them. Its assets had to be distributable only through a profit-sharing scheme and its surplus assets on dissolution had to be capable of being passed on only to other common ownership enterprises. A co-operative enterprise had both to be controlled by the majority of its employees and to be in substance a co-operative association having regard to the application of its income and the other provisions of its constitution. If a society or a company limited by guarantee that was a bona fide co-operative society satisfied these requirements, grants and other benefits were available from central or local government. Section 1 of the 1976 Act, which dealt with those, was repealed in 2004. However, the definition remains and applies for the

5 [1896] 1 Ch 187.
6 SI 2014/210, art 2.
7 See CCBSA 2014, ss 67 and 68.

purpose of tax relief on loans by individuals to co-operatives under s 401 of the Income Tax Act 2007 and loans and grants by 'designated' local authorities under s 3 of the Inner Urban Areas Act 1978.

The Credit Unions Act 1979 (CUA 1979) set up a whole structure for the registration of credit unions as industrial and provident societies. A society registering under this Act was subject to different rules from those applicable to other societies wherever the 1979 Act differed from the 1965 Act. The differences (which continue under CCBSA 2014) include the minimum number of members required, the nature and uses of share capital, the society's powers and objects, its right to hold land, and its lending and investment powers. Credit unions are also subject to more stringent regulation than other societies because they are financial services businesses. CUA 1979 is fully discussed in **Chapter 13**.

2.1.7. 1980 to 2000: A period of modest change

The 1980s produced no primary legislation principally concerned with industrial and provident societies. However, the Insolvency Act 1986 applied on the winding up of a society and the possibility of liability for fraudulent or wrongful trading applies to the directors of societies, although the provisions of the Company Directors Disqualification Act 1986 and the Insolvency Act provisions permitting the rescue of companies through the making of an administration order by the court or the use of voluntary arrangements or schemes of arrangement did not apply until SI 2014/229, made under s 255 of the Enterprise Act 2002, applied them from 6 April 2014.

The Friendly Societies Act 1992 (FrndSocA 1992) amended the Friendly Societies Act 1974 (FrndSocA 1974) to provide for the registration of certain societies under the IPSA 1965. It allowed certain friendly societies to provide a wider range of insurance and investment services with a level of supervision and investor protection equivalent to that applicable to other providers of such products. A Friendly Societies Commission was established and provided with the necessary powers and functions to this end and the requirements of the EC Life and Non-Life Insurance Directives were implemented for societies engaging in insurance business of the kind covered by the directives. The Friendly Societies Commission was abolished by the Financial Services and Markets Act 2000 and its functions were transferred to the Financial Services Authority. From 2012 those functions were divided between the Financial Conduct Authority, which registers friendly societies and deals with aspects of their regulation concerning consumer protection, and the Prudential Regulation Authority, which deals with their prudential regulation.

The FrndSocA 1992 ended new registrations under FrndSocA 1974 and provided for the registration under the 1992 Act of all new friendly societies, and any friendly societies already registered under the FrndSocA 1974, which wished to expand the scope of their activities. Those societies that register under the FrndSocA 1992 as 'incorporated friendly societies' gain the capacity to carry on a wide range of business and to have subsidiaries in addition to corporate status. Those already registered under the FrndSocA 1974 (known as registered friendly societies) and not incorporated under the FrndSocA 1992 retain their unincorporated status and more limited powers under the earlier Act.

However, of the classes of society entitled to register under the FrndSocA 1974, only one was the friendly society properly so called. Friendly societies are concerned with mutual insurance among their members. Registration under the Act was also available to social clubs, concerned with the provision of social and recreational facilities for members; benevolent societies, providing benefits to non-members and not to members; and specially authorised societies concerned, for example, with the promotion of science, literature or the arts. Of these, working men's clubs formed the largest group. After the FrndSocA 1992 no new registrations of such societies are permitted and to encourage those already registered to change their status, the FrndSocA 1974 was amended to allow them to register under the IPSA 1965 and laying down both the procedure to be followed to achieve this and the consequences of following it.[8]

This created a new registration route for conversion into industrial and provident societies. Most of the societies in question will either operate in a co-operative manner for the benefit of their members or will fit within the 'community benefit' category. The provision is transitional as new societies will register directly under *CCBSA 2014* but it may operate for many years to come in relation to existing societies registered under the FrndSocA 1974.

With effect from 1 September 1996 a number of amendments were introduced to the IPSA 1965 and the Credit Unions Act 1979. Use was made of powers conferred on government by the Deregulation and Contracting Out Act 1994 to make two Deregulation Orders. These statutory instruments amended the legislation to ease the burdens on societies and credit unions and to deal with some of the disadvantages societies endured compared with companies. This was in line with the criteria in the 1994 Act that the Orders should remove or reduce statutory burdens without removing necessary protection.

The Deregulation (Industrial and Provident Societies) Order 1996, SI 1996/1738 from 1 September 1996:

- reduced the minimum membership for non-federal societies from seven to three;
- required the signatures of only the secretaries of any two member societies to form, or amend the rules of, federal societies;
- gave societies up to seven months from the end of their accounting period to submit an annual return;
- extended the time-limit for registering charges on society assets from 14 to 21 days and allows late submission without the need for a court order – subject to third party rights;
- allowed societies with turnover under £90,000 to opt out of any audit and those under £350,000 to opt out of a full audit of their accounts;
- allowed continued exemption from the need to prepare Group Accounts without annual application to the Registry unless circumstances have changed.

The Deregulation (Credit Unions) Order 1996, SI 1996/1189, from 1 September 1996:

- allowed credit union membership to be based on either living or working in a locality;
- allowed the Registry to accept a statutory declaration by three members and the secretary of a credit union as proof of a common bond;

[8] See Section **3.11.** below.

- increased the shareholding limit for a credit union member to the higher of £5,000 and 1.5% of the credit union's total shareholding;
- secured a loan of less than a member's shareholding on the shares to extend the possible repayment time; but
- prevented withdrawal of the shares used as security;
- allowed non-qualifying members to borrow up to the same limit as other members;
- increased the limit on borrowing by a member of a credit union approved by the Registry for the purpose to the lower of £10,000 or an amount worked out by reference to the society's total shareholding or reserves.

2.1.8. Early twenty-first century reforms: Private members' bills and secondary legislation

The Financial Services and Markets Act 2000 (Mutual Societies) Order 2001 (Mutual Societies Order 2001) was made under the Financial Services and Markets Act 2000 to transfer the powers of registration from the Registry of Friendly Societies (which, alongside the offices of the Chief Registrar, assistant registrar for Scotland and other assistant registrars, ceased to exist) to the newly created Financial Services Authority.

From about 2000, and prompted by the government of the day to move away from the previous strategy of pressing for a Co-operatives Act, the co-operative and mutual sectors, through the Co-operative Party adopted a strategy of promoting private members bills. The first of these was the Industrial and Provident Societies Act 2002, presented by Gareth Thomas MP, which introduced new requirements for the conversion of societies into companies, and started to provide for the updating of industrial and provident society law in line with company law. The additional requirement for conversion into a company, partly prompted by a (failed) threat of demutualisation to the Co-operative Wholesale Society in 1997, was for not less than half of those members, who were then entitled to vote, to vote at the first meeting held to consider such a resolution. The company law assimilation provision enabled the Treasury, where modification was thereafter made to company law and it appeared expedient to the Treasury to assimilate company law and industrial and provident society law, to amend industrial and provident society law by order, save in relation to certain specified exceptions.

In 2003, Council Regulation EC 1435/2003 introduced the concept of a European Co-operative Society (SCE). The intention was to create a legal entity capable of registration in any member state in order to facilitate co-operatives wishing to engage in cross-border business. It allows the creation of new co-operative enterprises by natural or legal persons at European level, and a directive enacted alongside it ensures the rights of information, consultation and participation of SCE employees. In May 2010 a total of only 17 SCEs were found by research conducted for the European Commission.[9]

Although no SCEs had been registered in the UK at the time of writing (May 2014), the EU Regulation and Directive were implemented by the European Co-operative Society Regulations 2006, SI 2006/2078 and the European Co-operative Society (Involvement of

[9] See 'Study on the implementation of the Regulation 1435/2003 on the Statute for European Cooperative Society (SCE)' Vol 1, p 28 available at: http://ec.europa.eu/enterprise/policies/sme/promoting-entrepreneurship/social-economy/co-operatives/index_en.htm#h2–9.

Employees) Regulations 2006, SI 2006/2059. The indirect influence of the SCE regulation and directive can be seen in the 2006 FSA Policy Note permitting non-user investor members in UK co-operatives.[10]

The Co-operatives and Community Benefit Societies Act 2003 was the second private members bill to be promoted, and it was introduced by Mark Todd MP. Its first provision was to enable the Treasury to bring forward, in secondary legislation, provisions under which community benefit societies could permanently prevent any use of or dealing with their assets except for the benefit of the community. This was the introduction of the so-called (but inaccurately named) 'asset lock'.[11] The same concept was about to be introduced for company law via the Companies (Audit, Investigations and Community Enterprise) Act 2004, which created the community interest company. The second provision brought aspects of industrial and provident society law relating to societies' ability to enter into transactions into line with the corresponding legislation relating to companies. That provided protection for those dealing with societies and their committees from adverse consequences if a society or its committee acted outside the society's rules. The third provision brought industrial and provident society legislation into line with the company law rules about executing deeds and documents and entering contracts.

The Community Benefit Societies (Restriction on Use of Assets) Regulations 2006, SI 2006/264 implemented the asset-lock provisions of the Co-operatives and Community Benefit Societies Act 2003. It allows community benefit societies to introduce a rule to ensure, that on dissolution or amalgamation, their assets will permanently be used to benefit the community. It eliminates the possibility that a society's accumulated assets could be distributed to members following conversion to a company.

The Friendly and Industrial and Provident Societies Act 1968 (Audit Exemption) (Amendment) Order 2006, SI 2006/265 raised the threshold above which non-charitable industrial and provident societies were required to appoint an auditor to audit their end-of-year accounts and balance sheets to £5.6m turnover and £2.8m balance sheet total, in line with the existing thresholds for non-charitable companies. It also raised the asset level to £2.8m for charitable societies, while leaving the turnover amount at £250,000.

The Building Societies (Funding) and Mutual Societies (Transfers) Act 2007 was a private members bill introduced by Sir John Butterfill MP. The first two provisions sought to liberalise the wholesale funding limits on building societies, and to place building society members on a par with creditors on a winding up. The third provision aimed to make it easier for mutual societies to transfer their business to subsidiaries of other mutual societies, by enabling them to merge by way of transfer of engagements. While this mechanism for merger was possible within industrial and provident societies, friendly societies and building societies, it was not possible between those three different types of legal entity. The 'Butterfill Act' made it possible for the Treasury to bring forward detailed orders enabling transfers between the three different types of mutual organisations, including to an 'EEA mutual', namely a European Co-operative Society.

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[10] See Financial Services Authority, 'Investor membership of co-operatives registered under the Industrial & Provident Societies Act, 1965, A Policy Note by Michael Cook and Ramona Taylor' available from https://drive.google.com/#folders/0B3k1mIyJumBSbGFQeU.

[11] See Sections **1.3.3.**, **4.3.** and **12.6.1.** below.

The Mutual Societies (Transfers) Order 2009, SI 2009/509 was the first such order, enabling a building society to transfer engagements to the subsidiary of another mutual society. The order also specifies mutual insurers as a type of EEA mutual society for the purposes of the Building Societies (Funding) and Mutual Societies (Transfers) Act 2007, so that the modified transfer provisions may apply to a transfer to a subsidiary of a mutual insurer. The 2009 Order facilitated the transfer of engagements of the Britannia Building Society Ltd to the Co-operative Bank plc. That transaction was one of the factors that led to the 2013 recapitalisation and demutualisation of the Co-operative Bank PLC, a wholly-owned subsidiary of the Co-operative Group Ltd, and had serious implications for the financial stability of the Co-operative Group Ltd itself.

The Co-operative and Community Benefit Societies and Credit Unions Act 2010 introduced a number of changes following consultation with the sector. The changes were: to require new industrial and provident societies (other than credit unions) to be registered either as co-operative or as community benefit societies (previously they were registered as industrial and provident societies); to rename the Industrial and Provident Societies Acts; to apply the Company Directors Disqualification Act 1986 to industrial and provident societies; to give the Treasury powers to apply to industrial and provident societies, with appropriate modifications, company law on investigations, company names and dissolution and restoration to the register; and to give the Treasury powers to make provision for credit unions corresponding to any enactment applying to building societies.

The Mutual Societies (Electronic Communications) Order 2011, SI 2011/593 amended the legislation applying to building societies, friendly societies, industrial and provident societies and credit unions to facilitate the use of electronic communications by these mutual societies in their communications with their members, the public and with the FSA, in its capacity as the registrar of mutual societies. The amendments allowed societies to elect to use electronic communications to comply with their statutory obligations to send certain information to members and to the FSA, to operate electronic ballots and to make available online facilities for the appointment of proxies.

The Legislative Reform (Industrial and Provident Societies and Credit Unions) Order 2011, SI 2011/2687 introduced a series of reforms for industrial and provident societies and for credit unions. The former were as follows: to abolish the minimum age for membership and reduce the minimum age for becoming an officer of a society; to remove the restriction on the maximum holding of non-withdrawable shares in an industrial and provident society; to amend the provision on charging a fee for a copy of a society's rules; to facilitate the easier dissolution of societies; to give societies the flexibility of choosing their own year-ends; to remove the requirement on societies to have interim accounts audited. The changes for credit unions were: to amend the requirements for membership of a credit union; to reform restrictions on non-qualifying members of credit unions; to allow credit unions to admit bodies corporate to membership; to allow credit unions to offer interest on deposits; to abolish the 8% per annum limit on dividends; to amend the 'attachment of shares' provisions; to allow credit unions to charge the market rate for providing ancillary services to their members.

2.1.9. 2012 to 2014: The FCA and the 2014 consolidation and reforms

The Financial Services Act 2012 abolished the Financial Services Authority and divided its functions between the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA). Broadly, the PRA took over the prudential regulation function in respect of banking and insurance businesses while the FCA remained responsible for the regulation of markets and for consumer protection in the financial services field. The Financial Services Act 2012 (Mutual Societies) Order 2013, SI 2013/496 transferred the registration function for mutual societies to the FCA and the prudential regulation function for those engaged in banking and insurance, such as credit unions, building societies, and friendly societies, to the PRA.

The Co-operative and Community Benefit Societies Act 2014 is a consolidating Act, the first since 1965. It aims to make the legislation as clear as possible, and to deal with the fact that it had become complicated and difficult to navigate around. It had become important to address these issues, not least because the public sector reform agenda, together with a renewed surge of self-help activity within communities in response to worsening economic circumstances was leading to increased interest in industrial and provident societies. The only substantive changes to the law introduced by the 2014 Act are those that the Law Commission and the Scottish Law Commission have recommended in order to facilitate the production of a satisfactory text.

However, more substantive changes to the law were also introduced in 2014 by four statutory instruments which all came into force on 6 April that year.

The Industrial and Provident Societies and Credit Unions (Arrangements, Reconstructions and Administration) Order 2014, SI 2014/229 used the power granted by s 255 of the Enterprise Act 2002 to apply the insolvency rescue procedures of creditors' voluntary arrangements, administration and schemes of arrangement under the Insolvency Act 1986 and the Companies Act 2006 to societies.

The Co-operative and Community Benefit Societies and Credit Unions (Investigations) Regulations 2014, SI 2014/574 apply Part 14 of the Companies Act 1985 to societies so that the FCA have powers equivalent to those available to the Department for Business Innovation and Skills (BIS) for companies where they take the view that fraud or other wrongdoing requires the inspection or investigation of a society.

SIs 2014/229 and 2014/574 are continued in operation from 1 August 2014 by s 151 and para 5 of Sch 5 of CCBSA 2014.

The Industrial and Provident Societies and Credit Unions (Electronic Communications) Order 2014, SI 2014/184, made under ss 8 and 9 of the Electronic Communications Act 2000, permitted the electronic submission of a single registration document to the FCA when an application was made to register a society. Its amendment of the 1965 Act was consolidated by s 3(1)(b) CCBSA 2014.

The Industrial and Provident Societies (Increase in Shareholding Limit) Order 2014, SI 2014/210 used the power available to HM Treasury under s 2 of the Industrial and Provident Societies Act 1976 to raise the limit on the amount of withdrawable share

capital that a person other than another society can hold in a society from £20,000 to £100,000. That provision was consolidated from 1 August 2014 by s 24 of CCBSA 2014.

From 6 April 2014, s 3 of the Co-operative and Community Benefit Societies and Credit Unions Act 2010 came into effect and added s 22E to the Company Directors Disqualification Act 1986 to apply the disqualification provisions to committee members and officers of societies – commenced by art 2 of SI 2014/183. After the consolidation on 1 August 2014, s 3 of the 2010 Act and the amendment of the 1986 Act remain in force.[12]

2.2. INDUSTRIAL AND PROVIDENT SOCIETIES TODAY

2.2.1. Overall numbers

The legislation outlined above and discussed in the rest of this book governs a variety of societies. Previous editions of this handbook have included at this point substantial detail about the range and type of registered societies. This has become more difficult, as the data published about registered societies by the registration authority (now the Financial Conduct Authority) has reduced over recent years.

The last annual report of the Financial Services Authority reported that at 31 March 2013 there were 7,578 industrial and provident societies on the register (2012: 8,022). The overall reduction during the year was due to the cancellation of the registration of societies that had failed to file annual returns and accounts for several years, and also to amalgamations and transfers of engagements. The same report also recorded that there were 444 credit unions on the register at 31 March 2013 (2012: 481).

The nature of the societies registered under the Industrial and Provident Societies Acts and now CCBSA 2014 is varied and can be analysed in at least two ways. One distinction (discussed in **Chapter 3**) is between co-operative and community benefit societies. Since the implementation on 1 August 2014 of s 2(1) of CCBSA 2014 this distinction has become more straightforward as new societies are required to register as one or the other type though societies already on the register do not have to do so. There are considerable similarities between the two categories. The main difference is that co-operatives, in the view of the FCA, conduct their business 'for the mutual benefit of their members in such a way that the benefit which members obtain will in the main stem from their participation in the business' while adhering to the generally accepted Co-operative Principles (set out in **Chapter 3**) of one member one vote, limited return on capital, distribution (if any) of profits to members by reference to their trade with the society, and open membership. Thus, providing co-operatives adhere to these principles, they can operate for the benefit of members.

Community benefit societies, on the other hand, must operate for the benefit of persons other than members. Thus they are expected to be non-profit distributing and to have rules prohibiting the distribution of assets among members while providing a limited return on capital and allowing control by members but not open membership. Housing

[12] CCBSA 2014, s 151 and Sch 7.

associations are the classic examples of community benefit societies and probably represent the largest group of non-co-operative societies registered under the legislation (see further below).

2.2.2. What societies do: The main categories

Societies may also be classified according to their activities. Historically, statistical information on this basis was published annually by the Registrar, but today (save in relation to credit unions for which data is now published by the Prudential Regulation Authority) the only way of providing such information is through data supplied by so-called 'sponsoring bodies'. These are trade associations or promotional bodies representing groups of societies with a common interest, and which register their own model rules. Currently the sponsoring bodies whose model rules are the most used are the Clubs and Institutes Union, the National Housing Federation, Co-operatives UK, the Royal British Legion, the Rugby Football Union, the Association of Conservative Clubs, Supporters Direct and the Plunkett Foundation. The information set out below is intended to provide some insight into the wide range of registered societies through the larger groups of registered societies. It is by necessity selective.

The figures included are largely based on the number of registered societies recorded by the FCA as using the model rules of the various sponsoring bodies in May 2013. That information was kindly supplied to the authors by the mutuals registration team of the FCA. It is important to remember that those figures exclude any society that uses bespoke rules rather than relying on Model Rules from a sponsoring body.

2.2.2.1. Consumer co-operative societies

Historically from the commencement of industrial and provident society legislation this was the largest category of registered societies, running shops and subsequently supermarkets and department stores. By 1903, by way of illustration, there were 1,481 retail or 'distributive' societies alone. In recent years, the wholesaling and retailing functions have become combined under the same ownership. Most of the societies in this category today (of which there are approximately 20) are consumer co-operatives operated and run on the basis of Co-operative Principles with a membership consisting of those who buy from the co-operative at retail level. Consumer co-operatives, by and large, do not restrict themselves to trading with members.

According to data published by Co-operatives UK, the apex organisation for UK co-operatives and promoter of model rules for (among other things) retail and worker co-operatives, the annual turnover of the consumer retail societies in 2012 was £17.1 billion. This was mainly accounted for by the trade of the 10 largest societies (taking into account the merger of Anglia and Midlands in 2013 to form the new Central England Co-operative), and of this total £13.6 billion comprised the turnover of Co-operative Group Ltd.[13]

2.2.2.2. Worker co-operatives

In 2001 the Industrial Common Ownership Movement (ICOM) and a range of other co-operative bodies merged with Co-operatives UK, making it the overall umbrella

[13] http://www.uk.coop/economy2013.

organisation for UK co-operatives and co-operative development organisations and its model rules span the whole range of co-operatives and community organisations.

According to Co-operatives UK, there are some 106 worker co-operatives in the UK with a combined turn-over of £112 million, of which the turnover of the largest 10 worker co-operatives accounts for some £101 million.[14]

2.2.2.3. Housing associations, housing co-operatives and community land trusts

There are two main groups of registered societies in the housing sector. Housing co-operatives are organisations that are owned, managed and democratically controlled by their member tenants. They are usually small organisations. By contrast housing associations, which are often community benefit societies (some are registered as companies limited by guarantee), can be very large, owning and managing thousands or even tens of thousands of homes. Since the 1980s, housing associations have been the vehicle for taking over housing previously delivered by local government.

Community land trusts are member-controlled organisations defined in s 79 of the Housing and Regeneration Act 2008. They are formed to acquire and manage land and other assets in the interests of the local community and are usually concerned with the provision of affordable housing, community regeneration and employment in a particular locality. Some CLTs use community interest companies but others use community benefit societies.

FCA figures indicate that a total of 543 societies using National Housing Federation Model Rules, 52 using Abbeyfield Society Model Rules, and 26 using Scottish Federation of Housing Associations Rules, were on the register in May 2013.

At the same date, 44 societies using CDS Co-operative Housing Society Model Rules for housing co-operatives, and 10 using 'land for people' Central Community Land Trust Model Rules were on the FCA register. A total of 67 societies were on the register using Radical Routes Model Rules, some of which would be housing co-operatives, and some workers' co-operatives.

2.2.2.4. Clubs

These comprise social and recreational societies, often known as 'working men's clubs', which were previously registered as friendly societies but now can only register under co-operative and community benefit society law. Their origins lie in the same nineteenth century movement for self-improvement and education, which gave rise to friendly societies, co-operative societies and trade unions. Their predominant modern function is to provide recreational facilities, and members benefit from lower prices for purchases from the clubs and organised entertainments, sporting activities, excursions and social events. The vast majority of such clubs are affiliated to the Clubs and Institutes Union (CIU) whose model rules permit members of an affiliated club to visit other affiliated clubs.

[14] http://www.uk.coop/economy2013.

FCA figures indicate that a total of 1,429 societies using CIU Model Rules were on the register in May 2013. At the same date 378 were on the register using Royal British Legion Model Rules, 222 using Association of Conservative Clubs Model Rules, and 16 using Royal Naval Association Model Rules.

2.2.2.5. Agricultural societies

These include marketing, purchasing and machinery-owning co-operatives. Such societies provide mechanisms whereby those involved in farming and agriculture can collaborate to meet their collective needs as trading organisations, and membership of such co-operatives includes sole traders, partnerships, companies or other societies. A marketing co-operative purchases the produce of its members so that, as smaller scale producers, they are at less of a commercial disadvantage in the supply chain. It also enables them to undertake a certain amount of processing themselves so that farmers can capture some of the downstream value – for example in making cheese and other dairy-based products. The purchasing and machinery-owning societies may include seed, fertiliser, animal feed or agricultural equipment. On the same principle, some societies may also provide services to their members such as transport, seed testing, forestry services or pest control. Some societies have as their purpose the development of agriculture and agricultural techniques.

FCA figures indicate that a total of 25 societies using Federation of Agricultural Co-operatives (UK) Ltd Model Rules, 13 using the Welsh Agricultural Organisation Society Ltd Model Rules, 12 using the Scottish Agricultural Organisation Society Ltd Model Rules, and two using National Farmers' Union Model Rules, were on the register in May 2013.

2.2.2.6. Football supporters trusts

These are new societies established since 2000 so that fans of football clubs have a voice in the affairs of their club. Promoted by Supporters Direct, which is the representative body for supporters trusts, such trusts are now widespread with 161 trusts throughout England, Wales and Scotland, together with a number of rugby league clubs, although not all take the form of registered societies.[15]

FCA figures indicate that a total of 44 societies using Supporters Direct Model Rules were on the register in May 2013.

2.2.2.7. Community-owned village shops and enterprises

Aside from the historic co-operative retail societies, there is a separate growing movement emerging from within communities to retain or recover essential community services. This particularly includes village shops, but also pubs, specialist food producers, community-supported agriculture and farmers markets. Plunkett Foundation is the leading organisation providing support for such ventures.

FCA figures indicate that a total of 92 societies using Village Retail Services Ltd Model Rules, 35 using the Plunkett Foundation Model Rules, 34 using Wessex Community Assets Ltd Model Rules, 18 using Women's Institute Country Markets Ltd Model Rules,

[15] Data provided as at 27 February 2014 by Supporters Direct.

and one using Highlands and Islands Development Board Model Rules were on the register in May 2013. At the same date, 19 registered societies used the Community Transport Association Model Rules.

However, information provided by the Plunkett Foundation in May 2014 indicates that at that date, the number of shops using co-operative or community benefit society rules was 198 (of 314 currently trading) and the number of pubs using those rules at the same date was 23 (of the 26 currently trading).

2.2.2.8. Energy co-operatives and societies

A significant twenty-first century development involving the use of the society structure has been the growth of renewable energy generation by solar panels or wind turbines. Societies have been formed to raise capital to develop renewable power sources and encourage membership among members of a local community supportive of green energy. Such societies are not usually strictly 'co-operatives' as they do not supply energy directly to their own members. They are, rather, community benefit societies.

The FCA reported, as at May 2013, seven societies on the register using Baywind Energy Model Rules (through the Energy4all development company), and five using Sharenergy Co-operative Rules.

2.2.2.9. Rugby Football Union

The RFU is the national governing body for grass-roots and elite rugby, with 548 incorporated clubs in its membership, of which 294 are societies.[16]

The FCA reported, as at May 2013, 265 societies on the register using Rugby Football Union Rules, eight using Welsh Rugby Union Model Rules, and six using Rugby Football Referees Union Model Rules.

2.2.2.10. Credit unions

These are a form of savings and loan co-operative with a common bond between its members, which is registered under the Credit Unions Act 1979. Members save by buying society shares and then borrow from the society at a low rate of interest.

According to data published by the Prudential Regulation Authority[17] the total number of registered credit unions in the UK including Northern Ireland at 30 September 2012 was 595. The total number of members including juvenile depositors was 1,619,710, and total deposits amounted to £1.8 billion.

[16] Data accurate at 24 February 2014 and provided by RFU.
[17] http://www.bankofengland.co.uk/pra/Pages/regulatorydata/creditunionsstatistics.aspx.

2.3. THE RANGE OF MODEL RULES REFERRED TO IN THIS BOOK

The model rules discussed in this *Handbook* cover a range of societies, as follows:

- Consumer Co-operatives – Co-operatives UK 12th Edition Model Rules (amended 2012);
- Worker Co-operative model rules – Co-operatives UK;
- Society for the benefit of the community – Co-operatives UK;
- National Housing Federation – Model Rules 2011 (version 2);
- Clubs and Institutes Union – Model Rules for a Working Men's Club;
- Co-operatives UK & Scottish Agricultural Organisation Society – Agricultural Co-operative (IPS) – Agency Model Rules.

CHAPTER 3

REGISTRATION

3.1. THE FINANCIAL CONDUCT AUTHORITY

Since 1 April 2013 the Financial Conduct Authority (FCA) has been responsible for a number of tasks relating to mutual societies. It functions as the registrar for societies registered or treated as registered under the Co-operative and Community Benefit Societies Act 2014 (CCBSA 2014). This function is similar to that performed by the Registrar of Companies for companies registered under the Companies Act 2006. The registration function does not involve prudential or conduct regulation of the kind applied to persons authorised to carry on regulated activities (financial services) in the UK under s 31 of the Financial Services and Markets Act 2000 (FSMA). Whilst it is entirely possible that a registered society becomes authorised to carry on regulated activities, the functions the FCA exercises in respect of such regulated activities stem from applicable domestic and European financial services legislation and not from the mutual societies legislation discussed in this book.[1]

The FCA's statutory functions under mutual societies legislation are carried out within the FCA by the Mutual Societies Team which operates within the FCA's Authorisations Division. Any society with a registered office in the Great Britain is subject to the FCA's registration procedures.

The FCA can be contacted at:

Mutual Societies Team
Financial Conduct Authority
25 North Colonnade
Canary Wharf
London
E14 5HS

Further information about the FCA and its role as the registrar for mutual societies can be found on its website[2] and in the notes that it has published as an aid to completing relevant forms and other informal but published FCA guidance. Those publications do not amount to general or specific 'Guidance' as defined in FSMA 2000 and as such are not subject to the statutory procedural requirements, which include a consultation and the performance of a cost benefit analysis.[3] However, as guidance issued by a public

[1] See Section **3.2.** (below) and Financial Services Act 2012, ss 50–54, and Financial Services Act 2012 (Mutual Societies) Order 2013, SI 2013/496 ('Mutual Societies Order 2013'), art 2.
[2] http://www.fca.org.uk/firms/firm-types/mutual-societies.
[3] FSMA 2000, s 139A(3)–(5).

authority their status is still subject to normal public law principles. This means that the guidance is not binding on those to whom it applies, nor does it have 'evidential' effect. It is really an expression of the FCA's position in respect of a particular aspect of the legislation within its remit and how it would expect societies to act. Having said that, such guidance may be subject to judicial review.[4]

3.2. THE ROLE OF THE FCA AND THE PRA SINCE 2013

Before 1 April 2013, the Financial Services Authority (FSA) exercised functions under the legislation that governs the establishment and operation of mutual societies, such as the Industrial and Provident Societies Act 1965. As part of the creation of a single financial services regulator in 2001, the FSA took over the role carried out by the Registrar of Friendly Societies for mutual societies from the early nineteenth century. The FSA also exercised functions as the single supervisory authority under FSMA and related financial services legislation. In other words, the FSA registered societies and regulated those societies that were carrying on regulated activities such as accepting deposits and entering into a regulated mortgage contract as a lender.

In the aftermath of the financial crisis of 2008–2011, the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) replaced the FSA in exercising functions under FSMA and this also required changes to the legislation governing mutual societies. These changes were made through the Mutual Societies Order 2013, SI 2013/496 (Mutual Societies Order 2013). Generally speaking, the Mutual Societies Order divided functions previously exercised by the FSA under mutuals legislation, between the PRA and the FCA and inserted co-ordination mechanisms to allow for a consistent and effective approach under the new system of dual-regulation.

3.2.1. The functions of the FCA

The functions the FCA has taken over from the FSA under mutual legislation include those related to registration, maintenance of the register and the public file. However, the FCA is also responsible for the prosecution of offences, and most of the functions concerning the administration of mutual societies. This is consistent with the split in functions between the PRA and the FCA under financial services legislation.

The Mutual Societies Order 2013 applies FSMA 2000 to the functions transferred to the FCA by providing that those functions are to be treated as if they had been conferred on the FCA by FSMA. So, for example, the FCA can arrange for the transferred functions to be discharged by a 'committee, sub-committee, officer or member of staff of the FCA', providing any legislative functions are carried out by the FCA's governing body (the 'Board').[5] The provisions about: the investigation of complaints against the FCA; FCA records; the FCA annual report; its annual public meeting; penalties; fees; duty of FCA and PRA to ensure co-ordinated exercise of functions and to prepare memoranda of understanding; the FCA's power to give guidance; and the FCA's exemption from liability in damages also all apply to the transferred functions.[6]

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4 *Gillick v West Norfolk and Wisbech Area Health Authority* [1986] AC 112 at 163, 178.
5 FSMA 2000, Sch 1ZA, para8.
6 Mutual Societies Order 2013, Sch 1, para 2(2), (6)–(10).

The duty to consult and to perform a cost benefit analysis under s 137A(5) will apply when guidance is issued to or given to registered societies generally or to a class of such societies.[7] Any guidance issued by the FCA that is not subject to a consultation requirement is excluded from competition scrutiny under FSMA 2000.[8] However, the jurisdiction of the High Court or Court of Session over acts or omissions of the FCA in discharging its functions conferred by s 415 of FSMA applies to its functions in respect of mutual societies.[9]

The FCA, when making rules, giving general guidance or determining the FCA's general policy and principles in respect of its functions under mutual societies legislation, is not required to comply with its general duties under s 1B of FSMA.[10] Those general duties include acting so far as reasonably possible in a way compatible with the FCA's strategic objective of ensuring that relevant markets function well and advancing one or more of its operational objectives – consumer protection, integrity, competition and, for certain activities of PRA-regulated persons, the continuity objective. HM Treasury can override this; it was its policy intention not to apply the FCA's objectives to its functions under mutual societies legislation.[11]

The Mutual Societies Order 2013 introduces a requirement for the FCA to exercise monitoring and enforcement powers in respect of mutual legislation similar to the one imposed on it by virtue of s 1L of FSMA 2000: 'The FCA must maintain arrangements designed to enable it to determine whether persons are complying with requirements imposed on them by or under … (a) legislation relating to mutual societies …'.[12]

This contrasts with the situation of the FSA under the previous Mutual Societies Order 2001, which only stated that if the FSA decided to maintain arrangements to monitor and enforce mutual societies legislation, it was entitled to delegate those functions. The FSA was not required to maintain such arrangements.

These adaptations ensure that while the role of the FCA in respect of mutual societies is primarily to register the societies, keep a public record, and ensure that registered societies qualify, and continue to qualify, for registration under the relevant 'mutual' legislation, it also has a duty to maintain arrangements to determine whether societies, their members, committees, and their officers are complying with those requirements. It is for this reason that, at the time of writing (June 2014), the FCA is in the process of reviewing, clarifying, and developing its procedures and the requirements for societies to provide initial and ongoing information to assist the FCA in determining whether they are complying with the legislation.[13]

It has always been clear that the registration function for societies differs from the equivalent role carried out by the registrar of companies (Companies House) under the Companies Act 2006. The FCA has to be satisfied that a society is a co-operative or a community benefit society both on registration and while it remains registered.[14] That

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7 Mutual Societies Order 2013, Sch 1, para 8.
8 Mutual Societies Order 2013, Sch 1, para 10.
9 Mutual Societies Order 2013, Sch 1, para 2(2)(g) and see Section **10.2.5.** below.
10 FSMA 2000, s 1B(7).
11 Ibid and see HM Treasury, 'A new approach to financial regulation: draft secondary legislation' (October 2012), paras 4.12–4.14.
12 Mutual Societies Order 2013, Sch 1, para 5.
13 See Section **3.3.3.** below.
14 CCBSA 2014, ss 3(2) and 16(1).

information is gathered in the application form for registration or to register a rule amendment, from information supplied by society members or others, and, it seems likely, from 2014, from reports submitted annually by societies to allow the FCA to monitor continued compliance. The FCA can cancel the society's registration if the appropriate condition is no longer met.[15] By comparison, Companies House can rely on a statement of compliance that the requirements of the Companies Act have been met on registration and then has a limited ongoing monitoring role.[16]

Exactly how the FCA will implement its duty under Mutual Societies Order 2014 to maintain arrangements to determine compliance with the legislation is, at the time of writing, still unclear, although Section **3.3.3**. (below) gives some indication.

A report ordered by the House of Commons and published on 18 February 2010 on the failure of the Presbyterian Mutual Society (an industrial and provident society registered with the Department of Enterprise Trade and Investment Northern Ireland (DETINI) under laws of Northern Ireland) may provide some insight, at least on how the government would regard the registrar's functions. The Treasury Committee of the House of Commons states:

> 'We understand that the Registrar had no regulatory functions in relation to industrial and provident societies, and could take no action. But we do not believe that the Department of Enterprise, Trade and Investment NI was so circumscribed. We note DETINI's opinion that it was not their legal responsibility to regulate the PMS or manoeuvre them into regulation. We are dismayed, however, that the Department had access to all the relevant information and yet this did not result in any preventative action or further examination being undertaken. We are surprised that DETINI did not consider whether the regulatory gap needed to be filled. This might well have entailed action in London as well as in Belfast, but as the department closest to the problem, DETINI should have taken a lead in identifying the problem, and in seeking a solution.'[17]

The same report, states that because, in the United Kingdom, industrial and provident societies are not regulated but 'registered' and in England and Wales and Scotland the FSA (now FCA) is responsible both for the registration of societies and the regulation of financial services firms, 'it is well placed to draw the attention of the regulator to registered bodies which appear to be straying into regulated business'.[18] Both of these paragraphs and the general tone of the report suggest that, while the FCA is not expected to act as a regulatory authority for societies, it is not limited to purely administrative tasks.

In other words, its role under mutual legislation does not involve the protection of consumers, integrity and competition in the same way as its role as financial services regulator. However, the FCA does have a role in determining whether a society is and remains either a bona fide co-operative or a community benefit society and whether it is breaching other requirements of mutual or other legislation.

The continued validity of things done by the FSA before the transfer of its functions to the FCA does not technically represent a particular issue as by virtue of s 1A of FSMA 2000 the body corporate known as the FSA was renamed the FCA. This has the effect

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15 CCBSA 2014, s 5(5).
16 Companies Act 2006, s 13.
17 Treasury Committee, *The failure of the Presbyterian Mutual Society*, (HC 2009–10, 260), para 38.
18 Ibid, para 26.

that it is the same body corporate that carried out functions before 1 April 2013. Additionally, s 54(2) of the Financial Services Act 2012 (FSA 2012) prevents the revocation of any order made under a provision relevant to mutual societies before the transfer of functions and references, in legislation or elsewhere, to the FSA can be read as references to the FCA, except in respect of a PRA function.[19]

3.2.2. The functions of the PRA

Under FSMA, the PRA is the prudential regulator of all deposit-takers, insurers and the systemically important investment firms, focusing on their safety and soundness. The Mutual Societies Order 2013 assigned to the PRA all functions of the FSA under the previous legislation that are relevant to the safety and soundness of PRA authorised mutual societies such as credit unions.

The policy rationale behind this approach was twofold. On the one hand, it followed the general objective of the financial services reform of developing financial stability. The PRA has a core general objective, of promoting the safety and soundness of deposit-takers, insurers and systemically important investment firms. By applying that to its functions under mutual societies legislation, the PRA is required to exercise its functions for mutual societies in ways that advance this and its other objectives. In other words, the PRA can operate with consistent objectives irrespective of whether it is exercising FSMA functions or mutuals functions. On the other hand, applying the PRA's objectives to its functions under mutual societies legislation ensures that Parliament can hold the PRA to account against its mandate of promoting the safety and soundness of firms when carrying out its those functions.[20]

Given that the reform in financial services was a response to the financial crisis, this public policy seems entirely reasonable. However, it does blur the lines between financial regulation and the registration function for mutual societies. Before this change it was clear when the FSA was exercising its functions as registrar rather than its function as financial services regulator.

Reflecting that policy, the PRA is required to exercise its functions under mutual legislation in a manner that advances its objectives.[21] However, the Mutual Societies Order 2013 treats the PRA in a similar way to the FCA in respect of the discharge of its functions. Like the FCA, the PRA can arrange for the transferred functions to be discharged by a 'committee, sub-committee, officer or member of staff', providing any legislative functions are carried out by the PRA's governing body (the 'board').[22] The other FSMA roles that have been transferred are: the investigation of complaints against the PRA; the PRA annual report; penalties; fees; and the duty of FCA and PRA to ensure co-ordinated exercise of functions and to prepare memoranda of understanding.[23]

The Mutual Societies Order 2013 sets out transitional provisions stating that, subject to exceptions, anything done by the Financial Services Authority before 1 April 2013 in exercise of a function, which on that date is exercisable by the PRA by virtue of the

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19 FSA 2012, Sch 20, para 3.

20 HM Treasury, 'A new approach to financial regulation: draft secondary legislation' (October 2012), para 4.10.

21 FSMA 2000, ss 2B and 2J; Mutual Societies Order 2013, Sch 1, para 3(2)(b).

22 FSMA 2000, Sch 1ZB, para 16.

23 Mutual Societies Order 2013, Sch 1, paras 3(2) and 6.

Mutual Societies Order 2013 is, to the extent appropriate, to be treated as if it had been done by the PRA.[24] The exceptions are that any amendments made by the order requiring documents, information or other matters to be notified, copied or sent to the PRA do not have effect if the information was sent to the FSA before 1 April 2013 and that, where the order makes amendments requiring the PRA to consent to or be consulted on a particular matter, that does not take effect if the FSA was consulted on or approved a particular matter before 1 April 2013.[25]

3.2.3. The FCA's approach to mutual societies

In advance of CCBSA 2014 coming into force on 1 August 2014 and in the light of the substantive changes to the law introduced from April 2014, the FCA reviewed its approach to its statutory role of registering societies and ensuring that they comply with CCBSA 2014. The 2014 changes to the law are discussed in the relevant sections of this book and their legal sources are outlined in Section **1.4.1.** The main changes were:

- The limit on the amount of withdrawable share capital that an individual or company could hold in a society was increased from £20,000 to £100,000.
- The administration procedure and creditor voluntary arrangement insolvency rescue procedures and the Companies Act scheme of arrangement provisions were applied to societies.
- The Financial Conduct Authority (FCA) was given additional powers to investigate societies.
- Electronic submission of registration documents was simplified.

The development of the approach to the registration requirements for co-operatives and community benefit societies began in 2011 under the FSA. At that time, advice was taken from Cobbetts LLP on the FSA's role. That advice was made public[26] and was the subject of consultation with relevant stakeholders in 2012.

A new FCA publication, building on that consultation, is expected to appear in 2014. It is likely to update and elaborate in one document existing information for FCA staff, registered societies and the public on procedures, forms and the FCA's role in respect of co-operative and community benefit societies. At the time of writing in June 2014, the document was not yet publicly available.

The effect of the requirement in Mutual Societies Order 2013[27] that the FCA maintain arrangements to determine whether societies and their committees and managers are complying with the requirements of the legislation gave further impetus to the development of FCA practices expected to be outlined in the 2014 guidance.

The 2014 changes to the law have encouraged the FCA to develop the criteria it applies to decide whether the registration requirements are met. It seemed at the time of writing that the main developments of FCA criteria and practice in 2014 might include:

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24 Mutual Societies Order 2013, Sch 12 para 3.
25 Ibid paras 1 and 2.
26 But only by the editor of this work at https://drive.google.com/file/d/0B3k1mIyJumBSLUU2Mkl2cTFJVk0/edit?usp=sharing.
27 Mutual Societies Order 2013, Sch 1, para 5 and see the text to fnn 14–19 above.

- the encouragement or requirement of increased annual reporting by societies to their members, focused on the society's continued compliance with registration requirements;
- an obligation to confirm in the society's annual return that there has been no material change in the conduct of the society's affairs that would alter statements made in the original application for registration;
- a requirement for FCA approval for share issues to check for conformity with those requirements;
- a requirement to file a statutory declaration on the issue of a loan security to the effect that the society's registration requirements will still be met after the issue of the security;
- greater elaboration in the FCA publication of its understanding of the limits on returns on capital offered to holders of society shares or loan securities.

The treatment of the concepts of a bona fide co-operative and a community benefit society discussed in Sections **3.4.1.** and **3.4.2.** below are informed by the anticipated content of the guidance to be issued in 2014 as well as the information available in June 2014.

However, on those and other issues readers should visit the FCA's website[28] for up-to-date information on its approach, which is likely to develop over time.

3.3. MEANING OF 'REGISTERED SOCIETY' AND CONDITIONS FOR REGISTRATION

3.3.1. Meaning of registered society

CCBSA 2014 defines two categories of 'registered society':

- those registered or treated as registered under the renamed Co-operative, Community Benefit Society and Credit Unions 1965 (formerly Industrial and Provident Societies Act 1965) before 1 August 2014; and
- those registered under CCBSA 2014.[29]

This allows for societies that were registered under previous legislation to still be caught under the provisions of the CCBSA 2014.

The key difference between the two categories is that, from 1 August 2014, a society is *registered as* either a co-operative or a community benefit society. It must meet the requirement for one or other of those categories and be registered on that basis. Before 1 August 2014, registration was permitted so long as a society fitted one of those categories and registration was *as* an industrial and provident society (now renamed 'co-operative and community benefit society').

For societies registered under CCBSA 2014, a future change from a co-operative to a benefit of the community society or vice versa will involve rule amendments. It will also involve the cancellation of registration in one category and re-registration in the other.

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28 http://www.fca.org.uk/firms/firm-types/mutual-societies.

29 CCBSA 2014, ss 1 and 150.

The administrative practice that the FCA will apply to that process is unclear at the time of writing. It may invove the registration of a new society, a transfer of the old society's engagements to it, and the cancellation of the old society's registration at its own request.

For a pre-commencement society (registered before 1 August 2014) wishing to amend its rules to change them from those appropriate to a co-operative to those suitable for a benefit of the community society, or vice versa, registration under the CCBSA 2014 as either a co-operative or a benefit of the community society will be necessary and the FCA will check that the CCBSA 2014 requirements are met.

Both cases will involve FCA scrutiny to ensure that the proposed rule amendments and the proposed activities and structure of the society will comply with the requirements set out in Section **3.4**. below for a co-operative or a community benefit society, depending on the category to which the re-registered society will belong.

For the registration of a credit union, special rules apply under the Credit Unions Act 1979.[30]

Two types of society can be registered under CCBSA 2014 provided they meet the conditions for registration (discussed below). These are:

- a co-operative society; and
- a community benefit society.[31]

Pre-commencement societies continue to be registered and enjoy all the privileges of a registered society.[32]

3.3.2. Conditions for registration for all societies

In addition to the characteristics and conditions for registration that apply separately for co-operatives and community benefit societies,[33] any society seeking registration must comply with certain general conditions:

- It must be a society for carrying on any industry business or trade.[34] A 'trade' in this context includes dealings of any kind with land. While this is normally an easy condition to satisfy, societies that hold shares in another organisation without carrying on any activity of their own may have to engage with the FCA and explain how the mere holding of shares amounts to an industry trade or business.
- It must have at least three members or two members if both are registered societies.[35] It is important to note that the minimum of two applies only if both members are registered societies. If one or more members are companies, the minimum of three members will still apply. In the case of a credit union the minimum membership for registration is 21.[36]

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30 CCBSA 2014, s 2(4) and see **Chapter 13**.
31 CCBSA 2014, s 2(1).
32 CCBSA 2014, ss 1(1)(b) and 150(1).
33 See Section **3.4.** below.
34 CCBSA 2014, s 2(1).
35 CCBSA 2014, s 2(2)(b).
36 Credit Unions Act 1979, s 6(1)(a) and see **Chapter 13** below.

- Its rules must contain provision in respect of the matters specified in s 14 CCBSA 2014.[37]
- Its registered office must be in Great Britain or the Channel Islands.[38] Every society must have a registered office which is the address to which all official communications may be sent. The address of the registered office must appear in the rules of the society.[39] The registered office is usually its principal office but need not be. Any change in the society's registered office must be notified to the FCA and, on registration, takes effect as a change of rule.[40]
- It must have a name that the FCA does not consider undesirable.[41]

The CCBSA 2014, in line with previous legislation, recognises that a society exists before registration makes it a 'registered society'. It already has members and a secretary and exists as an unincorporated association. As Lewison J put it in *Boyle v Collins*[42] in respect of the registration section under the (now repealed) Industrial and Provident Societies Act 1965:

> 'Subject to immaterial exceptions, section 1 of the 1965 Act enables a society to be registered if it is a bona fide co-operative society; its rules make provision for prescribed matters, and its registered office is in Great Britain. It follows from this that the existence of a society must pre-date the registration. This is reinforced by section 2(1)(b) which says that an application for registration must be signed by the secretary of the society and three members. This necessarily presupposes that there is a secretary and a membership of the society before it is registered. Normally a society of this kind will be an unincorporated association and trustees will hold its property for the benefit of the members for the time being.'

This is also supported by CCBSA 2014, s 57, which, subject to any agreement to the contrary, deems any contract made by or on behalf of a registered society before it was registered to have effect between the person purporting to act for the society or as an agent for the society and the other party.

Arguably the most important condition that a society seeking registration must meet is that it is shown to the satisfaction of the FCA:

- in the case of registration as a co-operative society, that the society is a 'bona fide co-operative society', or
- in the case of registration as a community benefit society, that the business of the society is being, or is intended to be, conducted for the benefit of the community.[43]

Whether this condition is met will depend on the specific characteristics of the society, which are discussed below. However, where this condition is not met to the satisfaction of the FCA, it has the power to refuse registration. More importantly, where a society has already been registered and fails to satisfy the FCA that it continues to meet this condition, the FCA has power to cancel the society's registration.[44]

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37 CCBSA 2014, s 2(2)(c) and see **Chapter 4**.
38 CCBSA 2014, s 2(2)(d).
39 CCBSA 2014, s 14 para 3.
40 CCBSA 2014, s 16(3).
41 CCBSA 2014, s 10(1) and see Section **3.5.2.** below.
42 [2004] EWHC 217 [18].
43 CCBSA 2014, s 2(2)(a).
44 CCBSA 2014, ss 2(2) and 5(5).

3.4. BONA FIDE CO-OPERATIVE OR COMMUNITY BENEFIT SOCIETY

3.4.1. Bona fide co-operative

CCBSA 2014 provides limited assistance in defining the concept of a bona fide co-operative society. For the purposes of registration a 'co-operative society' does not include a society that carries on, or intends to carry on, business with the object of making profits mainly for the payment of interest, dividends or bonuses on money invested or deposited with, or lent to, the society or any other person.[45] That provision originated in the Prevention of Fraud (Investment) Act 1939, which introduced the requirement that a society must be a co-operative or community benefit society to be permitted to register under this legislation.[46] Given the context of that legislation and the parliamentary debates at the time, it is clear that the intention of the legislature was to prevent the use of co-operative societies for 'share pushing' and similar purposes.[47] Thus there is no general prohibition on the payment of interest on, for example, society shares or loan securities. The question is whether such payments can be said to be the object for which its business is carried on.

Generally speaking, the FCA's approach is to apply the generally acknowledged Co-operative Principles developed by the International Co-operative Alliance (ICA) to decide the question, with particular reference to the provisions of the society's rules. The latest refinement of those principles and the defining features of co operatives were agreed at the ICA Congress in Manchester in September 1995:[48]

> **'International Co-operative Alliance**
> **Statement on the Co-operative Identity**
>
> **Definition**
>
> A co-operative is an autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise.
>
> **Values**
>
> Co-operatives are based on the values of self-help, self-responsibility, democracy, equality, equity and solidarity. In the tradition of their founders co operative members believe in the ethical values of honesty, openness, social responsibility and caring for others.
>
> **Principles**
>
> The co-operative principles are guidelines by which co-operatives put their values into practice.
>
> **1st Principle: Voluntary and Open Membership**

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45 CCBSA 2014, s 2(3).

46 See Section **2.1.5.** above and Ian Snaith, 'What is an industrial and provident society?' (2001) 34 Journal of Co-operative Studies 37–42.

47 See the comments of the President of the Board of Trade at Standing Committee A Official Report Prevention of Fraud (Investments) Bill, 5 December 1938, cols 70–1.

48 International Co-operative Alliance, *Statement on Co-operative Identity*, Geneva 1995 downloaded from http://ica.coop/en/whats-co-op/co-operative-identity-values-principles on 29 June 2014.

Co-operatives are voluntary organisations, open to all persons able to use their services and willing to accept the responsibilities of membership, without gender, social, racial, political or religious discrimination.

2nd Principle: Democratic Member Control

Co-operatives are democratic organisations controlled by their members, who actively participate in setting their policies and making decisions. Men and women serving as elected representatives are accountable to the membership. In primary co operatives, members have equal voting rights (one member, one vote) and co operatives at other levels are also organised in a democratic manner.

3rd Principle: Member Economic Participation

Members contribute equitably to, and democratically control, the capital of their co operative. At least part of that capital is usually the common property of the co operative. Members usually receive limited compensation, if any, on capital subscribed as a condition of membership. Members allocate surpluses for any of the following purposes: developing their co-operative, possibly by setting up reserves, part of which at least would be indivisible; benefiting members in proportion to their transactions with the co-operative; and supporting other activities approved by the membership.

4th Principle: Autonomy and Independence

Co-operatives are autonomous, self-help organisations controlled by their members. If they enter into agreements with other organisations, including governments, or raise capital from external sources, they do so on terms that ensure democratic control by their members and maintain their co-operative autonomy.

5th Principle: Education, Training and Information

Co-operatives provide education and training for their members, elected representatives, managers, and employees so they can contribute effectively to the development of their co-operatives. They inform the general public – particularly young people and opinion leaders – about the nature and benefits of co-operation.

6th Principle: Co-operation among Co-operatives

Co-operatives serve their members most effectively and strengthen the co operative movement by working together through local, national, regional and international structures.

7th Principle: Concern for Community

Co-operatives work for the sustainable development of their communities through policies approved by their members.'

The last three principles do not have a major impact on the legal framework within which co-operatives work, but the first four are typically used by the FCA as criteria in deciding whether an organisation is a bona fide co-operative.

These principles apply in the context of particular co-operative sectors. Membership of a worker co-operative must be open to all employees but need not be open to others and any distributions of surplus will be in proportion to the work done by members. In the case of housing co-operatives, it is tenants to whom membership must be open and

distributions may be by rent rebate. For consumer co-operatives membership will be open in the fullest sense, since anyone can be a consumer, and dividends on purchases are the appropriate mechanism for distributions of surplus. In all cases there must be a limited return on capital and only in secondary co-operatives will a departure from the one member one vote principle be justified. The mechanisms for democratic control by the election of officers may vary from a secret postal ballot to a show of hands at a general meeting and elections need not necessarily be contested.

At the time of writing, the Information Notes on Registration issued by the FCA to assist users of the service provide the best guide to their approach to the exercise of their statutory discretion under the CCBSA 2014. New guidance is likely to be published later in 2014. For up-to-date information, readers should consult the FCA website.[49]

The criteria used by the regulator as set out in the Information Notes are:

> 'Such societies are formed primarily to benefit their own members, who will participate in the business of the society.
>
> To satisfy us that it will be a bona fide co-operative, a society will normally have to fulfil the following conditions, the first four of which also reflect the International Co-operative Alliance's Statement on the Co-operative Identity:
> - **Community of interest** – There should be a common economic, social or cultural need or interest among all members of the co-operative.
> - **Conduct of business** – The business will be run for the mutual benefit of the members, so that the benefit members obtain will stem principally from their participation in the business. Participation may vary according to the nature of the business and may consist of:
>   - buying from or selling to the society;
>   - using the services or amenities provided by it; or
>   - supplying services to carry out its business.
> - **Control** – Control of the society lies with all members. It is exercised by them equally and should not be based, for example, on the amount of money each member has put into the society. In general, the principle of 'one member, one vote' should apply. Officers of the society should generally be elected by the members who may also vote to remove them from office.
> - **Interest on share and loan capital** – Where part of the business capital is the common property of the co-operative, members should receive only limited compensation (if any) on any share or loan capital which they subscribe. Interest on share and loan capital must not be more than a rate necessary to obtain and retain enough capital to run the business. [Section 2(3) of the 2014 Act] states that a society may not be a bona fide co-operative if it carries on business with the object of making profits mainly for paying interest, dividends or bonuses on money invested with or lent to it, or to any other person.
> - **Profits** – If the rules of the society allow profits to be distributed, they must be distributed among the members in line with those rules. Each member should receive an amount that reflects the extent to which they have traded with the society or taken part in its business. For example, in a retail trading society or an agricultural marketing society, profits might be distributed among members as a dividend or bonus on purchases from or sales to the society. In other societies (for example, social clubs) profits are not usually distributed among individual members but members benefit through cheaper prices or improvements in the amenities available.
> - **Restriction on membership** – There should normally be open membership. This should not be restricted artificially to increase the value of the rights and interests of current members, but there may be grounds for restricting membership in certain circumstances, which do not offend co-operative principles. For example, the

[49] http://www.fca.org.uk/firms/firm-types/mutual-societies.

membership of a club might be limited by the size of its premises, or the membership of a self-build housing society by the number of houses that could be built on a particular site

- Applicants should note that in stating the reasons for registration it is not acceptable merely to quote 'the objects rule'. We expect you to show which of the rules demonstrate that the society is a boba fide co-operative.

We may cancel the society's registration if at any time it appears that the society no longer complies with the conditions of registration.'[50]

The last point underlines that, apart from the need to establish that a society meets the statutory requirement on first registration, it is necessary that it should continue to do so. The FCA has power to cancel the registration of a society for failure to adhere to the registration requirements.[51]

In the new guidance to be issued later in 2014 the FCA seems likely to emphasise that a society may not qualify as a co-operative despite being democratically controlled and member owned if it relates to more than 25% of its members only through their share capital and provides the vast majority of its goods and services to non-members.

New guidance may explicitly permit multi-stakeholder co-operatives to weight the values of the votes of different member groups to protect the interests of non-investor members, providing no member can vote more than once. That allows another category of co-operative to join the well-established secondary co-operatives exception to the one member one vote principle. Wholly owned subsidiaries of co-operatives are to be expected to remain fully committed to co-operative values and principles.

Because the FCA must now maintain arrangements designed to enable it to monitor compliance with CCBSA 2014 requirements, it can be expected to monitor, at least on receiving a complaint and perhaps annually, whether societies are complying with the registration requirements.[52] That would involve monitoring whether the society's business is run in accordance with co-operative principles or community benefit objectives as well as checking rule amendments. That opens up the possibility of members' complaints to the FCA resulting in an informal investigation about that question.[53]

3.4.2. Community benefit societies

The objective of a community benefit society must reflect a commitment to conduct the business of the society for the benefit of the community. The FCA will regard the purpose of the society as a key criterion to determine whether registration under this

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[50] PRA and FCA, Mutual Societies Application Form, Registering a New Industrial and Provident Society; or Re-registering a Friendly Society as an Industrial and Provident Society; or Converting a Company into an Industrial and Provident Society: Notes (FCA Information Note) at pp 8–9. Downloaded from http://www.fca.org.uk/your-fca/documents/forms/registering-a-new-industrial-and-provident-society-notes on 29 June 2014.

[51] CCBSA 2014, s 2(1)(a) and see Section **12.8.** (below).

[52] Mutual Societies Order 2013, Sch 1, para 5 and see Section **3.2.1**. above.

[53] That is consistent with practice in the past. See Registry of Friendly Societies, *Report of the Chief 1989–1990*, which, at para 4.9, stated the principle and which elsewhere reported on action in respect of the relationship of Co-operative Retail Services Ltd (CRS) and the Co-operative Wholesale Society (CWS), based on the absence of member control of CRS and, separately, on the decision to take no action in respect of the run up period to the proposed conversion of Unichem Ltd into a company.

category should be granted. A rationale which reinforces the approach of the FCA to these societies is to be found in the Information Note:

> '[A] key difference between the regulation of companies and industrial and provident societies is that societies for the benefit of the community registered under the [CCBSA 2014] enjoy exemptions from statutes designed to protect persons who provide finance to a business.
>
> For example, section 85 of the Financial Services and Markets Act 2000 prohibits transferable securities from being offered to the public in the United Kingdom unless an approved prospectus has been made available. However, if certain conditions are met, this prohibition does not apply to community benefit societies …
>
> Our assessment of the application will take into account whether the strength of the benefit which will be delivered to the community through the society's activities outweighs the reduction in the regulatory protection that will be available to those who subscribe capital to the society.'[54]

In one of the few changes to the substantive law included in the consolidating CCBSA 2014, the requirement for a society seeking to register as a community benefit society to have special reasons to be registered under mutual legislation rather than under the Companies Acts was repealed.[55] That was in accordance with a Law Commission recommendation presented to Parliament as part of the consolidation procedure. The rationale was to align the position in Great Britain with that found in Northern Irish legislation and to amend the legislation in accordance with FCA practice, itself based on the Hansard Report of debates on the Prevention of Fraud (Investments) Act 1939 which introduced the 'special reason' requirement.[56]

The FCA Information Notes on Registration set out the criteria for registration of a community benefit society:

> 'We will normally expect a society to fulfil these conditions:
> - **Conduct of business** – The business must be run primarily for the benefit of people who are not members of the society, and must also be in the interests of the community at large. It will usually be charitable or philanthropic in character.
> - **Interest on share and loan capital** – It is unusual for a benefit of the community society to issue more than nominal share capital (for example, one £1 share per member). Where it does issue more than nominal share capital or where members make loans to the society, or both, any interest paid must not be more than a reasonable rate necessary to obtain and retain enough capital to run the business.
> - **Profits and assets** – The society's rules must not allow either profits or the society's assets to be distributed to the members. Profits must generally be used to further the objects of the society by being ploughed back into the business. Where profits are used in part for another purpose, that purpose should be similar to the main object of the society, for example for philanthropic or charitable purposes. The rules must specify the beneficiary or beneficiaries, if any.
> - **Where the rules of the society allow assets to be sold**, the proceeds of the sale should be used to further the society's business activities only.
> - **Dissolution** – The society's rules must not allow its assets to be distributed to its members on dissolution. The rules should state that on dissolution the assets should be

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54 FCA Information Note, p 9.

55 See Industrial and Provident Societies Act 1965 (IPSA 1965), s 1(2)(b) and compare CCBSA 2014, s 2(2)(a)(ii).

56 Law Commission and Scottish Law Commission, *Co-operative and Community Benefit Societies Bill* (Cm 8768, 2013), Appx 1 Recommendation 1, pp 2–3.

> transferred, for example, to some other body with similar objects. If no such body exists, the rules should state that the assets must then be used for similar charitable or philanthropic purposes.'

The FCA may cancel a society's registration if at any time it appears that the society no longer complies with the conditions of registration.

These criteria underline the fundamental difference between a co-operative and a community benefit society. The former serves its members' interests and the latter serves the interests of a community outside its membership. A clear example of this can be found in the housing field. A housing co-operative will be owned and controlled by its own tenant members. They will elect the committee or board and the business will be run in their interests as tenants. A housing association will be registered as a community benefit society and will have a membership not primarily composed of tenants while its object will be to serve the community by providing social housing. The inability of a housing association to distribute its assets or profits will be laid down in its rules but is also guaranteed by the role, in England, of the Homes and Communities Agency as the regulator of that sector and guardian of the public funds invested in it. This has not prevented the development of tenant management and stakeholder representation on the boards of some housing associations.

The question of structuring social housing providers with significant tenant voice but protection of the dedicated assets may involve the imaginative use of mutual society structures and the combination of both co operative and community benefit elements. However, the registration of the society must be as either a co-operative or a community benefit society and the FCA must be satisfied that it meets the appropriate definition. This issue can arise in connection with other bodies holding 'community assets' and allowing consumer participation but not full control. They will usually be registered as community benefit societies to underline the 'locking in' of the assets to serve community purposes but may include minority user representation at board level and user consultation on policy decisions.

A community benefit society with rules preventing 'trading at a profit' and prohibiting any distribution to members can be regarded as an 'investment company' for the purpose of taxation if its actual activities, history and plans involve holding assets to produce a profitable return as its central ('very') business.[57] This was established in *Cook (Inspector of Taxes) v Medway Housing Society Ltd*,[58] a case involving a society providing housing at a return below the market rate.

It seems likely that the guidance being developed by the FCA during 2014 will elaborate on the question of the appropriate return on capital to be permitted in the case of a community benefit society, particularly the limit in the present Information Note to 'a reasonable rate necessary to obtain and retain enough capital'. For example, fuller indications may be given of acceptable levels of return, by reference to other financial products such as deposits in savings accounts or the interest paid on commercial borrowing. That would address the problem that a rate necessary to obtain and retain capital for a risky project could be comparable to the return on equities in a company

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[57] Income and Corporation Taxes Act 1988, s 130 and see also s 1218B of the Corporation Tax Act 2009.

[58] [1997] STC 90 and see *Dawsongroup Plc v Revenue and Customs Commissioners* [2010] EWHC 1061 (Ch) [16] and [38].

limited by shares, an approach that would undermine the dedication of the society's assets to community benefit and fail to emphasise the need for the rate to be 'reasonable'.

The Charity Commission also has clear and strict requirement about the terms of shares issued by a community benefit society which seeks or has charitable status.[59]

It also seems likely that in the case of a community benefit society engaging in a joint venture, the FCA will want the society to show how the venture will benefit the community, particularly where the joint venture is with a for-profit business.

Unlike the condition for registration as a co-operative, the criterion for registration as a community benefit society does not include a requirement for either open membership or member control. However, in some cases, such as certain housing associations in England where society membership is restricted to the board itself, the FCA may in future seek assurances that the board will display transparency of decision-making, independence among board members and continuity of community benefit to compensate for the lack of scrutiny that may arise from the absence of society members other than board members.[60]

In terms of monitoring these societies, the existing FCA Information Note states:

> 'We will be encouraging societies for the benefit of the community to publish a voluntary annual statement of their activities setting out how they have fulfilled their objectives. The purpose of the report is to promote public confidence in the society. The report is not a statutory requirement, so we do not prescribe its form and content. However, we intend to provide a space for it in annual return forms and societies that wish to do so can include it in their accounts.'[61]

3.5. RULES AND NAME

3.5.1. Rules

Two copies of the rules of the society to be registered (or one if the application is made electronically) must be sent to the FCA together with the application for registration.[62]

If model rules are used and the application to register is made through one of the sponsoring bodies that supply them, the fee will be lower. If the model rules are used without any amendment the lowest available fee applies. If there are between one and six amendments a higher rate applies, between seven and ten amendments will attract a yet higher level while 11 or more amendments attract the full fee payable for a 'free draft'.[63] The FEES module of the FCA Handbook specifies all its rules relevant to fees charged to mutual societies that do not carry on regulated activities. That indicates that

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[59] See Charity Commission Statement in CC23 on Exempt Charities at http://www.charitycommission.gov.uk/detailed-guidance/registering-a-charity/exempt-charities-cc23/industrial-and-provident-societies/ and see Section **8.1**.

[60] See Section **7.1**. below text to footnote 5.

[61] FCA Information Note, pp 9–10.

[62] CCBSA 2014, s 3(1)(b).

[63] See Section **3.7.** below.

any number of changes to a single numbered rule and its sub-clauses count as a single amendment and information fitted into a space provided in the model is not regarded as an amendment.[64]

The model rules have been agreed by the FCA and are thus not likely to give rise to any queries when they are used. However, it is important for a group setting up a society to be sure that the model they have chosen is appropriate to their particular needs and to discuss any problems with the sponsoring organisation.

The FCA's decision not to register a society because of anything contained in or omitted from its rules (or on any other ground except a failure to satisfy the 'bona fide co-operative' or 'community benefit' conditions in CCBSA 2014, s 2(2)(a)) is subject to appeal to the High Court (in England) or (in Scotland) to the Court of Session.[65] If the appeal succeeds the FCA must issue an acknowledgement of registration.[66]

The High Court and Court of Session can also hear proceedings arising out of any act or omission of the FCA in the discharge of its functions and that jurisdiction is expressly stated to be in addition to any other jurisdiction exercisable by those courts.[67] This may mean that an FCA decision about whether or not a society meets the co-operative or community benefit registration requirements could be challenged under s 415 of FSMA if s 2(2)(a) of CCBSA 2014 was incorrectly applied. This may be an academic point, however, as the conditions must be met to the FCA's 'satisfaction'. That makes such a challenge costly to mount and unlikely to succeed.

Rulings as to the interpretation of s 14 CCBSA 2014 about the matters to be included in the rules, the meaning of the rules themselves and whether the society is engaged in business or trade have always been open to challenge on appeal. However, in any case in which the objection to the rules is based on the FCA's opinion on whether the society is a bona fide co-operative or community benefit society no appeal under CCBSA 2014 is possible and only a challenge under s 415 of FSMA 2000 could be considered. This is likely to be in the nature of judicial review rather than an appeal. This puts a considerable premium on the way in which an FCA decision is justified.

For example, an objection to the existence of certain classes of share in a society (such as preference shares) based on the interpretation of s 14(9) of CCBSA 2014 would be subject to appeal. The same decision based on the effects of the proposed structure on the distribution of surplus, voting rights of members or the return on capital would not be subject to appeal if it amounted to a refusal to register based on failure to comply the co-operative or community benefit registration conditions. Only s 415 of FSMA 2000 could be used in such a case.

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64 FEES Annex 1AR and App 1 Annex 4R http://www.fshandbook.info/FS/html/FCA/FEES last visited 29 June 2014.

65 CCBSA 2014, s 9(2)(a) and (b).

66 CCBSA 2014, s 9(6).

67 FSMA 2000, s 415 and Mutual Societies Order 2013, Sch 1, para 2(2)(d).

3.5.2. Name

The FCA is entitled to refuse to register a society under a name which is, in its opinion, undesirable.[68] For this reason it is advisable to consult the FCA on this question in advance of an application to register.

The FCA information notes[69] on change of name indicate how the FCA approaches this question. A name will be refused as 'undesirable' when it is the same as, or too similar to, the name of an existing society or company or a charity name or, usually, one that existed at some time in the last 10 years. If a name implies regional national or international pre-eminence (eg 'International' or 'European'); royal, public authority or Government patronage; operation in a particular geographical area; links to another organisation or a particular individual; or that the society is a trust, the FCA will have to be convinced that this can be justified on the basis of the reality of the society's business and structure. The FCA Change of Name Notes list particular names, the use of which must be supported by evidence, or, in some cases, permission from a relevant body eg the use of 'dentist' requires permission from the General Dental Council.[70] The lists and rules are similar to those applied to companies by primary and secondary legislation but for societies they are applied as an exercise of the FCA's discretion on what may be 'undesirable'. It seems likely that, in the light of the new registration system under CCBSA 2014 under which societies register as either co-operatives or community benefit societies, restrictions will be added on each type of society including a word appropriate to the other in their name. For example, a community benefit society might not be permitted to register with the word 'co-operative' or 'co-op' in its name.

'Limited', or in the case of a society with a registered office in Wales which wishes to use the Welsh equivalent 'cyfyngedig', must be the last word in the name.[71] The FCA can only permit the omission of 'limited' or 'cyfyngedig' if it is satisfied that the objects of the society are 'wholly charitable or benevolent'.[72] This implies that any surplus is not distributable to members. Most societies engaged in business will be required to include the word. The policy behind the provision of the CCBSA 2014 and the practice of the FCA is to warn potential creditors of the risk they incur in dealing with a body whose members enjoy limited liability in carrying on a business. The FCA may direct the society to reinstate the word 'limited' (or 'cyfyngedig' where appropriate) as part of its name if the FCA believes that the society's objects are no longer wholly charitable or benevolent. In such a case the FCA must give the society notice of the direction.[73]

A registered society that is a charity, but which does not include the word 'charity' in its name, must state that it is a charity in legible characters in:

- all its notices, advertisements and other official publications;
- all its business correspondence;
- all its bills of exchange, promissory notes, endorsements, cheques and orders for money or goods purported to be signed by or on behalf of the society;
- all conveyances purporting to be executed by or on behalf of the society;
- all its business documentation; and

68 CCBSA 2014, s 10(1).
69 PRA and FCA Mutual Societies Application Form Change of Name: Notes ('FCA Change of Name Note').
70 FCA Change of Name Notes Appendices A to C.
71 CCBSA 2014, s 10(2).
72 CCBSA 2014, s 10(3).
73 CCBSA 2014, s 10(4).

- all its websites.[74]

References to a conveyance include any document for the creation, transfer, variation or extinction of an interest in land and any references 'execution' include purported execution, and the doing of any act which (though not by itself execution) combined with other acts constitutes execution or purported execution.[75]

This requirement does not apply to any document in Welsh where the society's name includes the word 'elusen' or 'elusennol'. Otherwise the statement that the society is a charity must be in English.[76] In this requirement and the CCBSA 2014 generally references to a charity mean a charity as defined in ss 1(1) and 7(2) of the Charities Act 2011 – 'an institution established for charitable purposes which falls to be subject to the control of the High Court in the exercise of its jurisdiction in respect of charities'.[77]

The purpose of this provision is to put parties dealing with the society on notice that it will be subject to s 47 of the CCBSA 2014, which limits the protection they would otherwise enjoy under ss 43 and 45 of the CCBSA 2014. This applies to those dealing with charitable societies if there is a problem with either the capacity of the society or with the capacity of the board or committee in connection with an act or transaction. In the case of a non-charitable society there is a higher level of protection. This provision is the equivalent of s 194 of the Charities Act 2011, which applies to a charity that is a company registered under the Companies Act 2006.[78] Sections **11.2.** and **11.3.** below deal with the effects of these provisions of CCBSA 2014.

Every society must ensure that its registered name appears in a conspicuous position and in legible characters on the outside of its registered office and every other place the society carries on business.[79] The name must also be mentioned in all the society's:

- notices, advertisements and other official publications;
- business correspondence;
- bills of exchange, promissory notes, endorsements, cheques and orders for money or goods, purporting to be signed by or on behalf of the society;
- other business documentation; and
- its websites.[80]

References to a society's website in those CCBSA 2014 provisions include any section of another person's website that relates to the society if the society placed the section on the other person's website or it was placed there with the society's authorisation.[81]

No society is required have a common seal but where a society has one it must have the society's registered name engraved on it with legible characters.[82]

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74 CCBSA 2014, s 12(1).
75 CCBSA 2014, s 12(6)(a) and (b).
76 CCBSA 2014, s 12(2) and (3).
77 CCBSA 2014, s 149.
78 Charities Act 2011, ss 193 and 353.
79 CCBSA 2014, s 11(1).
80 CCBSA 2014, s 11(2).
81 CCBSA 2014, ss 11(5) and 12(6)(c).
82 CCBSA 2014, s 50(1) and (2).

If a society omits the necessary information from a document or website, any society officer or other person acting for the society who issues, signs or executes the document, or who authorises those things to be done, or causes or authorises the appearance of a non-compliant website on the internet is guilty of an offence. In addition, if the offence relates to bills of exchange, promissory notes, endorsements, cheques and orders for money or goods, purporting to be signed by or on behalf of the society, the person convicted is personally liable to pay any amount due to the holder of the document and not paid by the society.[83]

The name of the society may be changed by passing a resolution at a general meeting where appropriate notice of the resolution was given to the members and the FCA gives its approval in writing. Appropriate notice in this case will be the notice required in the society's rules for a change of name or, if not specified, the notice period for a change of rules. The FCA will have to be given reasons when the application is made to register the change and will apply the same criteria as it would on the registration of a new society's name. However, on a name change, the FCA will, among other things, need to be satisfied that the change is necessary and will not confuse those dealing with the society, or be prejudicial to people having claims on the society.[84]

In the case of both changes of name and original registrations, prior consultation with the FCA is advisable. Up to three names will be checked by the FSA in advance if submitted in writing and in order of preference and an indication of approval of a name will be given without prejudice to the final decision.

The Registrar of Companies is obliged to maintain an index of the names of registered societies so as to ensure that those registering a company or changing a company name do not choose one already used by a society.[85] The change of name will affect none of the society's rights or obligations or any litigation current or pending in which it is involved.[86]

The FCA's Change of Name Form is used to change the name.

3.6. APPLICATION TO REGISTER

The formal application to register is made by sending a completed FCA registration form[87] together with two copies of the society's rules (or one if the application is made by electronic means). The application form can be obtained from the FCA's website and must be signed by three members and the secretary or, where both or all of its members are registered societies, the secretaries of two of those registered societies.[88]

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83 CCBSA 2014, ss 11(2) and (4) and 12(4) and (5).
84 FCA Change of Name Notes, p 2.
85 Companies Act 2006, s 1099(3)(e).
86 CCBSA 2014, s 13(3).
87 'Mutual Societies Application Form – Registering a New Industrial and Provident Society; or Re-registering a Friendly Society as an Industrial and Provident Society; or Converting a Company into an Industrial and Provident Society Form' (the 'Application Form').
88 CCBSA 2014, s 3(1).

The application form requires the society to state the proposed name of the society as well as the address to which communications by the FCA are to be sent. In addition, the members completing the application form must provide their names, addresses and contact numbers.

The application form also requires the society to list, alongside each requirement of the legislation about matters to be provided for in a society's rules, the number of the rule that deals with that issue.[89] To assist the FCA in deciding whether registration is possible in the category sought, the society must submit an explanation with reference to the appropriate rules of how it qualifies for registration as either a bona fide co-operative or a community benefit society. Anyone registering a community benefit society must also specify the community that the society will benefit, what activities it will undertake, how such activities benefit that community, how the society plans to fund its activities and how any surplus will be applied. If the society is to be a charity, details of the charity's trustees must also be submitted.

All applications must also include details of any close links which the society or any member of its committee has, or intends to have, with any society, company or authority. If the application form is submitted by a sponsoring body because its model rules are to be used it must be endorsed by that body by signing the application form before being sent to the FCA.

Any document may be 'delivered' to the FCA in any electronic or hard copy form that the FCA accepts.[90] The FCA and PRA have also been empowered to impose requirements as to the form, authentication and means of delivery of documents sent to it electronically. This includes the software or hardware to be used and technical specifications on matters such as protocol, security and encryption. However this does not extend to requiring the electronic submission of documents and is subject to consistency with statutory requirements about the form, authentication, or delivery of documents.[91]

For the purposes of CCBSA 2014 a document sent in electronic form includes documents sent by electronic means such as email, or fax or documents sent by other means while in electronic form for example in a data disk. A document is sent by electronic means if it is either sent initially and received at its destination by means of electronic equipment for the processing (including digital compression) or storage of data or entirely transmitted, conveyed and received by wire, by radio, by optical means or by other electromagnetic means. This includes any information sent as an email attachment or that is uploaded to a website. The definition applies whether CCBSA 2014 uses the word 'send', or other words such as 'deliver', 'furnish', 'issue', 'produce', 'provide', or 'supply'.[92]

In addition, the document or information must be sent in a form and by a means that the sender reasonably considers will enable the recipient to both read or, in the case of an image, see it with the naked eye and, in any case, retain a copy of it.[93] The requirement of legibility means that, if the sender did not consider or could not reasonably have considered that the form of the document or the means of sending

89 Application Form, Question 6, p 4.
90 CCBSA 2014, s 143(1)(c).
91 CCBSA 2014, s 144.
92 CCBSA 2014, s 148(2), (3) and (6).
93 CCBSA 2014, s 148(4) and (5).

would allow it to be read and a copy retained, it is not regarded as having been sent in electronic form and, since it was not sent in any other form, it will not be regarded as having been sent at all.

3.7. FEES

The powers of the FCA and PRA to make rules requiring the payment of fees extend to fees levied in connection with 'mutual expenditure'. That expression is defined as any expenditure of the FCA or PRA incurred for any purpose incidental to or in connection with carrying out functions under the mutual societies legislation or otherwise exercisable by virtue of the Mutual Societies Order 2013.[94]

The FCA or PRA can also charge a 'reasonable fee' to the public for inspecting, or providing a person with copies of, documents held by them in connection with CCBSA 2014.[95] That seems to allow changes to the 'reasonable' fees charged for copying and inspecting records filed by societies, without the need for the FCA or the PRA formally to make rules or provide guidance under FSMA 2000.

Under para 23 of Sch 1ZA and para 31 of Sch 1ZB of FSMA, the FCA and PRA may make rules about fees on the basis of meeting expenses incurred in carrying out their functions or for incidental purposes such as repaying their loans and maintaining reserves while ignoring income from penalties for the purpose of setting fee levels. They can also recover any unpaid fees as a debt due to them.[96]

The FCA and PRA raise their entire budget from fees payable by those firms or societies that are regulated or registered. As a result, the FCA's 'annual funding requirement' (AFR) and its allocation are the basis of the arrangements for raising fees. However, the FCA or PRA, when exercising their rule-making powers to raise fees in connection with mutual expenditure, are not required to issue draft rules with an explanation of their compatibility with the agencies' statutory objectives.[97]

The yearly 'consolidated policy statement' (CPS) explains fully the overall background and basis of the FCA's fee policy. Consultation papers and relevant policy statements are available from the FCA website.

Those liable to pay fees are divided into 'fee blocks' in an attempt to allocate regulatory costs to the types of permitted business covered by the different categories of business and recover those costs from fee-payers that fall within that fee-block. This reduces the possibility of cross-subsidy between different sectors of the financial services industry. It also allows the FCA to allocate costs in an efficient and economical way by avoiding the extra operational costs of putting systems and processes in place to apportion costs to individual fee-payers at a highly granular level or base them on the risk profile (impact and probability of failure) of the 29,700-plus individual fee-payers the FCA regulates.[98]

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94 Mutual Societies Order 2013, Sch 1, paras 2(2)(a), 3(2)(a), 6 and 7 applying FSMA 2000 Sche 1ZA and 1ZB and see also FEES Annex 1AR and App 1 Annex 4R http://www.fshandbook.info/FS/html/FCA/FEES last visited 29 June 2014.

95 CCBSA 2014, s 145.

96 FSMA 2000, Sch 1ZA, para 23 and Sch 1ZB, para 31.

97 Mutual Societies Order 2013, Sch 1, para 6(3) disapplying FSMA 2000, s 138I(2)(d).

98 See FCA Handbook, FEES Module, App 1.

Mutual societies, for which the FCA only deals with registration and does not exercise any of its other regulatory functions, are placed in separate fee block 'F'. This block bears the specific costs of the FCA's registration only function for mutuals and a share of the overheads of the FCA regarded as appropriate for those activities.

The main types of fee used by the FCA are periodic fees, usually paid annually. In respect of a specific society, these provide funding for the registration of rule changes, recording or registration of other kinds of constitutional changes and even the de-registration process. For registered societies general annual fees also contribute towards the maintenance of the public record file and answering queries from societies and the public about registered societies – see 'FCA website FEES FAQs – Mutuals FAQs' on the FCA website. The application fee would cover the cost of processing applications including the registration of a new society's rules and the creating an entry in the public register. Currently the FCA charges a periodic fee which depends on the society's total assets.

The minimum fee of £55 is payable for the smallest societies, with total assets under £50,000, rising to £425 for those with total assets above £1 million. Application fees are levied only for the registration of a new society and not for rule amendments, transfers of engagements or other events.

The payment of annual periodic fees to retain registration is novel for societies and is in danger of making this legal form unpopular in comparison with a company structure. Replacing charges for rule amendments and other changes with an annual fee will avoid distortions of decisions about rule change or restructuring due to fee levels but the annual charge, even in its tiered form, may discourage use of the mutual society structure at all.

For companies, the charges in 2014 are £40 for registering a company (£13 via software and £15 for web incorporation) and £40 to file an annual return (£13 if done electronically). This excludes any service of checking rules and rule amendments to ensure that the company maintains its co-operative or community benefit nature which is the major cost attaching to the mutual societies registration function. It also acknowledges the enormous economy of scale enjoyed by the Registry of Companies in dealing with approximately 3 million registered companies in Great Britain compared to the fewer than 10,000 registered mutual societies.

It is to be hoped that, when fixing fees in future years, the FCA will remain sensitive to the limited turnover and scale of many registered societies and to the risk of a flight of co-operatives and community benefit societies to the registered company legal form with the consequent loss of a specifically mutual legal form and the regulatory assurance of a co-operative or altruistic corporate objective provided by the current legislation.

The fees payable by societies for the services of the FCA are set out in the FEES module of the FCA's Handbook under FEES App 1. FEES App 1 includes both legally enforceable rules and official guidance from the FCA. Registered societies not authorised to carry on regulated activities under s 31 of FSMA 2000 and 'sponsoring bodies' that publish model rules in respect of societies have to pay an application fee. However, only registered societies are subject to a periodic fee, after the year in which the society is first registered.[99] Payment must be made on or before the date specified by the FCA.[100] For

[99] FEES App 1.2.5R.

societies, the periodic fee is 'tiered' depending on the total assets of the society declared in its annual return most recently filed with the FCA. The concession of a tiered fee was gained from the FSA in 2002 as a result of fears that many smaller societies would be driven to convert to companies if the fee was at the level originally contemplated.

Registered societies can seek to delay payment on the basis that they are faced by an 'emergency' as defined in FEES.[101] They must then pay within five days of the end of the 'emergency' period.[102] An emergency must be unavoidable by taking reasonable steps, outside the control of the society, its members and its employees, and make it impracticable for the society to pay on time or comply with another specific rule in FEES. In that case, while the emergency continues and the society can show it is taking all reasonably practicable steps to deal with its consequences and comply with the rule, compliance will not be required.[103] The FCA must be notified of the emergency as soon as practicable and kept informed of progress. In the absence of an emergency, a registered society has to pay an additional 'administrative fee' of £250 if it does not pay its annual fee on or before the due date. In addition, interest at 5% above the Official Bank Rate accrues daily from the due date if a society is more than 15 days late in paying.[104] These sanctions are legally binding rules and so only the discretion explicitly conferred in the strictly defined 'emergency' situation is available to the FCA on this question.

To deal with the system's reliance on the total assets shown in a society's annual return to establish the appropriate 'tiered' fee, FEES App 1.2.5A and FEES App 1.2.5B provide that a society which has not yet been required to submit an annual return should pay the lowest periodic fee specified for the year in question and that, if a society has failed to submit its annual return by the date required by the legislation, it pays the amount due for the total assets shown in the last annual return that it did file plus an administrative fee of the lower of the periodic fee payable by it on the basis of that last annual return and £250. Failure to submit the annual return in time may, in addition, lead to prosecution and a fine imposed by the court.

While sponsors are not currently subject to a periodic fee, if a sponsoring body did not pay the annual fee by the due date for a set of model rules, those rules lose their status as models and anyone using them to register a society would have to pay the higher rate for the registration application applicable to 'free drafts'.[105] There is no charge for the amendment by sponsors of model rules.[106]

Application fees to register a new society or a new set of model rules must be paid in advance at the following rate set out FEES App 1 Annex 1AR:

Transaction	Amount Payable (£)
Application using *model rules* without any amendment to the model	40

[100] FEES App 1. Annex 1R.
[101] FEES App 1. Annex 3R.
[102] FEES App 1.2.8R(2).
[103] FEES App 1 Annex 3.1R(1) and (2).
[104] FEES App 1.2.9R.
[105] FEES App 1.2.11G which is formal Guidance.
[106] FEES App 1.2.12G.

Transaction	Amount Payable (£)
Application using *model rules* with between 1 and 6 amendments to the model	120
Application using *model rules* with between 7 and 10 amendments to the model	350
Application using *model rules* with 11 or more amendments to the model, or using free draft rules	950

The application fee for a new set of model rules payable by sponsoring bodies (this fee is not payable by sponsoring bodies in respect of the model rules of credit unions) is £950.

Since the above information is subject to change, readers should check the FCA website for the most recent information.

3.8. EFFECT OF REGISTRATION AND ACKNOWLEDGMENT

Once the FCA is satisfied that the society has complied with all the provisions of CCBSA 2014 about registration, it must register the society and issue an acknowledgement of registration under the FCA seal.[107] The acknowledgement of registration is conclusive evidence that the society is duly registered under the CCBSA 2014 and of the rules of the society in force at the date of the society's registration.[108]

The FCA's decision not to register a society because of anything contained in or omitted from its rules (or on any other ground except a failure to satisfy the 'bona fide co-operative' or 'community benefit' conditions) is subject to appeal to the High Court (in England and Wales) or to the Court of Session (in Scotland).[109] If the appeal succeeds the Registrar must issue an acknowledgement of registration.[110] Section 415 of FSMA 2000 also confers jurisdiction on the High Court and Court of Session to hear proceedings arising out of any act or omission of the FCA in the discharge of its functions.[111]

It is from the date of the acknowledgement that the society has corporate status and that the members enjoy the benefits of limited liability status. The society may sue or be sued and any legal proceedings pending by or against trustees will be brought or continued by or against the society. Any property held by others on trust for the society will vest in it on that date.[112] As Lewison J put it in *Boyle v Collins*:[113]

'Thus once a society has been registered under the [now repealed]1965 Act its legal status changes. It becomes a body corporate, and it no longer needs trustees to act on its behalf. It has legal personality.'

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[107] CCBSA 2014, s 3(2).
[108] CCBSA 2014, s 3(7).
[109] CCBSA 2014, s 9(2).
[110] CCBSA 2014, s 9(6).
[111] See Section **3.5.1.** above.
[112] CCBSA 2014, s 3(3) to (6) and see *Queensbury Industrial Society v Pickles* (1865) LR 1 Exch 1.
[113] [2004] EWHC 271 [19].

The status of the society as a corporate body puts it, for this purpose, in the same position as a company. There is a strong presumption that each such corporate entity is to be treated as a separate person in law unless one of the well-established exceptions to that rule apply. An example of the application of this rule to a society is to be found in the case of *Brookes v Borough Care Services*[114] in which the Employment Appeal Tribunal (EAT) rejected an argument that a society to which a local authority had transferred its care homes for the elderly was to be regarded as the same entity as the local authority. The EAT applied the leading company law authority of *Adams v Cape Industries plc*[115] to reach its conclusion that the two bodies were separate entities in the absence of proof of one of the exceptional situations in which the corporate veil might be pierced.

3.9. RECORDING RULES

Before the transfer of functions to the FSA (now the FCA) in 2001, a society was registered either in England and Wales or in Scotland, depending on the location of its registered office. Before 2001, a society in one of those jurisdictions was required to record its rules in the other one to gain the benefits of incorporation there.[116] That changed from 1 December 2001 as all societies in England, Wales and Scotland were registered in respect of the whole of Great Britain and the Channel Islands with the (then) FSA under the Financial Services and Markets Act 2000[117] and that continues with the FCA[118] under the CCBSA 2014.

However, societies registered under the equivalent Northern Ireland legislation can record their rules and any amendments to them with the FCA so as to gain the status of a society registered in Great Britain and the Channel Islands for the purpose of certain provisions of CCBSA 2014.[119]

The provisions in question are, in general, those in which the status of registered society affects a provision of CCBSA 2014. For example, Northern Ireland societies whose rules are recorded gain the benefits of corporate personality, count as registered societies for the purpose of the minimum membership of a society, the execution of documents, and the exception to the holding limit for withdrawable share capital available to registered societies holding shares in another society. Such Northern Ireland societies are also covered by the obligation to display the society name on premises in Great Britain and the Channel Islands, the contractual and other effects of society rules, the power to hold land and invest, aspects of the rules about conversions and transfers of engagements, offences and their prosecution, the determination of disputes and certain provisions about documents, both electronic and hard copy.[120]

The effect of the recording of the rules is that, in the listed provisions of CCBSA 2014, references to a registered society include the Northern Ireland society that has recorded its rules in respect of things it does or does not do in Great Britain and the Channel

[114] [1998] ICR 1198.
[115] [1990] Ch 433.
[116] Industrial and Provident Societies Act 1965, s 8.
[117] FSMA 2000, ss 338(3), 432(3), Sch 18, Part IV, para 19 and Sch 22.
[118] CCBSA 2014, s 2.
[119] CCBSA 2014, s 142(1).
[120] See list of provisions in CCBSA 2014, s 142(3).

Islands. Similarly, references in the listed provisions to registered rules and rule amendments are taken to include that society's rules as if they had been registered in Great Britain and the Channel Islands.[121]

3.10. CONVERSION FROM A COMPANY

It is possible for a company registered under the Companies Acts to determine by special resolution to convert itself into, and register as, a society.[122] Such a resolution must be passed by:

- a show of hands at a general meeting, a majority of at least 75% of members who, being entitled to vote, do so in person or by proxy; or
- on a poll at a general meeting, members representing at least 75% of the total voting rights of members who, being entitled to vote, do so in person or by proxy; or
- on a written resolution, members representing at least 75% of the total voting rights of all eligible members[123].

The notice of the meeting must include the text of the resolution and state that it is a special resolution. A written resolution must itself include the information that it is a special resolution.[124]

The FCA website provides forms and accompanying notes for 'Converting from a company to a Co-operative and Community Benefit Society'.

In some cases, the nominal value of a member's shareholding in the company may exceed the statutory maximum allowed for a society by CCBSA 2014. The company resolution for conversion can deal with this by converting the excess into transferable loan stock at a rate of interest and on conditions as to repayment fixed by the resolution.[125]

Section 116 CCBSA requires that the resolution for conversion be sent to the FCA together with a copy of the rules of the society that the company intends to become. The resolution must appoint three members of the company to sign the rules with the company's secretary. The resolution may authorise the members to accept any alterations to the rules proposed by the FCA without further consultation with the company or may require them to lay the proposed alterations before a general meeting of the company.[126]

On the registration of the society the FCA must give the society a sealed or signed certificate that the rules have been registered in addition to the usual acknowledgement of registration given to a society.[127]

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[121] CCBSA 2014, s 142(2) and (5).
[122] CCBSA 2014, s 115(1).
[123] Companies Act 2006, s 283(2), (4) and (5).
[124] Companies Act 2006, s 283(3) and (6).
[125] CCBSA 2014, s 115(2).
[126] CCBSA 2014, s 115.
[127] CCBSA 2014, s 115(6).

A further copy of the resolution under the seal of the company and the certificate of registration issued by the FCA must be sent to the Registrar of Companies and on the registration by the latter of the special resolution and certificate, the conversion takes effect.[128]

The conversion renders the registration of the company under the Companies Acts void and the registration is duly cancelled by the Registrar of Companies.[129] However, the rights and claims of all parties and the liability of the company to a penalty are preserved as if there had been no conversion and have priority (as against the property of the society) over all other rights or claims against it.[130]

The name under which the new society is registered on conversion must not include the word 'company'.[131]

3.11. CONVERSION FROM A FRIENDLY SOCIETY

Since 1 February 1993, it has been possible for a society registered under the Friendly Societies Act 1974, other than a registered friendly society, to apply for registration as an industrial and provident society.[132] These provisions were inserted in the Friendly Societies Act 1974 by the Friendly Societies Act 1992 which closed off new registrations of societies under the 1974 Act. Only friendly societies can register under the 1992 Act. New social clubs or benevolent societies not registering as companies will use the CCBSA 2014.

Only societies already registered under the Friendly Societies 1974 Act that are not friendly societies can use this procedure to register under the CCBSA 2014. A friendly society is concerned with the mutual insurance of its members. The societies that can register under CCBSA 2014 are either primarily concerned with matters other than mutual insurance (as in the case of social clubs) or are concerned with the interests of non-members (for example, benevolent or learned societies). New societies of this kind no longer have the option of registering under the Friendly Societies Act 1974 or the Friendly Societies Act 1992. They will either use a company structure or register under the CCBSA 2014 from the beginning. The intention of the re-registration provisions is that existing societies that are not friendly societies but are registered under the Friendly Societies Act 1974 should be converted to either co-operative societies or community benefit societies. Social clubs form the largest group of societies to which this provision applies but it is also open to benevolent societies and those established for a special purpose such as the promotion of arts or learning.

The procedure to be applied by a society choosing to follow this route is to draw up a proposal to register under CCBSA 2014 and to submit it to the members for their approval using the procedure required to amend the society's rules.[133] The proposal will usually be drawn up by the committee of the society and agreed with the FCA before being submitted to the membership. The Friendly Societies Act 1974 requires that the

[128] CCBSA 2014, s 115(8)–(9).
[129] CCBSA 2014, s 115(10).
[130] CCBSA 2014, s 117.
[131] CCBSA 2014, s 115(7).
[132] Friendly Societies Act 1974 (FrndSocA 1974), s 84A and Sch 6A, inserted by Friendly Societies Act 1992 (FrndSocA 1992), Sch 16, para 5.
[133] FrndSocA 1974, s 84A(1).

proposal be submitted to the members and approved by them. The procedure which applies will depend on the rules of the society as the Friendly Societies Act 1974, like the CCBSA 2014 does not lay down an amendment procedure but requires the rules of societies to do so.[134]

Once the proposal to register as either a co-operative society or community benefit society has been approved by the members, the society's application will be submitted to the FCA together with any rule amendments that have been approved by the membership at the same time. It will be subject to the same criteria as other applications to register a society but the probability is that any of the categories of society that are able to use this procedure will satisfy the criteria of either being a bona fide co-operative or a society for the benefit of the community with little difficulty. Section 84A and Sch 6A of the Friendly Societies Act 1974 are primarily concerned with the consequences of the registration of the society under the CCBSA 2014.

The society continues to be entitled to all rights and subject to all liabilities that applied to it immediately before registration.[135] This includes all rights and liabilities under the law of the United Kingdom or any other state.[136] The registration of the society under the Friendly Societies Act 1974 becomes void at the moment of its registration under CCBSA 2014 and must be cancelled by the FCA.[137]

The schedule provides that the officers of the society other than trustees become the officers of the co-operative or community benefit society and all documents whether contracts, deeds, bonds, documents affecting property or litigation and all agreements or transactions whether in writing or not are taken to refer and apply to the new society rather than the former friendly society.[138] References in agreements to members or officers are to be taken to refer to officers or members of the new society and the contracts of employment and all rights and duties of the society are vested in the new society. Continuity of employment is preserved through the transition.[139]

Other provisions address the change from an unincorporated friendly society, which has to rely on trustees to deal with its property, to either a co-operative society or community benefit society that can, as a legal person, hold property in its own right. All property, whether located in the United Kingdom or elsewhere, held on trust for the society immediately before its registration automatically vests in the new registered society.[140] The same rule applies to property held on trust for a branch of a society whether the branch was separately registered or not. In this context, 'property' includes not only land but all other assets such as vehicles, equipment, furniture, investments and money.

The former trustees must deliver all society or branch property and documents relating to the property, rights, liabilities or financial affairs of the society or the branch to the registered office of the co-operative or community benefit society within 90 days of its registration.[141] The liabilities of trustees for breaches of duty that occurred before the

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134 FrndSocA 1974, s 7(2)(a) and Sch 2 para 4.
135 FrndSocA 1974, s 84A(3).
136 FrndSocA 1974, s 84A(4).
137 FrndSocA 1974, s 84A(6).
138 FrndSocA 1974, Sch 6A, paras 2(2) and 3.
139 FrndSocA 1974, Sch 6A, para 4.
140 FrndSocA 1974, s 84A(2) and (4)(a).
141 FrndSocA 1974, s 84A(5).

date of registration are preserved and the right of the old society to a remedy for such breaches is transferred to the industrial and provident society.[142] The trustees of a society or a branch cease to hold that position on the registration of co-operative society or community benefit society.[143] Any reference to the trustees of a branch or a society in any agreement, deed, bond or other instrument in force immediately before registration takes effect as a reference to the co-operative society or community benefit society.[144]

3.12. SOCIETIES REGISTERED UNDER EARLIER ACTS

Any express or implied reference in CCBSA 2014 to a registered society includes a society that, immediately before 1 August 2014, was registered or treated as registered under the Industrial and Provident Societies Act 1965 and this extends to rule amendments and acknowledgements of registration of either a society or a rule amendment.[145] Certain additional provisions apply to such 'pre-commencement societies' to preserve transitional provisions as legislation has changed from 1893 onwards.[146]

For example, any society that was registered before 26 July 1938 and has not invited anyone to subscribe for, acquire, or offer to acquire securities, or to lend or deposit money, on or after that date has to be wound up rather than being subject to cancellation of its registration if the FCA believe it no longer satisfies the bona fide co-operative or community benefit society registration conditions. This concerns the 1939 introduction of the current registration criteria. Limits on changes introduced in 1894 to prevent powers in the legislation from being subject to contrary provision in society rules when the legislation was silent on the point are also maintained. Similarly, CCBSA 2014 preserves both the validity of resolutions by committees permitted to amend society rules within certain time limits when statutory limits were raised and the limits on the effect of changes to the rules governing the validity of society transactions on the basis of the absence of a seal. Schedule 3 of CCBSA 2014 is worth consulting in the case of any transaction earlier than 20 October 2003.

[142] FrndSocA 1974, s 84A(3).
[143] FrndSocA 1974, Sch 6A, para 2(1).
[144] FrndSocA 1974, Sch 6A, para 4(1) and (2).
[145] CCBSA 2014, s 150(1)–(3).
[146] CCBSA 2014, s 150 and Sch 3.

CHAPTER 4

THE RULES OF THE SOCIETY

4.1. INTRODUCTION

The registered rules of a society perform a number of vital functions. They represent the constitution of the society and are an important source for determining its relations with the outside world, for example, on its objects and powers.[1]

The rules also govern the legal relationship between the members and the society as a contract made by the society with each and every member. They translate the Co-operative Principles or community service ideal on which the society is based into legally binding rights and obligations.[2]

The CCBSA 2014 by and large allows societies to adopt whatever rules they wish. Unlike the Companies Act 2006 it does not lay down specimen or model rules that can be adopted wholesale. Such a system could not easily accommodate the diversity of the societies that register as co-operatives or community benefit societies. However, the rules of a society must provide for the matters mentioned in CCBSA 2014, s 14.[3] The forms used on first registration and to register an amendment of the rules also require details about the content of the rule book.

The system of model rules and registration through a sponsoring body (use of which reduces the registration fee) encourages consistency between similar societies.[4]

The FCA must satisfy itself that the rules conform with CCBSA 2014, s 14 and that they comply with Co-operative Principles or show that the society will operate for community benefit. This can result in the imposition of requirements as to the content of the rules.

4.2. LEGAL EFFECT OF RULES

The registered rules of a society bind the society, all the members of the society and all persons claiming through them as if each member had signed the rules and, in England, affixed her seal to them. They also operate as if they contained a legally binding promise (a 'covenant') on the part of each member and any person claiming through him to

1 See Sections **7.1.**, **7.3.**, **7.5.** and **11.4.** below.
2 CCBSA 2014, s 15.
3 See Section **4.4.** below.
4 See Section **3.6.** above.

conform to the rules, subject to any other provision of the CCBSA 2014.[5] People claiming through members include, for example, those who become entitled to a member's shares on his or her death.

The effect of this provision is that the rules confer rights and impose duties on both members and the society without proof of a contract between them at common law. Section 33(1) of the Companies Act 2006 is worded similarly in relation to the articles of association of companies. That has been held by the courts to mean that those documents create a contract between the members and the company and between the individual members.[6] Thus the society is regarded as a party to the contract in the rules. The fact that it is not taken to have sealed them means that the limitation period for actions to enforce obligations may vary. It is only six years if the member sues the society for an amount due because the debt is not a 'speciality debt' incurred under seal. If the society sues the member for an amount due, the deemed sealing of the rules by the member of an English society probably makes the debt a 'speciality debt' to which a 12-year limitation period applies.[7]

The contractual effect of the rules is subject to the provisions of CCBSA 2014 and its mandatory provisions will apply regardless of the provisions of the rules.[8] However, societies have power to make any rules which are not unlawful at common law (for example, as being in restraint of trade) or inconsistent with the provisions of CCBSA 2014 or any other legislation. Provisions of the CCBSA 2014 or instruments made under it requiring or authorising society rules to deal with any matter are without prejudice to that power. Thus while those matters must be dealt with or are expressly said to be capable of being the subject-matter of rules, other matters may also be contained in the rules.[9]

In rare cases, an old society's rules could limit its use of any powers given by CCBSA 2014 and not made to depend on provisions of the society's rules. However, that only applies to a society already registered on or before 1 January 1894, with rules registered on or before 12 September 1893 (and not any later) that restrict powers now given unconditionally by the CCBSA 2014. Few societies will be caught by this limit on their powers, which, for others, was originally removed by the Industrial and Provident Societies Act 1894, a provision continued ever since, currently by CCBSA 2014.[10]

The contract in the rules, like the one to be found in company articles, can be changed by the use of the procedure laid down in the rules and contemplated by the CCBSA 2014.[11] This is not the case with most other contracts in which each and every party has to agree any change in the contract unless some other procedure was contained in the original agreement. In this respect the position under the CCBSA is closer to the common law than is that under the Companies Act 2006. A society's rules can be changed by a procedure laid down in the rules themselves but the provisions as to the amendment of a company's articles are laid down in the statute.[12]

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5 CCBSA 2014, s 15(1).

6 *Wood v Odessa Waterworks* (1889) 42 Ch D 636 at 642 *and Salmon v Quin and Axtens Ltd* [1909] 1 Ch 311.

7 Limitation Act 1980, s 5 and *Re Compania de Electricidad de la provincia de Buenes Aires Ltd* [1980] Ch 146, 186–7.

8 CCBSA 2014, s 15(1).

9 CCBSA 2014, s 23(2).

10 See now CCBSA 2014, s 150 and Sch 3, para 3.

11 CCBSA 2014, s 14(5).

12 Companies Act 2006, s 21.

It seems that, like a company's articles, a society's rules cannot be rectified by the court on the grounds that they do not reflect the true agreement of the parties.[13]

Despite the contractual effect of the rules, there are limits on the scope of the rights and obligations that can be enforced under them. It is generally accepted that a member must be bound or benefited as a member. For example, it has been held that a sum due from the secretary of a society because he has embezzled funds is not 'due from the member simply by virtue of his relationship with the society'. Consequently it did not come within the debts covered by the particular mortgage deed in issue in that case.[14] Such money would be recoverable in tort or contract or an action for breach of fiduciary duty but it would not be recoverable under the contract in the rules.

This doctrine is a reflection of the principle developed by the courts in the interpretation of Companies Act 2006, s 33(1) and its predecessor sections about the binding nature of the articles of association of companies. This limits the effect of the contract in the articles to rights and obligations granted to, or imposed on, members as such to the exclusion of claims by individuals (who happen to be members) in some other capacity, such as director or solicitor of the company.[15] This limits the effect of the contract in the document to dealing with 'insider' rights related to membership.[16] It has been suggested in the company context that the rights that might be conferred by the articles can be divided into three groups. 'Category 1 rights' are attached to particular shares and can be enforced. 'Category 2 rights' or benefits are purportedly conferred regardless of membership and are unenforceable 'outsider rights'. 'Category 3 rights' are conferred on a person for as long as he or she is a member and are class rights and therefore probably enforceable.[17]

This at least redefines the problem, which has been the subject of considerable controversy. Certain writers do not accept the view set out above. Some argue that all members have the right to have the company run in accordance with its articles and others have suggested that there is a right to have decisions taken by the correct organ or that contractual effect applies only to certain definitive provisions.[18]

The similarity of the wording of the Companies Act 2006, s 33(1) and CCBSA 2014, s 15(1) indicates that the courts would take a similar approach to both sections. However, the nature of particular societies may determine those matters that are to be taken as falling within CCBSA 2014, s 15 and giving rights to members as such. Provisions in a society's rules about the economic relationship between members may affect members as such because of the nature of its functions. In the case of most companies it is the role of members as shareholders who supplied capital that will most readily fall in this category. However in, for example, a worker co-operative, provisions dealing with members as workers may have this effect as that is the basis of their link with each other through the society. Such an approach would recognise the unique

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13 *Scott v Frank F. Scott (London) Ltd* [1940] Ch 794.

14 *Bailes v Sunderland Equitable Industrial Society Ltd* (1886) 55 LT 808 at 811.

15 *Eley v Positive Government Security Life Assurance Company* (1876) 1 Ex. D 88 *and Beattie v E and F Beattie Ltd* [1938] 3 All ER 214.

16 See *Hickman v Kent or Romney Marsh Sheep-breeders' Association* [1915] 1 Ch 881 at 897.

17 *Cumbrian Newspapers Group Ltd v Cumberland and Westmoreland Herald Newspaper and Printing Co Ltd* [1987] Ch 1; and *Palmer's Company Law,* paras 2.1121–2.1127.

18 See *Quin and Axtens Ltd v Salmon* [1909] AC442 and the arguments of: Wedderburn [1957] Cambridge Law Journal 194 and [1965] 28 MLR 347; Goldberg [1972] 35 MLR 362 and [1985] 48 MLR 158; Gregory [1981] 44 MLR 526; Prentice [1980] 1 Company Lawyer 179 and Drury [1986] CLJ 219.

nature of societies and the way in which they differ from companies. The classification of rights by reference to share classes in the *Cumbrian Newspapers* case does not reflect this difference.

If the particular claim by someone who is a member of the company is based on some contract other than the articles, a provision of the articles can provide evidence of the terms of the other contract. In the company context this will most commonly apply to situations in which the directors are serving as such and the articles stipulate some of the terms on which they serve, for example the amount they are paid or the means by which that is to be fixed. In such a situation the court will wish to discover the terms of the separate contract between the director and the company and, in doing so, can consult the articles.[19]

Similar issues about the terms of service of the chief executive or other full-time officer referred to in the rules may arise for a society. The best practice is to have a separate service contract between the society and the officer, which is entered into by the board in accordance with the rules. The functions of the office holder, for example powers to contract on behalf of the society, may be governed by the rules but the terms of service should be agreed in a separate contract.

4.3. COMMUNITY BENEFIT SOCIETIES WITH RESTRICTED ASSETS

Community benefit societies (but not co-operatives) can restrict the use to which their assets can be put, and a community benefit society may, either on registration or by passing a special resolution after registration, include a statutory 'asset lock' in its rules.[20] For this purpose 'special resolution' has the same meaning as that set out in s 112 of CCBSA 2014, about the passing of a special resolution for a society's conversion into, transfer of engagements to, or amalgamation with, a company.[21] As a result, the resolution must be passed by a majority of 75% of members entitled to vote and actually voting in person or by proxy at a first meeting and of which no less than 50% of all eligible members must have voted on the resolution. The resolution must then be confirmed by a simple majority at a second meeting.

The stringent majority and turnout requirements for a rule amendment imposing a restriction on the use of assets is explained by the fact that once the restriction is included in the rules of a society it can never be altered or removed.[22]

Only 'prescribed' community benefit societies can apply the asset lock. Societies that are charities and those that are registered providers of social housing are excluded from the category of prescribed societies.[23]

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19 *Re New British Iron Co ex parte Beckwith* [1898] 1 Ch 324 *and Swabey v Port of Darwin Gold Mining Co* [1889]1 Meg 385 but contrast *Re Richmond Gate Property Co Ltd* [1965] 1 WLR 335.

20 CCBSA 2014, s 29 and Community Benefit Societies (Restriction on Use of Assets) Regulations 2006, SI 2006/264 ('Asset Lock Regulations').

21 Asset Lock Regulations, reg 4.

22 Asset Lock Regulations, reg 7.

23 Asset Lock Regulations, reg 5.

4.3.1. The restrictions

Assets can only be used where the use or dealing is directly or indirectly for the benefit of the community or in such circumstances as are prescribed by the Asset Lock Regulations.[24]

The wording of the rule to be included either on the registration of the society or by later rule amendment in the society's rules as a restriction on use, is prescribed by the Asset Lock Regulations and no deviation from that wording is permitted.[25] The wording of the rule is set out below and has been adapted to reflect the transitional provisions of CCBSA 2014.[26]

> **'Restriction on use**
>
> Pursuant to regulations made under section 1 of the Co-operatives and Community Benefit Societies Act 2003:
>
> (1) All of the society's assets are subject to a restriction on their use.
>
> (2) The society must not use or deal with its assets except—
> (a) where the use or dealing is, directly or indirectly, for a purpose that is for the benefit of the community;
> (b) to pay a member of the society the value of his withdrawable share capital or interest on such capital;
> (c) to make a payment pursuant to sections 36 (payments in respect of persons lacking capacity) 37 (nomination by members of entitlement to property in society on member's death), 40 (death of a member: distribution of property not exceeding £5,000) of the Co-operative and Community Benefit Societies Act 2014;
> (d) to make a payment in accordance with the rules of the society to trustees of the property of bankrupt members or, in Scotland, members whose estate has been sequestrated;
> (e) where the society is to be dissolved or wound up, to pay its creditors; or
> (f) to transfer its assets to one or more of the following—
> (i) a prescribed community benefit society whose assets have been made subject to a restriction on use and which will apply that restriction to any assets so transferred;
> (ii) a community interest company;
> (iii) a registered social landlord which has a restriction on the use of its assets which is equivalent to a restriction on use and which will apply that restriction to any assets so transferred;
> (iv) a charity (including a community benefit society that is a charity); or
> (v) a body, established in Northern Ireland or a State other than the United Kingdom, that is equivalent to any of those persons.'

The wording of the rule is effectively identical to the wording in the statutory provisions[27] describing the restriction on the use of assets and the restrictions are now dealt with in turn.

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[24] CCBSA 2014, s 29(1) and (2) and Asset Lock Regulations, reg 6.
[25] Asset Lock Regulations, reg 2 and Sch 1.
[26] CCBSA 2014, s 151 and Sch 5, para 3.
[27] CCBSA 2014, s 29(1) and (2) and Asset Lock Regulations, regs 3 and 6.

4.3.2. The scope of the restrictions

The prescribed rule specifies that 'all' of the society's assets are subject to a restriction on their use. This reflects a choice by Treasury in making the Asset Lock Regulations to apply the restrictions in all cases to all of the society's assets as is permitted by s 29(1)(c) of CCBSA 2014. Other possibilities permitted by that section would have been to prescribe particular types of asset to which the restriction would have applied or to define in the Asset Lock Regulations the assets that a society might specify in its rules as subject to the restriction.[28]

4.3.3. Permitted dealing with assets

The prescribed rule sets out a number of permitted dealings as follows:

4.3.3.1. The benefit of the community – where the use or dealing is, directly or indirectly, for a purpose that is for the benefit of the community

The text of the prescribed rule, like s 29(2)(a) of CCBSA 2014, permits dealings with and uses of assets for purposes that are directly or indirectly for the benefit of the community. This clearly relates to the object or objects specified in the society's objects rule and accepted on registration as amounting to a community benefit. Transactions such as buying or selling assets of any kind, borrowing or lending, employing people and otherwise making contracts to further the society's business will fall within this requirement as they are, in effect, means of achieving the end of community benefit. It is for this reason that the popularly used description of the restrictions permitted by this legislation as an 'asset lock' can be misleading. The restriction is on the payment of assets to members or others and on the transformation of the society into an entity serving non-altruistic purposes. Transactions at market value carried out as part of the operation of the business will convert the assets into some other form as when cash is used to purchase goods or services or land is sold and the proceeds used to expand operations.

The use of the words 'direct and indirect' emphasises the breadth of the concept linking the purpose for which the asset is used or for which the dealing takes place with the community benefit that is the society's object. When the Asset Lock Regulations were drafted the consultation document stated: 'it is the value of the assets that will be locked, rather than the assets themselves' and that the asset-lock framework was a means of ensuring that the locked assets of the society would be protected for community benefit purposes during its lifetime. The consultation document invited consultees to consider whether the 'use or dealing' provisions should be narrowed to allow societies only to dispose of assets for purposes within their objects and not to deal with them in other ways. The example given was renting out assets at market rates rather than making them available to the community the society was dedicated to serving.[29] The Asset Lock Regulations were, after the consultation, drafted to allow the wider range of uses and dealings for appropriate purposes.

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[28] CCBSA 2014, s 29(1) (a) and (b).

[29] HM Treasury, Regulatory issues for Industrial and Provident Societies: A consultation document, July 2004, paras 3.5. and 3.16.

The breadth of the permitted uses or dealings can also be seen from the list of the other permitted dealings and uses to be found in the rest of the rule. They involve payments to creditors or to members or their successors or transfers of the society's assets to successor entities. This emphasises the intention to prevent the dedication of the society's resources to other objectives or the payment of its resources to members or others outside the context of transactions and operations carried out in the course of its business and dedicated to the community benefit objects for which the society was formed and registered.

However, a difficult issue arises when the indirect benefit of the community may only be achieved by a payment to members. The rules of the society dealing with the maximum level of interest on shares will have been approved by the FCA as acceptable in the context of a community benefit society and the payment of some return will be necessary to attract share capital from members. As a result, such payments seem to fall within this exception in the prescribed rule. However, the drafting of the later exceptions can be interpreted as restricting both interest payments and the repayment of the nominal value for non-withdrawable shares. That may make reliance on the indirect community benefit exception necessary in the case of, for example, transferable shares which are entitled to interest payments under the society's rules or their terms of issue.

The restriction on the use of assets does not prevent or limit rule amendments including amendments to the objects rule. Such changes could alter the community to be benefited or the way in which the community benefit was to be delivered, for example by changing the business activities in which the society might engage. The protection of the assets in that situation would rely on the role of the FCA in policing rule amendments to ensure that the rule change did not prevent the society from meeting the qualifications for registration as a community benefit society.

4.3.3.2. Share capital

The prescribed rule (provision (2)(b)) allows the society to pay a member the value of his or her withdrawable share capital and interest on 'such capital'. This confirms that community benefit societies can use withdrawable share capital and permits its withdrawal even where a society has chosen to impose a restriction on its use of assets. The interpretation of the provision does, however, give rise to some issues. A narrow and literal interpretation of this part of the prescribed rule might be taken to indicate that only one payment of the whole capital in the member's share account is permitted. However, both the context of this provision within the Asset Lock Regulations and longstanding practice of societies using withdrawable share capital indicate that payments to a member of part of his holding should be covered by the exception. That interpretation permits a society to operate a share account with payments into and withdrawals from the account from time to time as permitted by the society's rules. The provision also expressly permits a payment of the value of interest to the member and that implies that payments of interest may be credited to the account from time to time or, if the rules of the society permit, paid to the member as soon as the interest accrues. This supports an interpretation of the provision that also permits the payment to the member of the value of part of the capital value of his or her withdrawable share capital itself from time to time although those words are not used in the provision.

A more difficult question seems to arise from the reference in the rule only to withdrawable share capital. Does this mean that holders of other types of shares can

never be paid the value of their share capital or interest on it? Forms of share capital not labeled as withdrawable are not specifically dealt with in the legislation, other than by the acknowledgment that they may be transferable.[30] Only withdrawable shares, therefore, are the subject of an overriding statutory 'permission' for the society itself to repay its shareholders without entering a solvent liquidation. Other shares would be subject to the rule in *Trevor v Whitworth*[31] which applies to companies (albeit now in a statutory form) in circumstances in which the Companies Act 2006 does not empower the company to purchase its own shares or, by some other procedure, return assets to shareholders. The common law rule prohibits a purchase or redemption by a company of its own shares on the ground that this would permit the owner-members to be paid ahead of creditors. The case held that such a payment was not a risk that creditors should be required to run in the case of a company with limited liability. Since the policy of that fundamentally important company law precedent applies equally clearly to registered societies with share capital, members holding shares not classified as withdrawable cannot be repaid the value of those shares by the society before a solvent liquidation procedure takes place, except on the death of the shareholder where ss 37–40 CCBSA 2014 apply to permit such payments.

There are two difficulties with rule (2) of the prescribed rule in respect of non-withdrawable shares in societies. First, is the payment of interest on those shares permitted and, second, can those shareholders, as contributories, be paid the nominal value of their shares plus accrued interest in accordance with their rights under the terms on which the shares were issued even on a solvent liquidation?

The first problem arises from the argument that, since the rule provides a specific exception to permit the payment of interest to a member of the society who holds withdrawable share capital, it implicitly regards the payment of interest on shares as prohibited use of the society's assets and so prevents the payment of interest on shares that are not withdrawable. When the wording of the rule as a whole is considered, it is hard to escape that conclusion, inconvenient and anomalous as it may be. It would be possible to change the position by further regulations to permit the payment of interest to the holders of non-withdrawable shares as well as the holders of withdrawable shares but without such an amendment it seems that payment of interest on such shares may not be permitted.

A similar problem arises about the payment to holders of non-withdrawable shares of the nominal value of the shares. It is reasonable that no repayment by the society of the capital of such shares should be permitted without a solvent liquidation of the society. As noted above, that appears to be the position at common law under the rule in *Trevor v Whitworth* unless legislation specifically permits it. In addition, where non-withdrawable shares are transferable under the rules of the society and the terms on which the shares were issued, it will be possible for a member to transfer his or her shares to another member or a person who will become a member after the transfer, so long as any procedure laid down in the society's rules is followed. This provides a means for the member to receive the nominal value of the shares if the transferee is willing to pay that.

There is no policy justification for refusing to allow the return of the nominal value of shares when the society is subject to a solvent liquidation. To prevent such payment

[30] CCBSA 2014, s 14(9).
[31] (1887) LR 12 App Cas 409, HL.

would also undermine the possibility of transferring shares before that time by indicating that a transferee who held them on solvent dissolution of the society would not receive payment of their nominal value. The literal wording of the prescribed rule appears to prohibit that as rule (2)(e) permits payment to the society's creditors 'where the society is to be dissolved or wound up'. The holders of shares in the society are not creditors. On the face of it, this prevents even the repayment of the nominal value of the shares to members holding non-withdrawable shares. However, in a solvent winding up the Insolvency Act 1986 would provide a solution if the rights of the holders of such shares were held to extend to the repayment of the nominal value of the shares. Section 107 of the Insolvency Act 1986, which applies to voluntary liquidations, provides that after the society's liabilities have been satisfied, its property shall, unless its rules provide otherwise, be 'distributed among the members according to their rights and interests' in the society. Insolvency Act 1986, s 154 empowers the court in a compulsory liquidation to adjust the rights of the contributories among themselves and distribute any surplus among the persons entitled to it. In both cases the issue would depend on the rights of the members. However, those provisions of primary legislation should prevail over a conflicting provision of society rules and even conflicting secondary legislation, such as the Asset Lock Regulations.

The argument based on the provisions of the Insolvency Act 1986 is reinforced by s 29(2)(a) of CCBSA 2014. That paragraph authorises a use or dealing by a society with its assets that is directly or indirectly for the benefit of the community. Although the provision appears as rule (2)(a) of the prescribed rule, it is in fact a case in which the use or dealing is directly authorised by the CCBSA 2014. A society's ability to raise capital from its members would be very seriously impaired if it were unable to repay the nominal value of the shares to those who took them. This surely makes a use of assets to repay such capital after dissolution or solvent liquidation when all creditors have been paid at least 'indirectly' a use of assets which furthers the purpose of the society to benefit the community and so a use of assets not subject to the restriction. This view is reinforced by the availability of the right to repay capital value when shares are issued as withdrawable and payment to a nominee of a deceased member is necessary to avoid the nominee's holding of shares exceeding the maximum amount permitted.[32]

The argument of indirect community benefit applies equally strongly to payments of interest from time to time out of profits to holders of non-withdrawable shares. Shares on which no interest can be paid are just as unattractive as those on which no repayment of nominal value is ever possible. However, an amendment of the Asset Lock Regulations to expressly provide power for a society which has chosen to restrict its use of assets to pay interest and to repay its members the nominal value of their non-withdrawable shares on dissolution would put the matter beyond doubt.

4.3.3.3. Member's death or incapacity

The prescribed rule permits payment under CCBSA 2014 to a medically incapable member or on a member's death under a nomination or otherwise.[33]

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[32] CCBSA 2014, s 39(3) and (4).

[33] Para (c), reflecting Asset Lock Regulations, reg 6(a)(ii), and see Sections **8.3.4.**, **8.3.6.** (below).

4.3.3.4. Bankrupt members and creditors on winding up

As one would expect, creditors are unaffected by the asset lock. This is true of both the society's own creditors[34] and those of a member who claims through the trustee in bankruptcy.[35] It will be for the creditors to provide appropriate evidence as to their entitlement to the property, but the asset lock does not put a member or society's property beyond the reach of creditors.

4.3.3.5. Transfers to other asset locked bodies

The restriction on asset use was not intended to prevent transfers and dealings between entities that share a similar asset lock or are subject to similar restrictions on the use of their assets. This is reflected in the wording of rule (f) which permits the transfer of assets to a stated list of entities. This includes to other asset-locked societies, charities, community interest companies and registered providers of social housing that also have a restriction on the use of assets equivalent to a restriction that applies to the society.

The Asset Lock Regulations also have the effect of amending the reorganisation provisions of CCBSA 2014.[36] The restriction on dealing and transferring assets also apply on such reorganisations. The effect of this is that a prescribed society (i e a society that is not a charity or registered provider of social housing) whose assets are restricted under s 29 of CCBSA 2014 and the Asset Lock Regulations can only amalgamate with or transfer its engagements to another society that is subject to a similar asset-use restriction. A prescribed society with an asset use restriction may only convert itself into, amalgamate with or transfer its engagements to a company that is a community interest company, a company registered as a provider of social housing or a charity.[37] That ensures that a similar asset lock will continue to apply in all such cases and is a fundamental element in the asset-lock arrangements.

4.3.4. Asset-lock enforcement by the FCA

The Asset Lock Regulations empower the FCA to enforce the statutory asset-lock provision rather than simply the provisions of a society's rules.[38] That overcomes the procedural and practical problems that surround the enforcement of society rules by either the society itself or its members. However, a breach of the rules by the directors or officers of a society will be a breach of their fiduciary duties and could result in a civil suit against them by the society or by a derivative action.[39]

The FCA is subject to two requirements when deciding whether to use its powers to enforce an asset lock: it must exercise the powers only to the extent necessary to maintain confidence in societies; and it must consult the PRA if the society is PRA-authorised.[40]

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34 Asset Lock Regulations, reg 6(a)(iv).
35 Asset Lock Regulations, reg 6(a)(iii).
36 CCBSA 2014, ss 109, 110 and 112.
37 Asset Lock Regulations, reg 6(b).
38 Asset Lock Regulations, reg 9(1).
39 See Section **7.4.** (below).
40 Asset Lock Regulations, reg 8.

If the FCA considers that a society is contravening its asset lock, enforcement begins with a written warning notice informing the society (and any officer against whom enforcement is proposed) of the action the FCA plans to take to enforce the asset lock. The notice must state the period within which the officer or society must make representations to the FCA and the FCA must then decide within a reasonable time whether to take the enforcement action.[41]

If the FCA decides to take enforcement action, it must serve a written decision notice on the society or officers who are subject to the decision. The decision notice must give reasons for the use of the power, set out the terms of the enforcement measures and indicate that an appeal can be made to the High Court (or Court of Session in Scotland) within 28 days. At the end of the appeal period, or of the appeal hearing if one is brought, the society must comply with the FCA decision or the decision as varied on appeal unless the FCA decision was quashed on appeal.[42] The warning and decision notices are served by being delivered to a person, left at or posted to their last-known address, or emailed to them. In the case of a corporate body it is given or sent to the secretary at the registered office.[43]

The actions ordered by the FCA can extend to any 'steps necessary for securing that a contravention is brought to an end or is not repeated'.[44] That includes but is not limited to a restitution order where the society has suffered loss and an officer was 'knowingly concerned' in the contravention of the asset lock. The officer can be required to pay the society an amount that the FCA considers just in the light of the extent of the society's loss as a result of the contravention within a time laid down by the FCA. If payment is not made on time the amount due becomes a debt due from the officer to the society.[45] The removal of the officer can also be ordered.[46]

The FCA's direct enforcement powers apply when a contravention of the asset lock has already occurred. If a first contravention or new contraventions seem likely, the FCA can apply to the High Court (or Court of Session) for a restraining order (or interdict) to restrain or prohibit the contravention. The order can apply to the society and any officer who is, has been, or is likely to be knowingly concerned in the contravention and can order the officer to take particular steps to prevent the contravention or to bring it to an end.[47] Failure to obey the order will amount to contempt of court.

The FCA's powers give teeth to the asset lock that action by the society itself or a minority of its members would lack. However, the FCA's power to apply to court does not exclude the right of others to do so.[48]

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41 Asset Lock Regulations, reg 12.
42 Asset Lock Regulations, regs 13 and 14.
43 Asset Lock Regulations, reg 16.
44 Asset Lock Regulations, reg 9(2).
45 Asset Lock Regulations, reg 10.
46 Asset Lock Regulations, reg 11.
47 Asset Lock Regulations, reg 15.
48 Asset Lock Regulations, reg 15(4).

4.4. CONTENT OF THE RULES

Society rules must deal with particular issues.[49] Many of those issues are dealt with in more detail in other chapters. However, here are the main features of the CCBSA 2014 requirements under four headings.

4.4.1. The society's external relations and powers

A society's rules must set out its objects, name and registered office.[50] The powers of a society to borrow or to accept deposits of money, the conditions under which this may be done, any provisions as to security and maximum limits must be incorporated in the rules.[51] Similarly, its investment powers and any limits on them must be laid down.[52] These rules will confirm the scope of a society's powers to those dealing with it. They will also make clear the internal procedures to be followed and whether powers can be used by the board, the general meeting or officers.

Societies have power to own and deal with land and CCBSA 2014 gives some protection from problems about the authority of people carrying out those transactions on behalf of the society. However, a society's rules may restrict its power to hold or deal in land and limit the powers otherwise conferred by the Act.[53]

4.4.2. Membership

A society's rules must deal with the admission and withdrawal of members, and make provision for the claims of the successors of deceased members and the trustees in bankruptcy of bankrupt members.[54]

A person under the age of 18 may be a member of a registered society unless the society's rules provide otherwise. Subject to any provisions to the contrary in the society's rules, a person aged between 16 and 18 can enjoy all the rights of a member of a society and execute all instruments and give all receipts necessary to be executed or given under a society's registered rules. A person under the age of 16 may not be a member of a society's committee or a trustee, manager or treasurer of the society.[55]

Specific provisions in society rules are needed if members are to be given additional rights to inspect the society's books.[56] Similar specific provisions are needed to allow loans to members, usually only with security.[57]

A society can impose 'reasonable fines' on its members for breaking its rules if those rules provide for that.[58]

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49 CCBSA 2014, s 14 but for credit unions see Credit Unions Act 1979, s 4 and Sch 1 and Section **13.4.1**.
50 CCBSA 2014, s 14(1)–(3).
51 CCBSA 2014, s 14(8).
52 CCBSA 2014, s 14(14).
53 CCBSA 2014, s 26.
54 CCBSA 2014, s 14(4) and (11).
55 CCBSA 2014, s 31(1).
56 CCBSA 2014, s 104.
57 CCBSA 2014, s 34.
58 CCBSA 2014, s 23.

4.4.3. Decision-making and the organs of the society

Provisions must be included in the rules about all of the following:[59]

- voting rights
- holding meetings
- amending the rules
- appointment of the board or committee and officers
- powers of the board or committee and officers
- remuneration of the board or committee and officers
- removal of the board or committee and officers
- the custody and use of the society's seal, if it has one
- the application of the society's profits.

The content of these rules is left to the society providing the FCA is satisfied that the rules as a whole meet the requirement for that particular society's registration as a bona fide co-operative or a community benefit society. A society may also wish its rules to deal with certain other matters, referred to in CCBSA 2014.

(a) Rules can require officers to enter bonds or securities for the payment of compensation to the society for any losses caused by their failure to render proper accounts for money they have paid or received.[60] Society rules must deal with this if the requirement is to be imposed. In large societies this is seen as an obsolete procedure and even in smaller societies, such as clubs with part time officers, it is now rare.

(b) Declaring which officer has to carry out the society's duties under CCBSA 2014 to prevent criminal liability for failures from falling on all committee members who were not ignorant of and did not attempt to prevent the breach of duty.[61]

(c) Provisions should be made to deal with disputes within the society.[62]

4.4.4. Shares and accounts

The rules must state whether shares are to be transferable or withdrawable and specify how such transactions are to be carried out.[63] Withdrawable share capital is not permitted if the society carries on or is registered with the object of carrying on the business of banking.[64]

Provision must be included about how members' property or shares are dealt with on the withdrawal, death or bankruptcy of the member.[65]

The maximum shareholding for any member must be laid down in the rules.[66] This can be any amount up to the £100,000 statutory maximum for a member or higher for a member exempted from the maximum limit.[67]

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[59] CCBSA 2014, s 14(5), (6), (12) and (13).
[60] CCBSA 2014, s 41.
[61] CCBSA 2014, s 128 and see Section **10.2.** (below).
[62] See CCBSA 2014, ss 137–140 and Sections **10.1.1.** and **10.1.2.** (below).
[63] CCBSA 2014, s 14(9).
[64] CCBSA 2014, s 4(1).
[65] CCBSA 2014, s 14(9) and (11).
[66] CCBSA 2014, s 14(7).
[67] CCBSA 2014, s 24(1) and see Section **8.2.2.**

The rules must provide for the audit of the society's accounts by one or more auditors appointed by the society in accordance with the requirements of Part 7 of CCBSA.[68]

4.5. COPIES OF RULES

A copy of the rules of any registered society must be given by the society on demand to anyone who asks for them. They must be given free of charge to a member who has not already been given a copy and at a charge not exceeding £5 (or such other amount as the Treasury may specify by order) to anyone else.[69] It is an offence to give a copy of rules of a society other than the ones currently registered on the pretence that they are the existing rules or that there are no others. It is also an offence to give a copy of the rules of an unregistered society on the pretence that they are the rules of a registered society. The offence is committed by the person who gives the rules. This might be the society itself if the act is done on its behalf or the person who hands the rules over. In each case, however, the prosecution must prove that the rules were given with intent to mislead or defraud the recipient of the rules.[70]

Society rules can lay down the form of any instrument that is to be used for their purposes.[71] Forms might be laid down to be used, for example, to transfer shares, to apply for membership, or to nominate candidates for election to the board or committee.

4.6. CHANGING THE RULES

The rules of a society must provide for the mode of making, altering or rescinding rules.[72]

The CCBSA 2014 does not lay down any particular procedure for the amendment of rules, such as the need for a special majority like the 75% needed under s 283 of the Companies Act 2006 to amend a company's articles of association. Society rules provide for the procedure to be used for their own amendment. In fact the rules of most societies require that the power to amend the rules be exercised by the general meeting and set a special majority of, for example, two-thirds or three-quarters of the members present and voting. It is helpful for the rules to require the notice of a meeting at which an amendment is to be discussed to give enough details of the proposed amendment for members to decide whether to attend.

If a society wishes to confer certain powers of amendment on its board rather than the general meeting, this would have to be agreed by the FCA either as a rule amendment or in the rules of a society applying for registration. The test applied would be whether the provision weakened democratic control, particularly in the case of a co-operative. A general rule that all amendments could be made by the board would fall foul of that principle, but a limited power to change particular detailed provisions might not.

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68 CCBSA 2014, s 14(10) and see Section **9.2.3.**
69 CCBSA 2014, s 18.
70 CCBSA 2014, s 19.
71 CCBSA 2014, s 23(2).
72 CCBSA 2014, s 14(5).

An amendment can either rescind a rule or lay down a new one or both and parts of the existing rules can be deleted, added to or altered. Alternatively, the whole set of rules can be rescinded and replaced.[73] The validity of any amendment depends on its registration by the FCA.[74]

Notice of any change in the address of the society's registered office must be sent to the FCA immediately by the society secretary on the form provided for the purpose. The FCA then acknowledges this as a registered change in the rules, which are effectively amended from that time.[75]

For many societies, advice on the drafting of amendments and the procedures for their registration is available from their secondary or sponsoring organisation. The FCA is not required to examine drafts of changes and will not provide legal advice on amendments. It expects societies to consult their sponsoring bodies or, failing that, to take professional advice. However, FCA Guidance available on their website provides some help.

Rules do not have to be amended to address outdated legislative references or references to predecessor registrars, as these will be interpreted according to current legislation. Nevertheless, it is desirable to amend the text of society rules at an appropriate opportunity to avoid misleading those who use them. Under the FCA's fee structure, rule amendments incur no registration fee.

4.6.1. Amendments permitted

4.6.1.1. Statutory limitations

CCBSA 2014 lays down certain restrictions on the amendments that may be made to a society's rules.

(**a**) **Increases in members' liability** An amendment to society rules cannot bind an existing member to increase his or her liability to contribute to the loan or share capital of the society without his or her written consent.[76] That provision particularly affects an amendment to force members to take or subscribe for more shares than they hold at the date of registration of the amendment or to pay more than the remaining unpaid amount on shares they already hold.

(**b**) **Change of name** Any change to the society's name must be approved by the FCA as well as being embodied in a resolution passed by the society's general meeting in accordance with the procedure and notice periods laid down in the society's rules either specifically for a change of name or, failing such a provision, for an amendment of the rules. The FCA will ask why the society is proposing to change its name when the application is made to register the change, and will apply the same criteria as it would on the registration of a new society. However, on a name change, the FCA will also have to be convinced that the change is necessary and will not confuse those dealing with the society or be prejudicial to people with claims against it.[77] No change of name affects the rights or obligations of members or of the society and pending legal proceedings can

[73] CCBSA 2014, s 149.
[74] CCBSA 2014, s 16(1) and Section **4.6.2.** below.
[75] CCBSA 2014, s 16(3).
[76] CCBSA 2014, s 15(2).
[77] See FCA Guidance available from their website.

be continued by or against the society under the new name.[78] The new name must be shown at the registered office, all places of business, and on all advertisements, letters, notices and other documents of the society as well as its seal, if any.[79]

HM Treasury has power to make regulations to apply Part 5 of the Companies Act 2006 to societies with appropriate modifications.[80] That would bring the regulatory rules about society names into line with the equivalent rules for companies. At the time of writing no such regulations had been made.

(c) **Conformity with CCBSA 2014** The FCA may only register amendments to the rules if it is satisfied that they are not contrary to CCBSA 2014. This allows the FCA to prevent the registration of amendments that would stop the society from satisfying the registration requirement for a bona fide co-operative or a community benefit society and so prevents the demutualisation of a society by rule amendment.[81]

4.6.1.2. Limitations developed by the courts

The courts have also laid down certain limitations on the powers of societies to amend their rules.

(a) **The subject matter of amendments** In some cases the courts have suggested that a society's power to change its rules is limited to 'such amendments as can reasonably be considered to have been in the contemplation of the parties when the contract was made, having regard to the nature and circumstances of the contract'.[82] Lord Atkin said that 'if a man enters into an association with others for a business venture he commits himself to be bound by the decision of the majority of his associates on matters within the contemplated scope of the venture. But outside that scope he remains dominus and cannot be bound against his will'.[83]

In *Hole v Garnsey* it was held that members who had not voted for an amendment to increase the obligations of members to subscribe to its funds were not bound by it and the possibility was left open that such an amendment might be wholly void even against those who voted for it. It was suggested in that case that in addition to such an amendment to achieve that result (which is now subject to s 15(2) CCBSA 2014), a decision to change the location and nature of a society's business by the amendment of its objects clause might be prohibited.

This principle was also considered in a more recent Court of Appeal case. That case concerned the amendment of a society's rules to permit the distribution of its assets among its members on its dissolution. That was prohibited by an existing rule but a specific provision in the rules allowed the amendment by a special majority of the rule in question.[84]

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78 CCBSA 2014, s 13(3).
79 CCBSA 2014, s 11.
80 CCBSA 2014, s 135.
81 CCBSA 2014, s 16(4) and see Section **4.6.2.** below.
82 *Hole v Garnsey* [1930] AC 472 per Lord Tomlin at p 500.
83 Ibid at p 493.
84 *Datchet Co-partnership Housing and Allotment Society Ltd v The Official Solicitor* Court of Appeal (Civil Division) (Transcript Association) May 19 1990 LexisNexis.

This restriction on the power of a society to amend its own rules is not clearly defined. It seems that an amendment to change in a fundamental way the nature of the society may not be possible by rule change. Basic and wholesale changes in the objects rule as to the nature and location of the business to be carried on may be within this category, so may changes to the rule about distribution of profits during the society's life or its assets on dissolution. However, the existence of a provision in a society's rules allowing the amendment of the rule in question either by the procedures that apply to all rules or by a special majority or procedure will be evidence of an intention on the part of the founders to permit such a change.

The court will seek to ascertain the intention of the founders from the rules themselves. This will involve considering all relevant rules including the objects rule and those dealing with amendment. The interest that the founders may have contemplated protecting will also be relevant and may be discovered by considering the circumstances of the formation of the society and its operation. The proposed change is then considered against the apparent intention of the parties. The court may find that certain limited changes to the rule in question are permissible while those so fundamental as to be outside the contemplation of the founders can be prevented.

In the *Datchet* case the Court of Appeal found that the absence of a group of members or others with a clear interest in preventing a change to the rule on the distribution of assets, when combined with a provision expressly permitting amendments to that rule, indicated that the change should be permitted. However, all the judgments in that case accepted the existence of a principle which could prevent changes outside the contemplation of the original parties at least if the considerations which gave rise to that limitation still applied. The principle in *Hole v Garnsey* has also been applied by the Court of Appeal in the context of a Lloyds of London Premium Trust Deed, in *Lord Napier and Ettrick v RF Kershaw Ltd (No2)*,[85] to strike down a change outside the scope for amendments contemplated by the parties to the original deed.

Later cases emphasise the question of interpretation and see the *Hole v Garnsey* doctrine as an indication to be used as part of that exercise. Since the 1990s the courts have accepted that the interpretation process for all contracts, of which society rules are one type, involves aiming to find the meaning that the document would convey to a reasonable person having all the background knowledge reasonably available to the parties at the time of agreeing it. That includes anything that would have affected the way a reasonable man would have understood it but excludes previous negotiations and declarations of subjective intent.[86] This broad approach is applied to the interpretation of documents in each case. In the context of a society set up as a co-operative or community benefit society, the registration conditions clearly point to an interpretation likely to further that end, maintain that status, and avoid demutualisation.

The FCA is likely to refuse to register amendments prevent the society from conforming to the bona fide co-operative or community benefit registration requirements. The court, it seems, may also be used to this end. Subject to an asset lock if a community benefit society has chosen to apply one, conversion of a society into a company may avoid this restriction on profit allocation and the distribution of assets if the necessary procedures are followed and special majorities are obtained for the conversion.[87] If there were a

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85 [1997] LRLR 1.

86 *Investors Compensation Scheme Ltd v West Bromwich Building Society (No 1)* [1998] 1 WLR 896, 912–4 and see, for example, *PNPF Trust Co Ltd v Taylor* [2010] EWHC 1573 (Ch).

87 See Section **12.4.** below.

problem with an amendment of the objects rule, the existing rule might allow the society to hold shares in a company or society that carried on a business that the society could not conduct. Otherwise, the importance of drafting a wide and clear objects clause at the beginning is underlined by the possible problems of amendment.

It is unfortunate that the provisions of CCBSA 2014 about dissolution may, in some cases, allow distribution to members according to capital interest in the society if the rules of the society do not prevent that. A rule change by a society to prevent distribution of assets on dissolution in breach of Co-operative Principles or for private gain rather than community benefit should not fall foul of *Datchet's* application of the *Hole v Garnsey* principle. However, an attempt to offer members the chance to take further shares to achieve an equal distribution of surplus on the dissolution of a society was struck down as the use of a power for an improper purpose in one Court of Appeal case.[88]

(**b**) **Minority protection** Although there appear to be no reported cases applicable to co-operative or community benefit societies, it is likely that the courts would apply the principles developed in the context of company law to limit the right of a majority of members to use their power to amend the rules in a manner oppressive of a minority of members.

However, the limitation imposed by this principle is ill defined and amounts to an obligation on the voting members to exercise the power to alter the society's rules for the benefit of the society as a whole.[89]

There is a presumption that the power was exercised for the proper purpose and the principle merely requires members to act in what in their opinion is the interest of the society as a whole. The court will not substitute its view of that interest for the honest opinion of the members.

The concept of the interests of the society as a whole for this purpose seems to amount to the interests of the members.[90] To succeed in mounting a challenge on the basis of this principle, an amendment would have to be so evidently in the interests of the majority and against the interests of the minority that it was impossible for the majority to have believed it to be in the interests of the society's membership as a whole. Alternatively, there would have to be evidence that the majority excluded any consideration of the interests of the whole membership from their decision-making process. Such evidence might come from their statements or their behaviour.

The 'interests of the society' can fairly be regarded as the interests of the members in the case of a bona fide co-operative. However, in the case of a community benefit society this is inappropriate. The interests of the society in such cases should be identified as the interests of the group that it was intended to serve. The identity of that group could be ascertained by reference to the society's rules especially the provisions dealing with its objects. The test applicable might then be whether the majority considered the amendment to be in the interests of that group. In the case of a bona fide co-operative the majority should presumably consider the interests of members not merely as

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88 *Fletcher v South Leamington New Allotments Association Ltd* CA 24.3.94 LEXIS (the 'clodhoppers" case) and see **Chapter 12** below.

89 *Allen v Gold Reefs of West Africa Ltd* [1900] 1 Ch 656 per Lindley MR at p 672.

90 *Greenhalgh v Aderne Cinemas Ltd* [1951] Ch 286 per Evershed MR at p 291.

shareholders but in the capacity relevant to the co-operative, consumers, workers, tenants or borrowers and lenders depending on the type of co-operative concerned.

In the *Datchet* case,[91] the rule in *Hole v Garnsey* was described by Dillon LJ as being 'concerned with justice to dissentient members'. Perhaps this means that it is the equivalent for societies of the principle in *Allen v Gold Reefs*, which applies to companies. However, there is room for both doctrines to apply to societies. The *Hole v Garnsey* approach, which protects an original intention, is more appropriate for community benefit societies while the company law doctrine allowing greater scope for members to change the rules unless there is an intention to further purely sectional interests is suitable to co-operatives that serve their own members. At present it is not clear how the courts might tackle the application of these principles.

As long as the process of voting complies with CCBSA 2014 and the society's rules and the proposers of the amendment believe that they are acting in the interest of the society as a whole, it will be difficult for the minority to mount an effective challenge unless the *Hole v Garnsey* doctrine can be applied.

4.6.2. Registration of amendments

No amendment to a society's rules is valid until it has been registered with the FCA.[92]

Societies that are registered providers of social housing require the permission of the body responsible for regulating such providers for amendments to their rules. Notice of the proposed rule change has to be given to the Homes and Communities Agency, the Welsh Ministers or the Scottish Ministers in Scotland (as appropriate). These provisions are designed to protect the public funds provided to social landlords and the interests of the tenants. The written or sealed consent of the relevant regulator will be required before the Registrar will register the rule amendment and, in the absence of either that consent or the registration of the rule amendment by the Registrar the amendment will have no legal effect.[93]

In England, the above requirement to obtain permission and consent only applies to certain 'regulated' amendments. Those regulated amendments include amendments that alter the society's objects, make provision for the distribution of assets to members or enable the society to become or cease to be a subsidiary of another entity. All other amendments can be made without the social housing regulator's consent.

Notice also has to be given to the relevant social housing regulator of any change in the name of the society or the location of its registered office.

For societies that operate in Scotland and are registered with the Office of the Scottish Charity Regulator (OSCR) applications for rule amendments must also be submitted to OSCR for their consideration. The Regulator will require proof of any formal consent from OSCR.

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91 *Datchet Co-partnership Housing and Allotment Society Ltd v The Official Solicitor* Court of Appeal (Civil Division) (Transcript Association) 19 May 1990 LexisNexis.

92 CCBSA 2014, s 16(1).

93 Section 212 Housing and Regeneration Act 2008, s 212 (for English societies); Housing Act 1996, Sch 1, para 9 (for Welsh societies); Housing (Scotland) Act 2010, s 93 (for Scottish societies).

All amendments to the rules of the society must be sent in duplicate to the FCA. They must normally be signed by three members and the secretary. However, if the society is a federal and all its members are other registered societies, they must be signed by the secretary of each member society or of any two if there are more than two.[94] These copies must be sent together with appropriate form, signed by the secretary and containing a statutory declaration by an officer of the society that the amendment was duly passed in accordance with the rules. No fee is payable for the registration of rule amendments.

If the FCA is satisfied that an amendment to the society's rules is not contrary to the provisions of the CCBSA 2014, it must issue an acknowledgment of registration that is conclusive evidence of the fact of registration.[95] It is possible to appeal against the FCA's refusal to register an amendment.[96]

A failure to register an amendment makes it totally ineffective.[97] However, the FCA's certificate is not only conclusive of the fact of registration but means that 'it is incompetent for anybody to raise objections on points of procedure and detail' as to matters that occurred before registration.[98] This suggests that irregularities as to the calling of the meeting at which the amendment was passed or as to the way the meeting was run cannot be raised. However, defects involving fraud, a lack of power to make such a provision, or a breach of the rules and principles discussed at para 4.6.1. above are matters of substance and not mere formalities and could still make the amendment ineffective.[99]

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94 CCBSA 2014, s 16(2).
95 CCBSA 2014, s 16(4).
96 CCBSA 2014, s 17.
97 *Re Londonderry Equitable Co-operative Society* [1910] 1 IR 69.
98 *Re Quinn and National Catholic Benefit and Thrift Society's Arbitration* [1921] 2 Ch 318 per Eve J at p 324 on the almost identical wording of s 13 of the Friendly Societies Act 1896.
99 *R v Davis* (1866) 13 LT 629; *Cullerne v London and Suburban General Permanent Building Society* (1890) 23 QBD 485 at 488.

CHAPTER 5

MEMBERSHIP

5.1. THE NATURE OF MEMBERSHIP

In previous editions of this handbook, this chapter started with the question 'who may be a member?'[1] However, in the light of developments over recent years including the use of co-operative and community benefit societies for wider purposes, particularly in relation to public services, it is appropriate to reflect briefly on the nature of membership.

Historically societies were established by individuals in communities. Such individuals were both the 'promoters' and the first members, and they were then joined by others who qualified for and were subsequently admitted as members. Those members owned, funded, and had ultimate democratic control over their society, subject to its rules. Membership involved holding at least one share, and by statute there was always been a maximum shareholding limit for any one member.[2] Rules were also required by statute to include provisions about the nature of such shares.[3]

Following the change of law in 1939 (see Section **2.1.5.**), there were effectively two categories of society capable of registration, namely 'bona fide co-operatives' and 'societies for the benefit of the community', now 'community benefit societies'.[4] In the second half of the last century it became increasingly common to register housing associations as societies for the benefit of the community. Such organisations were often established by prominent individuals looking to address housing needs in their community. In such cases, the promoters and first members were establishing something for the benefit of others; membership was generally not open; and it was not uncommon to provide that those subsequently appointed to the board or committee would also become members. In this context, membership had become a formality, leaving boards without any meaningful accountability to members.

More recently, with growing interest in a 'localism' agenda, the engagement of individuals in communities and the pursuit of alternative models of ownership for public service provision, this restricted approach to membership has changed. Since the advent of the Community Mutual model for housing in Wales (2001) and the Community Gateway model in England (2002), community benefit societies have been registered with membership open to those accessing the services concerned. Membership in those societies has become a mechanism for the state to transfer an asset or service into the

1 See now Section **5.2.** below.
2 See now CCBSA 2014, ss 14(7) and 24.
3 See now CCBSA 2014, s 14(9).
4 CCBSA 2014, s 2(1)(b).

ownership of the community. Such membership, which is often based on the holding of one share only by each member, can be criticised as tokenism; but it remains an important mechanism to give local communities and constituencies within such communities (such as residents, service-users or volunteers) a voice in governance by electing their own representatives, and enjoying some form of ownership.

In this context, membership of community benefit societies has become a mechanism to confer influence in relation to a community asset or service, and a share in a new form of public ownership. This development reflects and in some cases draws on the creation of a new corporate structure by health sector legislation in 2003 – the so-called 'public benefit corporation' introduced for NHS Foundation Trusts.[5] There, membership is open to the public and staff, and can also be open to patients and carers as separate constituencies, and the corporate entity is (at least technically) at arm's length from the state, despite contractual links and financial dependence.

By way of summary, while the traditional economic and democratic facets of membership continue to apply to co-operative societies, for community benefit societies the concept of membership is evolving. For them, the economic aspects seem to be less significant than the democratic and participatory ones. The future is likely to be shaped by legislative developments concerning share capital.[6]

5.2. WHO MAY BE A MEMBER?

A member has the rights and duties set out in the rules of the society. Open membership is an important Co-operative Principle and should be reflected in both the law and the rules of individual co-operative societies. However, it is recognised that it may be appropriate for there to be qualification criteria for membership – for example, membership of a worker co-operative only to be open to employees. Open membership is not a requirement for community benefit societies but it may be appropriate in some cases, particularly where the aim is local ownership and engagement. In Section **5.5.** of this chapter, which covers the specific provisions of the rules of different types of society, the factors determining who may join are set out.

The primary concern of the FCA on the registration of community benefit societies is that the society serves people other than its own members and that the profits and assets of the society cannot be distributed to members. The shareholding of the members and the return on any loan capital they invest is also usually expected to be limited.[7]

The general law lays down a number of rules about the qualifications for membership. Unless the rules of the society provide otherwise, a society may admit to membership:

- any human person regardless of age;
- any corporate body whose regulations so permit.

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5 Health and Social Care (Community Health and Standards) Act 2003, s 1 and Sch 1.
6 See **Chapter 8** below.
7 See Sections **3.3.** and **3.4.** above

5.2.1. Members under 18

A person under the age of 18 may be a member unless the rules of the society provide to the contrary.[8] The result of the introduction of this provision in January 2012 is that societies must now specify in their rules if they wish to establish a minimum age for membership. If their rules are silent on the issue, there is now no minimum age.

The general law limits the legal capacity of persons under 18, and that general position is preserved by s 31(2) of CCBSA 2014, which provides that a person aged 16 or over may execute all instruments and give all receipts required under a society's rules. That limits that capacity to those aged 16 or more but is said to be subject to the society's rules, which may therefore be able to give that power to people aged less than 16. However, subject to that, a person under the age of 18 may enjoy all the rights of a member of a registered society.[9] In line with company law, the minimum age for being a member of a society's committee is now reduced from 18 to 16 and that is not said to be subject to the society's rules.[10]

Societies in which the role of members requires full legal capacity, such as housing co-operatives in which members must be tenants, or where other legal constraints, such as the licensing laws in the case of social clubs, require that only adults be members, need to include a provision in their rules setting 18 as the minimum age.

5.2.2. Corporate bodies

Since corporate bodies possess legal personality they can be members of other corporations. A number of statutory provisions deal with this issue.

A corporate body may hold shares in a society in its own name unless the society's rules prohibit corporate membership.[11] The corporate bodies most likely to join societies are other co-operative and community benefit societies and companies registered under the CA 2006. However the phrase is wide enough to include corporations created by charter such as universities, those created by statute such as local authorities or those incorporated by their own Act of Parliament. The rules of a society may exclude corporate membership altogether or may limit it to certain classes of corporate body. An application to register a new society can be signed by the secretaries of two members where both or all members are other co-operative or community benefit societies, otherwise three members need to sign.[12]

If one registered society is a member of another one, references in the legislation (or presumably, a society's rules dealing with matters that are left to them by the Act) to members making applications or signing documents, are to be taken to mean two committee members and the secretary of the member society.[13] It should be noted that this provision only applies where one society is a member of another.

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8 CCBSA 2014, s 31(1).
9 CCBSA 2014, s 31(2)(a).
10 CCBSA 2014, s 31(3) and see CA 2006, s 157(1).
11 CCBSA 2014, s 32.
12 CCBSA 2014, s 3(1)(a).
13 CCBSA 2014, s 33.

In the case of a company that is a member of a society, s 44 of the CA 2006 provides that a document is validly executed by a company if it is signed on its behalf by two directors, or one director and the secretary, or by a director in the presence of a witness who attests the signature.

Where a corporation is a member of a company, it may by resolution of its directors or other governing body authorise a person or persons to act as its representative or representatives at any meeting of the company. A person authorised by a corporation is entitled to exercise on behalf of the corporation the same powers as the corporation could exercise if it were an individual member of the company.[14] It also covers the role of a corporate body that is a creditor of a company and needs to participate in creditors' meetings. This covers a society that is a member of a company as well as one company that is a member of another one.

However as regards matters affecting a society as a member of a company, CCBSA 2014 also lays down a provision. A society which has invested funds in the shares of any body corporate (this includes companies) can appoint one of its members as a 'proxy' even if that person is not a shareholder in the other body corporate.[15] Such a member is then taken to be the holder of the society's shares while the appointment lasts for all purposes except transferring the shares or giving a receipt for a dividend paid on them.[16] Those words, like the words of s 323 of CA 2006, imply that the representative may be able to appoint his or her own proxy under ss 324–331 of CA 2006 to vote in company meetings as the society itself could use that power.

The overlap between s 323 of the Companies Act 2006 and s 28 of CCBSA 2014 is unfortunate but should not cause major difficulties. If the society is a creditor or debenture holder the former should be used although s 28(1) CCBSA 2014 refers to investing funds 'in the shares or on the security of any other body corporate', s 28(2), which confers powers, refers only to shares and not to debentures. Under s 323 the method of appointment of the representative is specified as a resolution of the directors or other governing body of the society. Under s 28 of CCBSA 2014 the society's rules can specify the method of appointment.

5.2.3. Unincorporated associations and unregistered general partnerships

Since, by definition, unincorporated associations do not possess legal personality, they cannot themselves be members of societies. In England partnerships between individuals for business purposes within the definition in s 1 of the Partnership Act 1890 cannot be members of a society for the same reason. Despite being registered for limited liability purposes, the same is true of a limited partnership registered under the Limited Partnerships Act 1907.[17] However, a limited liability partnership registered under the Limited Liability Partnerships Act 2000 is a corporate body and so could be a member of a society in the same way as any other corporation.[18]

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14 CA 2006, s 323.
15 CCBSA 2014, s 28(1).
16 CCBSA 2014, s 28(2).
17 *Re Barnard* [1932] Ch 269.
18 Limited Liability Partnerships Act 2000, s 1(2).

One or more individuals can hold membership of a society on behalf of an unincorporated organisation such as an unregistered general partnership or an unincorporated association. The individual will hold the shares on trust for the other members of the organisation but, as far as the society is concerned, he or she is registered as an individual member. This procedure can give rise to practical difficulties in a society in which members hold shares as investments of significant value and not as tokens of membership. For example, if the rules provide that a member may hold only one share account, then a person could not hold one account for an organisation and another as beneficial owner. Even if the rules have no such provision, care would have to be taken that the total holding of the person in their own right together with the amount held on behalf of the organisation did not exceed the statutory limit or such lower amount as the society's rules lay down. This is based on the requirement that no member may 'have or claim an interest' in withdrawable shares in a society exceeding the statutory limit (currently £100,000) and the assumption that holding shares as a trustee constitutes an 'interest' for this purpose.[19]

Since 2012, credit unions have specifically been authorised to have 'corporate members' and both unincorporated associations and unregistered general partnerships are included in the definition of such members but on the basis of the membership of an individual acting in the capacity of partner or unincorporated association committee member.[20]

5.2.4. Joint membership

The prevalence of joint membership goes back to the days when co-operative society share accounts were used as an alternative to bank accounts. Many older societies still retain the possibility of joint membership in their rules, but where shareholding by members has become nominal, joint membership is less common. Unless the rules of a society provide to the contrary, joint membership is possible. Under the general law it is open to people to hold property in this way.

The current statutory limit of £100,000, or lower amount fixed by a society's rules, applies to a member's interest in any withdrawable share account, whether joint or held by one person.[21] The holding of a member is calculated for this purpose by including the jointly held shares in the amount held by each of the joint holders individually. Thus if A and B hold £99,000 jointly and each holds £501 individually the maximum limit is exceeded by both of them, as the joint holding is added to each individual holding to calculate its value for this purpose. The justification for stating that this is the rule is to be found in s 24(1) CCBSA 2014. That subsection states that a member 'may not have or claim any interest in the society's withdrawable shares exceeding £…'. The words 'exceeding £…' seem to qualify the words 'withdrawable shares' rather than the word 'interest'. Since both of the joint holders have 'an interest' in the shares held jointly those shares all count towards the limit.

This interpretation has the advantage that it avoids the need for societies to quantify the precise interest of a member in a joint account. In a case in which money was paid into and withdrawn from a joint account over a long period by each of the holders that might be a difficult task as evidence of intention would be needed unless the beneficial

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19 CCBSA 2014, s 24(1).

20 CUA 1979, s 5A(6) inserted by art 15(2) of LRO 2011 SI 2011/2687 and see Section **13.4.2.** below.

21 CCBSA 2014, ss 14 and 24(1).

interest of the holders of each of the joint holders could easily be established from a clear statement in a document. Since 2012 the limit has not applied to shares that are not withdrawable.[22]

When a joint account is opened it will be wise to stipulate which of the holders is to exercise the one vote that the account will carry. In the absence of a rule to the contrary, the signatures of all the joint holders should be required for any withdrawal from the account or transfer of the shares and all should be required to sign any other documents such as receipts for payments of interest or dividend. By analogy with cases on bank accounts, the society faces a risk of negligence liability if it allows withdrawals from a joint share account on only one signature where the rules or terms of the share account are silent.[23] Many of the model rules deal with this issue by allowing joint shareholders to nominate one of their number to receive notices and stating that the first named will be assumed to be intended to receive them in the absence of a choice.

5.3. ADMISSION TO MEMBERSHIP

The rules of every society must deal with the terms of admission of the members, including any society or company investing funds in it.[24] In registering a co-operative society, the FCA expects that membership should normally be open. It should not be restricted artificially to increase the value of the rights and interests of current members, but there may be grounds for restricting membership in certain circumstances, which do not offend co-operative principles. For example, the membership of a club might be limited by the size of its premises, or the membership of a self-build housing society by the number of houses that could be built on a particular site.[25]

Any other requirements as to membership are left to be laid down in the society's rules. They will normally require a member to hold one or more shares as a condition of membership. They may draw a distinction between the founder members who signed the registration documents of the society and those who join later.

The other qualifications laid down by the rules of a society will vary to reflect its nature and objects.

The procedure for admitting members will be laid down by the rules (or in a separate document made under the rules) but will usually be a decision of the board or committee or an officer authorised by it. Some societies allow an appeal from their decision to the general meeting if membership is refused.[26]

5.4. TERMINATION OF MEMBERSHIP

A person's membership of a society may end in one of four ways:

- expulsion by the society;
- automatic termination under the rules;

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22 Article 3 of LRO 2011 and see now CCBSA 2014, s 24(1).
23 See eg *Fielding v Royal Bank of Scotland* [2004] EWCA Civ 64.
24 CCBSA 2014, s 14(4).
25 See Sections **3.3.** and **3.4.** below.
26 See Section **5.6.** below.

- death (or dissolution in the case of a corporate member);
- voluntary withdrawal.

Most model rules deal with this issue in some detail.

5.4.1. Expulsion

It is advisable for the rules to contain an express power to expel members, for two reasons. First, although societies wish to encourage membership, they need to be able to protect themselves against those who become members but whose actions or behaviour would damage or destroy the society. It makes sense for the society to be able to protect itself in order to achieve its objects. The second reason is that there is uncertainty as to whether the courts would accept that a power of expulsion can be implied simply on the basis that it is necessary to achieve the objects of the organisation as set out in the objects rule. There is case law authority that a member cannot be expelled from an unincorporated association unless its rules specifically provide for such action.[27]

More recent case law accepts that it is possible for a power to expel or discipline members to be implied into rules. In *McVitae v UNISON*,[28] disciplinary offences allegedly committed before the amalgamation of two trade unions were pursued against a member by the new amalgamated union. On the application of the member for an injunction to restrain that process, the court held that cases such as *Dawkins v Antrobus* should not be interpreted so widely as to prevent the possibility of ever implying a power to expel a member. Rather, the court did have such a power but it should be exercised with care and only where there were compelling circumstances to justify it. In the present case any breach of a rule which appeared both in the rule book of the pre-amalgamation union of which a person was a member and also in the rule book of the post-amalgamation union should be subject to disciplinary process but a rule which appeared only in the post-amalgamation rule book should not. This approach was justified on the basis that a refusal by the court to imply such a power would be contrary to both the expectations of the members and common sense. However, even with this more liberal attitude to implied powers in rules, it is still desirable to insert express provisions on issues such as expulsion for the sake of certainty and the ability to control the wording and scope of the rule inserted.

The model rules vary in their approach to this issue. In cases where continued membership depends on the existence of some other legal relationship such as employment in a worker co-operative, a tenancy in the case of a housing society, or the continued existence of a members' agreement in the case of an agricultural co-operative, the termination of that contractual relationship may end membership automatically. In the case of societies such as consumer co-operatives and working men's clubs, expulsion is provided for separately. It may be based on a ground such as behaviour contrary to the interests of the society, or likely to bring the society into disrepute.

An important point arises in relation to the mechanism for expulsion and, in particular, how the decision is made. Until recently, it was common for the power to be exercisable by the general meeting, or the board or committee with an appeal to the general meeting. While this is consistent with the democratic control of the society by its

[27] *Dawkins v Antrobus* (1881) 17 Ch D 615 per Jessel MR at 620.
[28] [1996] IRLR 33.

members, it can result in decisions being taken on personal grounds, rather than on what is in the best interests of the society. Whereas the committee making such a decision would owe normal duties to the society to makes such a decision in its best interests, members at a general meeting would owe no such duties. This suggests that it might be preferable for such decisions to be restricted to those who owe duties to the society – for example an initial decision to be made by a sub-committee, with a right of appeal to the full committee.

Whoever makes the decision, it is also important that the process followed is fair. Rules will often provide detail as to the notice to be given to the member of the meeting at which their expulsion will be considered, the alleged wrongdoing, their right to attend the meeting, making the decision and making representations.[29]

It is for the body authorised by the rules to decide on an expulsion to determine whether the grounds set out in the rules are satisfied in a particular case. For example, behaviour prejudicial to or contrary to the interests of the society might include prejudicing a co-operative's trading interests by competing with it, failing to work diligently in the case of a worker co-operative or annoying fellow tenants in a housing association. Unacceptable, offensive or violent behaviour in the club might fall within the definition in the case of a social club. The court will only intervene to set aside the decision of the society if it is clear that no reasonable body could have found the member guilty of such conduct on the basis of the evidence before the meeting or if proper procedures for representations by the accused member, notice of the meeting and of the charge and the appeals procedure, if any, were not followed. The court will not hear an appeal on a dispute as to the credibility of the evidence or substitute its own judgment on whether a case was made out for that of the appropriate organ of the society.

A case that illustrates the approach of the courts is *Bradman v Radio Taxicabs Ltd.*[30] In that case the court upheld the expulsion of a member from a society set up to provide a radio service for its taxi driver members. The driver had assaulted the dispatcher who decided which taxi took calls received from customers. The driver believed that he was nearer the fare in question than the driver who was actually sent. The court decided that a letter sent to the member before the hearing of the expulsion case sufficiently specified the charges that he faced and thus that the board meeting that decided to expel him in accordance with the society's rules was properly convened.

A verbal statement to the member before the hearing to the effect that he could call witnesses if he chose gave him an opportunity to present his case. His request at the end of the hearing for a radio call to page witnesses and the implicit request for an adjournment could be rejected by the board in its discretion without court intervention. The expulsion of the member for life was regarded as not being unduly harsh as the board ran the association for the benefit of the members and they were entitled to choose with whom they associated and to uphold and enforce the decisions of dispatchers who were in the position of umpires. Assaults on the dispatchers were a risk to the well-being of all members. This case shows the breadth of the discretion that the courts allow and indicates that the issue of whether notice of the rights of the member was given to them is one of fact as to the information actually supplied.

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[29] See Section **5.6.** on the specific rules for detail.

[30] (1984) 134 NLJ 1018.

The decision to expel must be taken in good faith for the benefit of the society as a whole: 'The powers of the committee are powers to be exercised in the interests of the association as a whole, and not in the interests of a particular section of the committee.'[31]

There must not be some other motive such as wishing to end legal proceedings launched to set aside an earlier expulsion. Irrelevant considerations that have no bearing on the question of whether the member has behaved in the way that the rules lay down as necessary for expulsion must be ignored: *Tantussie v Molli*.[32]

The procedure laid down in the rules must be followed carefully. Even a failure that may not have affected the decision such as not sending notice of the meeting to one member who is known to be unable to attend may be fatal. Notice must also stipulate what is to be considered by the meeting.[33]

Whether the society's rules lay down the procedure to be followed in expulsions or not (and most of the model rules do), it is essential that the member knows the charge to be answered and is given an opportunity to answer it. Failure to follow this procedure will make the expulsion invalid as a breach of the rules of natural justice and it may be set aside by the courts. It is also essential that none of those involved in the decision-making have any personal interest in the outcome of the proceedings which could even be suspected of making them biased.[34]

It is wise, if possible, to ensure that any appeal is heard by different people from those who made the first decision so as to avoid the appearance or reality of bias in the appeal hearing. However, this does not seem to be 'essential' to comply with the law.[35]

5.4.2. Automatic termination

It is open to the rules of a society to lay down that the membership will terminate automatically on the occurrence of a particular event. It is desirable that the event that is to terminate membership automatically be well defined and easily established.

Some societies will provide for the automatic termination of membership if a member's share capital falls below the minimum level laid down in the rules. In the case of agricultural co-operatives set up for marketing purposes, the termination of a person's marketing contract with the co-operative may be an event which ends membership status. In a housing society, membership may be open to prospective tenants but end automatically if no tenancy is taken within a certain time of joining or of being offered one. Loss of the status of employee in a worker co-operative or of tenant in a housing co-operative may result in the automatic termination of membership.

Under the heading of 'automatic termination', it is also convenient to deal with another mechanism for termination of membership.

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31 *Woodford v Smith* [1970] 1 WLR 806 per Megarry J at 816.
32 (1886) 2 TLR 731.
33 *Young v Ladies' Imperial Club Ltd* [1920] 2 KB 523 and *MacLelland v National Union of Journalists* [1975] ICR 116.
34 See *Ridge v Baldwin* [1964] AC 40 per Lord Hodson at p 132 for a summary.
35 *Leary v National Union of Vehicle Builders* [1971] Ch 34 per Megarry J at 48.

It is important to maintain an up-to-date register of members. Some model rules now include provisions to enable societies to remove members from the register where the society has lost contact. Such provisions include a requirement to take specifically listed steps to try to make contact with the member at their last-known address. They may also require other steps such as advertising the intention to remove the member from the register. Removal from the register and consequent treatment of the member's shares is then based upon the failure of the member respond to the society. Rules may then deal with renewed contact from the member.

5.4.3. Death or dissolution

The death of a member automatically terminates membership unless the rules specify otherwise, in which case the rights and duties attached to membership devolve as part of the estate. Most society rules spell out the effect of death on membership. The rules of all societies must state how claims by personal representatives of deceased members are to be dealt with.[36]

In relation to corporate bodies, some rules specify that the liquidation of a corporate member has the same effect as death of an individual person. In any event, the dissolution of a corporate body will terminate its membership as it then ceases to exist.

Some rules will also lay down how other insolvency processes such as corporate or individual administration, creditors' voluntary arrangements or individual bankruptcy affect the membership status of an individual or corporate member. If the society's rules are silent, the consequences of any particular procedure will have to be found by consulting the legal rules governing that particular insolvency process and their effect on the insolvent person's capacity to operate as a member. That is in principle more likely to be affected in a co-operative of businesses than in a members' club.

5.4.4. Voluntary withdrawal

Since membership of societies is essentially voluntary, withdrawal from membership will usually be permitted by the rules. In the case of co-operatives, Principle 1 of the ICA Statement of Co-operative Identity Values and Principles specifically states that co-operatives are voluntary organisations based on voluntary and open membership.[37]

A society's rules must deal with the decision-making as to whether, and, if so, how members may withdraw.[38] This implies that the rules of a society may deny members this right or limit its exercise. Subject to the need to include some provision, the issue of voluntary withdrawal is one for the rules and is dealt with by different societies in the way best calculated to meet their needs – with particular reference to the danger of a run on capital.

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36 CCBSA 2014, s 14(11).
37 See http://ica.coop/en/whats-co-op/co-operative-identity-values-principles.
38 CCBSA 2014, s 14(11).

5.4. KEEPING A REGISTER OF MEMBERS

Information about the members of a society must be kept in a register, which must be kept at the society's registered office. The register must be kept in a bound book or some other way that allows for precautions against falsification and its detection if it occurs.[39]

Under s 30(2) the register must contain:

- the member's name and postal address;
- where the member has notified the society of an electronic address for the purposes of receiving notices or documents, the electronic address and the purposes for which it has been notified;
- the number of shares held by the member and the amount paid or agreed to be considered as paid on the shares;
- a statement of other property in the society held by the member (whether in loans, deposits or otherwise);
- the date the person was entered on the register as a member;
- (where applicable) the date the person ceased to be a member.

The information listed here except the detail of members' shares and other property in the society must be available for inspection by all members by the creation of a duplicate register with only this information in it or the construction of the one register so that only this information is revealed.[40]

Anyone authorised by the FCA who produces evidence of their authority is entitled to inspect the whole register at all reasonable hours.[41]

The register is taken to be correct for all legal purposes unless it is proved to be inaccurate as the Act lays down that it is prima facie evidence of the information it contains as to membership and shareholdings.[42]

In cases where the registered member and holder of shares is acting as a trustee for others, as in the case of a holding by one of joint owners or a holding by a representative of an unincorporated association, the rights against the trustee of those whose names do not appear will not be affected by the entry in the register. However, the society is entitled to act on the basis that the register is an accurate record of shareholdings for the purpose, for example, of serving notices of meetings or deciding who can vote at them. The fact that the address of a member shown on the register is presumed to be accurate in the absence of evidence to the contrary protects a society that keeps its register up to date and uses it to decide where to send any notices required under the Act or the society's rules.

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39 CCBSA 2014, s 30(5) and (6).
40 CCBSA 2014, s 30(7).
41 CCBSA 2014, s 30(8).
42 CCBSA 2014, s 30(9).

5.5. THE MODEL RULES

5.5.1. Consumer co-operatives: 12th Edition Model Rules (amended 2012) sponsored by Co-operatives UK

5.5.1.1. Admission to membership

Membership is open to anyone who is 16 years old or any corporate body. Applications must be made on a form specified by the board and must include an application for the minimum number of shares.[43] The board has an absolute discretion to accept or refuse a membership application and can delegate responsibility for deciding membership applications to the secretary or, under their supervision, other employees[44]. No person can be admitted to membership before the expiration of a qualifying period of six calendar months from the date of receipt by the society of a duly completed membership application in the prescribed form.[45] Every member must hold at least one fully paid up share, and all shares must be paid for in full on application.[46]

5.5.1.2. Expulsion

A member can be expelled by a resolution of the board approved by not less than two-thirds of those attending and voting at a meeting.[47] Procedures for expulsion are set out in the rules and must be based on a complaint by a member to the secretary that another member has acted in a way detrimental to the interests of the society. The member complained about must be given an opportunity to answer the complaint and attend the meeting which is to consider expulsion.[48]

5.5.1.3. Automatic termination

The secretary may remove members from the register of members where the society has evidence that a member no longer lives at the address shown in its register of members as long as certain procedures are carried out. Similarly, if a member has not, throughout the immediately preceding period of twelve calendar months, maintained a balance in their share account of at least £1, and again if certain procedures are carried out, the member can be removed from the register.[49] In both cases, the procedures are designed to ensure that the member has the opportunity to remedy the situation and remain on the register.

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43 Rule 5.2.
44 Rule 5.4.
45 Rule 5.5.
46 Rule 7.2.
47 Rule 6.2.
48 Rule 6.2.
49 Rules 12.5 and 12.7.

5.5.2. Worker co-operatives: Co-operatives UK Worker Co-operative Model

5.5.2.1. Admission to membership

Only employees may be members of the co-operative and employees are defined as anyone over the age of 16 holding a contract of employment with the co-operative to perform at least eight hours of work per week.[50] All employees can be admitted to membership. However, a general meeting may, by majority vote, exclude from membership newly appointed employees during any reasonable probationary period specified in their terms of employment and any employees working less than a prescribed number of hours per week (or per month). In each case the criteria for exclusion must be apply equally to any employees who meet them.[51] In accordance with the Co-operative Principle of voluntary and open membership, while the co-operative undertakes to encourage its employees to become members, membership must be voluntary and cannot be a condition of employment.[52] No person is to be admitted into membership unless are at least 16 years of age, support the aims of the co-operative, and have completed an application for membership, which includes an application for at least one share.[53]

5.5.2.2. Expulsion

A member may be expelled for conduct prejudicial to the co-operative by an extraordinary resolution passed by a majority of not less than 75% of votes cast at a general meeting, providing that the grounds for expulsion have been specified in the notices calling the meeting. The member whose expulsion is to be considered or, if they choose, their representative must also have been given an opportunity to make representations to the meeting.[54]

5.5.2.3. Automatic termination

In addition to the usual events discussed above this occurs when an individual ceases to be in the employment of the co-operative.[55]

5.5.3. Society for the benefit of the community – sponsored by Co-operatives UK

5.5.3.1. Admission to membership

The board may admit to membership any individual, corporate body, nominee of a unincorporated body, firm, partnership or corporate body who supports the objects of the society and who has paid or agreed to pay any subscription or other sum due in respect of membership.[56] No natural person can be admitted to membership of the

[50] Rules 3 and 14.
[51] Rule 15.
[52] Rule 16.
[53] Rule 17.
[54] Rule 22.
[55] Rule 21(a).
[56] Rule 12.

society unless they are at least 16 years of age. All those applying for membership must support the objects of the society and complete an application for membership and at least one share in the society. The application form must be approved by the directors, who must also approve each individual application for membership.[57]

5.5.3.2. Expulsion

A member can be expelled by an extraordinary resolution for conduct prejudicial to the society. The grounds for expulsion must have been specified in the notices calling the meeting and the member, or their representative, must be given the opportunity to make representations to the meeting.[58]

5.5.4. National Housing Federation – Model Rules 2011 (version 2)

5.5.4.1. Admission to membership

The board sets reviews and publishes its policies and objectives for admitting new shareholders. The board is only to admit new shareholders in accordance with such policies.[59] An applicant for a share must apply in writing to the association's registered office setting out their reasons for applying and their qualifications in accordance with the association's policies. They must pay £1, which is returned to them if the application is not approved.[60] Every application is considered by the board.[61] The board can accept or reject the application. If the application is approved, the name of the applicant and the other necessary particulars are entered in the register of shareholders. One share in the association is issued to the successful applicant.[62] The following cannot be shareholders: a minor; a person who has been expelled as a shareholder (unless authorised by special resolution at a general meeting); an employee of the association or an employee of any other group member; a person who has been removed by the board by the board or the general meeting; a person subject to a court order, which wholly or partly prevents them from personally exercising any powers or rights on the basis of their mental health.[63] A shareholder can be the nominee of an unincorporated body.[64] A corporate body can be a shareholder.[65]

5.5.4.2. Expulsion

A shareholder may only be expelled by a special resolution at a special general meeting called by the board, with appropriate notice, setting out the particulars of the complaint of conduct detrimental to the association and requesting the shareholder to attend the meeting to answer the complaint. At the general meeting called for this purpose the shareholders consider the evidence presented by the board and by the shareholder if any.[66]

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57 Rule 13.
58 Rule 17.
59 Rule C11.
60 Rule C12.
61 Rule C11.
62 Rule C13.
63 Rule C6.
64 Rule C7.
65 Rule C8.
66 Rule C15.

5.5.4.3. Automatic termination

In addition to the reasons mentioned above, a number of additional grounds are given in these rules. They include failing to participate in, or deliver written apologies in advance of, two consecutive annual general meetings of the association and ceasing to be a board or committee member, unless the board resolves that they can remain a shareholder. In addition, being subject, as an association resident, to a possession order, an anti-social behaviour order or injunction, a demoted tenancy or closure order or an order to recover money due to the association, other than one suspended or for instalment payments, results in termination of membership. A resident member in breach of a suspended possession order, or in material or serious breach of their tenancy agreement or lease with the association is similarly treated.[67]

5.5.5. Agricultural Co-operative (IPS) – Agency Model Rules sponsored by Co-operatives UK & Scottish Agricultural Organisation Society

5.5.5.1. Admission to membership

The co-operative can admit to membership any individual, corporate body or nominee of an unincorporated body, firm or partnership that is an agricultural producer that wishes to use the services of the co-operative and has agreed to be party to a members' agreement.[68] 'Members Agreement' means a written contract between a member and the co-operative under which the member participates in the use of the facilities and services provided by the co-operative for members.[69] No natural person shall be admitted into membership of the co-operative unless they have attained the age of 16. All those wishing to become a member must support the objects of the co-operative and complete an application for membership, which includes an application for at least one share. The application form must be approved by the directors and the directors must also approve each application for membership.[70]

5.5.5.2. Expulsion

A member can be expelled for conduct deemed by the board to be prejudicial to the co-operative, providing the member has been given 28 days' notice specifying the date, time and place of the meeting and setting out the grounds for expulsion and the member's opportunity to attend the meeting and make representations.[71] The resolution is passed and the member is expelled immediately if a majority of at least 75% of directors present, including those not present in person, vote in favour of the expulsion.[72]

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67 Rule C14.
68 Rule 14.
69 Rule 3.
70 Rule 15.
71 Rule 18.
72 Rule 19.

5.5.5.3. Automatic termination

In addition to other reasons mentioned above, membership terminates if a member is no longer eligible for membership or ceases to be party to a members' agreement, at which point membership of the co-operative ends.[73]

5.5.6. Social Clubs – Model Rules for a Working Men's Club – sponsored by Clubs and Institutes Union

5.5.6.1. Admission to membership

Any two members of at least six months standing may propose and second a candidate for membership provided they are able from personal knowledge to vouch for his respectability and fitness to be a member and both sign a nomination form to this effect. The candidate must deposit the full amount payable for one share. The deposit is returned if the membership application is rejected. The candidate must also sign any declaration of his concurrence with, and adherence to, the purposes of the club required by the managing committee. Election to membership is by the managing committee and the candidate and his proposer and/or seconder must appear in person before the managing committee. No candidate under 18 years of age or who is an employee of the club can be elected. The name and address of the candidate, with the names of his propose and seconder, are prominently displayed in a part of the principal club premises frequented by the members for at least seven days before the day on which his name is submitted for election.[74]

5.5.6.2. Expulsion

The secretary, president or any other officer may order the withdrawal from the club premises of any member who infringes any rule or by-law, or whose conduct in their opinion renders the member unfit for further entry to the club. At the next ordinary meeting of the managing committee, the relevant secretary, president or officer lays a complaint and the managing committee decides whether or not to formally charge the member. If they decide to do so, they must write to the member setting out the charges and summon him to appear before the managing committee, giving at least three clear days' notice. If the charge is upheld by a simple majority of the managing committee, they can then decide, by a two-thirds majority to reprimand the member, suspend him or her for up to 12 months or expel them.[75] The member can appeal to the General Secretary of the Clubs and Institutes Union.[76]

5.5.6.3. Automatic termination

In addition to the usual reasons mentioned above, membership of a social club is terminated by non-payment of subscription, and anyone whose membership ends in that way must pay any fee or fine imposed by the managing committee before being

[73] Rule 17.
[74] Rule 7.
[75] Rule 13.
[76] Rule 14.

re-elected to membership. Membership also terminates automatically if a member becomes an employee of the club other than as its secretary.[77]

[77] Rule 12.

CHAPTER 6

MEETINGS

6.1. INTRODUCTION

The concept of democratic control is fundamental to societies. For co-operatives it is one of their defining principles and for community benefit societies it can be a feature that distinguishes them from other legal structures such as companies, despite the history of the boards or committees of some community benefit societies being empowered to appoint their own members.[1] The co-operative and community benefit legal structure is flexible on the methods of democracy employed so long as the rules of co-operative societies meet the requirement of member control. This chapter deals with members' meetings and similar methods of decision-making by members.

6.1.1. What is a meeting?

In societies, as in companies, a meeting does not have to involve physical presence face to face. In *Byng v London Life Association Ltd*[2] Sir Nicholas Browne-Wilkinson VC said:[3]

> 'The rationale behind the requirement for meetings in the Companies Act 1985 is that the members shall be able to attend in person so as to debate and vote on matters affecting the company. Until recently this could only be achieved by everyone being physically present in the same room face to face. Given modern technological advances, the same result can now be achieved without all the members coming face to face: without being physically in the same room they can be electronically in each other's presence so as to hear and be heard and to see and be seen.'

There is every reason to suppose that this position also applies to meetings required to be held under the CCBSA 2014. Since 1990 technological methods covering greater distances than an overflow meeting room (the position in the *Byng* case), such as online or telephone video-conferencing, have become more widely available at reasonable cost. The *Byng* case shows that word 'meeting' in the statute certainly includes 'real-time' two-way communications that permit all those involved both to hear and be heard and, perhaps, to see and be seen. It also shows the willingness of the courts to look to the purpose of requiring meetings rather than being tied to a narrow traditional understanding of the term. If the rules of a society provide for all those entitled to attend a meeting to do so by means of a telephone conference, that may be permissible. Telephone conferences are more likely to be used for board meetings than general

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1 See Section **5.1.** above.
2 [1990] Ch 170.
3 At p 183.

meetings because of the numbers involved but a society with a small number of members, such as some worker co-operatives, might use this procedure for general meetings.

The enactment of the Mutual Societies (Electronic Communications) Order 2011, SI 2011/593 and the Industrial and Provident Societies and Credit Unions (Electronic Communications) Order 2014, SI 2014/184, using powers conferred by the Electronic Communications Act 2000, shows Parliamentary support for electronic communication between societies and their members and with the FCA. The amendments relevant to societies have now been consolidated by CCBSA 2014. However, the SI 2011/593 assumed that societies were free to use their rules to achieve results explicitly achieved by amending friendly society and building society legislation on, for example, proxy voting and ballots. Such amendments were not needed for co-operative and community benefit societies because the legislation is silent on those issues.

6.1.2. Unanimous Informal agreement of members

Similarly, although co-operatives and community benefit societies are not subject to ss 288–300 the Companies Act 2006 permitting written resolutions to be used by private companies, the common law permits informal assent by all the members of the company to a decision even in the absence of writing and on the basis of acquiescence by all the members entitled to vote.[4] That principle applies to friendly societies as it applies to companies so there can be little doubt that it applies to co-operative and community benefit societies.[5]

Many model rules allow 90% of all members to agree to reduce the notice period for general meetings.[6]

6.1.3. Importance of society rules and effect of non-compliance

The emphasis on member control in most societies makes the legal rules governing meetings and the election of a board or committee important. Decisions allocated to members by the rules, such as the amendment of rules and the appointment of auditors, and resolutions setting society policies, are dealt with at general meetings. In some cases the election of officers is also conducted at meetings.

It is important that the procedures laid down in the society's rules are followed if the decisions of a meeting or elections of officers are to be indisputably legally valid. In many cases defects such as a failure to give notice of meetings as required by the rules have been held to be fatal to the decisions made at the meeting.[7] This is because the rules are a contract between the members and the society and among the members and are interpreted accordingly.[8]

In some circumstances a failure to follow the rules precisely may not affect the validity of what is done but it is safer to comply strictly. Under modern case law, courts can take

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4 *Re Duomatic Ltd* [1969] 2 Ch 365.
5 *Speechley v Allott* [2014] EWCA Civ 230 at para 36.
6 See Section **6.4**.
7 See eg *Young v Ladies' Imperial Club* [1920] 2 KB 532 and *MacLelland v National Union of Journalists* [1975] ICR 116.
8 *Dawkins v Antrobus* (1881) 17 Ch D 615.

into account the purpose of the rule in question and the effect of the failure to follow it when deciding the meaning of the rule and the effect of failure to comply.[9]

In the Court of Appeal case of *Speechley v Allott*,[10] Lewison LJ, giving the court's unanimous judgment, suggests two questions to be considered. He also suggests the appropriate approach to answering them:

(1) What do the rules require? This is a matter of contractual interpretation since the rules are a contract but must be tackled making due allowance for the fact that the rules are to be operated by non-lawyers. Even after making that allowance strict compliance may be required.

(2) What is the effect of non-compliance with those requirements? Here allowance is made for the possibility that the rules in question may, on their true construction, be satisfied by 'adequate compliance'. The words of the rules are considered in the light of their subject matter, background, purpose and the actual or possible effect of non-compliance on the parties to the case. It is assumed that those agreeing the rules would have intended a sensible result.

In *Speechley v Allott* the rules required elections for certain positions in a bowling club registered under the Friendly Societies Act 1974 to take place by secret ballot and after the annual general meeting. In fact, they took place by show of hands at that meeting. The court held that to be a serious breach of the rules, the way members voted on a show of hands would be known to all present and the procedure in the rules allowed a wider group than those attending the meeting to vote. For those reasons certain officers were found not to be duly elected. However, in the same case, the invalid expulsion of certain members was held in the lower court not to invalidate a vote in which they did not take part as, had they participated, the result of the vote would have been no different.[11]

6.1.4. Ballots and referenda of members

It is possible but rare for societies to provide in their rules for referenda of members by ballot, rather than at meetings, on issues other than the election of the committee or board. If this is done the issue of how a question is phrased and who can decide to call for a referendum arises. It could be a right reserved to the committee or one given to a certain percentage of members who wished to put an issue to the members. In the latter case a procedure would be laid down by the rules for the service of the requisition on the secretary of the society and for that officer to administer a ballot on the question raised by the requisitionists.

The election of officers and the committee or board may be by a secret ballot of the members. This can be either a postal ballot (which will be expensive) or by the votes of members cast by secret ballot in person at some convenient place. In the case of both the election of the committee and the use of a ballot for some other question, the rules may lay down whether any literature may be sent to the members or displayed by candidates or advocates of particular policies and, if so, whether or not this is to be at the society's expense. Society rules may also regulate canvassing by candidates for election.

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9 See eg *Re GKN Bolts and Nuts Ltd* [1982] 1 WLR 774 per Sir Robert Megarry VC at 776.

10 [2014] EWCA Civ 230, at paras 28 and 29.

11 *Speechley v Allott* [2014] EWCA Civ 230, paras 47 and 77.

6.1.5. Proxies and postal votes

A proxy casts a member's vote on their behalf at a meeting. A system of postal or electronic voting permits members to vote directly and not through someone else, for example to elect a committee by those means. Both systems are possible in societies if the rules provide for them.

The use of proxy voting through an invitation to members to appoint, for example the chair of the meeting, as their proxy to cast a vote on the election of directors or particular resolutions as instructed by the member, is the usual practice for public limited companies and building societies. It is less common in co-operative or community benefit societies. It allows for the participation of the membership on a national basis through an annual or special general meeting of all members of the company or society, which the majority of those voting will choose not to attend. It is often argued that, despite the regulation of the process by the UK Listing Authority for companies with listed shares and by legislation for building societies, to ensure, for example, that members are able to use a board member as their proxy even if they wish to vote against the recommendation of the board, the proxy system favours the existing management team and board.[12] They not only circulate information and views in support of their own position but also design ballot papers and proxy forms so as to encourage members to support that view. Those taking a different view can only circulate a text of limited length as permitted by either the legislation or the regulator and, in some cases, may have to meet all or part of the cost of that process themselves.

6.1.6. Delegate systems, 'serial' meetings and direct ballots of members

The consumer co-operative movement, in particular, traditionally favoured systems based on one of two models – or on a hybrid of the two. The alternative approaches are either one 'serial' meeting held at different locations within the trading area on different occasions (in the case of a local or regional society) or a structure of regional committees or boards which themselves choose from their own number the main or central board of the society – often with a 'card vote' based on the number of members believed to exist in their region. The former system does not involve proxy or direct postal voting by individual members who do not attend the meeting. The latter system depends on the election of delegates who then elect those at the next level – sometimes through a number of layers. These systems are likely to involve a lower turnout of the membership to vote either for those they are electing or on resolutions and tend to favour activist groups such as employees or the ideologically committed who will attend meetings and serve on committees. The issue is then whether those directors on the society's central board – if elected and held to account on a regional basis – have an incentive to pay sufficient attention to the overall picture of the society's operations rather than the position in their own region.

At the time of writing, May 2014, the Co-operative Group Ltd seems likely to move to one member one vote elections and away from a delegate based structure for the selection of directors.[13]

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[12] See Listing Rule 9.3.6 and s 5(8) and Building Societies Act 1986, Sch 2, para 24(4) and (4A).

[13] Paul Myners, 'The Co-operative Group Report of the Independent Governance Review' 7 May 2014 http://www.cooperative.coop/PageFiles/989348879/Report_of_the_Independent_Governance_Review.pdf.

The review of governance systems was triggered by the disastrous problems of the Co-operative Bank which led to its recapitalisation and demutualisation in 2013. Those problems were attributed, in part at least, to the deficiencies in the supervision and appointment of senior executives in the Co-operative Group and the Co-operative Bank by the indirectly elected 'lay' directors who had little business experience and were not, in the case of the Co-operative Group, joined by independent professional non-executive directors (IPNEDS).[14]

As noted above, proxy voting and postal voting are possible if a society's rules permit it and a ballot system can be adopted. In some societies these traditional methods are combined with systems of opinion-testing, such as opinion polls and focus groups, to allow the voice of a large and diverse membership to be heard. Similarly, in benefit of the community societies, in which control by user members is not inherent in the structure, a board or committee may consist of members chosen by or from different constituencies such as employees, users, relevant local authorities or others (including independent persons) to achieve a balance of interests. There is also a long tradition of 'co-partnership' cooperatives in which both control and profit distributions are shared between, for example, employee and consumer members. CCBSA 2014 permits variation, flexibility and change over time by leaving most issues to be settled by the society's rules within the broad and open textured requirement that the society be and remain a bona fide co-operative or a benefit of the community society.

One use of this flexibility has been the trend in the early years of the twenty-first century for many larger consumer co-operatives to use methods of online and postal voting to encourage member participation in elections. Electronic communications can be used even more extensively by co-operatives with a small number of members who are widely dispersed geographically.

However, for most societies it is still through meetings that democratic control is exercised. The rules governing meetings have two main sources – CCBSA 2014 and the society's own rules. Certain procedural matters may be governed by the common law if the rules of the society and CCBSA 2014 make no provision.

In this chapter, the rules laid down in CCBSA 2014 are dealt with in Section **6.2.**, and some of the common features of the rules of societies are considered in Section **6.3**. The particular rules adopted in some of the model rules used by different categories of society are discussed in Section **6.4**.

6.2. PROVISIONS OF THE ACT AS TO MEETINGS

6.2.1. CCBSA 2014: General provisions

The rules of a society must provide for 'the mode of holding meetings, the scale and right of voting and the mode of making, altering or rescinding rules'.[15] This provision means that the FCA can consider the provisions of society rules on this when deciding

[14] See Sir Christopher Kelly, 'Failings in Management and Governance: Report of the independent review into the events leading to the Co-operative Bank's capital shortfall' 30 April 2014 at http://www.thekellyreview.co.uk/.

[15] CCBSA 2014, s 14(5).

whether a new society or amendments to the rules of an existing society meet the registration requirements of s 2 of CCBSA 2014.

CCBSA 2014 does not lay down many general rules about the types of meeting that a society might call, how often they should be called, the notice needed for meetings or resolutions, or the majority required for particular resolutions. Those matters are generally left to society rules.

A society's rules should provide for at least one general meeting, usually annually, to which audited accounts can be presented. Society rules should also deal with the procedure for calling special or extraordinary meetings needed for particular decisions, such as the amendment of the rules. As outlined below, on certain matters such as a transfers of engagements, the amalgamation of the societies, the use of the administration procedure, conversion into a company or dissolution under the Insolvency Act 1986, CCBSA 2014 or the IA 1986 lay down specific requirements. More fundamentally, the FCA would refuse to register rules that did not provide for sufficient meetings to allow for democratic control. The society would not then be able to register as a co-operative under s 2(1)(a) of CCBSA 2014. For similar reasons societies other than federal co-operatives should generally allow for one member one vote at meetings and should not generally attach votes to shares.

Meetings can be delegate meetings (delegates appointed by members) if the rules of a society lay this down. This would apply to a society that had other societies as its members, for example a secondary co-operative, or to a very large society.[16]

6.2.2. CCBSA 2014: Particular meeting provisions

CCBSA 2014 lays down requirements about meetings for some decisions and in certain particular situations. They include the following provisions.

6.2.2.1. CCBSA 2014 reorganisations

A 'special resolution' must be passed in accordance with statutory procedures and majorities for:

- the amalgamation of two societies;
- a transfer of engagements from one society to another;
- the conversion of a society into a company; and
- the conversion of a company into a society.[17]

6.2.2.2. Winding up under company procedures

A society can be dissolved by being wound up by an order or resolution made 'as is directed in the case of companies'. Provisions about company winding up then apply as

[16] CCBSA 2014, s 149.
[17] CCBSA 2014, ss 109–117 and see Sections **3.10.** above and **12.2. to 12.5**. below.

if the society were a company, subject to some minor modifications.[18] As a result, resolutions complying with Companies Act 2006 or Insolvency Act 1986 requirements must be used for such decisions.[19]

6.2.2.3. CVAs, administration procedure, and schemes of arrangement

Similarly, if a society uses the Companies Act and Insolvency Act procedures of creditors voluntary arrangements, administration, or schemes of arrangement applied by the Industrial and Provident Societies and Credit Unions (Arrangements, Reconstructions and Administration) Order 2014, SI 2014/229, the resolutions required must generally follow the pattern applied in the case of companies using those procedures, subject only to adaptations made by SI 2014/229.[20]

6.2.2.4. Ratification and relief from director liability

If a society committee member acts beyond the capacity of the society, the ratification of their act and relief from the committee member's liability to the society for its consequences under require two separate special resolutions.[21] Those resolutions must be passed at a general meeting by at least 75% of the eligible members who vote and at least 21 days' notice of the meeting and the resolution must be given in accordance with the rules.[22] A copy of the special resolution, signed by the chair of the meeting and the secretary, must be sent to the FCA for registration. Those provisions were originally introduced by s 3 of the CCBSA 2003 to reflect the position in company law as it then was. As a result, they use the 75% majority required for Companies Act special resolutions.

6.2.2.5. FCA power to call meeting

The FCA has power to call a meeting if at least 10% of a society's members (or, if less, 100 members) apply.[23] An application under this section must be supported by such evidence for the purpose of showing that the applicants have good reason for requiring the examination or meeting (and do not have malicious motives) as the FCA directs.[24] The FCA can direct when and where such a meeting is to be held and what is to be discussed and determined.[25] The meeting can appoint its own chair regardless of the provisions of the society's rules and has all the powers of a meeting called under those rules.[26] The FCA may require the applicants to give security for the costs of the meeting.[27]

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18 CCBSA 2014, s 123.
19 See Section **12.2.** below.
20 See Section **12.8.** below.
21 CCBSA 2014, s 43.
22 CCBSA 2014, s 44.
23 CCBSA 2014, s 106(1).
24 CCBSA 2014, s 106(3).
25 CCBSA 2014, s 107(3).
26 CCBSA 2014, s 107(4).
27 CCBSA 2014, s 106(5).

6.2.2.6. Obligatory AGM for accounts and auditor?

The accounts of a society must be audited, if the society cannot or does not opt to disapply those requirements under s 84 CCBSA 2014. Section 82 CCBSA 2014 regulates the publication of the revenue account and balance sheet and the requirements with which they must comply. This may imply that the accounts should be presented to a meeting of the society, as the revenue account or balance sheet must be signed by the secretary and two committee members, which would in practice usually be done after presenting them to the members. If auditors are to be replaced a special procedure must be followed and CCBSA 2014 assumes that the process takes place at a members' meeting.[28] Auditors have a right to attend a society's general meeting and to be heard on matters that concern them as auditors.[29] Reporting accountants appointed under s 85 CCBSA 2014 for a year in which the society has disapplied the audit requirement but has a turnover in excess of £90,000, have special rights of audience at society general meetings in respect of their report or other matters relevant to their functions.[30] Auditors may require representations to be made before a general meeting, to be read out at a general meeting; however this does not affect the rights of the auditor to be heard orally.[31] All of these provisions assume that societies will have an AGM to receive annual accounts and they may well implicitly require all societies to have at least one annual general meeting of members or their delegates.

6.3. RULES AS TO MEETINGS: SOME GENERAL POINTS

6.3.1. The need for diversity

The rules of a society should reflect its particular needs. For example, a large consumer co-operative will be concerned to allow as many of its members as possible to attend its meetings. If it covers a wide geographical area it may provide for one meeting with a fixed agenda to be held at different locations on different dates. Votes will be counted cumulatively and members will only be allowed to vote at one meeting. If this method is used there is no room for amendments or motions to be proposed from the floor, the rules will have to require that they be submitted in advance and provide the manner and period for submission.

A sports or social club will usually have one site which is accessible to members and will be able to hold meetings there. The provision of refreshments free or at a concessionary price may encourage attendance. In the case of a worker co-operative with a small membership the workplace will be accessible to all members and direct democracy may be used for decision-making. Larger worker co-operatives may have to use a system of delegate meetings.

It is also possible for the rules of a society to make provision for meetings to take place electronically, in a way that allows all attendees to hear, be heard and make comments.[32] Provision should be made within an electronic meetings policy for matters such as giving details of remote participation in meeting notices, proof of identity, and ongoing

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[28] CCBSA 2014, s 93.
[29] CCBSA 2014, s 87(8).
[30] CCBSA 2014, s 88(4).
[31] CCBSA 2014, s 95 and see generally **Chapter 9** below.
[32] *Byng v London Life Association Ltd* [1990] Ch 170 per Browne- Wilkinson VC at p 183.

confirmation as to participation during the course of a meeting. Virtual meetings cannot be held without a location, however, and there should always be attendees at the specified location(s) for a meeting to be valid if the meeting is required to be held by CCBSA 2014 or is carrying out a statutory procedure.

Unlike CA 2006, CCBSA 2014 does not provide for written resolutions but rules can provide for this in circumstances where a meeting is not required by the legislation. Most members of societies are asked to provide an email address at which they can agree to receive notices or documents. Societies can also draft their rules to allow for resolutions to be approved by electronic means. Section 148 CCBSA 2014 provides helpful definitions of 'electronic form' and 'by electronic means', which may be used in society rules. The approval of resolutions in writing or electronically without a meeting can only be allowed by society rules when a meeting is not required by legislation. If a meeting is required by law, there must be real-time communication between those attending to meet the requirements of *Byng v London Life Association Ltd*[33] set out above.

In the case of large societies spread over a wide geographical area, it may be necessary for decision-making to be divided between a number of different levels of council or committee, each elected by the body below it. Members will elect those delegates who are to represent them and, indeed, there may be further indirect election from that body. Until 2014, the Co-operative Group Ltd was the classic example of such a society because of its geographical diversity and large and hybrid membership (individuals and other societies). The rules, or regulations made under them, will define the powers, role and function of each level of delegate meeting as well as setting out their relationship with the board of the society.

6.3.2. Some common provisions

The rules of a society will usually lay down periods of notice for calling meetings and for particular types of resolution. The amendment of the rules or the expulsion of a member may be the subject of such provisions. Voting procedures and the powers and role of the chair are often set out in some detail. Where legislation specifies notice periods or procedures, they must be followed and society rules cannot override such requirements.

Rules will often define two classes of meeting: an annual general and a special, or extraordinary, general meeting. This draws on company law provisions in force before the Companies Act 2006. Since CA 2006 private companies are no longer required to have an annual general meeting unless the company constitution requires it or a certain proportion of members demand one.[34] CCBSA 2014 does not explicitly require particular meetings other than for particular decisions such as reorganisations.[35] The matter is left to society rules and the FCA's role in deciding whether a society's rules meet the registration requirements.[36] Part 7 of CCBSA 2014, which deals with accounting and audit requirements, can be argued to impose an implicit requirement on societies to hold an annual general meeting to receive accounts and hear the auditor's views if he or she wishes to be heard.[37]

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33 [1990] Ch 170.
34 CA 2006, ss 303–306.
35 See **Chapter 12**.
36 CCBSA 2014, ss 3(2), 14(5) and 16(4).
37 See Section **6.2.5.** above.

Many societies will draft provisions in their rules to allow for written resolutions for those matters which the Act does not require to be agreed at a meeting.

The annual general meeting will usually receive the accounts, balance sheet and auditors' report and consider a report by the board or committee. It will elect the committee or board or at least the part of it retiring that year, if that is not done by ballot of the members. The rules will usually allow that meeting to deal with any other business specified on the notice calling it. The rules will often give the secretary or the board the responsibility for calling the annual meeting but they will specify a time for it within a limited period after the end of the accounting year. Some societies may require a regular six-monthly meeting to receive accounts and reports for the half year between annual meetings. The FCA have allowed the registration of rules that provided for general meetings to be held less often than once a year after the society was up and running although an annual general meeting is still commonplace.

Rules will usually provide for a special general meeting to consider only those matters mentioned in the notice by which it was called. Such a meeting can usually be called by the board of the society or by the requisition of either a proportion of the total membership or a fixed number of members.

In addition to provisions about annual and special general meetings, the rules of small societies concerned to retain a large measure of direct democratic control will require frequent meetings. This is particularly common in worker co-operatives.[38]

In the case of all meetings certain general questions will arise and should be dealt with under the rules of a society.

6.3.2.1. Notice

Rules should provide for notice. They may require that it be posted, delivered or sent by fax or electronic communication to individual members and the secretaries of corporate members. On the other hand they may only require that it be prominently displayed in a place that members frequent, such as the workplace for a worker co-operative, the stores of a consumer co-operative or the club noticeboard for a working men's club. The provisions of the rules about notice must be scrupulously followed.

Rules will often lay down that accidental failure to give notice will not invalidate proceedings at that meeting, they will also contain provisions about deemed receipt of notices. However, even if the rules make no provision, failure to give adequate notice can still invalidate a meeting's decision.[39]

The rules of many societies lay down that the business of a special general meeting is to be limited to that stated in the notice convening it. In *Speechley v Allott*[40] the Court of Appeal referred to the purpose of the notice and not only the literal meaning of the rule on the question of validity. A failure to inform members that the election of officers was to be by show of hands when the rules required a ballot and a failure to provide details of candidates or allow for nominations meant no adequate notice of the business of a

[38] See Co-operatives UK *The Worker Co-operative Code* (2nd edn, 2012), p 2.

[39] *Young v Ladies' Imperial Club* [1920] 2 KB 532 and *MacLelland v National Union of Journalists* [1975] ICR 116.

[40] [2014] EWCA Civ 230.

meeting had been given. Displaying it on the door of a club house when the rules required it to be displayed on the noticeboard inside would not in itself have been fatal.[41]

Where provisions dealt with in Section **3.2.2.** apply, mandatory requirements about the contents and timing of notices may well be laid down and they prevail over society rules if there is a conflict.

6.3.2.2. Quorum

The rules usually lay down a quorum for meetings. This can be a fixed number or a proportion of the membership. If this is not reached the meeting cannot take place. To overcome this, many rules provide for an inquorate general meeting to be adjourned (perhaps for one week) and for the adjourned meeting to be able to transact business regardless of the numbers attending. Rules frequently lay down that a meeting that is quorate at the beginning cannot become incompetent because it later becomes inquorate. If the rules do not fix a quorum, the common law lays down two as the minimum number that can constitute a meeting.[42]

6.3.2.3. The chair

It will be necessary for someone to chair a meeting to ensure the efficient execution of business and to keep order. This is a matter for the rules. Many societies will have a president or chair elected by either the members or the committee to perform this task at both general meetings and committee or board meetings. If that person is not present at a meeting or is unwilling to take the chair, the rules may provide for a person elected vice-chair to step in. Otherwise they may specify that the job is to be done by any director present or by a member chosen by the meeting. Some rules will allow each meeting to choose its own chair.

6.3.2.4. Procedure

This is often determined by the standing orders of the society. The rules may give the board power to draft these. In some societies the rules themselves set out the procedures to be followed. There are generally accepted conventions such as the requirement for a proposer and a seconder for resolutions and the order of speeches by proposer and seconder with the right of reply by the proposer after the debate. They will operate in the absence of any standing orders or provisions in the society's rules. The chair will make rulings on such matters as which speakers are to be heard and how long contributions should last. However, such rulings can be challenged in which case a vote of the whole meeting is necessary to decide whether to uphold the chair's ruling.[43] Where provisions are drafted into the rules, members are aware of them from the beginning without the need to consult another document; however this can make the rules cumbersome. The size of a society's membership will determine how many detailed procedural rules are necessary.

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41 *Speechley v Allott* [2014] EWCA Civ 230 at paras 42 and 50.

42 *Sharp v Dawes* (1876) 2 QBD 26.

43 For guidance on usual procedures, see Michael Cannell and Norman Citrine (eds), *Citrine's ABC of Chairmanship* (4th Edition, NCLC/Fabian Society 1982).

6.3.2.5. Voting

This will usually be by show of hands but the rules may provide for a ballot of the members present. The normal principle for non-federal co-operative societies is one member one vote. The rules should deal with the issue of whether members can appoint proxies to vote on their behalf and, if this is allowed, the procedure for authorising a proxy and notifying the society of their identity. The rules governing the representation of corporate members should also be set out. The rules may state which of two or more joint members can vote (eg the first listed in the register). Rules will normally allow most decisions to be made by a simple majority of the total of those present and voting and those voting by proxy. However, the amendment of the rules or the expulsion of a member may be stated to need a special majority of, for example, two-thirds or three-quarters. Although most rules provide for a majority of those voting some may require a particular majority of those entitled to vote.

CCBSA 2014 requires a special majority for a transfer of engagements, the amalgamation of societies, or the conversion of a society into a company.[44] For insolvency procedures and schemes of arrangement the CA 2006 rules will apply unless SI 2014/229 applies a different rule.[45]

The chair is normally given a casting vote by the rules but will not have one unless the rules provide one.[46]

6.3.2.6. Adjournment

Rules will often include a power to adjourn a meeting and limit the business of the adjourned meeting to that which was unfinished at the original meeting.

6.4. THE MODEL RULES

6.4.1. Consumer Co-operatives – Co-operatives UK 12th Edition Model Rules (amended 2012)

These rules differentiate between an ordinary meeting and a special meeting. One ordinary meeting each year is to be the AGM and other ordinary meetings may be convened, to be called interim meetings.[47]

The business that can be transacted at an ordinary meeting includes consideration of the accounts, balance sheets and reports of the directors and auditors, the allocation of profits, the announcement of board election results the fixing of directors' remuneration and the appointment of the auditor. In addition, any motion proposed by a member of which 21 days written notice has been given by the member to the Secretary can be considered. Any amendments to the proposals in a meeting notice must be received by the organisation with not less than 14 clear days' notice of the date of the meeting.[48] A special members' meeting cannot transact any business not specified in the notice

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44 See **Chapter 13**.
45 See **Chapter 13**.
46 *Re WR Willcocks and Co Ltd* [1974] Ch 163 at 167.
47 Rule 9.
48 Rule 9.3.

convening it. An ordinary meeting may be made a special members' meeting for any purpose of which due notice has been given, provided that such business is not brought on until the business of the ordinary meeting is concluded.[49]

Ordinary meetings must be convened by the secretary on an order of the board.[50] Special member's meetings shall be convened by the secretary, either on an order of the board, or on a written requisition signed by 50 members. Special members meetings shall be held as soon as is reasonable after the receipt of the order or delivery of the requisition.[51]

All members are entitled to one vote on any resolution. In the case of joint shares, the voting member shall be the one appearing first named in the register of shareholders.[52] The board may make provision for electronic voting.[53] Voting is on a show of hands, unless a ballot is demanded by the board or by 10 members present at the meeting. All resolutions shall be carried by a simple majority of votes and in the event of an equality of votes the chair of the meeting has a second or casting vote.[54]

The chair of the board, or in their absence another member of the board, shall chair a members' meeting. If no member of the board is present, such member as the meeting may determine shall chair the meeting.[55]

Ten members having a vote and being present in person, shall be a quorum. A members' meeting may proceed to business if a quorum is present within half an hour after the time fixed for the meeting. If a special members meeting convened on the requisition of the members is inquorate, it shall be dissolved. If an ordinary meeting or a special meeting convened by order of the board in inquorate, it shall stand adjourned to the same day in the week following, at the same time and place, and the adjourned meeting may proceed to business whatever is the number of members present. No meeting shall become incompetent to transact business from the want of a quorum arising after the chair has been taken.[56]

6.4.2. Worker co-operatives model rules – Co-operatives UK

These model rules require an annual general meeting to be held within six months of the end of the financial year.[57] Its agenda follows the usual pattern of including accounts and reports, appointment of the auditor, election of the board or committee, application of profits and any other business included in the notice of the meeting.[58] However, the particularly democratic nature of workers' co-operatives is reflected in rule 40 which provides:

> 'In accordance with the Co-operative Principle of democratic member control, the Co-operative shall ensure that, in addition to the annual general meeting, at least four other general meetings are held annually. The purpose of these meetings is to ensure that Members

[49] Rule 9.4.
[50] Rule 9.5.
[51] Rule 9.7.
[52] Rule 9.12.
[53] Rule 9.13.
[54] Rule 9.14.
[55] Rule 9.15.
[56] Rule 9.16.
[57] Rule 38.
[58] Rule 39.

> are given the opportunity to participate in the decision making process of the Co-operative, review the business planning and management processes and to ensure the Co-operative manages itself in accordance with the co-operative values and principles.'

That provision is in addition to the usual provision allowing 10% of the members, or 100 members (whichever is less), to require the board to call a meeting for a particular purpose and to call it themselves if the board fail to do so.[59] All members must be given 14 days' notice of a general meeting by post or by hand unless a general meeting agrees that they can be displayed at places of business instead but for a meeting that is not the AGM, 90% of all members can agree to shorter notice. Notices of meetings must specify the time, place, date and business of the meeting and contain any proposed resolutions.[60]

The quorum is the greater of three or half of the members unless the figure is changed by extraordinary resolution but that includes members not present in person.[61] Voting, speaking and attendance at meetings can be by electronic means.[62] Meetings are chaired by the chairperson of the co-operative or another person chosen by the meeting if they are absent or unable to act as chair.[63]

Voting is first by show of hands and that decides the question unless three members demand a paper ballot.[64] If there is a tie, the chairperson has no second or casting vote and the resolution is lost.[65]

Rule 65 provides that certain decisions at general meetings are to be made by passing extraordinary resolutions (such as decisions to expel members or wind up the society). An extraordinary resolution is one passed by a majority of not less than 75% of votes cast at a general meeting and an ordinary resolution is one passed by a simple majority (51%) of votes cast.[66] A resolution may be passed at a general meeting or by written resolution, which may consist of several identical documents signed by one or more members.[67] For a decision for which CCBSA 2014 requires a meeting, such as a transfer of engagements, a face-to-face or real-time electronic meeting will be required.[68]

6.4.3. Society for the benefit of the community – Co-operatives UK

Under these rules the society must hold a general meeting within six months of the end of the financial year specifying it as its AGM in the notice.[69] The rules set out the business of an AGM 'shall comprise, where appropriate', including the receipt of the accounts, balance sheets and reports of the directors and auditors (if any), the announcement of board election results or election of directors the allocation of profits, the appointment of an auditor if required, and any other business included in the notice of the meeting.[70]

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59 Rules 42 and 43.
60 See Rules 44 and 45.
61 Rule 49.
62 Rule 51.
63 Rule 50.
64 Rules 60 and 62.
65 Rule 61.
66 Rule 66.
67 Rule 67.
68 *Byng v London Life Association Ltd* [1990] Ch 170.
69 Rule 22.
70 Rule 23.

The secretary, at the request of the board may convene a general meeting. The purpose of the general meeting must be stated in the notice.[71] The board must convene a general meeting if one-tenth of the total number of members, or 100 members, whichever is the lesser, sign an application and deliver it to the registered office. The purpose of the general meeting shall be stated in the application for and notice of the meeting. No business other than that stated in the notice of the meeting can be conducted at the meeting.[72] If the Board does not, within a month, convene a meeting to be held within six weeks of the application, any three society members can do so at the society's expense.[73]

The directors 14 days' notice of an AGM to all members. All other general meetings are convened with at least 14 clear days' notice but may be held at shorter notice if 90% of the members agree to that in writing.[74]

Auditors (where appointed) are entitled to attend general meetings.[75]

No business shall be transacted at a general meeting unless a quorum is present which shall include those members not present in person. Unless amended by extraordinary resolution, a quorum shall be three members or a percentage of the membership (such percentage to be inserted by the society) whichever is the greater.[76] *A* meeting that is inquorate after half an hour or which becomes inquorate must be adjourned but the adjourned meeting can proceed with those members present if it does not reach a quorum within half an hour of its starting time.[77]

If the chair, whose role is to facilitate the meeting, is absent or unwilling to act then the members present shall choose one of their number to be the chair for that meeting.[78]

The directors may make whatever arrangements they consider appropriate to enable those attending a general meeting to exercise their rights to speak or vote at it including by electronic means. In determining attendance, it is immaterial whether any two or more members attending are in the same place as each other, provided that they are able to communicate with each other.[79] This applies the principle of real-time meeting by electronic means in *Byng v London Life Association Ltd*.[80]

A resolution put to the vote at a general meeting is decided on a show of hands unless a paper ballot is demanded in accordance with the Rules.[81] In the case of an equality of votes, the chair does not have a second or casting vote and the resolution is deemed to be lost.[82]

Rule 47 provides that certain decisions at general meetings are to be made by passing certain resolutions (such as decisions to expel members or wind up the society) and

71 Rule 24.
72 Rule 25.
73 Rule 26.
74 Rule 27.
75 Rule 31.
76 Rule 32.
77 Rule 36.
78 Rule 33.
79 Rule 34.
80 [1990] Ch 170.
81 Rule 42.
82 Rule 43.

contains options for the society to consider when drafting its Rules. An extraordinary resolution is one passed by a majority of not less than 75% of votes cast at a general meeting and an ordinary resolution is one passed by a simple majority (51%) of votes cast and resolutions may be passed at general meetings or by written resolution.[83] A written resolution may consist of several identical documents signed by one or more members.[84]

6.4.4. National Housing Federation – Model Rules 2011 (version 2)

The rules of a society that bases its constitution on the Model Rules of the National Federation of Housing Associations follow the usual division of general meetings into the annual general meeting and special general meetings. The rules lay down the functions of the annual general meeting.[85] All other general meetings are designated as special general meetings and can be convened by order of the board or on the written requisition of one-tenth of the membership (to a maximum of 25 but not less than three). On a requisition being delivered, the association has 28 days to convene the meeting after which time the requisitionists may themselves convene it. Fourteen clear days' notice is required of all general meetings and the notice must state the type of meeting being convened and the business that it is to transact as well the time, date and place of the meeting.[86] However, Rule C22 allows that 75% of shareholders may agree, by consenting in writing, or by electronic communication, to a general meeting being held with less notice than required by Rule C20.

A quorum is one-tenth of the shareholders, with a minimum of six members to a maximum of 25. At least two shareholders must be present in person.[87] An inquorate meeting requisitioned by shareholders will be dissolved; however any other general meeting can be adjourned for one week and then proceed with the number of members actually present.[88] Adjournment by the chair with consent of a majority of members is permitted and no notice is required for the adjourned meeting but only business left unfinished or not reached may be discussed there.[89]

Meetings are normally chaired by the chair of the committee but in his or her absence or if he or she is unwilling to act the meeting elects its own chair.[90] Voting is normally by show of hands, except where a ballot is demanded.[91] Proxies are permitted. Proxies are appointed by a written instrument under the hand of the appointor and delivered to the society not less than two days before the meeting at which the proxy is to act. The chair's decision on the acceptability of any proxy is final.[92]

Rule C35 allows for written resolutions to be treated as valid and effective as though they were passed at a properly called and constituted meeting of the association, provided that it has been delivered in accordance with the Rules.[93] Rule C36 sets out the requisite majorities for the passing of the various types of resolution where written

[83] Rule 48.
[84] Rule 49.
[85] Rules C16 and C17.
[86] Rule C20.
[87] Rule C23.
[88] Rules C24 and C25.
[89] Rule C26.2.
[90] Rule C27.
[91] Rule C29.
[92] Rule C28.
[93] Rule C35.

resolutions are used. This procedure may not be effective if used for decisions, such as transfers of engagements, discussed in Sections **12.2.** to **12.5.**, about which the CCBSA 2014 sets out the procedure and requires a meeting to be held.

6.4.5. Agricultural Co-operative (IPS) – Agency Model Rules sponsored by Co-operatives UK & Scottish Agricultural Organisation Society

The Co-operatives UK & Scottish Agricultural Organisation Society model rules require the co-operative to hold an annual general meeting within six months of the end of the financial year.[94] The business of the AGM is to comprise the receipt of the accounts and balance sheet, auditors reports, the appointment of the auditor, the election of the board (or the results if the election was previously held by ballot), the application of surplus and any other business included in the notice. Appointed auditors are entitled to attend general meetings.[95]

The secretary convenes a meeting at the request of the directors and notices must state the date, time, purpose and place of the meeting, along with the general nature of the business to be transacted.[96] The board of directors upon an application of one-tenth of the total number of members, or 50 members, whichever is the lesser, shall convene a general meeting.[97]

No business shall be transacted at a general meeting unless a quorum is present; these Model Rules currently have three as a quorum; however the co-operative may provide for a different quorum.[98]

Rules 31 to 35 deal with notice requirements for meetings, Rules 37 to 39 chairing, attendance and speaking, and Rule 40 adjournment, in much the same way as the models discussed above.

Each member has one vote and proxy voting is permitted, provided that no person (excluding the chair) shall hold a proxy for more than 10% of the members at any one time in any general meeting.[99]

Rules 51 to 53 make specific provision for certain decisions at general meetings to be made by passing extraordinary resolutions, including winding up and amalgamation. Extraordinary resolutions require a majority of not less than 75%.[100] Resolutions may be passed in writing and may consist of several identical documents.[101] However, a written resolution cannot be a substitute for a meeting where CCBSA 2014 requires a meeting to take place, for example to carry out a transfer of engagements or similar reorganisation.

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94 Rule 26.
95 Rule 27.
96 Rules 28 and 31.
97 Rules 29.
98 Rule 36.
99 Rule 45.
100 Rule 52.
101 Rule 53.

6.4.6. Social Clubs – Model Rules for a Working Men's Club – sponsored by Clubs and Institutes Union

In the CIU model rules a distinction is made between an ordinary general meeting and a special general meeting. There will be two ordinary general meetings each year, to be held not later than 31 March (this meeting is to be the annual general meeting) and not later that 30 September respectively, dates to be fixed by the managing committee.[102]

In each case 10 days' notice of the meeting with a copy of the agenda are to be posted in the club. In each case the business of the meeting is to receive the accounts, balance sheet and the auditor's report, and to consider other business submitted by the managing committee or by a member on seven days' notice of the motion to the secretary, in writing.[103]

Special meetings are to be called by the secretary either on the direction of the managing committee or on a requisition signed either by one quarter of the membership or 50 such members (whichever is fewer).The requisition must state the purpose of the meeting and the meeting is to be held not less than 14 days and not more than 21 days after the receipt of the requisition by the secretary.[104] Notice of the meeting and the object for which it was called must be posted by the secretary at least ten days before the date of the meeting and the business to be considered by the special general meeting is limited to the matters specified in the notice.[105]

A general meeting may proceed if at least one more member than the number of members of the managing committee is present within one hour after the time fixed for the meeting, that being a committee consisting of the president, vice president, treasurer and a minimum of six and up to 12 committee members.[106]

In the event of there not being a quorum, within an hour of the time fixed, for a meeting convened on the requisition of the members, such meeting shall be dissolved. In the case of a meeting convened by the managing committee it is adjourned to the same time one week later and can then proceed regardless of the number present.[107] There is also a general power to adjourn general meetings.[108] The principle of one member one vote applies at general meetings.[109]

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[102] Rule 15(1).
[103] Rule 15(1) and (3).
[104] Rule 15(2)(b).
[105] Rules 15(3) and (4).
[106] Rule 15(5).
[107] Rule 15(5).
[108] Rule 15(6).
[109] Rule 15(7).

CHAPTER 7

DIRECTORS AND OFFICIALS

7.1. THE ROLE OF A SOCIETY'S COMMITTEE OR BOARD

The board or committee is a smaller group who are entrusted by the members with the role of running the society on their behalf. As a result directors or committee members owe legal duties to the society, as developed by the courts, to act in its interests with the utmost good faith and reasonable care, skill and diligence. Those duties reflect the directors' role and position and resemble the legal duties of agents and trustees.[1] The powers and functions of the board or committee are defined by a combination of the Co-operative and Community Benefit Societies Act 2014 (CCBSA 2014) and the society's own rules and all officers and employees of a society have a duty to act in accordance with both the law and the society's rules.

Few of the legal rules governing the committee or board of a society and its senior employees are to be found in the CCBSA 2014. The other sources for those rules are the rule book of each particular society and the case law developed by the courts in the context of company directors. In the case of all employees, including senior managers or executives the terms of the contract of service will lay down certain duties and others will be implied by the courts because the contract exists. Because it is important for those involved with societies and their advisers to be aware of the whole picture, this chapter deals with the key rules even if they are not to be found in the CCBSA 2014.

Some societies will describe their governing body as a committee. Others will refer to it as a board. The words used make no difference to the legal position of the organ or the individual directors or committee members.

The democratic control required of the constitution of a society usually takes the form of a division of powers between the general meeting of members on the one hand and the committee or board of directors on the other. Providing the board is elected by the members the system remains democratic. The size and diversity of some societies may require a range of different boards or committees dealing with either specialist subjects (eg a member relations committee in a consumer co-operative) or different geographical areas (eg regional boards from which a central board is elected). Many societies will have senior employees who perform a management role under the supervision of the board or committee. They can provide expertise and management skills. Unlike most company boards, the committees or boards of societies are often composed mainly of part-time non-executive members who have no management role in the society outside their position as directors or committee members. The boards of most companies are dominated by full-time executive directors. However, those PLCs with shares listed on

[1] See Section **7.4.** below.

the London Stock Exchange or similar markets usually have a substantial number of outside independent non-executive directors who are selected for their expertise and experience and fill certain roles, such as chair of the company and membership of both the audit and remuneration committees of the board. In the context of the Corporate Governance Code applicable to listed PLCs great emphasis is placed on the role of such non-executive directors in holding executives to account.[2]

Other variations in society practice will depend on the scale of a society's business, the number of members it has, and its ethos. Some co-operatives with a small membership operate on a collective basis with all society members as directors. In the case of a small worker or consumer co-operative, this may replicate partnership governance as laid down in the default provisions of partnership law combining it with the principle of open membership by admitting all employees or consumers as members and directors.[3] However, because CCBSA 2014 requires all society rules to provide for a committee and officers,[4] this is sometimes achieved by making all members directors and providing for removal from the board to amount to expulsion from the society. Another route is for the society's rules to confer all decision-making power on the general meeting but that may duplicate meetings unnecessarily. Any member that has the role of director will have the legal duties of directors.

Some community benefit societies operating as housing associations have a membership composed solely of the board because the board chooses as members only people it wants to serve as directors. This unity of the membership of both the society and the board is combined with a closed membership. The FCA, at the time of writing find this system of closed membership acceptable in the context of a community benefit society, which is required only to serve a community other than its own members, particularly in the context of the regulatory framework applicable to providers of social housing. A society registered as a co-operative must maintain open membership as a condition of registration and so a housing co-operative must remain open for all its tenants to join if they wish to and must have a system of democratic member control. It was the policy of the Registry of Friendly Societies, before the registration function was transferred to the FCA in 2001, to expect some element of member control even in community benefit societies but that seems to have changed after the transfer.[5]

Another combination of roles may involve a board with members wholly or mainly elected by society members only after their expertise and suitability for the role has been assessed by a nomination committee. That committee of the existing board would use criteria about expertise and experience to search, or employ a specialist firm to search, for candidates for the role of independent professional non-executive director. The election process might involve contested elections for some or all board seats with others subject to 'take it or leave it' endorsement of individual candidates proposed through the nomination committee system, as is common in listed PLCs and building societies. It is also possible to combine a system of that kind with a directly elected members' council to assist in holding the board and the executives to account, with election by and from

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2 Financial Reporting Council, *The UK Corporate Governance Code* (September 2012).

3 See Sections **1.2.2. (b)** and **(c)** above on partnerships.

4 CCBSA 2014, s 14(6).

5 See Registry of Friendly Societies, *Guide to the Law relating to Industrial and Provident Societies* (HMSO, 1978), para 7: 'In considering whether a [community benefit society] should be registered regard is also had to … the matters referred to at (c). in paragraph 6 above'; and para 6: '(c) control of the society will … be vested in its members equally and not in accordance with their financial interest in the society. In general therefore the principle of "one man one vote" must obtain' and compare Guidance expected to be available from the FCA website from August 2014 on registration as a community benefit society.

the membership for part of the board, or a combination of those possibilities. That kind of system seeks to address issues about lack of business expertise among members in societies with a large-scale business and a widely dispersed membership, especially where members are not themselves businesses.

An absence of experience and expertise at board level can seriously weaken the ability of the board and other organs of a society to hold executives to account and to make effective decisions on complex business strategies and transactions. On the other hand, the use of procedures involving screening candidates for the board may reduce members' sense of participation and ownership of the society and the extent to which the board reflects the social, ethnic, and gender composition of the society's membership. At the time of writing, the UK Co-operative Group appeared to be moving towards a 'nomination committee' system. The change arose from the traumatic demutualisation of the Co-operative Bank, the Co-operative Group's substantial debt burden (which led to pressure from bank lenders for more effective governance) and perceived failings in the previous governance system, which was based on indirect election of directors through a complex delegate system with no provision about candidates' business qualifications or experience.[6]

The Co-operative Group developments reflect an innovative attempt to work out the governance implications of a tendency long noted by scholars of co-operatives, which also reflects some aspects of the equivalent problems of Stock Exchange listed companies with a widely dispersed investor ownership. As the professionalisation of business management necessarily increases when the scale of operation exceeds a certain size, owners, whether investors or co-operative members, cannot easily hold executives to account directly. How can indirect member control be made effective in large and complex organisations? These issues have given rise to a number of debates, which will no doubt continue.[7]

Finally, in some contexts, regulatory intervention impacts on the control of boards by society members. In housing, community benefit societies registered as social landlords are subject to the powers of their regulator. The Homes and Communities Agency (the HCA) in England, the Welsh Government in Wales, or the Scottish Housing Regulator (SHR) in Scotland have power to remove and replace any committee member who is insolvent, disqualified from being a director of a company, incapable due to mental disorder. They can also remove one who has failed to act or cannot be found if that impedes the proper management of the society. The regulator can also appoint a committee member if the regulator believes an additional committee member is necessary for the proper management of the society's affairs. These provisions protect the public funds provided to social landlords and the interests of the tenants. Notice has

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6 See Paul Myners, *The Co-operative Group Report of the Independent Governance Review*, 7 May 2014 and Sir Christopher Kelly, *Failings in management and governance, Report of the independent review into the events leading to the Co-operative Bank's capital shortfall,* 30 April 2014.

7 On companies, see the classic 1932 work, AA Berle and GC Means, *The Modern Corporation and Private Property* (Harcourt, Brace and World, 2nd edn, 1967) and the deluge of academic literature on corporate governance that ensued. On co-operatives, see Claudia Bajo and Bruno Roelants, *Capital and the Debt Trap* (Palgrave Macmillan, 2011) – especially the critiques of co-operatives discussed at pp 102–5 and the case studies in chs 5–8. For a study of International practice see Professor Johnston Birchall, *The governance of large co-operative businesses* (Co-operatives UK, 2014).

to be given to effect the removal or appointment.[8] Payments to committee members and employees are also regulated for registered providers in England.[9]

In credit unions, the regulatory requirements of the approved person and senior management arrangement regimes of the PRA limit the role of members by imposing limits on the people who can serve in certain roles and laying down requirements for management systems.[10]

7.2. LEGAL BASE AND DIVISION OF POWERS

7.2.1. Legal base

The structure of the committee or board system is determined by the rules of each society. For a society with few members (eg a small worker co-operative) the committee may consist of all members so that a system of direct democracy prevails. At the other extreme, some large societies have traditionally had a complex committee structure. The role of the committee or board will be laid down by the rules of the society. In most cases it is supervisory, appointing and removing senior executives or managers, monitoring the society's performance, planning its development and ensuring that the expertise of management is properly directed.

The CCBSA 2014 lays down a few of the functions of the board or committee as a whole and of individual committee members. The board must deal with the property of members who have died or who are mentally incapable.[11] It has power to decide the form and amount of any security to be provided by the society's officers, if the society's rules make such provision.[12] A receipt to discharge a mortgage of property to the society and any documents to be signed because the society is a member of another society depend on the signatures of two committee members and the secretary.[13] When the society seal, if it has one, is used all committee members and the society secretary are authorised signatories.[14] Published accounts must be signed by the society secretary and two committee members on behalf of the whole committee, who must therefore have considered and agreed them.[15] A number of decisions about group accounts are allocated to the committee.[16] Every committee member potentially has liability for offences committed by the society.[17]

Subject to those few specifically allocated powers, the role of the committee or board is laid down in the society's rules.

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8 Housing and Regeneration Act 2008, ss 266–267; Housing Act 1996, s 7 and Sch 1, paras 4 and 8; and Housing (Scotland) Act 2010, s 60.
9 Housing Act 1996, s 7 and Sch 1, paras 2 and 3.
10 See Section **13.6.2.** below.
11 CCBSA 2014, ss 36(1), 39(2) and (4), and 40(3) and see Sections **8.3.4.–8.3.6.** below.
12 CCBSA 2014, s 41.
13 CCBSA 2014, ss 33 and 71.
14 CCBSA 2014, s 53(6).
15 CCBSA 2014, s 82(1).
16 CCBSA 2014, ss 98 and 99.
17 CCBSA 2014, s 128.

7.2.2. Division of powers: board and general meeting

The powers of the board or committee must be set out in the rules.[18] This is usually done by laying down that the board or committee will manage or conduct the business of the society. The rules often state that the board or committee will act in all things in the name of the society and on its behalf. Some rules will list particular functions such as buying and selling goods or hiring and dismissing employees but this should be said to be without prejudice to the more general power to manage the society's business.

It is often the practice for rules to follow the provisions commonly found in the articles of companies. This will give the board power to do anything that the society can do and that is not required by the law or other provisions of the rules to be done by the general meeting. This wide power may also be made subject to any direction given by the general meeting but the same special majority needed to amend the rules is usually required by the rules for such a direction.

These powers are conferred on the board or committee as a body. Individual directors or committee members will be able to act only if they are authorised to do so by the board, but the rules will usually allow for such delegation of power to a sub-committee or individuals. Some rules will set out that the society is to have a chief executive officer or a team of executives and will lay down their powers. They may also give particular powers to committees that are to perform particular functions, such as a member relations committee in a consumer co operative or a loans committee in a credit union. In that case the powers of those bodies derive from the rules and are defined by them. If there is no such provision, sub committees or particular full-time officers will have the powers delegated to them by the board in accordance with the rule permitting such delegation. The effect of the agency relationship that is likely to exist between employees and a society on society contracts is discussed below.[19]

The law allows the rules of a society to define the powers of the board or committee and the general meeting as it chooses subject to CCBSA 2014 provisions requiring certain matters to be decided by a particular organ. Once that division of powers is laid down in the rules, neither body can interfere in the exercise by the other of its own powers. This means that the power of members in general meeting to control the board or committee is limited to their right to amend the division of powers set out in the rules for the future, to remove directors or committee members in accordance with the rules' provisions as to that, to refuse to re-elect particular board or committee members when they reach the end of their term of office or, if the rules allow for it, to pass a special direction requiring the board to behave in a particular way in the future. What the general meeting may not do is to make a decision on a matter which is within the powers of the board or amend the rules (or give a direction) with retrospective effect. Likewise the board cannot decide on a question that the rules leave to the general meeting.

This analysis is based on the well-established rules developed by cases dealing with the same issues in companies. It has long been held that powers conferred in the constitution on the board are not subject to any overriding right of the general meeting to reverse a

[18] CCBSA 2014, s 14(6).
[19] See **Chapter 11**.

board decision as if the board were merely an agent.[20] Those principles apply to societies. In one Scottish Court of Session case concerning the powers of a society board Lord President Clyde stated:

> 'It was suggested at one stage of the argument, and it appears to have formed a substantial consideration in the mind of the Sheriff Principal, that the rule operated as a delegation of powers by the society to the committee of management. But, in my view, no question of delegation of powers by the society to the committee arises in this case … the committee of management in this case are much more than agents. They are part of the statutory constitution of the society. They are not a body to which the society, as I see it, has ever delegated powers at all. If matters are entrusted by the constitution of the society to the control of the committee, that committee is supreme and final Lord in regard to them …'[21]

The same approach was taken by the Registrar of Friendly Societies in two arbitration cases concerning the powers of the general meeting and the committee of a society. If a matter is clearly allocated to the society's committee, the general meeting has no power to make decisions on that and the secretary can refuse to accept a mandatory resolution on the question for addition to the agenda of the general meting, although a resolution recommending a course of action would be acceptable.[22] This shows the application of this approach in the co-operative context although arbitration awards do not represent legal precedents.

Rules will commonly specify the role of the secretary of the society and give that officer responsibility for submitting annual returns, calling meetings when requested to do so, and maintaining records and minutes (including the register of officers and members). Most of the documents required by the Act to be submitted for registration purposes have to be signed by the secretary.

The frequency of board meetings may be laid down by the rules. They often allow meetings to be called as required but specify a minimum number to be held each year. Rules may lay down basic procedural rules such as the quorum for board meetings, who is to chair them, whether there is a casting vote and that decisions are to be by a majority of those voting. A certain number of directors or committee members may be empowered to call special board or committee meetings to discuss matters specified in the notice of the meeting given to the secretary. More detailed procedural rules about the running of committee or board meetings may be contained in standing orders made by the committee or board under a power given in the society's rules.

The rules should lay down that decisions of the board or committee are not affected by defects in the appointment of the board or committee or any of its members.

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20 See *Automatic Self-Cleansing Filter Co v Cuninghame* [1906] 2 Ch 34 CA; *Quin and Axtens Ltd v Salmon* [1909] AC 442; and *Breckland Group Holdings v London and Suffolk Properties Ltd* [1989] BCLC 100.

21 *Alexander v Duddy* (1956) SC 24, 28–9.

22 See *Roper v Long Eaton Co-operative Society Ltd* (1952) Chief Registrar's Report Part 3, p 3 and *Ruddock v Watford Co-operative Society Ltd* (1956) Chief Registrar's Report Part 3, p 3.

7.3. APPOINTMENT, ELECTION AND REMOVAL OF DIRECTORS

7.3.1. CCBSA 2014 and society rules

The rules of all societies must provide for the appointment and removal of a committee (by whatever name) and of managers or other officers.[23] A person under the age of 18 may be a member unless the registered rules provide otherwise but no-one under the age of 16 can be a member of the committee or a trustee, manager or treasurer of a registered society.[24] Details of a society's officers must be kept in the register of members and are to be included in the society's annual return to the FCA.[25]

The FCA will be concerned, on both the registration of a new society and the registration of amendments to rules, to ensure that a co-operative society is run democratically. Subject to this broad requirement, CCBSA 2014 leaves the organisation of the election and appointment of the directors or committee to the rules of each society.

The details of the provisions in each set of model rules are dealt with below.[26] The rules normally lay down the number of committee or board members required or maximum and minimum numbers within which the size of the board is decided. The rules will also fix the term of office. Casual vacancies can often be filled by co-option.

The removal of directors or committee members must be provided for by the rules. The Act requires that some provision be made but does not lay down the majority.[27] Some rules allow removal by simple majority while others require a two-thirds or three-quarters majority, sometimes after initial suspension from office by a decision of the committee.

Qualifications for membership of the board or committee are laid down by the rules. They will usually specify membership of the society and may lay down a minimum shareholding, purchasing or other financial qualification for candidates for election to the board. Bankruptcy, mental or physical incapacity, serious criminal offences, failure to attend a number of consecutive board meetings without permission and competing with the society or behaviour prejudicial to its interests are common grounds for disqualification from board membership for existing directors.

Despite the fact the Company Directors Disqualification Act 1986 (CDDA 1986) now applies to societies, the rules should also disqualify from board membership anyone currently subject to a disqualification order under the CDDA 1986. The procedure and grounds for disqualification under CDDA 1986 is discussed below.[28]

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23 CCBSA 2014, s 14(6).
24 CCBSA 2014, s 31(1) and (3).
25 CCBSA 2014, s 30(3) and see Annual Return Form on FCA website.
26 Section **7.8.** below.
27 CCBSA 2014, s 14(6).
28 See Section **7.6.** below.

The rules of a society may require a committee member, secretary, treasurer, manager or other officer of a society who has receipt or charge of money to give security for an amount decided by the committee, which will cover any failure by that person to account for money that they hold.[29]

7.4. GENERAL DUTIES OF DIRECTORS AND OFFICIALS

7.4.1. Legal basis of duties

The general duties of directors or committee members are discussed in this section. They have been developed by the courts in the context of company directors, agents, and trustees and are owed to the society as a separate legal person and not to individual members.[30]

The Companies Act 2006 codified the equivalent duties of company directors with some changes.[31] Since that codification does not apply to societies, this section is based on the duties applicable to company directors without the statutory changes specifically introduced by the codification. However, the codified general duties of company directors are said to be based on 'certain common law rules and equitable principles as they apply in relation to directors' and are to be interpreted and applied in the same way as such rules or principles with regard being had to corresponding rules and principles in interpreting and applying the duties.[32] For that reason, some post-2006 case law on the general duties of company directors may be directly relevant to society directors and developments in the wider context of the fiduciary duties of trustees, agents and other fiduciaries and of the common law negligence liability are relevant to the general duties of both company and society directors.

Taking those legal developments into account, the duties dealt with in this section are:

- Duty to obey the law and comply with the society's rules – section 7.4.2.
- Duty to use powers only for the purposes for which they were conferred – section 7.4.3.
- Duty to act in good faith in the best interests of the society and to act fairly between different classes of membership – section 7.4.4.
- Duty to exercise independent judgement – section 7.4.5.
- Duty to exercise reasonable skill, care and diligence – section 7.4.6.
- Duty to avoid conflicts of interest – section 7.4.7.
- Duty not to misapply society assets or make a secret profit – section 7.4.8.
- Duty of confidentiality – section 7.4.9.
- Enforcement of the duties – Section **7.4.10.**

Later sections of this chapter deal with the concepts of fraudulent and wrongful trading that arise on the insolvency of the society and the possibility of disqualification under the CDDA 1986.[33]

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29 CCBSA 2014, s 41.
30 *Percival v Wright* [1902] 2 Ch 421 and see Section **7.4.10.** below.
31 CA 2006, ss 170–181.
32 CA 2006, s 170(3) and (4).
33 See Sections **7.5.** and **7.6.** below.

It is possible for society rules to redefine some duties. For example, the strict conflict of interests principle and its consequences may be modified in society rules. They commonly lay down a procedure for directors to declare and register a conflicting interest and abstain from voting or participating in board discussion. That redefines the duty as a duty to comply with that rule. Permission by the society after it has been given full information, often granted through the board, may authorise an action that would otherwise be a breach of duty. In other cases, permission or approval by a general meeting of members may be required, as in the case of a decision not to hold directors liable for a breach of the rules when an act beyond the society's powers was carried out.[34]

Each of the listed duties is now considered in turn.

7.4.2. Duty to obey the law and comply with society rules

The duty to obey the law is self evident and cannot be reduced or waived by society rules. This applies to the criminal offences created by CCBSA 2014, s 127 or 128 and under other legislation, such as health and safety or consumer protection laws, where offences by a society may also result in liability for committee members or officers of the society.[35]

The duty to comply with society rules is well established at common law and is similar to the duty of a trustee to follow the terms of the trust deed under which he or she operates or the duty of an agent to follow their mandate. The company case law has generally involved exceeding the powers of a company or those conferred by the constitution on the board.[36] In the context of societies this could involve a breach of the rules about the powers of the society or the board or a failure to follow procedures laid down in the society's rules. Society rules often require the board to conduct the society's affairs so that it follows co-operative values and principles.

7.4.3. Duty to use powers only for the purposes for which they were conferred

Directors must use powers that they are given for the purpose for which they were given. The use of a power for some other ('collateral') purpose will be a breach of duty. This presupposes that one or more purposes can be found for a particular power given by the rules and that the purposes for which it was actually used can be discovered, although an improper purpose of a majority of the board will probably be enough to cast doubt on the validity of the use of the power.[37] The difficulty of answering these questions makes it hard to challenge decisions on this basis. The case law is mainly concerned with decisions by the directors of companies to issue shares to alter the majority in the general meeting rather than to raise capital.[38] However, the use of a power given by the rules to slow down or limit the rate at which shares could be redeemed might be used for the

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34 CCBSA 2014, s 43(6) and (4).

35 See Section **10.2**. generally on criminal offences.

36 See *Re Oxford Benefit Building and Investment Society* (1886) 35 Ch D. 502; *Cullerne v London and Suburban General Permanent Building Society* (1890) 25 QBD 485 and *Rolled Steel Products (Holdings) Ltd v British Steel Corp* [1986] Ch 246 and see Sections **11.4.** and **11.5.** on the way such problems affect transactions between the society and those with whom it deals.

37 *Eclairs Group Ltd v JKX Oil and Gas Plc* [2013] EWHC 2631 (Ch).

38 See, for example, *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821.

wrong purpose if it were exercised for a reason other than preventing a run on the society's funds. Similarly it is a misuse of a power to decide when to call a general meeting if a date is deliberately chosen to prevent certain members from attending.[39]

The courts will use this rule to prevent directors from exercising their powers for the sole purpose of interfering with the constitutional right of the members to elect the board or dismiss directors in accordance with the rules. The power to issue shares in a company is not to be used to maintain the directors' control or that of their friends over the company. Similarly, the use by company or society directors of the power to make contracts and manage the business purely to retain control is a breach of duty, even if it is done in good faith. In one case,[40] directors who, in good faith, caused a company to enter a management agreement that prevented shareholders from deciding who was to run the company were found to have used the power for a collateral purpose. Dillon LJ observed[41] when considering the constitution of that particular company, that: 'The function of the directors is to manage, but the appointment of the directors who are to do the managing is constitutionally a function of the shareholders in general meeting.' However, in a case in which the constitution of the National Association for Mental Health, a company limited by guarantee, allowed the expulsion of members and its council decided in good faith to exercise that power in respect of an organised group of members with, as Scientologists, views that the council saw as contrary to the society's principles, no injunction was granted to annul the decision.[42] In that case the council believed that their opponents were about to take control of the society through its electoral process but a power conferred by the rules was used directly to expel them in a procedurally correct manner which included an appeal to the general meeting, so that the members by majority would ultimately decide the issue. That gave the full membership the ultimate say.

The cases show that the precise content of this duty will depend both on the wording and context of the rule, which gives the power and, if a breach of duty is alleged, an assessment of the purpose that the board had in mind when it used the power.

7.4.4. Duty to act in the society's best interests

In reaching decisions and exercising their powers under the law and the rules of the society, directors must act in good faith in what they consider to be the best interests of the society and not for any collateral purpose.[43] They must act in the interests of the society in question and not of some other body. Directors of a subsidiary society or company appointed by the holding society or company must not serve only the group interest on the subsidiary's board. They must actively consider the interests of the subsidiary as a separate entity.[44] In practice this obligation is only likely to be enforced if the subsidiary is not 100% owned by the holding society or company that appointed the directors. However, even in the case of a wholly owned subsidiary, there will be a risk of action against directors who acted in breach of duty if control of the subsidiary changes eg by the transfer of control of the legal entity without all necessary 'whitewashing' resolutions being passed by its general meeting to prevent it later suing its former

39 *Cannon v Trask* (1875) LR Eq 669 and see *Eclairs Group Ltd v JKX Oil and Gas Plc* [2013] EWHC 2631 (Ch).
40 *Lee Panavision Ltd v Lee Lighting Ltd* [1991] BCC 620.
41 Ibid at 635.
42 *Gaiman v National Association for Mental Health* [1971] Ch 317.
43 *Re Smith and Fawcett Ltd* [1942] Ch 304.
44 *SCWS v Meyer* [1959] AC 324 and *Charterbridge Corporation v Lloyds Bank Ltd* [1970] Ch 72.

directors. Similarly, if a society, including a 100% owned subsidiary, becomes insolvent and a liquidator, receiver, or administrator decides that it should pursue claims against former directors there will be a practical risk of personal liability.

The court looks to the belief of the directors themselves about what is in the interests of the society and will not substitute its own view for theirs. This duty generally depends on the subjective belief and honesty of the director at the time of the decision rather than any later judicial view of the society's interests and the effect of a decision on them. However, in an extreme case, the court may be reluctant to accept that an honest and intelligent director of that society could possibly have believed, in the circumstances of a particular decision, that his or her actions were in the interests of the society.[45]

The interests of the society are the interests of the members as a whole, both present members and future members.[46] This means that decisions that favour employees or involve the donation of assets to other bodies must be justified by reference to the interests of members. While the business is a going concern benefits to employees can usually be justified on the basis of improving their performance and thus the effectiveness of the society's business. This will not be the case if assets are to be donated to employees at the end of the society's existence as no business is to be carried on afterwards. Such a step would require one of the objects of the society to be the benefit of employees and might need a general meeting decision by members.[47] There is no provision in CCBSA 2014 requiring and permitting directors to have regard to employees' interests or providing for decisions to benefit employees on the cessation or transfer of the business. Section 187 of the Insolvency Act 1986 only permits a liquidator to carry out a decision reached under s 247 of the Companies Act 2006 and thus it cannot apply to benefit employees on the winding up of a society.

Donations to other bodies such as the ancillary co-operative organisations, trade unions or political parties should be justified on the basis that they are in the interests of the society or that the rules provide for donations to such bodies either as an object of the society or as a means of distributing any surplus.[48]

If a society is insolvent or close to it, the interests of the society become the interests of its creditors and directors should be mainly concerned with the effects of their decisions on that group. The duty would still be owed to the society and not to individual creditors but their interests would supersede those of the members and, of course, if the society goes into liquidation their collective interests can be pursued by the liquidator at common law or by the use of provisions such as s 212 of the Insolvency Act 1986.[49]

The duty to act fairly between members arises where a decision that is considered to be in the interests of the society in good faith may have an adverse impact on particular members or groups of members. The duty on company directors existed at common law and has been carried over into the codified duties as a matter to which directors must have regard.[50] The company law cases have usually concerned share issues which

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45 See *Charterbridge Corporation v Lloyds Bank Ltd* [1970] Ch 62, 74.
46 *Greenhalgh v Aderne Cinemas Ltd* [1951] Ch 286 at 291.
47 See *Parke v Daily News Ltd* [1961] 1 WLR 493.
48 *Re Horsley and Weight Ltd* [1982] Ch 442.
49 See *Liquidator of West Mercia Safetywear v Dodd* [1988] BCLC 250 CA; *Colin Gwyer and Associated Ltd v London Wharf (Limehouse) Ltd* [2003] 2 BCLC 153; and *GHLM Trading Ltd v Maroo* [2012] EWHC 61 (Ch).
50 CA 2006, s 172(1)(f).

excluded particular groups of shareholders, such as those resident in certain jurisdictions where regulatory requirements would increase the cost of raising the capital.[51] There is no duty to sacrifice the interests of the society to the interests of a particular group of members but the consequences for particular members must be considered.[52] This might be of particular relevance in a multi-stakeholder co-operative where good faith board decisions in the interests of the society as a whole also need to balance the interests of different member groups.

7.4.5. Duty to exercise independent judgement

Directors must not follow instructions from anyone and must always consider any issue independently while honestly seeking to pursue the interests of the society. This means that when a director is elected by a particular constituency of members they owe their duty to the whole society membership and must not follow instructions without considering each decision.

Problems have arisen when, as part of a company's business, it has entered contractual arrangements committing it to a particular course of action in the future. Does this not prevent directors from exercising independent judgement while the arrangement is in place? In the leading case,[53] the Court of Appeal both affirmed the existence of the duty to exercise independent judgement and dealt with that question. It ruled that if directors properly exercise their discretion in a way that restricts future conduct by entering into an agreement with that effect, later compliance with the commitment they entered did not breach the duty to exercise independent judgement.

Similarly, if directors behave in a way authorised by the society rules, for example by delegating decisions or powers in accordance with the rules, that does not amount to a breach of this duty, although they will retain a duty to supervise the performance of those to whom they have delegated powers.[54]

7.4.6. Duty of care, skill and diligence

The duty of care and skill involves potential liability for failure to behave with appropriate competence and diligence. If someone is found to have fallen below the standard laid down, he or she is liable in damages for that failure to the person to whom the duty is owed. In the context of directors or committee members, all directors' duties are owed to the society and not to individual members. Since the basis of liability is a failure to exercise the necessary degree of skill and care, there is no need to show knowledge or intention to cause loss. Conduct is judged against the level of diligence and competence set by the courts. Most societies will carry insurance to cover their directors for any potential liability for breach of this duty but the policy will usually be limited to a maximum level of cover.

The position of the directors or committee members of societies in this respect is similar to that of the directors of a company. Consequently the standards to be applied by the courts are derived from the law applicable to company directors. Broadly, the level of

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[51] *Mutual Life Insurance Co of New York v Rank Organisation Ltd* [1985] BCLC 11.

[52] See ibid at 24; and *Re McCarthy Surfacing Ltd* [2008] EWHC 2279 (Ch) at para 81.

[53] *Fulham Football Club Ltd v Cabra Estates* [1994] 1 BCLC 363.

[54] *Dovey v Cory* [1901] AC 477 and *Re Barings plc No. 5 Secretary of State for Trade and Industry v Baker (No 5)* [1999] 1 BCLC 433 aff'd [2000] 1 BCLC 523 CA.

care and skill required of non-executive directors by the common law rules is lower than it is for executive directors. However, the late twentieth century saw an increase in expectations for all directors and a minimum level of knowledge, skill and experience is now applied to all directors, varying only according to their function. In the case of executive directors the level of care, skill and diligence required is higher because their service contracts impose higher standards.

The courts accept that the conduct of business is an inherently risky matter. They will not substitute their own judgement for that of the directors or the committee on business decisions but will only consider whether the directors or committee members carried out the duties imposed on them by the law.

Since the early 1990s, the courts have held directors to the standard first described in s 214 of the Insolvency Act 1986 to impose liability for wrongful trading. That requirement is codified in the Companies Act 2006 as a duty to exercise reasonable care, skill and diligence, meaning:

> 'the care skill and diligence that would be exercised by a reasonably diligent person with the:
> (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company, and
> (b) the general knowledge, skill and experience that the director has.'[55]

That standard applies to societies as well as companies because at common law it was accepted in a number of cases before 2006 as an accurate expression of the common law principle.[56] Since the 1980s this approach has replaced the emphasis previously given to a purely subjective level of knowledge and skill in nineteenth and early twentieth century case law. That process has accompanied the emergence of corporate governance codes developing best practice for both co-operatives and listed companies.[57]

A helpful summary of the modern approach to this legal duty was given by Jonathan Parker J:

> '(i) Directors have, both collectively and individually, a continuing duty to acquire and maintain a sufficient knowledge and understanding of the company's business to enable them properly to discharge their duties as directors.
>
> (ii) Whilst directors are entitled (subject to the Articles of Association of the company) to delegate particular functions to those below them in the management chain, and to trust their competence and integrity to a reasonable extent, the exercise of the power of delegation does not absolve a director of a duty to supervise the discharge of the delegated function.
>
> (iii) No rule of universal application can be formulated as to the duties referred to in (ii) above. The extent of the duty, and the question whether it has been discharged, must depend on the facts of each particular case, including the director's role in the management of the company.'[58]

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55 CA 2006, s 174(2).

56 See *Re D'Jan of London Ltd* [1993] BCC 646 per Hoffman J at 648 and *Norman v Theodore Goddard* [1992] BCC 15.

57 See Section **7.7.** below.

58 *Re Barings plc and others (No 5) Secretary of State for Trade and Industry v Baker and others* [1999] 1 BCLC 433, 489.

It is widely accepted that there is one duty applicable to all directors but point (iii) in that quotation illustrates how the function of a particular individual and especially whether their role is as an executive or a non-executive affects the content of their duty. Note the emphasis in that statement on the duty to supervise. That is the role of the board in a modern business.

Under most society rules the board has a collective responsibility to manage the society's affairs and each director's duty is to take part in that because:

> 'That collegiate or collective responsibility must … be based on individual responsibility. Each individual director owes duties to the company to inform himself about its affairs and to join with his co-directors in supervising and controlling them.'[59]

The standard depends on the function carried out by the director and it is on that basis that the minimum level of knowledge skill and experience will be set. However, the actual level of knowledge, skill and experience of the individual involved can raise the level of skill that is expected. If the director is a qualified accountant or solicitor the level of skill expected of them as a director will be that expected from a reasonably competent professional of that kind performing the role that the particular director is expected to perform in that society.

If the board member has no experience, knowledge or training in business matters the level of skill to be expected of that person will be more limited. However, it never falls below the level required for the function performed in the society in question. As a minimum, even in a small society, there is a duty to ensure that statutory requirements are satisfied, for example as to the timely and accurate preparation and presentation of accounts.[60]

Even non-executive directors without particular financial expertise are expected to be able to understand the key implications of the information needed by board members to carry out their supervisory role. As Parks J said[61] in the context of an insurance company:

> 'When I make the point that the directors… were laymen so far as the accounting issues in the case are concerned, I am not suggesting that it would have been acceptable for them to be totally ignorant of accounting concepts as applied to an insurance company. In my view they would have been expected to be intelligent laymen. They would need to have a knowledge of what the basic accounting principles for an insurance company were, such as IBNR. They would be expected to be able to look at the company's accounts and, with the guidance they could reasonably expect from the finance director and the auditors, to understand them. They would be expected to be able to participate in a discussion of the accounts and to ask intelligent questions of the finance director and the auditors. What I do not accept is that they could have been expected to show the sort of intricate appreciation of recondite accounting details possessed by a specialist in the field.'

That statement was made in the context of an insurance company but the standard of the 'intelligent lay person' is an appropriate measure for the duties of each director, executive or non-executive, of any society.

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[59] *Re Westmid Packing Services Ltd, Secretary of State for Trade and Industry v Griffiths* [1998] 2 BCLC 646, 653.

[60] *Re Produce Consortium Ltd (No 2)* [1989] BCLC 520, 550.

[61] *Re Continental Assurance of London plc* [2007] 2 BCLC 287, 401–2 para 258.

The minimum legal requirement for anyone discharging the function of director involves a level of understanding of relevant concepts sufficient to permit meaningful discussion with executive management. The concepts involved include accounts and financial information, business strategy and performance, budgets and capital investment programmes, personnel policy, risk management, reviews of internal control systems, and the monitoring of senior management performance year by year. In each case, the level of an 'intelligent layman' is a useful measure of what can reasonably be expected of someone agreeing to serve as a director of a business organisation. The range and complexity of the information and concepts to be mastered will vary with the scale and scope of the business activities carried on by a particular society.

Careful consideration and diligent implementation of guidance from trade associations, federal bodies or regulators on the role of directors will assist board members in meeting their legal obligations. The task of reviewing with senior executives or managers, at least annually, the society's risk and control processes and the more regular discussion by the board of reports from managers to the board and/or Audit Committee on the matters covered by the Code are central to the competent performance of the directors' function. So is the assessment of the performance of the executives and liaison with the auditors in the absence of the executives.

Co-operative UK's Corporate Governance Code,[62] particularly those parts of it concerned with systems, provides a set of specific recommendations and principles available for use by a court or other body assessing whether directors have lived up to their duties of care, skill and diligence. Failure to adhere to the Code might be an indication of a breach of duty. The greater the failure to adhere to the spirit of the Code, the greater the danger – especially for those involved with the societies to which it is specifically directed. The similar guidance provided by other trade associations or regulators, such as the HCA for registered providers and the Association of British Credit Unions Ltd (ABCUL) and the PRA for credit unions, will perform an equivalent role for the societies to which they apply and for those determining whether their board members have lived up to their legal duties of care, skill and diligence.

If a society goes into insolvent liquidation or administration, directors may be required to contribute to the funds available to creditors from their personal assets if they have been guilty of wrongful trading before the insolvency proceedings began. Directors are also potentially liable to disqualification under the CDDA 1986, a threat that most often arises from insolvency proceedings. Since it is impossible to be sure that a society will never enter insolvent liquidation, all directors need to behave according to the standards discussed in Sections **7.5.** and **7.6.** below.

7.4.7. Conflicts of interest

There must be no possibility of a conflict between the director's duty to the society and his or her personal interest or interest in some other body.[63]

This strict rule applies very widely in any situation where either the interest of the director conflicts with the interest of the society or the director's duty to the society conflicts with their duty to another society or company.

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62 See Section **7.7.** below.

63 *Aberdeen Railway Company v Blaikie* (1854) 1 Macq 461.

If a contract is made between the society and a firm in which the director is a partner, there is a conflict because the director has a duty to the society to get the best price and the same duty to his or her firm or another company or society on the board of which he or she sits. Those were the facts of *Aberdeen Railway Company v Blaikie*.[64] Unless the society rules provide otherwise and any procedure they lay down is complied with, such a conflict gives the society the right to choose either to have the contract set aside (rescinded) and recover any loss from the director or to proceed with the contract and receive from the director any profits that he or she makes from it.

However, the principle is wider than the simple example of a contract in which the director is on both sides. It extends to any facts or circumstances in which a reasonable person would think there was a 'real sensible possibility of conflict'.[65] It is wide enough to cover a situation where a director comes across information or an opportunity in which the society might be interested (eg to buy land adjacent to society land) by chance and unconnected with their role as a director and takes the opportunity without informing the society. That may put them in conflict with the society's interests even if the society has no interest in the opportunity and no proprietary claim to it.[66] It is the inconsistency of the transaction with the duty to the society that leads to a breach of the duty and the ability of the society to demand the director's profits.[67]

Where there is a provision in the society's rules dealing with a conflict the rule must be followed. Such a rule may require a director to declare an interest to the board and to refrain from voting on the issue or it may permit certain transactions without the need for such procedures to be followed. If such a rule exists then, so long as the director follows its requirements, the society will not be able to challenge the transaction or claim the director's profits.

If there is no such rule the director will have to provide full information about the conflict of interests or interest and duty to the general meeting of the society, which will decide whether or not to use its remedies against the director and whether to consent to the breach of the 'no conflict' duty.[68] This contrasts with the position under the Companies Act 2006, s 175(4)(b), which changed the law to permit the board (excluding interested directors) to authorise a conflict of interest and retention of profits from it.

The society will lose its right to rescind the contract if it is impossible to return the parties to their original position, if it delays its repudiation of it unduly or if a third party who was unaware of the director's breach of duty has an interest in property that was transferred under the contract.

Conflicts between two different duties may arise for a director if they sit on the boards of two competing societies. Traditional legal doctrine has held that there is no specific rule against this.[69] However, the trend of recent case law has been to emphasise the difficulty of avoiding frequent conflicts of interest when decisions arise on the board, for example where one is the customer and the other the supplier or both are competing for

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64 Ibid.
65 *Boardman v Phipps* [1966] 3 All ER 721, 756.
66 *Bhullar v Bhullar* [2003] 2 BCLC 241.
67 *Quartermaster (UK) Ltd v Pyke* [2005] 1 BCLC 245 at [54]-[55].
68 *New Zealand Netherlands Society (Oranje) Inc v Kuys* [1973] 2 All ER 1222.
69 *London and Mashonaland Exploration Company Ltd v New Mashonaland Exploration Co Ltd* [1891] WN 165.

the same customers. This situation can only be dealt with by disclosure and consent on the part of both societies and directors will always be at risk of breaching their obligations to one society or the other.[70]

This last rule has particular resonance for the traditional organisational structures of the consumer co-operative movement. In the traditional system under which separate consumer co-operatives collectively form a wholesale society to purchase goods on their behalf and control the board of the wholesale society, the problem is limited so long as one society operates as a wholesaler and the others purely in retail, although issues about supply agreements and freedom to purchase elsewhere may arise. However, when, as happened in the UK the wholesale society increasingly operates as a retailer while its corporate members do the same, difficulties may arise. Clearly, the very nature of the structure alerts the board of one society to the interests of the directors who also serve its member societies and the rules may well provide clear evidence of an intention to permit what might otherwise be a conflict of interest. However, issues of confidentiality and concerns about specific business decisions might remain.

One can argue that this is a symptom of a legal system geared to a fall-back assumption of competing firms having difficulty in managing co-operative entities that aim to pool interests for common benefit. However, joint ventures and collaborative business arrangements between separately owned firms are not uncommon and, subject to compliance with rules of competition law, contractual and organisational arrangements can be designed to serve such purposes. The flexibility available in the structuring of UK business entities and in contract law facilitate that. The issue of conflicts of duties for directors must be addressed as part of those arrangements. The key is clarity of focus for each corporate structure, transparency, the use of appropriate constitutional and contractual arrangements, and the avoidance of excessively complex arrangements that grow up over time without being regularly reviewed.

7.4.8. Misuse of the society's information or property and secret profits

The assets of a society cannot be dealt with as if they belonged to a director or any other member. If property is not dealt with lawfully in the society's interests, the general law allows the society to sue for the return of misappropriated property or to seek compensation in the courts for losses caused by the misuse of the property by a director or official. As a separate legal person, a society can sue in the law of tort for wrongful interference with goods, trespass or dispossession of land, or deceit. It can use any relevant statutory remedies for breach of, for example,. intellectual property rights, to deal with straight forward misuse of its property. That applies against a director or anyone else. A society can also pursue any rights it may have under a contract and even non-executive directors will usually have made a contract of some kind with the society.

In addition to those general remedies, the CCBSA 2014 provides a cheap and speedy procedure. Money or other property belonging to the society that has been misappropriated or misused by a director in breach of duty can be recovered by an order of the magistrates' court with or without a conviction for a criminal offence.[71]

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[70] *Bristol and West BS v Mothew* [1996] 4 All ER 698, 712 and *Plus Group Ltd v Pyke* [2002] 2 BCLC 201, 222.

[71] CCBSA 2014, s 130.

In addition to the clear-cut duty of a director not to misappropriate or misuse the property of the society, there is a wider duty not to misuse information or take business opportunities available because of the director's position on the board. This arises from the fiduciary position of directors. To behave in this way would be to allow personal interests to interfere with the director's duty to the society and might amount to gaining a secret profit while serving the society in which case the profits must be handed over.

These principles are very wide and can result in directors having to account for profits that they make from information or business opportunities that they discover as directors and exploit personally. This is so in the absence of full disclosure to the company and approval at a general meeting and the duty extends to a decision in good faith in what the directors believe to be the society's best interests to invest personally in a scheme in which the society cannot afford to invest.[72] The duty extends to the use of such information even after the person concerned has left the board and even if a contract taken personally would not have been made available to the company by the other party in any event so that the company has not lost.[73] The key question on the application of this principle is how far it extends beyond a 'maturing business opportunity'[74] already being considered by the company. If the society has never operated and has no plans to operate in the area of business in which the opportunity arises then the principle may not apply and there may be no conflict of interest as the company may have no interest. However, if the directors who took up the opportunity were instrumental in a decision that the company's business would not extend to that opportunity or that the scope of its activities should be reduced, that may make them more likely to be held to be in breach of duty.[75]

A 'secret profit' is any payment received by a director in connection with their role that is concealed from the society. The classic example would be a bribe from a supplier to favour them when awarding contracts, which would also involve a criminal offence.[76] However, the concept also extends to less clear-cut situations and this aspect of the fiduciary duty to avoid conflicts of interest is applied strictly. The basis of this aspect of the duty was summarised recently by Mummery LJ:

> 'The applicable duties are of a director's loyalty to the Company and the duty to observe the no conflict principle, which embrace a duty not to make a secret profit for himself. The no conflict duty extends to preventing Mr Towers from disloyally depriving the Company of the ability to consider whether or not it objected to the diversion of an opportunity offered by one of its customers away from itself to the director personally.'[77]

That is the rationale for the emphasis on the non-disclosure of 'secret profits'. In that case, the director borrowed an old excavator and dumper truck from a company customer for his personal use for six months. He did not disclose the arrangement to the company. The interest of the company stemmed from the possibility that the customer would expect some benefit. The absence of bad faith by the director, quantifiable loss to the company, or any proof of actual benefit to the customer were all irrelevant and the director had to hand over the value of his benefit (£5,000) to the company. If the company had been informed and had approved the director's benefit using correct

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72 See *Regal (Hastings) Ltd v Guilliver* [1942] 1 All ER 378.
73 *Industrial Development Consultants Ltd v Cooley* [1972] 1 WLR 443 and *CMS Dolphin Ltd v Simonet* [2001] 2 BCLC 704, 733.
74 See *Canadian Aero Service v O'Malley* [1973] 40 DLR (3d) 371, Can SC at 382.
75 *Bhullar v Bhullar* [2003] 2 BCLC 241.
76 See Bribery Act 2010.
77 *Philip Towers v Premier Waste Management Ltd* [2011] EWCA Civ 923 [48].

procedures in accordance with its constitution and without any conflict of interest in the way the decision was made the profit would not have been secret, but none of that was done.

7.4.9. Confidentiality

The fiduciary duties to avoid conflicts of interest and not to misuse society property or information clearly include aspects of confidentiality. In addition, the contracts entered into by employees and non-executive directors will usually impose duties of confidentiality expressly or by implication.

However, the courts have developed a wider duty applicable wherever confidential information is disclosed, which the recipient knows or ought to know is fairly and reasonably regarded as confidential.[78] That duty applies whether or not a relationship such as society director and society or any contractual relationship exists. This area of law has two aspects. One is the protection of confidential information and the other is the protection of privacy.[79] In the context of directors' duties it is the protection of the society's confidential information that is involved. A breach of that duty can lead to an injunction against both the director and any recipient from them of the information, who obtained it knowing of the breach of confidence or otherwise fraudulently.[80] Damages will also be available as breach of confidence is a tort.

In the context of co-operatives and other societies where an element of member accountability is one of the defining features of the organisation, arrangements should be such that while these obligations are imposed in respect of commercially sensitive information, the society has a policy of maximum transparency in all other respects. Directors must decide, with advice from executives, which information is confidential and which is to be shared with the wider membership and when and how such sharing of information is to take place.

7.4.10. Enforcing the duties

The remedies available to a society for a breach of directors' duties cannot usually be exercised by individual members as the duties are owed to the society as a corporate body. If the society brings an action against a director for breach of duty it may seek:

- an injunction to stop a proposed breach of duty;
- damages for losses caused by a breach of duty;
- recovery of property misappropriated unless it has come into the hands of a purchaser who acted in good faith without notice of the breach of duty. Section 130 of CCBSA 2014 might be used in straightforward cases;
- an 'account' of profits made by the director in breach of duty. This is an order requiring that that amount be handed over to the society;
- an order rescinding a contract made in breach of duty unless it is impossible to restore both parties to their original position, too much time has elapsed, the society has affirmed the contract or an innocent third party would be affected.

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78 *A-G v Guardian Newspapers (No 2)* [1990] 1 AC 109, 291; *Campbell v MGN Ltd* [2004] UKHL 21 [13] [14].

79 *Douglas v Hello! Ltd (No 3)* [2007] UKHL 21 [255].

80 *Morrison v Moat* (1851) 9 Hare 241.

In addition to an action for breach of duties owed as director, any board member who has a contract of service with the society may be sued for breach of that contract and dismissed summarily if the breach of contract is serious.

The problems of enforcement of company directors' duties by company shareholders have given rise to much debate. The allocation of powers between board and general meeting usually gives the board the right to decide when the society or company will sue. This is obviously problematic when the people to be sued are directors. In principle, those who are potential defendants could be excluded from the decision making because of their conflict of interest, assuming they have not already been removed from the board. However, it is more likely that proceedings will arise from a change of control of the board by the election of new directors who consider taking action against former directors for breach of duty when they held office. Alternatively, the society may become insolvent in which case those decision-making powers may pass to an administrator or liquidator who could cause the society to sue former directors. This last possibility overlaps with the proceedings for fraudulent or wrongful trading or the disqualification of directors which can flow from the winding up of a society or company.[81]

If members wish to decide that a society should sue directors for breach of duty while the society remains a going concern and while the board is reluctant to do so, the complexity and cost of the rules that apply will present a formidable obstacle. For companies, the Companies Act 2006, ss 260–269, provide a statutory framework for such a derivative action by a group of members. Those provisions do not apply to societies that are still subject to a set of common law rules known as 'the rule in *Foss v Harbottle*'.

The starting point for those rules is that directors' duties are owed to the society as a legal person and not directly to its members.[82] The society is therefore the proper person to sue. That usually means that the decision on whether to litigate will be for the board under the allocation of functions in the society's rules and that, if the board decides to sue, the general meeting cannot prevent that by ordinary resolution.[83] Any other allocation of powers by the society's rules would also be upheld against a contrary view by the general meeting.[84] However, there seems to be a common law rule to permit the members, by ordinary resolution, to decide the question of whether to sue.[85] In some limited circumstances a minority may be able to take action against the wishes of that majority or of a board controlled by wrongdoers. This is obscure and complex but for completeness it is briefly summarised below.

The rule in *Foss v Harbottle*[86] lays down that it is only in exceptional circumstances that a minority of members can bring proceedings in the name of the company against the wishes of a majority in the general meeting or of the board. In effect, this means that the courts enforce majority rule in the society because a decision by the general meeting to initiate litigation against directors or to refuse to do so requires at least an ordinary resolution. The exceptions to the rule that permit a derivative action in the name of the society, initiated by a minority of members, are limited and the value of this remedy is

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81 See Sections **7.5.** and **7.6.** below.

82 *Percival v Wright* [1902] 2 Ch 421.

83 *John Shaw and Sons (Salford) Ltd v Shaw* [1935] 2 KB 113.

84 *Breckland Group Holdings Ltd v London and Suffolk Properties Ltd* [1989] BCLC 100.

85 *Foss v Harbottle* (1843) 2 Hare 461.

86 Which applied to companies until the change introduced by CA 2006, ss 260–269. The rule applies to trade unions, societies and other corporate bodies.

reduced by the fact that success results only in damages or returned property for the society and no direct benefit for the minority. However, the absence of any statutory derivative action for societies and of any remedy by way of petition on the grounds of 'unfair prejudice'[87] leaves only the common law derivative action or an application for a just and equitable winding up of a solvent society[88] as remedies for minorities if directors' duties are breached.

The established list of circumstances in which a simple majority of members cannot prevent an action by a minority of members is:[89]

- the enforcement by a member of a personal right against the society, for example on the basis of the contract in the rules established by CCBSA 2014, s 15. That could include a refusal of the individual's right to cast their vote[90] or the right to remain in membership by paying the correctly fixed membership subscription despite an invalid attempt to increase it in breach of the rules.[91] It can be difficult to work out which rights are individual and so directly enforcable a by a member and which are procedural and so only enforceable by the society itself;[92]
- an attempt by the society to pass a resolution by a simple majority rather than the super majority required by the rules;[93]
- member's right to an injunction to restrain a threatened breach of the rules;[94]
- remedies for directors' illegal[95] or ultra vires[96] acts.

The above are all circumstances in which the right to sue belongs to the individual member and the case brought is not strictly a derivative action as the member is entitled to sue in his or her own name.

Fraud on the minority by wrongdoers in control of the society is the one 'true' exception in which a derivative action is strictly required. It applies if there is 'fraud', widely defined as a breach of legal duty involving direct or indirect appropriation of society property or advantages in which other members are entitled to participate.[97] However, control of the society by those involved in the 'fraud' that prevents it from suing to right the wrong is also necessary.[98] This exception is intended to remedy the problem that a majority may use their control of the society to prevent it from suing directors for a breach of duty and so allow the effective expropriation of the minority's stake in the society.

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87 See Companies Act 2006, ss 994–999.
88 Insolvency Act 1986, s 122(1)(g) and see Section **12.2.** below.
89 *Edwards v Halliwell* [1950] 2 All ER 1064.
90 *Pender v Lushington* (1877) 6 Ch D 70 (a company case where shareholder refused the right to vote).
91 *Edwards v Halliwell* [1950] 2 All ER 1064 (a trade union case).
92 See *MacDougall v Gardiner* (1875) 1 ChD 13 (a company case on a refusal to allow a vote by poll).
93 *Edwards v Halliwell* [1950] 2 All ER 1064 (a trade union case where the subscription increase needed a two thirds majority by ballot and that procedure was not followed).
94 *Irvine v Union Bank of Australia* (1877) 2 App Cas 366 and see CCBSA 2014, ss 43(2) and 45(4).
95 *Smith v Croft (No 3)* (1987) 3 BCC 218.
96 *Taylor v National Union of Mineworkers (Derbyshire Area)* [1985] BCLC 237 and CCBSA 2014, ss 43–45.
97 *Burland v Earle* [1902] AC 83, per Lord Davey at 93 and see e.g. *Daniels v Daniels* [1978] Ch 406.
98 See *Prudential Assurance Co Ltd v Newman Industries (No 2)* [1981] Ch 257, 324–5 (Vinelott J) and [1982] Ch 204, 219 (Court of Appeal).

In all the circumstances mentioned above, issues about entitlement to bring a case are likely to be dealt with at preliminary hearings before any full hearing will consider the evidence and finally decide the case. That is one reason for the complexity and cost of such actions.

7.5. FRAUDULENT AND WRONGFUL TRADING

7.5.1. Application to co-operative and community benefit societies

An insolvent society can go into voluntary or compulsory liquidation on the grounds and using the procedures that apply to insolvent companies.[99] The rules applicable on insolvency open up a range of additional remedies against directors and others concerned in management.

Personal liability to pay money into funds available for creditors in the liquidation can apply to society directors if the liquidator applies to the court for an order and the court is satisfied that the director's behaviour meets the criteria for an order.[100]

In addition, from 6 April 2014, the provisions of the Company Directors Disqualification Act 1986 (CDDA 1986) have also applied to the directors or committee members of a society and the most common circumstance in which that will apply is corporate insolvency. That is dealt with below.[101]

7.5.2. Fraudulent trading

The key provisions in respect of this are that liability can be imposed on people who are knowingly party to running the society's business with intent to defraud the creditors of the company or of someone else or for any other fraudulent purpose.[102] Fraudulent trading applies not only to directors and shadow directors of the society, as wrongful trading does, but also to anyone else who was party to running the business.[103] However, to establish liability for fraudulent trading intentional dishonesty must be proved and that has caused difficulties in the past.[104] However, the requirement that the business was run with that intention can be satisfied even if only one creditor suffered loss.[105]

The liquidator (who is the only person allowed to apply for these remedies) must prove an element of dishonesty to establish fraudulent trading. This is more difficult than proving the knowledge or negligence required to show wrongful trading against a director or shadow director. Consequently, it is unlikely that an application based on fraudulent trading will be made against anyone who could be accused of wrongful trading.

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[99] CCBSA 2014, s 123(1) and see Section **12.8.** below.
[100] Insolvency Act 1986, ss 213 and 214.
[101] Co-operative and Community Benefit Societies and Credit Unions Act 2010, s 3 commenced by SI 2014/183, art 2 and see Section **7.6.** below.
[102] Insolvency Act 1986, s 213(1).
[103] Insolvency Act 1986, s 213(2).
[104] *Re William C Leitch Bros Ltd* [1932] 2 Ch 71, and *Re Patrick and Lyon Ltd* [1933] Ch 786 and see *Palmer's Company Law*, paras 15.599.18–15.599.25.
[105] *Re Gerald Cooper Chemicals Ltd* [1978] Ch 262 and *Morphitis v Bernasconi* [2002] EWCA Civ 289.

Note that an application in respect of fraudulent trading is only possible in the course of a liquidation and an order is only available if the society is wound up. The behaviour that is relevant will, however, usually have taken place before the society went into liquidation. The order will reflect the policy that the remedy is compensatory rather than penal and will reflect the losses to creditors caused by the fraudulent trading.[106] The contribution is paid into the assets available for creditors in general and is neither allocated to creditors who were defrauded nor subject to any floating charge over the society's assets.[107]

In the case of a society, criminal proceedings for fraudulent trading under s 993 of the Companies Act 2006 that apply to a company whether or not it is being wound up are not available as a society is not a company.

7.5.3. Wrongful trading

Only the liquidator can apply for an order on this ground and that is only possible during the course of an insolvent winding up of a society.[108] The cost of bringing proceedings for wrongful trading must be considered by the liquidator and weighed against the prospects of success and the amount likely to be recovered from directors. The courts have been unhelpful to liquidators' attempts to obtain finance for such proceedings from outside parties by applying the ancient tort of champerty to prohibit arrangements with unconnected financiers to hand over part of the amount recovered in return for them underwriting the cost of the proceedings in the event of failure.[109]

The section applies to directors and shadow directors. It is clear that a person will be liable as a director if they occupy the position of one, even if the rules of the particular society refer to them as a committee member. A 'shadow director' is any person in accordance with whose directions or instructions the directors of the society are accustomed to act. This excludes a person who gives advice in a professional capacity even if advice given in that capacity is usually followed by the directors.[110]

For an order to be available, the liquidator must show that, at a time when the person against whom the order is sought was a director or shadow director of the society, and before the commencement of the winding up that person either:

- knew or
- ought to have concluded

that there was no reasonable prospect that the society would avoid going into insolvent liquidation.[111]

If this is established the person may seek to use the defence that:

- after they first knew or first ought to have concluded that there was no reasonable prospect of the society avoiding insolvent liquidation;

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[106] *Re BCCI (No 15), Morris v Bank of India* [2005] 2 BCLC 328, 356.
[107] *Re Esal (Commodities) Ltd* [1997] 1 BCLC 705 CA and *Re Oasis Merchandising Services Ltd* [1998] Ch 170, 186.
[108] Insolvency Act 1986, s 214(1) and (2)(a).
[109] *Re Oasis Merchandising Services Ltd* [1998] Ch 170.
[110] Insolvency Act 1986, s 251.
[111] Insolvency Act 1986, s 214(2).

- they took every step with a view to minimising the potential loss to the society's creditors that they ought to have taken (assuming they did know that there was no reasonable prospect of the society avoiding insolvent liquidation).[112]

A director with actual knowledge that there is no reasonable prospect that the society will avoid insolvent liquidation can be held liable.[113] The issue of what is known to a director (or shadow director) is one as to which evidence can be given of things said, written or done by that person or others. Advice from a qualified professional (such as an accountant) to the effect that the society is insolvent or is unlikely to avoid liquidation is likely to be held to confer such knowledge on a director. Advice to the opposite effect may assist in protecting the board members from liability (on the basis of what they ought to have concluded as well as what they knew) if all relevant information was given to an adviser of appropriate sophistication and with adequate resources for the size of the society.

A director can also be held liable if he or she 'ought to have concluded' that there was no reasonable prospect of avoiding insolvency and a defence is available to a person who shows that they took every step to minimise loss to creditors that they 'ought' to have taken. These concepts involve a requirement that the behaviour of directors and shadow directors reaches a certain standard of competence and diligence. It is a failure to meet this requirement, rather than knowledge of the improbability of avoiding insolvent liquidation, that will most often lead to an order against a person on the basis of wrongful trading.

The standards of competence and diligence applicable to the conduct of directors and shadow directors in this context are those now clearly applicable at common law.[114]

The standard of diligence required is that of a 'reasonably diligent person'. This is a standard that can be applied to fit the role and situation of a particular director. The time spent on the society's business should be appropriate to the size and complexity of that business and the function of the director in question. It is not necessarily limited to attendance at meetings.

The knowledge, skill and experience assumed on the part of a director is defined by reference to two criteria. Note that both levels apply in all cases. Thus a person is assumed to have both the level of skill, knowledge and experience that they actually possess and the level that can reasonably be expected of a person carrying out the functions that they perform. Thus a person of limited skill, knowledge and experience who sits on the board of a society with a large turnover will be judged according to what would be expected of a person carrying out that function. A director who is given particular responsibility for aspects of the board's work will be judged by the standards applicable to someone with that function. In either case, the actual personal experience, knowledge and skills of the individual director may increase the standard of performance expected on the basis of his or her functions but cannot reduce it.

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[112] Insolvency Act 1986, s 214(3).
[113] Insolvency Act 1986, s 214(2)(b).
[114] Insolvency Act 1986, s 214(4) and see Section **7.4.6.** above.

In deciding on the level of performance expected, the courts will look at functions actually carried out and also at functions entrusted to a person but not actually carried out by them.[115]

The larger the society the higher will be the expectations of its directors. All societies will be assumed to have accounting systems that give their directors the information that would be available if the system conformed to the minimum requirements of the CCBSA 2014, ss 75–99. Larger societies will be expected to operate more sophisticated systems appropriate to the needs of their scale of business and directors will be assumed to have and to understand the information that such a system would have provided, whether or not such a system existed and whether or not the directors received or understood the information with which they were (or should have been) provided.

It is the availability of accounting information and the ability of the directors to analyse it so as to see problems with insolvency in advance that will usually be the most important element in deciding whether an order can be made under the section. The directors will be assumed to have known that which, according to these tests, they ought to have known at the time at which the information would have been available if proper systems had been in place. These criteria also apply to the question of the steps that ought to have been taken to minimise loss to creditors for the purpose of the defence in Insolvency Act 1986, s 214(3).[116] The 'intelligent layman' test discussed in Section **7.4.6.** above provides another perspective on the expectations arising from the basic function of being a director. That test was cited in a case specifically concerned with wrongful trading.[117]

The amount an individual will be ordered to contribute under the section will be decided on the basis of the losses suffered by creditors in the time between the date on which information was or ought to have been available to the directors ('the moment of truth') and the commencement of the insolvent liquidation. The court may apportion the amount to be paid by different individuals according to the degree of negligence displayed by each of them.

7.6. DISQUALIFICATION OF DIRECTORS

7.6.1. Grounds for disqualification

A disqualification order by a court or an undertaking in place of an order are the most likely remedies to be used against directors whose conduct falls short of the legal requirements. That is because this procedure is available to the Insolvency Service of the Department for Business Innovation and Skills (BIS). Enforcement of directors' general duties by the society is problematic.[118] The use of the fraudulent or wrongful trading remedies by a liquidator can be costly and risky.[119] However, there are about 1,200 cases of director disqualification every year in connection with companies[120] and since April

[115] Insolvency Act 1986, s 214(5).
[116] See generally *Re Produce Marketing Consortium Ltd* (1989) 5 BCC 569.
[117] *Re Continental Assurance of London plc* [2007] 2 BCLC 287.
[118] See Section **7.4.10.** above.
[119] See Section **7.5.** above.
[120] Insolvency Service Annual Report and Accounts 2011–2012, The Stationery Office, London, p 30.

2014 the procedure has been available against society directors.[121] To make the procedure even easier, since 2001 it has been possible for a disqualification to be agreed out of court between the Insolvency Service and the director.

The purpose of the disqualification process is to protect the public by prohibiting people who are unfit to be concerned in the management of a business. That is intended to deter misconduct and raise the standards of honesty and diligence in corporate management.[122] The purpose of applying the provisions to societies 18 years after their application to companies is to provide the same protections to those dealing with them as apply to those dealing with companies.

A new section was inserted in the CDDA 1986 to apply the Act to societies and make necessary adaptations. It provides that references to company directors and officers are to include a committee member or officer of a society.[123] The use of the word 'includes' allows for the same rules that include de facto company directors to apply to societies to extend the range of people subject to disqualification beyond actual committee members.[124] The reference to officers also clearly includes society chief executives and secretaries in the scope of CDDA 1986. However, references to shadow directors are to be disregarded when applying CDDA 1986 to societies.[125]

A range of grounds exist for disqualification under the CDDA 1986. They include:

- conviction for an indictable offence in relation to the formation, management, liquidation or cancellation of the registration of a society;[126]
- **either** conviction for a summary offence of failing to comply with CCBSA 2014 requirements to file documents with the FCA **or** for persistent default in that respect without actual conviction;[127]
- on the basis of fraudulent trading or other fraud without a conviction;[128]
- by the court when the director is found liable to contribute to society assets on the basis of fraudulent or wrongful trading.[129]

In the case of all those grounds the court has a discretion whether or not to disqualify the director and can do so for up to five years for failures to file documents and up to 15 years on any of the other grounds.

However, by far the largest number of disqualifications have arisen from the insolvency of a company. They are based on a finding of conduct that makes the person unfit to be a director. This ground applies only if the society has at some time become insolvent but does not depend on a conviction. Once the court has found unfitness in those circumstances, it *must* make a disqualification order of between two and 15 years' duration.[130]

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121 Co-operative and Community Benefit Societies and Credit Unions Act 2010, s 3 commenced by SI 2014/183, art 2.
122 *Secretary of State for Trade and Industry v Davies (No 2)* [1998] 1 WLR 422, 426 CA.
123 CDDA 1986, s 22E(3)(b).
124 On the meaning of this term see *Holland v The Commissioners for Her Majesty's Revenue and Customs and another* [2010] UKSC 51, [39].
125 CDDA 1986, s 22E(4)(e).
126 CDDA 1986, ss 2 and 22E(4)(a).
127 CDDA 1986, ss 3, 5 and 22E(4)(b).
128 CDDA 1986, s 4.
129 CDDA 1986, s 10.
130 CDDA 1986, s 6.

The requirement for disqualification on this ground is that:

- the person is or has been a director of a company or society that has at any time become insolvent by going into liquidation or administration; and
- their conduct as a director of that society or company (either taken alone or taken together with their conduct as director of any other company or companies) makes them unfit to be concerned in the management of a company or society.

The factors to be considered when a decision is being made on unfitness include any breach of directors' duties, including misapplication or retention of society property and a failure to exercise care, skill and diligence discussed in Section **7.4.6.** above. They also include the extent of director's responsibility for any failure by the society to comply with CCBSA 2014 requirements about record-keeping and accounts and for any transaction susceptible to being set aside under the Insolvency Act 1986 as an attempt to avoid debts. Those factors apply in all cases. Additional factors apply when the society has become insolvent and they focus on the extent of the director's responsibility for the cause of that, for any failure to supply goods already paid for, and for any failures to comply with certain requirements under the Insolvency Act 1986.[131]

An extensive case law has developed on disqualification orders and especially on the test for unfitness. As Professor Hannigan has written by way of summary:[132]

> 'The allegations of unfitness typically include that the director caused or permitted the company to trade to the detriment of its creditors; that the company continued trading while insolvent, usually by means of pursuing a policy of only paying those creditors who pressed; and that Crown debts were retained to finance continued trading …. Despite the financial difficulties, the directors continue throughout the period to obtain significant personal benefits by way of remuneration and frequently by misappropriating corporate assets and opportunities.'

Many of those examples have arisen in smaller companies. However, disqualification on the basis of unfitness can result from failures of diligence in a supervisory role in a large organisation. Unfitness can exist without any dishonesty. Indeed, many of the modern cases on the duty of care and skill deal with disqualification decisions.[133]

7.6.2. Effects of disqualification

A disqualification order prohibits the person to whom it applies from being a director or being concerned or taking part in promotion, formation or management of a company or a range of other corporate bodies including an LLP, a co-operative or community benefit society, an incorporated friendly society, a building society or a charitable incorporated organisation.[134] In many cases involving disqualification on grounds of unfitness, a legally binding undertaking to the same effect as a disqualification order is used by agreement between the director and the Disqualification Unit of the Insolvency Service. That cuts costs and reduces the work load of the courts. However, a director can never be compelled to give an undertaking.[135]

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131 Insolvency Act 1986, s 9 and Sch 1.
132 Brenda Hannigan, *Company Law* (OUP, 3rd edn, 2012), p 674.
133 See, for example *Re Barings plc, Secretary of State for Trade and Industry v Baker and Ors* [1998] BCC 583.
134 CDDA 1986, ss 22A–22F and see Limited Liability Partnerships Regulations 2001, SI 2001/1090, reg 4(2).
135 CDDA 1986, s 1A.

A register of disqualified company directors is kept by Companies House, which can be searched online to check the names of potential society directors to ensure that they are not already subject to an order.[136]

7.7. CORPORATE GOVERNANCE BEST PRACTICE: THE CO-OPERATIVES UK CODES

The question of the power of members of a society over the board, the relationship of the board with executive management, the role of the auditors and the information to be provided to members of societies have been the subject of considerable discussion. This topic, which is normally referred to as 'corporate governance', was considered by a working group established by Co-operatives UK's predecessor organisation, the Co operative Union, in 1993. It considered the recommendations addressed to public companies in the Cadbury Report on the Financial Aspects of Corporate Governance published in December 1992 by the Financial Reporting Council and the Stock Exchange.[137] The Co-operative Union Working Group reported in 1994 and a modified version of the Code of Best Practice to be found in the report was approved by the 1995 Co-operative Congress. A further working group considered developments in 2005 and a revised code was published that year, again mainly focused on the needs of consumer co-operatives. The Code was updated in consultation with Co-operatives UK members and published in November 2013. That is the current version of the Code at the time of writing.[138]

The Code explicitly applies only to consumer co-operatives meaning: 'a co-operative owned and controlled by its members, where its members are its customers. With its business focussed on operating traditional co-operative retail outlets in food, travel, funeral care and pharmacy.'[139] The consumer co-operative Code is divided into high level principles applicable to all co-operatives, supporting principles illustrating good governance compliance and provisions on which all co-operatives must report to their members annually. That report must disclose whether or not the society has complied with the provision. If it has not complied the report must set out the background to the situation, provide a clear rationale for the position taken which is specific to the co-operative, indicate whether the deviation from the Code's provisions is limited in time, and state what alternative measures the co-operative is taking to deliver on the principles set out in the Code and mitigate any additional risk.[140] This reflects the 'comply or explain' approach taken by both the consumer co-operative Code and the FRC UK Corporate Governance Code

A separate Co-operatives UK Code applies to worker co-operatives and reflects the smaller size, strong commitment to radical democratic or collective structures, and ethical conduct of those organisations. That Code was first developed in 2006 and was revised in 2012, in each case by the Worker Co-operative Council of Co-operatives UK, and has a very accessible and user friendly format.[141]

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136 Insolvency Act 1986, s 18.

137 Currently, after a number of revisions, Financial Reporting Council, The UK Corporate Governance Code (September 2012).

138 Co-operatives UK, *Corporate Governance Code for Consumer Co-operative Societies* (November 2013) ('CUK Code 2013').

139 CUK Code 2013, p 4.

140 CUK Code 2013, p 5.

141 Co-operatives UK, *The Worker Co-operative Code*, 2011/2012 ('CUK Worker Code') and see text to footnotes 152 and 153 below.

The first high level principle deals with the role of the members: 'Co-operatives are member-owned democratic organisations and the board should promote the growth, development and diversity of their membership and encourage members to actively participate in their governance.'

The supporting principles concern structures and policies to promote increased member involvement, clarity about the value a co-operative generates for its members, the definition of members' rights and responsibilities and their role in both holding the board to account and ensuring adherence to the ICA Statement of Co-operative Identity. Provisions are concerned with maintaining an accurate and up-to-date membership register, maintaining close relations with active members, and monitoring member involvement with the society. The second high level principle underlines board use of the AGM, and any interim meetings, to encourage members to exercise their democratic rights and actively participate. The supporting principles and provisions concern the advertisement and notice of members' meetings, the provision of adequate information to members, and particular provisions about consulting members on acquisitions or disposals amounting to more than 25% of members' funds.[142]

The central principle about the role of the board reads: 'Every co-operative should be headed by an effective board which is accountable to its membership and is collectively responsible for the long-term success of the business in accordance with the International Co-operative Alliance Values and Principles.'

Supporting principles emphasise the board's leadership role on strategic aims, its role in setting the society's values ethos and culture and ensuring that the management executive maintains those values. The board must identify business risks, ensure the risk is managed properly and be assisted by the head of internal audit. A key principle is that the board must ensure that the management executive maintains a sound system of internal control and ensure the integrity of financial information and other critical structural and operational procedures. There must be a formal schedule of matters reserved to the board. The board should meet without executive management present at least once a year. The frequency of board meetings, the way it operates and the division of decision-making functions between the board and executive management should be reported annually to members.[143]

That part of the Code is adapted to the traditional consumer co-operative system under which the board does not include executive managers but is composed wholly or mainly of elected directors who may have little or no business experience. To remedy the difficulty of part-time people with limited business expertise effectively holding the board to account, High level Principle G provides:

> 'To ensure that the board can fulfil its role properly and act to its full potential the board should consider the need to, and the benefits of, co-opting professional external directors to bring appropriate expertise and balance.'[144]

At the time of writing few consumer co-operatives had appointed such outside independent professional non-executive directors. In the aftermath of the demutualisation of the Co-operative Bank in 2013 and the financial problems and level of debt at

[142] CUK Code 2013, pp 6–8.
[143] CUK Code 2013, pp 9–10.
[144] CUK Code 2013, p 13.

the Co-operative Group Limited, it seems that a board composed of a mixture of outside professional non-executive directors, member-nominated directors, and executives might replace the old system. All would be members of the co-operative and, other than the internal executives, subject to a form of election or endorsement by members after vetting by a nomination committee of the board to scrutinise the candidate's level of competence. That would be combined with an elected members' council, which would hold the whole board to account. If that variation on the Myners Report[145] proposals becomes common, the Governance Code will need revision. Alternatively, other societies may draw the lesson that the appointment of some outside professional non-executives would be helpful if the traditional board system is retained.

The Governance Code elaborates on the responsibility of directors for serving the interests and protecting the assets of the members by exercising independent judgement and promoting the success of the society as a co-operative business. The board should be big enough to be representative and small enough to be effective and should act fairly and objectively in the interests of the co-operative and its members.[146] That involves dealing with conflicts of interest, attending sufficient board meetings to carry out their duties, ensuring they are appropriately trained and well informed and reporting to members annually on whether the co-operative is a going concern. No more than 33% of directors should also be employees and the Code provides for the exclusion of members of the management executive from the board.

The role of the chair as leader of the board is emphasised. He or she is responsible for ensuring that the board is in effective control of the society and able to challenge the chief executive when necessary, while acting as the link between chief executive, board and society secretary. The term of office of the chair should be no more than three years and no more than two terms should be served by one person. They must not be an employee and there should be a mechanism in place to remove a poorly performing chair.[147] The whole board is responsible for the appointment and removal of the chief executive and the secretary who should report to the board through the chair to emphasise his or her independence of the executive team and responsibility to the board. The board should develop a CEO succession plan and ensure regular board and board committee renewal, performance evaluation and ongoing training. Notice periods for senior executives should not exceed a year and, if they do, that must be reported to members in the annual report.[148]

The Code envisages that in addition to having all the information it requires the board, directors and board committees should be entitled to seek independent professional advice at the society's expense through the society secretary.[149] That is intended to allow a minority of the board concerned about a proposed decision to ensure that the whole board receives appropriate professional advice on an issue. This might, for example, consist of legal advice, advice on valuations, or a 'second opinion' on some proposed scheme concerning complex property transactions or taxation or other management or policy issues. It is important to emphasise that although a minority of the board can trigger the advice, the advice must not relate to some 'factional' issue.

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[145] Paul Myners, *The Co-operative Group: Report of the Independent Governance Review*, 7 May 2014.
[146] High Level Principles D, E and F, CUK Code 2013, pp 10–13.
[147] High Level Principle H CUK Code 2013, pp 14–15.
[148] High Level Principles I, J, K, L and N CUK Code 2013, pp 15–17 and 19.
[149] High Level Principle M CUK Code 201, p 18.

The Code emphasises the importance of board committees. An audit committee is particularly important. One purpose of that committee is to provide an opportunity for the society's auditors to discuss problems and concerns with the Audit Committee in the absence of management. This core recommendation follows the Governance Code applicable to PLCs with listed shares. The audit committee is the first line of defence and a key element in the control that the board should have over the internal systems and the vital financial information that it needs to carry out its role of monitoring management, assessing strategy and pursuing the interests of the society and its members. It is concerned with risk management internal audit, accounting policies, monitoring and reviewing the objectivity and effectiveness of the external auditor, the society's whistle-blowing policy and itself challenging the management executive.[150] At least one member of the audit committee of the board should have 'recent and relevant financial experience and preferably a professional accountancy qualification'.[151]

The Consumer Co-operative Governance Code seeks to combine some key elements of the UK Corporate Governance Code with an emphasis on co-operative values and identity, member control and the traditional UK consumer co-operative practice of excluding executives form the board. It also borrows from the general corporate governance debates and the FRC UK Corporate Governance Code in its emphasis on holding managers to account through audit and performance assessment.

The Worker Co-operative Code presents an alternative way of working. It identifies three organisational structures found in workers' co-operatives, namely:[152]

- The collective where 'governance, management and operations are not separate spheres. Members are at the same formal level as directors, or they act as if directors, using a flat structure where everyone has an equal say. Some people may take the lead in particular areas or activities, but roles can be changed depending on circumstances.'
- Self-managing work teams with 'semi-autonomous teams running different areas of the business: cafe/shop, sales/designers/printers, warehouse/drivers/buyers etc. These become self-managing, and nominate representatives from their own team to the elected body', which becomes necessary as the organisation grows.
- Hierarchy system: 'Usually this means a general manager or managers are chosen; sometimes elected or specifically recruited/selected by the elected body. They are accountable to the elected body, and have been given authority to manage the organisation. In larger co-operatives there may be multiple levels of management. A phrase used to describe this relationship is "management is not a status, but a process".'

The Worker Co-operative Code then provides a checklist of how a workers' co-operative should measure its structure and practices against the seven ICA Principles with specific indications of the implications of each principle.[153]

Voluntary and open membership means most employees should be members and most members should be employees and they should have clear and meaningful information and a members' agreement or job description.

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[150] See Section **9.2.3.** below and CUK Code 2013, pp 22–5.
[151] CUK Code 2013, p 22.
[152] CUK Worker Code, p 3.
[153] Ibid pp 5–8.

The Principle of Democratic Member Control is dealt with thus:

> 'Co-operatives are democratic organisations controlled by their members, setting policies and making decisions. Members serving as elected representatives are accountable to the wider membership. Worker co-operatives succeed when all members participate in transparent, fair decision making; but also where members are given delegated authority to act on behalf of the collective.
>
> Your co-operative should:
> 1 Ensure all members actively participate in the management of the business and long-term planning.
> 2 Effectively communicate, both between the co-operative and its members and between members themselves.
> 3 Collectively agree and delegate authority to individual members to act on behalf of the co-operative as and where necessary.
> 4 Ensure there are democratic processes, or democratic accountability, in all governance and management functions.
> 5 Regularly review its governance and business management processes as it grows and develops.'

Member economic participation includes the existence and development of collectively owned reserves, fair and equitable surplus distribution and planned and agreed member pay and benefits is combined with an emphasis on ensuring that members can invest in their co-operative.

Interestingly, it is under the principle of independence and autonomy that good financial controls and risk management, measuring both business and co-operative performance and building business capacity are listed.

Networking, trading and collaborating with other co-operatives while competing fairly and honestly with them are seen as the essentials of co-operation among co-operatives.

Concern for community is reflected in the control of environmental and social impacts of the business, living up to ethical business standards, including, health and safety and worker welfare, while prioritising ethical and sustainable initiatives and participating in the local communities.

The contrast between the two Codes reflects the different size, history and ethos of those two parts of the UK co-operative movement.

7.8. THE MODEL RULES

7.8.1. Consumer Co-operatives – Co-operatives UK 12th Edition Model Rules

The CUK consumer society model rules leave the question of the number of directors and the method of appointment to the special rules used by societies in conjunction with the general model rules.[154] The usual method of election of directors in this sector has been by secret ballot of the members over a period of days when voting takes place at the society's stores. That has now developed into postal and digital voting systems in

[154] CUK Consumer Model Rule 10.

many societies. Election is for a three-year term.[155] A power to co-opt up to two professional external directors in addition to the elected board is included.[156] Depending on the size of the society, there may be one board elected directly by the members or a structure of district or regional boards which are elected by members and in turn elect a central board. The districts or regions served by the board may coincide with the former areas of operation of separate societies that merged to form the society in question. Under the Model Rules the board may fill any casual vacancies by appointing the highest polling unsuccessful candidate in the last elections or they may hold an election to fill the post.[157]

No more than one-third of the board can be current employees but up to half can be current employees, former employees within the last three years with a pension or the spouses or partners of anyone in those categories.[158] Employees and professional external directors may not chair the board.[159] The limit on the number of directors who may be employees only occurs in the Model Rules for consumer co-operatives. The issue has arisen most acutely in this sector. It is felt that there is a danger that a majority of directors who are employees will prevent the effective control of the society by its consumer members. If the employees concerned were managers, their accountability to members would be reduced. If they were less senior, they might be influenced by management. For this reason the FCA, in approving new rules or amendments to rules, will not generally accept a rule permitting a number of employees on the board which allows that group a possible majority – taking account of the quorum for board meetings. Thus if the quorum for board meetings is five only up to two directors who are employees may be allowed. This principle has been worked out in the context of consumer co-operatives. However, it could be applied to any society other than a worker co-operative.

The removal of directors under the Model Rules is by two-thirds majority at a special general meeting of the society, which may be preceded by suspension by a decision of the board on the grounds that the director was guilty of conduct detrimental to the interests of the society.[160] These rules disqualify non-members, members without share capital for two years before nomination in the society or a different society that transferred its engagements to the society, bankrupts and the mentally incapable from holding office. Anyone interested in a contract with the society except as a member or employee of a company that makes such a contract is also disqualified.[161]

The Board has power to fix procedure at board meetings but, except in an emergency, seven days' notice of a meeting must be given to directors.[162] The board quorum is half of the directors.[163] Telephone, 'computer' and video-link participation is allowed and is deemed to constitute presence in person.[164] A quarter of directors can give 14 days'

[155] Rule 10.5.
[156] Rule 10.4.
[157] Rule 10.6.
[158] Rules 10.2 and 10.3.
[159] Rule 10.15.
[160] Rule 10.8.
[161] Rule 10.16.
[162] Rule 10.17.
[163] Rule 10.18.
[164] Rule 10.20.

notice to the secretary to call a special board meeting.[165] The chief executive must attend unless asked not to and the board may invite other executives to attend.[166]

A director's 'material interest' in any matter must be declared to the board and recorded by the secretary in a register of interests. The director must not be present when the matter is discussed or vote on it and failure to disclose can lead to removal from the board by majority vote of the other directors.[167]

These rules uphold the validity of the board's acts despite defects in the appointment of directors and empower the society to fix the remuneration of directors. They also indemnify directors and executives for any civil or criminal liability arising out of or in connection with the exercise of their duties on behalf of the society and authorise the society to buy insurance to cover itself and its directors and officers against liability for negligence breach of duty or default.[168] This reflects the usual position in the case of company directors and weakens the deterrent effect of any liability for breach of duty other than fraud or criminal offences, including those under CCBSA 2014.

The rules confer extensive powers on the board, emphasising its right to remove and appoint the chief executive and decide the composition of the management executive as well as exercising all the powers of the society not allocated to the general meeting, overseeing the work of the executive and deciding which matters must be decided by the board and not the executives.[169] The function and independence of the society secretary includes their role in ensuring information flows to the board and members, filing necessary returns and documents with the FCA, and ensuring compliance with the rules. The responsibility for day-to-day running of the society is clearly allocated to the chief executive and the management executive rather than the board.[170]

7.8.2. Worker co-operatives: Co-operatives UK Worker Co-operative Model Rules

The minimum number of directors is three and they must all be at least 18 years old.[171] These Model Rules then offer two alternatives for users. One is to operate as a collective on the basis that all members are directors and anyone ceasing to be a director also ceases to be a member.[172] The remaining rules about directors then apply to all members and they are all subject to the directors' duties discussed above. That makes the collective route appropriate only when all members can realistically devote the time and effort needed to operate the society and exercise directors' powers. That is the legal aspect of the practical difficulties of operating as a collective once a certain size threshold is reached.

The other option involves the election of a board by and from the members with the general meeting fixing the number of directors. At the first AGM after registration all the directors appointed by the founder members at registration step down and a new

[165] Rule 10.23.
[166] Rule 10.19.
[167] Rules 10.24–10.26.
[168] Rules 10.30–10.35.
[169] Rule 8.3–8.4.
[170] Rules 8.5–8.7.
[171] CUK Worker Model Rules 68 and 70.
[172] Rule 74.

board is elected. After that one-third of the board is elected every year but there is power for the board to co-opt a co-operative member to serve until the next AGM if a vacancy arises.[173]

The remaining rules dealing with the board apply to both options but in the case of the collective option they apply to all members as directors.

Society officers are chosen by the board from among their own number and have duties and rights given to them by the board.[174]

Removal as director without cause is possible by a simple majority vote at a general meeting for which the notice specifies that the question will be considered.[175] However, since the effect, under these rules, of a removal from the board in a collective is expulsion from the society, an extraordinary resolution with a 75% majority is needed in that case.[176] Automatic exclusion from the board follows from ceasing to be a member, written resignation, disqualification by law (usually under CDDA 1986), bankruptcy, or medical incapacity due to mental health issues.[177] In the case of all worker co-operatives removal from the board will have implications for the employment rights of the person involved. Where the collective model is used, removal from the board may amount to dismissal as an employee as membership will end with removal from the board and the co-operative may well only employ its members. That raises issues about compensation for unfair dismissal or redundancy and other employment rights, including non-discrimination on gender, sexual orientation, ethnicity or other grounds. Even where the collective model is not used the change from being a director to being a member may result in constructive dismissal if it represents a substantial change of role.

The directors are given wide powers to manage the business of the society and use all its powers as well as the right to delegate to sub-committees or officers.[178] However, that is subject to the need for member approval by extraordinary resolution (needing 75% of votes cast) at a general meeting of any transaction disposing of assets worth one-third of the total value of the last balance sheet.[179]

The basic rules for proceedings at board meetings are outlined in the society's rules and can be elaborated in bye-laws made either by the board or the general meeting. They include a right for any director to call a meeting, a quorum of the higher of half the board or three directors. The terms of members' employment contracts is excluded from the category of declarable interests on which directors may not vote but, it seems, may speak.[180]

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[173] Rules 71–73.
[174] Rule 100.
[175] Rule 99(c).
[176] Rule 65(a)(i).
[177] Rule 99 (a), (b) and (d)–(g).
[178] Rules 76–80.
[179] Rule 81.
[180] Rules 88–98 and 102.

7.8.3. Society for the benefit of the community – sponsored by Co-operatives UK

Under the Co-operatives UK Society for the Benefit of the Community Model Rules, the board consists of at least three directors, one-third of whom are elected annually by the members under one option. Under the other option, a range of directors can be appointed by an outside body, be on the board ex officio or be members co-opted by the board for their skills or experience.[181] No employee or person under 18 may be a board member. Removal of a board member is possible by a simple majority at a general meeting notice, which must specify that this question is to be considered. The board is given wide powers to manage the business of the society and the right to delegate to sub-committees. The basic rules for proceedings at board meetings are outlined in these Model Rules, which are not dissimilar to the workers' co-operative model.

7.8.4. National Housing Federation – Model Rules 2011 (version 2)

Societies using the model rules of the National Housing Federation (an umbrella body that represents non-profit housing associations) will have a board elected by ballot at annual general meetings and retiring one-third at a time after the first annual general meeting. The committee has a power of co-option that extends to non-members but there is a limit on the number of co-opted members and such members are not permitted to vote on matters 'directly affecting membership of the association or the election of officers'. Committee members are removable by a resolution passed by a two-thirds majority at a special general meeting and a replacement can be elected at the same meeting.[182] Absence from four consecutive meetings, bankruptcy, compounding with creditors and conviction of an indictable offence all result in the vacation of office.[183]

NHF rules also deal with the issue of committee members with an interest conflicting with that of the society. Their provisions are very full and list many transactions, for example by tenants, that are excluded from the conflict rules, while dealing thoroughly with the procedures to be followed in respect of conflicts that do arise.[184]

The board appoints the secretary, the chairman and any other officers that it considers necessary.[185] The chair has a casting vote. The board is to meet at least three times each year on seven days' notice being given by the secretary.

7.8.5. Agricultural Co-operative (IPS) – Agency Model Rules sponsored by Co-operatives UK & Scottish Agricultural Organisation Society

The SAOS and CUK Agricultural Agency Model Rules resemble the Workers Co-operative Rules apart from the absence of a collective option and certain provisions tailored to the needs of agricultural co-operatives. The minimum number of directors is three, they must all be at least 18 years old, there are three-year terms for the board, the

[181] CUK Bencom Model Rules 53–54.
[182] NHF Version 2 Model, Rule D9.
[183] Rule D8.
[184] D17–D27.
[185] Rules E1–E11.

board can co-opt people and the board's powers are formulated in the same way as in the Workers Co-operative Rules, including the power to delegate and establish board committees.[186]

One difference, which reflects the nature of agricultural co-operatives, is that executives are expected to serve on the board whether or not they are members and the board may include co-opted employee or external independent directors who need not be members and are selected for their particular skills or experience to serve a fixed period determined subject to a review every 12 months. External independent directors must never comprise a majority of the board.[187]

Similarly, the grounds for removal from the board reflect the circumstances of agricultural co-operatives. These rules add to the grounds found in the Worker Co-operative Model Rules provisions to deal with directors who represent member organisations. They lose office when they lose the endorsement of the organisation, when that organisation's membership ceases, it no longer exists or has not traded with the society for a year or has broken or terminated its member's agreement. Direct members must leave the board if they cease to trade for a year or are in breach of, or terminate, their members' agreement. In addition, directors lose office if, in the opinion of the other directors, recorded by board resolution, they trade in competition with the co-operative as a sole trader or in partnership. A director who becomes a controller, agent, or employee of any competitor organisation is also removed from the board.[188]

7.8.6. Social Clubs – Model Rules for a Working Men's Club – sponsored by Clubs and Institutes Union

The CIU model rules provide for a president, vice-president, treasurer, secretary and assistant secretary. The secretary remains in office during 'the pleasure of the club'. The others are elected annually. In each case this is done by ballot and officers are removable by a two-thirds majority of members voting at a special general meeting called for the purpose. The committee has power to fill casual vacancies.[189] The duties and functions of the officers are set out with some precision in these Model Rules. The committee members are also elected by ballot and removable by two-thirds majority at a special general meeting called for the purpose.[190] Loss of membership or suspension from membership of the club causes a committee member to cease to hold office, as does failure to attend three consecutive committee meetings.[191] Otherwise the committee retires in two parts to face re-election. The ballot is conducted by scrutineers under the supervision of the committee and takes place in one of the two weeks following the annual general meeting. The CIU rules lay down a sophisticated system of balloting on the basis of one member one vote per vacancy.[192]

The powers of the managing committee are set out and the persuasive nature of a resolution of the general meeting and the committee's right to the final decision is acknowledged.[193] One-third of the committee members are required for a quorate

[186] CUK/SOAS Agency Model Rule 54–70 and 73–75.
[187] Rules 59, 71 and 72.
[188] Rule 87.
[189] CIU Model Rule 17(2).
[190] Rule 20.
[191] Rule 17(2).
[192] Rule 31(4).
[193] Rule 17.

meeting and weekly meetings are required. In addition, a finance sub-committee is to be set up with detailed functions as set out in that rule to stock take, and to check books and documents such as invoices, delivery notes and stock vouchers. The rules specifically limit the powers of individual officers and committee members by denying them power to order goods or expend funds. That power is conferred on the finance sub-committee.[194] This will place a person who purports to exercise such authority in breach of duty to the club.

Since the rules make no express provision dealing with conflicts of interest between committee members or officers of a club and the club itself, in any situation in which such a person was interested in a contract or transaction involving the club the general law would apply.

[194] Rule 18.

CHAPTER 8

CAPITAL AND SURPLUS DISTRIBUTION

8.1. NATURE OF CAPITAL

The word 'capital' can have a number of different meanings in legal and financial terms. In the context of co-operative and community benefit societies it concerns long-term funding. Broadly, this can be supplied by members or by lenders. Members may supply capital directly in the form of the share capital they hold in the society. Equally, reserves built up by retaining trading profits are created by decisions of members or the board to plough back funds rather than distributing them or, for community benefit societies, expending them in fulfilling the objects. Loan capital is supplied by long-term funders and the term does not include the amount due to trade creditors in the short term.

In the case of co-operatives, the ICA Co-operative Principles require that capital should receive a strictly limited reward and the rules usually set limits to the return provided to both loan capital and share capital. In the case of shares any distribution to members, beyond interest at a modest rate on their share capital, must be in the form of a dividend on their transactions with the society. This is a key difference between co-operatives and private sector companies.

In the case of community benefit societies, at the time of writing (May 2014), the FCA Note on the Mutual Societies Application Form (p 9) indicates that the rate of interest to be payable on both share capital and loan capital should not, under the rules of any society, exceed a reasonable rate necessary to obtain and retain enough capital to run the business. The note also states that the society's rules must not permit either the profits or the society's assets to be distributed to the members. More up-to-date guidance will be available on the FCA website later in 2014. Community benefit societies may also include 'asset-lock' provisions in their rules.[1]

Where interest is to be paid on shares, typical rules often include a maximum rate of return and a mechanism to set the rate within that limit. The mechanism may include setting the rate to be paid after the end of the trading year so as to ensure that it does not cause financial issues for the society, but for a charitable society this would not meet the Charity Commission's requirements.

The Charity Commission has issued guidance on the payment of interest on share capital by charitable community benefit societies. The Commission's position is that a power of

[1] See Section **1.3.3.** and **12.7.1.** (below) for more details.

a community benefit society to pay interest on shares is not incompatible with charitable status, provided the following features[2] are required by the society's rules:

> '1. The interest rate is set at a level which is not in itself a motivation to buy shares and which the charity trustees can justify as being in the interests of the charity by reference to available commercial rates for borrowing.
>
> 2. The cost is part of the society's revenue expenses and is met before the surplus is determined.
>
> 3. The rates are declared in advance of the period for which they will become payable, just as for a bank or building society account, and never retrospectively.
>
> 4. There is a power to suspend interest payments in the interests of the society.
>
> 5. There is a power of the society to withhold repayment of the shares, either temporarily or indefinitely and to write the value down below the nominal £1.
>
> 6. The shareholding does not confer any rights to the underlying assets of the society.
>
> 7. In the event of a solvent dissolution, shareholders cannot be paid more than the nominal value of their shares.'

Section 2(3) of the Co-operative and Community Benefit Societies Act 2014 (CCBSA 2014) states that the expression 'co-operative society' in the Act does not include a society that carries on or intends to carry on business with the object of making profits mainly for the payment of interest, dividends or bonuses on money invested in, or deposited with or lent to the society or any other person. Since such an object would not fall within the alternative basis for registration in s 2(2)(a)(ii) of CCBSA 2014 as being for the benefit of the community, this precludes the registration of societies that would operate as investment trusts or unit trusts.

Notwithstanding the flexibility available, many community benefit societies and co-operative societies will use share capital as a token of membership and will only allow members to hold a single share of small value.

8.2. SHARE CAPITAL

One of the advantages of a society in respect of share capital is that it is free from some of the restrictions that apply to the shares in companies. There is no restriction in the Act on reductions of share capital or on a society buying back its own shares if they are issued as withdrawable shares in accordance with its rules. It is also possible (where a society's rules permit) for the value of share capital to be reduced. This means that the total share capital of a society can fluctuate in a manner that is not possible in the case of a company without the use of lengthy procedures prescribed in detail in the Companies Act 2006.

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[2] See Charity Commission Statement in CC23 on Exempt Charities at http://www.charitycommission.gov.uk/detailed-guidance/registering-a-charity/exempt-charities-cc23/industrial-and-provident-societies/.

8.2.1. Types of share

CCBSA 2014 does not lay down definitions of different classes of share. However, it does not prohibit the use of shares of different classes by one society and it contemplates the existence of shares which are transferable or non-transferable and withdrawable or non-withdrawable.[3]

The use of shares of different classes by a society must not threaten the principles which should govern societies. For instance, subject to the important caveats relating to investor shares (see below), assigning differential voting rights to classes of shares (as opposed to membership) would contravene the principle of one person one vote and the provision of a dividend payable by reference to the value of a shareholding would contravene the principles applicable to surplus distribution and the return to capital. For a community benefit society the voting provisions can in principle be more relaxed, but FCA practice has tended to apply similar principles to those for co-operatives and although differential voting may be used to reflect particular stakeholder interests these would not be related to the number of shares held. Any such voting provisions must also be compatible with certain statutory provisions such as those relating to transfers of engagements or amalgamations.[4]

As long as those principles are not violated, a society could offer, for example, different levels of preference for the repayment of capital on dissolution or the payment of interest. Such different rights could be combined with different terms as to the withdrawability or transferability of shares of each class. Even different levels of interest payable to different classes of share, perhaps depending on the level of priority for payment of interest or repayment of capital, should be permissible providing that the maximum level of interest payable for any class of share meets FCA requirements. Membership could be given on the basis of holding any share regardless of its class. A member's total holding of withdrawable shares would need to be monitored to ensure that it stayed within the statutory maximum, currently £100,000.

In practice, societies have rarely offered different classes of share, but since 2006 co-operatives have been able to take advantage of the Financial Services Authority's policy statement in relation to investor shares and, where they have done so, they will have had different categories.[5]

8.2.1.1. Withdrawable shares

One of the main advantages of using a society instead of a company is the availability of withdrawable share capital without significant regulation. They are often called 'community shares'. For the society there are benefits in having this relatively simple means of raising capital. For the members there is an ability to effectively 'sell' the shares back to the society rather than having to find a willing purchaser of what would be an unlisted and illiquid asset.

Societies that wish to use shares only as a token of membership and not as a source of capital will state in their rules that their shares are not withdrawable.

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3 CCBSA 2014, s 14(9).
4 See Section **12.3**. below.
5 See Section **8.2.4.3**. below.

The rules of societies must state whether shares are withdrawable and, if they are, how this is to be done and how payment of any balance is to be made to members.[6] Notice may be required for withdrawal and rules may provide for the suspension of rights of withdrawal or their limitation to certain proportions of the society's share capital or of a member's total holding to deal with the possibility of a 'run' on the society.

In order to be treated as capital rather than as a liability in the accounts of the society there must be clear unconditional right to refuse withdrawal stated in the rules of the society.[7] Such powers are typical in the model rules for societies that are intended to raise equity finance in this way.[8]

No society with a withdrawable share capital may be registered for or engage in the business of banking.[9] Exceptions exist for small savings schemes.[10] Deposits of up to £400 in any one payment of a total of up to £400 by any one depositor may be accepted under such schemes so long as they are payable on not less than two days' clear notice. While such a payment to depositors is due and unsatisfied no payment of withdrawable share capital can be made so if a depositor has asked for payment and has not been paid after giving the necessary notice, no share capital can be withdrawn by any member.

The Financial Services and Markets Act 2000 (FSMA 2000) regulates banking or deposit taking and other investment-related activities. In principle, accepting capital on a withdrawable (ie repayable) basis is deposit-aking, but one of the key advantages of withdrawable shares in registered societies is the fact that there is an exemption from the key parts of the FSMA 2000 regime.[11]

As risk-takers and owners of the business, shareholders, in principle, lose their investment if the society becomes insolvent. As part of the price to pay for the relaxed regulatory regime there is no recourse to the Financial Ombudsman Scheme nor to the Financial Services Compensation Scheme for shareholders in registered societies.

While the issuing of withdrawable shares is not regulated in the same way as other share issues, that does not mean that it is entirely uncontrolled or without risk for the issuing society. In particular, societies considering the issue of such shares need to be aware that the rules, the terms of any prospectus and other material relating to an offer will (taken together) create legal responsibilities to the shareholder-members and that any misleading statements are likely to be a breach of the Misrepresentation Act 1967. Where the terms of an offer are ambiguous or vague and there is a dispute, there is a risk that a court may interpret them in favour of the shareholder-members and against the society, possibly to the detriment of the other members. A society must address all these risks. The society cannot simply rely on statements that a shareholder should seek independent advice.

Co-operatives UK and Locality formed the Community Shares Unit with the support of the Department for Communities and Local Government in order to develop standards of good practice, encourage policy reforms and raise awareness to support the growth of

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6 CCBSA 2014, s 14(9).

7 UIT Factsheet 39, Members' shares in co-operative entities and similar instruments, interpreting relevant provisions of Financial Reporting Standard 25.

8 See Section **8.9.** below.

9 CCBSA 2014, s 67(1).

10 CCBSA 2014, s 67(2).

11 See Section **8.7.** below.

community share holding. In particular, the Unit has produced a range of useful guidance including a Handbook for organisations considering the issue of withdrawable shares. The Handbook is accessible on the Unit's website.[12]

To help address some of the risks identified above, the *Community Shares Handbook* includes guidance on some minimum statements to be included in any such documentation as well as sources of other materials that can be helpful such as the money advice notes on withdrawable shares.

This guidance recommends inclusion of the following information in all offers (unless not relevant in the particular case) with some additional information for particular types of offer.[13]

> '**Financial risk**: All community shares offer documents should make it absolutely clear that anyone buying community shares could lose some or all of the money they invest, without the protection of the government's Financial Services Compensation Scheme, and without recourse to the Financial Ombudsman Service. This warning should be prominently positioned in all offer documents and expressed in plain English.
>
> **Share capital**: The nature of share capital should be explained, and the full terms and conditions that apply to shares should be provided. If withdrawable share capital is being offered, applicants need to know that the only way of getting their money back is by selling shares back to the society, that notice has to be given of the intention to withdraw share capital, that directors may have the right to refuse requests for withdrawal, and any other restrictions or conditions that have been placed on withdrawal. It should be made clear that shares do not change in value, unless the rules provide for a reduction in share values, in which case the details of such provision should be made clear. If the share capital being offered is non-withdrawable, the scope, if any, for selling or transferring the shares should be explained.
>
> **Democratic rights**: The society convention of one-member-one-vote should be explained, and contrasted with the company convention of one-share-one-vote.
>
> **Investment limits**: The upper and lower investment limits should be stated, and the reasons for these limits should be explained.
>
> **Restrictions on financial returns**: The society's rules on financial returns to members, whether as interest on share capital or dividends on transactions should be explained, as should its policy or practices for setting its annual interest and/or dividend rate. Reference should also be made to the FCA's policies restricting financial returns to society members and the requirement that such returns depend on the profitable operation of the business.
>
> **Eligibility for membership**: The offer document should make it clear who is eligible to become a member of the society and invest in share capital. It should clearly set out any criteria or restrictions expressed in the rules in the society, including minimum age requirements, geographic location, or transactional relationship with the society.
>
> Some societies may also need to include information about the following matters, where these matters are relevant to the offer:
>
> **Money laundering**: Societies issuing withdrawable share capital are exempt from money laundering regulations; there is no legal obligation on societies to carry out identity checks on

[12] www.communityshares.org.uk.

[13] Community Shares Unit, The Community Shares Handbook, Section 5.

applicants. However some societies have adopted the Co-operatives UK Code of Practice in this area, to reduce the risk of money laundering. Where this is the case, such practices should be outlined in the offer document.

Conflicts of interest: Conflicts of interest can arise in some share offers, particularly those made by new societies where the founders, directors or promoters have a financial interest in the outcome of the offer.'

8.2.1.2. Transferable shares

The rules of a society must specify whether its shares are transferable and, if they are, to provide for the form of transfer and registration of the shares and the consent of the committee to transfers.[14] The Act does not lay down in detail the form a transfer document or register of shares is to take. Most societies do not use transferable shares and such shares are subject to the requirement to issue a prospectus unless they meet one of the other exemptions in the legislation.[15]

A society can impose any reasonable restrictions on the transfer of shares that it regards as necessary to prevent losses due to forgery. It can also charge 5p per £100 on transfers to provide compensation for such loss and can borrow on security to meet claims.[16]

8.2.1.3. Investor shares in co-operatives

Prior to 2006 the Financial Services Authority (**FSA**) prohibited a co-operative from having 'investor' members as opposed to participants in the business such as users or workers.

In 2006 the FSA published a policy note revising this policy called 'Investor Membership of Co-operatives Registered under the Industrial & Provident Societies Act, 1965' and drafted by Michael Cook and Ramona Taylor.[17]

The revised policy was that the FSA would permit investor membership where certain conditions were met. This remains FCA policy. The key conditions are:

'(a) We will wish to be satisfied that a society inviting investors into membership has protections in its rules which ensure that the participation of investors will not prejudice its standing as a bona fide co-operative society; the rules of a society must expressly provide for investor membership and set out the rights and conditions attaching to the shares, including the restriction on voting on a resolution to convert to company status;

(b) Shares issued to investors should be known as 'Investor Shares'. Investor Shares may be acquired by both natural and legal persons, subject to [any] statutory limit on the total interest a person, other than another [co-operative or community benefit society], may hold in the shares of a society registered under the Act; a user members should not be permitted to hold Investor Shares;

(c) The voting rights of holders of Investor Shares may be restricted as the rules of a society direct, and may include a power to elect one or more Investor Shareholder representatives to the committee; however, we would not register rules which would

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14 CCBSA 2014, s 14(9).

15 Financial Services and Markets Act 2000 (FSMA), ss 85, 86 and 102A-103 and Sch 11A and see Section **8.7.** below.

16 Forged Transfers Act 1891, ss 1 and 3.

17 Available from https://drive.google.com/file/d/0B3k1mIyJumBSTXRCN1RMOXIyaXc/edit?usp=sharing.

permit the holders of Investor Shares to vote on a motion to convert the co-operative to company status, as such a power could compromise a society's status as a bona fide co-operative;

(d) Investor Shares may be withdrawable or transferable; where transferable, the issuing society should take legal advice as to whether the issue falls within Part VI of the Financial Services and Markets Act 2000 ('FSMA');

(e) Investor Shares should only be issued as 'risk capital';

(f) The holders of Investor Shares may participate in the distribution of surplus as the society's rules direct; and

(g) Co-operatives should not issue Investor Shares without first discussing the risks and consequences with their legal advisors.'

8.2.2. Maximum limit on shareholding

Societies are required to lay down a maximum limit in their rules.[18] There is no statutory maximum for non-withdrawable shares. Societies that wish to use share capital as a token of membership may lay down a very low maximum, eg £1. If the statutory maximum is to be applied the current figure may be given, in which case the rules will require amendment if it is changed by statutory instrument subject to mechanisms in the amendment that may permit the committee to adopt the new limit as an interim measure (a procedure permitted by s 22 of CCBSA 2014). Alternatively, the maximum limit may be stated in the rules to be that laid down by statute in which case it will be the amount fixed in that way and will vary automatically with any changes to CCBSA 2014.

In general, no member of a society is permitted to have a holding of withdrawable shares in excess of £100,000.[19]

There are some exceptions to the maximum limit imposed by s 24. It does not apply to:

- A member who is a registered society.[20] This does not extend to other corporate bodies such as companies.
- A local authority that acquired its holding by virtue of s 58 or s 59(2) of the Housing Associations Act 1985 or s 22 of the Housing Act 1996.[21] Those sections empower local authorities to assist housing associations by subscribing for their share capital.
- If the society is a private registered provider of social housing, shares acquired by a local authority under the general well-being power in s 2 of the Local Government Act 2000 or the general power of competence in s 1 of the Localism Act 2011.[22]
- Any remaining member who acquired the holding under a provision of the Agricultural Credits Act 1923, which was repealed by the Statute Law Revision Act 1950.[23]

8.2.3. Joint shareholdings

Since s 24 of CCBSA 2014 prevents a member from having any 'claim or interest' in a society's shares in excess of £100,000, the whole of any amount in a joint account must

[18] CCBSA 2014, s 14(7).
[19] CCBSA 2014, s 24.
[20] CCBSA 2014, s 24(2)(a).
[21] CCBSA 2014, s 24(2)(b).
[22] CCBSA 2014, s 24(2)(c).
[23] CCBSA 2014, s 24(2)(d).

be attributed to each of its holders for the purpose of calculating the maximum. This means that in addition to the £100,000 limit on the amount invested in the joint share account, the whole amount held in that account must be added to the amount held by any of the joint holders in any other account they have to decide whether any of them have reached the maximum permitted holding. This also applies where an account is held by a member on trust for an unincorporated association or an unregistered general partnership and another is held by the same member in his or her own right; the maximum applies to the aggregate amount in all the accounts in which a person has a 'claim or interest'.

8.2.4. Minimum limit

The rules of societies will usually lay down a minimum level of shareholding required as a condition of membership. The rules may allow for the payment of instalments for the purchase of one share if that is the minimum laid down. Membership status will only be achieved under the rules of most societies when at least one fully paid share is held. If shares are partly paid, members holding them will be liable to pay the difference between the amount paid and the nominal value of the shares in the case of the winding up of the society.

A change in the rules of a society to increase the minimum shareholding required of members or otherwise to increase the liability of members to contribute to the society's share or loan capital does not bind existing members unless they agree to it in writing. Such a change does bind members who join after the amendment is made.[24]

8.2.5. Forfeiture or cancellation of shares

The Act makes no reference to the forfeiture of shares or their cancellation by the society. The rules of societies may make such provisions. If the shares are used as a form of membership fee, forfeiture and cancellation may occur when a member leaves the society. If shares are used as a source of capital and payment of instalments is allowed, arrears in payments on the shares may lead to forfeiture so that the shares become the property of the society and can be cancelled.

8.2.6. Lien over shares and set off

A lien is the right to hold another person's property until a debt is paid. Section 35(2) of CCBSA 2014 grants a lien to a society over the shares of a member for any debt due to the society from that member. In addition, it allows the society to set off any amount due to the member on those shares against such a debt. Accordingly, the member's shareholding can be used to cancel all or part of the member's debt to the society and the amount of the debt is deducted from the amount due to the member on the shares. This is the basis on which s 11A of the Credit Unions Act 1979 allows a loan by a credit union made when the member holds fully paid share capital in the credit union to the value or more than the value of the loan to be secured if the parties agree.[25]

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[24] CCBSA 2014, s 15(2).

[25] See Section **13.7.3.** below.

If the member has paid only part of the price of the shares that he or she holds and that amount is set off against the debt, the member will still be liable to pay the balance due on the shares.[26]

A society can use its right of set off even if it is in financial difficulty so long as it does so in good faith while it is still carrying on its business.[27]

8.3. INDIVIDUAL SHAREHOLDERS

8.3.1. Third party debt orders

In order to meet the accounting tests to be treated as share capital and to protect the society, a member's ability to withdraw shares will be subject to conditions, such as the service of notice, overall caps on the amount to be withdrawn and circumstances in which withdrawal can be refused. However, societies should be aware that there is a risk that a creditor of the member might not be bound by those conditions in the same manner and may be able to obtain a third party debt order in relation to the share account.

In some circumstances a judgment creditor can obtain a court order that a debtor of the judgment debtor pay to the judgment creditor the amount that the judgment debtor owes or the amount owed by the debtor to the judgment debtor if that is less. In other words, if A is owed money by B under a judgment and B is owed money by C, A may obtain a court order that C pay A. This is a third party debt order.

Under the case law rules a member's withdrawable share capital is not a debt due from the society to the member because of the conditions referred to above that need to be satisfied before the member is entitled to claim the amount in his or her share account. On this basis no third party debt order would be possible against the share account.

However, under s 40(1), (2) and (3) of the Senior Courts Act 1981 (and the equivalent provisions in s 108 of the County Court Act 1984) a debt is attachable if it takes the form of a sum standing to the credit of a person in 'any withdrawable share account, with a deposit-taker' and any condition that a person gives notice before the withdrawal, applies in person, or produces a share account book are to be ignored in deciding whether the particular sum is attachable. Section 40(3) also empowers the Lord Chancellor to add to those listed in the subsection new conditions to be disregarded. Section 40(4) permits him to make specific orders including within s 40 or excluding from it particular types of account or excluding from it accounts with a particular deposit-taker or type of deposit-taker. No such order has been made in respect of co-operative and community benefit societies. This means that the conditions laid down by or under a society's rules about the withdrawal of share capital do not prevent the amount standing to the member's credit in the account from being subject to a third party debt order.

By s 40(6) 'deposit-taker' means a person who may in the course of his business lawfully accept deposits in the UK and s 40(7) indicates that this must be read with s 22 of FSMA 2000, any orders made under it, and Sch 2 of that Act. Section 22 and para 4 of Sch 2

[26] *Lloyd v Francis* [1937] 4 All ER 489 at 491.
[27] *Re Gwawr-y-Gweith yr Industrial and Provident Society Ltd, Dovey v Morgan* [1901] 2 KB 477.

provide that 'accepting deposits' is a regulated activity and art 5 of the FSMA 2000 (Regulated Activities) Order 2001, SI 2001/544 defines that activity in a way which would include the acceptance of withdrawable share capital by societies – it includes money paid on terms that it will be repaid on demand or in agreed circumstances and used by the recipient either to lend to others or to finance to a material extent any of its other activities. It is submitted that the regulatory exemption in arts 4 and Sch 1, para 24 of the FSMA 2000 (Exemption) Order 2001, SI 2001/1201 does not exclude such share accounts from s 40 of the Senior Courts Act 1981 because societies are persons who may lawfully accept deposits in the course of their business in the UK if they do so using withdrawable shares. As a result, as deposit-takers operating withdrawable share accounts, societies can have third party debt orders under Part 72 of the Civil Procedure Rules 1998 made against them in respect of a member's share account. This applies to credit unions and to all other registered societies.

8.3.2. Forgeries

Unless its rules provide otherwise, the society must pay money due to a member who withdraws his or her shares only to the member or as authorised or instructed by the member. If the society is deceived by a forgery the society will have to restore the amount due to the member. Case law relating to forged cheques and similar forgeries indicates that there is no obligation in either contract or tort on a member who is unaware of a forgery to take precautions to prevent the presentation of a slip or passbook on which the signature is forged.[28]

However, if a member connives at a forgery he or she will have no remedy against the society and if the member learns of the forgery and does not claim against the society until it is too late for the society to proceed against the forger, the society will not be liable to the member.[29]

A society may be protected if it has a rule which allows it to pay out on an application apparently made by the member and accompanied by a passbook so long as the rule is drawn to the attention of members.

8.3.3. Limited liability

Sections 3 and 124 of CCBSA 2014 protect members by providing that they will only be liable to contribute to the society's debts if it becomes insolvent to the extent that there are any amounts outstanding to be paid on their shares. If all the shares held by a member are fully paid there will be no liability. This is a real protection for members.

As with any business, banks and others may have sufficient economic power to make all members agree to guarantee the society's debts personally and where they do so such a guarantee sits outside the statutory framework and limitation of liability.

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[28] *Tai Hing Cotton Mill Ltd v Liu Chong Hing Bank Ltd* [1985] 2 All ER 947.

[29] *Greenwood v Martins Bank* [1933] AC 51 and *Patel v Standard Chartered Bank* [2001] Lloyds Rep Bank 229.

8.3.4. Nomination

8.3.4.1. Nature of nominations

Every member of a society has the right to name the person who shall succeed to his or her interest in the society on his or her death. Provided the statutory limit on the value of the interest that can be nominated is not exceeded, the nomination will be effective to pass 'any property in the society (whether in shares loans or otherwise)'. The property affected by a nomination will be that held by the member at the time of death.[30] Such a nomination has precedence over a will or the rules that would govern the distribution of the estate on intestacy.

8.3.4.2. Form of nominations

A nomination must be in writing and signed by the member. Other than this there are no statutory requirements as to the form of the nomination. Thus, a simple undated, unwitnessed letter can serve as a nomination if it makes the member's wishes clear. It is desirable to have a witnessed, dated nomination if one can be obtained but a society cannot insist on this. The word 'writing' includes 'printing'.

8.3.4.3. Signature

It would seem that signature on behalf of the member, even if authorised by the member, will not suffice as the section refers to a written statement 'signed by' him.

8.3.4.4. Custody of nomination

The nomination must be delivered at or sent to the society's registered office during the lifetime of the member, or made in a book kept at the society's registered office. Accordingly, a form of nomination kept by a member in his or her own possession would not be an effective nomination, although it might stand as a will if all the formal requirements for a will were satisfied.

A nomination handed to an official or employee of the society will be valid and one posted before death but delivered to the society after death would probably be effective.

8.3.4.5. Register of nominations

Every society must keep a book in which the names of all persons nominated and any revocation or variation must be kept.[31] This requirement will be satisfied if a bound nomination book is kept but if looseleaf forms are used a separate register will be required.

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[30] CCBSA 2014, s 37.
[31] CCBSA 2014, s 37(5).

8.3.4.6. Restrictions on nominees

An officer or employee of the society may not be a nominee unless he or she is also the spouse, civil partner, father, mother, child, brother, sister, nephew, or niece of the nominator.[32]

8.3.4.7. Limitation on effect of nomination

If, at the date of the death of the nominator, the amount of property in the society comprised in the nomination exceeds £5,000 it is effective to pass up to £5,000, but no more.[33]

8.3.4.8. Disposal of nominated amount

On receiving satisfactory proof of the death of a nominator the society may dispose of the amount nominated.[34]

The society may pay the amount to the nominee or transfer it to his or her account or partly one and partly the other if the transfer of the whole would result in the nominee's holding more than the maximum permitted for the society.[35] This applies even if the society's shares are said to be non-transferable. If the transfer would lead to the maximum shareholding being exceeded the society must not transfer the (excess) shares, but must pay the nominee the value of the shares not transferred.

Any period of notice required of the nominator under the society's rules for the withdrawal of capital can be required of the nominee. Similarly, any debts owed to the society by the nominator that could have been deducted from his or her capital can be deducted from the amount to be paid or transferred under the nomination.

8.3.4.9. Nominees under sixteen

If the nominee is under 16 years of age the society should pay the nominated sum to either parent or to a guardian of the nominee or to any other person of full age who will undertake to hold it on trust for the nominee or to apply it for his or her benefit and whom the society may think a fit and proper person for the purpose. The receipt of that parent, guardian or other person is a sufficient discharge to the society for the amount paid.[36]

If the nominee is over 16 but under 18 the society may pay the nominated amount to an adult on the same terms. Alternatively, the nominee can be admitted to membership (if the society's rules permit) and his or her account can be credited with the nominated sum. The receipt of the new member will then be a good discharge for payment.

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32 CCBSA 2014, s 37(3).
33 CCBSA 2014, s 37(4) and Administration of Estates (Small Payments) Act 1965.
34 CCBSA 2014, s 39(1).
35 CCBSA 2014, s 39(2).
36 CCBSA 2014, s 38(2).

8.3.4.10. Revocation and variation

A nomination can be revoked or varied by a subsequent nomination or any similar document in the form of a revocation or variation signed by the nominator and delivered at or sent to the society's registered office during the maker's lifetime. All that was said on the form and custody of nominations applies to such documents.[37]

A nomination is revoked by the subsequent marriage of or formation of a civil partnership by the nominator. If the society pays in ignorance of the marriage or civil partnership it cannot be required to pay again.[38] Unlike a will, a nomination is not affected by the divorce of the nominator.

If the nominee predeceases the nominator the death destroys the validity of the nomination and consequently the property passes into the estate of the nominator and not that of the nominee.[39] This may be overcome by stipulating on the nomination form the intended destination of the property in the event of the first nominee predeceasing the nominator.

8.3.4.11. Rules

The rules of a society cannot remove or limit the statutory right of members to nominate property but they will often contain a full description of the right and indicate how it can be exercised. This provides useful information for members. The rules must state how the claims of members' nominees are to be dealt with.[40]

8.3.5. Payments on death

Societies must make provision in their rules about how a member's personal representatives are to be paid.[41] Rules usually lay down that property will be handed to them unless a valid nomination was made.

In the absence of a nomination, s 40 of CCBSA 2014 permits the committee of a society to distribute property to such persons as appear to them to be entitled to it without letters of administration or the probate of a will being produced in England or confirmation having been obtained in Scotland. This applies so long as the total property that the member had in the society was worth no more than £5,000. This rule can apply to any property that a member had in a society whether it was share capital, loan capital or a deposit. As with the right to pass property in the society by nomination, it only applies to members.

This procedure is discretionary and a society may insist on the production of letters of probate, or letters of administration (or 'confirmation' in Scotland) even if the member's property is of a value falling within s 40.[42] The power conferred by s 40 can be exercised

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37 CCBSA 2014, s 23(4).
38 CCBSA 2014, s 38(5).
39 *Re Barnes, Ashenden v Heath* [1940] Ch 267.
40 CCBSA 2014, s 14(11).
41 Ibid.
42 *Escritt v Todmorden Industrial Co-operative Society* [1896] 1 QB 461.

as to the balance of a holding left after the power of nomination has been exercised so long as the total holding was within the limit laid down for the application of the section before the nomination took effect.

The section only applies if the member's holding at the date of death did not exceed the limit. It does not apply if it is only the deduction of, for example, funeral expenses from it that brings it below the limit and it does not apply at all if the holding is above the limit at the date of death unlike a nomination which can apply to the extent of its maximum limit if the value of property held exceeds it.

If a society knows that probate, letters of administration or confirmation has been issued it should insist on their production regardless of the value of the member's holding in order to protect itself. If there is a dispute between claimants and the whole holding is not governed either by a nomination or the passing of jointly owned property to the surviving co-owner, it will be wise for the society to insist on the production of letters of administration, a confirmation or a grant of probate.

Section 40 does not allow the society to pay only some of those entitled or to allocate property arbitrarily. The normal legal rules as to the distribution of property on death must be followed.[43] However, if a society makes a payment or transfers property under s 40 to a person appearing to its committee at the time of the payment or transfer to be entitled to it, the transaction is valid and effective against any demand made by some other person.[44] Thus if the member left a valid will the property must be distributed in accordance with its terms and if the member died intestate, the rules laid down by the applicable law as to who takes property must be followed. Societies should consult standard works on the law of succession in England and Wales or Scotland to ascertain the appropriate distribution of the property of members under this provision.

If there has been no nomination and s 40 does not apply because of the value of the property in issue, the society must demand to see the grant of probate or letters of administration in England or the confirmation in Scotland so as to ensure that the property of the deceased member is handed to the correct personal representative. Payment is made to the executor of a will and not to a legatee. In the case of intestacy payment should be made to the administrator.

8.3.5.1. Joint membership in England

In the case of a share account held in the name of two or more members, the survivor is usually entitled to the holding on the death of the other joint holder. This is the position because the account is the type of property known as a chose in action and such property is always held jointly at common law so as to devolve on the survivor.[45] However, in equity, the account may be held as tenants in common. This would mean that the interest of one party would go into their estate on their death. This will be the case if the parties have indicated such an intention or 'severed' the existing joint tenancy.[46] The intention of the parties will determine the proportions that go to each person. The society is entitled to assume that they hold as joint tenants unless it has notice of the fact that the parties hold as tenants in common.

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43 *Symington's Executor v Galashiels Co operative Store* (1894) 21 R C of Sess 371.
44 CCBSA 2014, 40(3).
45 *McKerrell, McKerrell v Gowans* [1912] 2 Ch 648 at 653.
46 *Re Butler's Trusts, Hughes v Anderson* (1888) 38 Ch D 286.

8.3.5.2. Joint membership in Scotland

In Scotland the position depends on the contractual terms upon which the joint account is held.[47] This means that ownership of the account does not necessarily devolve to the surviving joint account holder even if control of the account may do. The account may be held:

- in the names of two or more persons;
- in the names of two or more persons with the addition of the word 'jointly';
- in the names of two or more persons with the addition of the words 'either' (or 'any') survivor; or
- in the names of two or more persons with the addition of the words 'jointly or survivor'.

The first two cases have the same effect. In the event of the death of one joint holder there is a presumption that the holding belongs equally to all the holders. Thus, if the account is held by two persons jointly, on the death of one, half should be paid to the survivor and half to the legal personal representative (or next of kin) if they are different persons.

In the third and fourth cases, on the death of one joint holder there is a presumption that only the survivors are entitled and the whole amount may be paid to them.

The presumptions mentioned in the preceding paragraphs can be overcome by evidence to the contrary. A society's rules may assist to provide greater clarity on the position.

8.3.6. Payment on mental incapacity or bankruptcy

If the committee of a society is satisfied that the person with whose holding they are dealing has not had any person appointed to administer his property on his behalf, the society may dispose of the holding of a mentally incapable member or the interest of a mentally incapable person claiming through a member without a court order subject to observance by the society of the requirements set out in CCBSA 2014.[48] This does not apply where the member lacks capacity within the meaning of the Mental Health Act 2005, there is a donee of an enduring power of attorney or lasting power of attorney or a deputy appointed for the member by the Court of Protection and that donee or deputy has power in relation to the member for the purposes of the Act.[49]

In any case in which this has occurred or in which an application for a court order has been made or is about to be made, the society should await the order and should not make a payment under s 36. If, in respect of any holding or interest in a society of any person (whether by a member or not), the court has made an order for the disposal of the holding or interest or has appointed a person to deal with the holding, the society must, and may safely, deal with the holding according to the directions of the order or of the person appointed. In the case of an appointee, the society should require to see the order making the appointment before accepting directions. If the society is aware that

47 *Cairns v Davidson* 1913 SC 1054.
48 CCBSA 2014, s 36.
49 CCBSA 2014, s 36(4).

proceedings that may lead to an order or appointment are pending, it should delay payment to anyone until the order or appointment has been made.

'Persons claiming through a member' include nominees, executors and administrators. The power conferred by s 36 applies to any 'shares loans or deposits' but can only be applied to such investments held by members. The investments of non-members cannot be dealt with in this way.

8.3.6.1. The decision to pay

The section requires the board to consider medical evidence that the member (or person claiming through him or her) is incapable through mental disorder or mental disability of managing his or her affairs before exercising its power. A doctor's certificate will suffice.

It must be established to the board's satisfaction that it is just and expedient to pay the person claiming payment and that the applicant is a proper person to receive payment on behalf of the mentally incapable member. Normally this will be a person whom the board believes will use the amount handed over for the benefit of the mentally incapable person.

A transfer is not the payment of a sum within the meaning of the Act. This means that a society will have no protection if it merely transfers the mentally incapable person's account into the name of the claimant or transfers the holding into the claimant's account in the society.[50]

8.3.6.2. Receipt

The receipt of the recipient is necessary and is a good discharge to the society. If the society pays in accordance with s 36 it cannot be required to pay again.[51]

8.3.6.3. Bankruptcy

The rules of societies must make provision for the disposal of property in the society held by persons who become bankrupt. Society rules normally lay down that such property is to be transferred to the trustee in bankruptcy.[52]

8.4. LOAN CAPITAL

8.4.1. Power to borrow

The validity of an act done by a registered society may not be called into question by reason of anything in its rules.[53] This does not apply to charitable societies except in favour of a person who gives full consideration in relation to the act *and* who has no

[50] *Gloucester Union v Gloucester Co-operative and Industrial Society* [1907] 96 LT 168.
[51] CCBSA 2014, s 36(7).
[52] CCBSA 2014, s 14(11).
[53] CCBSA 2014, s 43 and Section **11.2.2.** below.

knowledge of the limitation in the rules or no knowledge that the society is a charity.[54] It is an offence for a charitable society not to include its charitable status on its website and on all business documentation.[55] Where a society has done so, knowledge is likely to be imputed to people dealing with that society.

The power of a society to borrow depends on the terms of its rules. A society's rules must state whether or not the society has powers to borrow or take money on deposit and, if so, on what conditions, with what security and up to what maximum limit.[56]

Without s 43 CCBSA 2014, a loan contract would be void and totally ineffective if no power to borrow were given by the rules of the society.[57] However, if the rules of the society contain an object and a clause conferring power to do all things necessary and expedient to further it, loans taken to further that object might well have been valid before s 43 and its predecessor provisions were enacted. If a power to borrow exists but is used for an improper purpose (eg a loan for a business not allowed by the object clause) then the loan contract is not 'ultra vires' and void but is a misuse of the powers of the board and will be enforceable by the lender unless the lender was aware of the misuse of power, in which case their complicity in the breach of duty of the board will deprive them of the right to enforce the contract.[58]

In the absence of any express borrowing power it is possible that the courts could find implied powers to borrow so that the society would have power to borrow to pursue its objects without any express powers being included in the rules. However, while this is the case with companies, the fact that the CCBSA 2014 requires society rules to deal with this question, and to impose a maximum borrowing limit, might make the courts reluctant to pursue the company analogy for this purpose. The Act's provisions make it unlikely that any society will have rules which deny it the power to borrow.

The rules of a society must lay down a maximum borrowing limit but the Act gives no indication of what the limit should be.[59] The doctrine of constructive notice would mean that, at common law, anyone dealing with the society was taken to have notice of the limit if it is in the society's rules, which are available to the public at the FCA.[60] However, the constructive notice doctrine was removed from 1 April 2004. Since that date, no party to a transaction with a society has bound to enquire about whether the transaction is permitted by the society's registered rules, or about any limitation on the powers of the committee to bind the society or to authorise others to do so.[61]

In addition, even at common law, a lender without actual notice of any breach of a lending limit whose own loans to the society do not exceed the limit will be presumed to have no notice of any internal decisions or arrangements which do not appear in the publicly available documents.[62] However, it is still common practice for commercial

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54 CCBSA 2014, s 47.
55 CCBSA 2014, s 12.
56 CCBSA 2014, s 14(8).
57 *Re Airedale Co-operative Worsted Manufacturing Company Ltd* [1933] Ch 639.
58 *Rolled Steel Holdings Ltd v British Steel Corporation* [1985] 3 All ER 52.
59 CCBSA 2014, s 14(8).
60 *Ernest v Nicholls* (1857) 6 HLC 401 laid down the constructive notice doctrine and CCBSA 2014 ss 3(7), 143(2) and 145 oblige the FCA to maintain a register in which rules can be read by the public.
61 CCBSA 2014, s 46 from 1 August 2014 and previously IPSA 1965, s 7C inserted by CCBSA 2003, s 3 from 1 August 2004.
62 *Royal British Bank v Turquand* (1856) 6 E and B 327.

lenders to require a certificate from an officer of the society confirming that the borrowing in question will not lead to a breach of the borrowing limit in the rules.

If loans are taken for an amount in excess of the limit permitted by the rules and the directors of the society have provided personal guarantees of the whole amount, their knowledge of the society's affairs and of the limit on the amount that may be borrowed will prevent them from avoiding liability for the amount guaranteed over and above the limit in the rules.[63]

If, despite the statutory protections, a loan is held to be void, it is not possible for the lender to recover his or her money or to enforce the loan but any monies still in the hands of the society will be the purported lender's money if identifiable or traceable. In addition, if there is in fact a qualified power to borrow and the loan money has been used to pay off existing intra vires debts that element of the loan can be treated as valid.[64]

8.4.2. Bonds and other debt instruments

A society with appropriate powers in its rules may issue debt instruments as well as or instead of entering into loan agreements. Long-term debt instruments issued in the main regulated capital markets or by way of private placement have become a very significant form of funding for housing associations as well as some other types of society.

Debt instruments can take a wide variety of forms, including bonds issued on the main capital market, notes placed privately with institutional investors (commonly known as private placements), and retail bonds. Debt securities can be issued either on a secured or an unsecured basis. Capital repayment can be on a bullet repayment basis or with structured repayments and obligations can be denominated in currencies other than sterling. In other words, debt securities can have most of the flexibilities and features available through loan finance with the most significant difference being the fact that the debt instruments themselves can be transferable. In practice, there is little trading of securities apart from those that are listed.

Where a society issues securities denominated in currencies other than sterling it would be usual for them also to hedge the currency risks with an appropriate swap transaction with a strong counterparty. Given the history of case law on challenges by organisations to their liabilities under swap transactions[65] counterparties are likely to require a society to have an explicit rule permitting it to enter into the appropriate swap.

A registered society under CCBSA 2014 can issue listed securities. Unlike a share company it does not need to be a public limited company to do so.[66] However, some societies choose to raise such finance through a separate vehicle for reasons relating to flexibility of borrowing in their group structure, accounting reasons or certain other technical advantages that may apply in their particular circumstances. Where this structure is adopted the issuing vehicle enters into a loan agreement with the society and the society is a borrower in the usual way pursuant to that loan agreement.

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63 *Munster and Leinster Bank Ltd v Barry* [1931] IR 671.

64 *Sinclair v Brougham* [1914] AC 398 and *Re Airedale Co-operative Worsted Manufacturing Company Ltd* [1933] Ch 639.

65 See for example, *Hazell v Hammersmith and Fulham LBC* [1991] 2 WLR 372.

66 Companies Act 2006, s 755 only applies to registered companies.

8.4.3. Security for debt capital and the registration of charges

The rules of a society must provide for the security that is to be given to lenders. Most rules give the society power to provide security for its borrowings in this way. To give security is to give the lender the right to claim payment out of particular property over which the security operates. This will give priority over unsecured creditors or, in respect of that property, over those whose security does not cover those assets.

Such security in the form of a mortgage or charge can be given over any of the property of the society if the rules permit this. A mortgage or fixed charge will prevent the society from disposing of the property over which it operates. A floating charge secures the loan on all the assets of the kind charged which are owned by the society at the particular time when it crystallises. Until then assets subject to it can be dealt with in the normal course of business. This type of security is particularly suitable for use over the society's stock in trade where these have a value and the lenders require security over it.

Lenders may seek a fixed and floating charge in a debenture that is stated in the document creating it to be secured by a fixed charge over listed assets such as land, buildings and capital equipment and a floating charge over all of the society's other assets.

In England and Wales, holders of floating charges granted by societies other than private registered providers of social housing (in England) or registered social landlords (in Wales or Scotland) cannot appoint administrative receivers but must appoint an administrator.[67]

A receiver or manager appointed over the society's property must notify the FCA of his appointment within one month and must make six-monthly returns of receipts and payments while he continues to act.[68]

8.4.4. Registration or 'recording' of charges

Before the Industrial and Provident Societies Act 1967 (IPSA 1967) any charge given by a society over its chattels required registration under the Bills of Sale Acts 1878 and 1882. It was not registrable under the Companies Act nor exempt from Bills of Sale Act registration but could be effective over assets other than chattels.[69] The fact that all assets covered by a charge registered under the Bills of Sale Acts 1878 and 1882 had to be listed, prevented the registration of a floating charge. Consequently, societies could not provide this form of security.

IPSA 1967 rectified this situation and has now been consolidated in CCBSA 2014 in a way that allows both English and Scottish societies to give security by way of a floating charge.[70] In respect of Scotland this is achieved by the application to societies of relevant

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[67] CCBSA 2014, s 65 and the Industrial and Provident Societies and Credit Unions (Arrangements, Reconstructions and Administration) Order 2014, SI 2014/229. See Section **12.9.** below for a fuller discussion of insolvent societies.

[68] CCBSA 2014, s 66.

[69] *Great Northern Railway Company v Coal Co-operative Society* [1896] 1 Ch 187 and *Re North Wales Produce and Supply Society Ltd* [1922] 2 Ch 340.

[70] CCBSA 2014, ss 59–64.

provisions of the Companies Act 1985 and the Insolvency Act 1986.[71] In England and Wales, where the floating charge was the creation of the Courts of Chancery, the CCBSA 2014 deals with the problem of the Bills of Sale Acts by laying down that an instrument for which an application for recording under s 59(3) of CCBSA 2014 has been made to the FCA is not a bill of sale or registrable as such.[72]

This means that a failure to apply to the FCA to have the charge recorded may make the instrument an unregistered bill of sale and, so, ineffective over chattels although providing security in respect of other assets that it covers.[73] This contrasts with the status of a floating charge granted by a company but not registered under the Companies Act 1985. Such a charge is not an unregistered bill of sale as bills of sale created by companies are specifically excluded from the requirements of the Bills of Sale Acts 1878 and 1882.[74] If this is the case, an unrecorded charge granted by a society over chattels would not even grant a security interest against the society.[75] In the case of an unregistered company charge, security against the company exists but all priority in insolvency or against creditors or registered charges is lost.[76]

However, this line of reasoning depends on the decision in *Great Northern Railway Company v Coal Co-operative Society*[77] that a debenture issued by an industrial and provident society was not excluded from the application of the 1882 Act. The view was expressed obiter by Phillimore J in *Clark v Balm, Hill and Co*,[78] a case concerning a Guernsey company, that the *Great Northern Railway* decision was incorrect and that 'all debentures of incorporated bodies are exempt from the Act of 1878' and were not brought within the 1882 Act by s 17 of the 1883 Amendment Act which was passed only from an abundance of caution. In *Slavenburg's Bank v International Ltd*[79] Lloyd J expressed a preference for the approach of Phillimore J in *Clark*. On that view, an unrecorded charge granted by a society would not be void against the society itself even in respect of chattels and might have priority over the claims of unsecured creditors in a liquidation, although it would lose priority against charges recorded earlier. Support for this position can also be drawn from the argument that the mischief of 'secret bills' at which the Bills of Sale Acts are aimed only applies to individuals and corporate bodies for whose charges no statutory registration procedure is in place.[80] A statutory registration system has been in place for societies since 1967. That is a change since the *Great Northern Railway* case was decided and an argument about the intention of the legislation might be more persuasive now that the courts have moved away from the narrowly literal approach to statutory interpretation that was common in Victorian times.

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71 CCBSA 2014, s 62 applies Companies Act 1985 Pt 18 and Insolvency Act 1986, s 122(2) to societies with some modifications.

72 CCBSA 2014, s 59(2).

73 *Re North Wales Produce and Supply Society Ltd* [1922] 2 Ch 340.

74 Bills of Sale Act (1878) Amendment Act 1883, s 17.

75 Bills of Sale Act (1878) Amendment Act 1882, s 8 and see *Re North Wales Produce and Supply Society Ltd* [1922] 2 Ch 340.

76 Companies Act 2006, s 874.

77 [1896] 1 Ch 187.

78 [1908] 1 KB 667 at 670.

79 [1980] 1 WLR 1076 at 1097–8.

80 See *Online Catering Ltd v Acton* [2010] EWCA Civ 58 per Ward LJ at paras 17–21.

8.4.4.1. Floating charges in England

A document by a society that is registered in England or Wales that creates or is evidence of a fixed or floating charge on assets of the society is not a bill of sale under of the Bills of Sale Acts 1878 to 1882, and is not invalidated by those Acts if an application to record the charge is made under CCBSA 2014.[81]

An application for recording a charge is made by delivering to the FCA by post or otherwise within 21 days beginning with the date of the making of the document:

- a certified copy of the document;
- a completed copy of the FCA form for notification of charges signed by the secretary, a solicitor acting for the society or a person interested in the charge on behalf of the society; and
- the appropriate fee.[82]

The FCA will then send an acknowledgment to the applicant. Such a document bearing the FCA's seal or stamp is to be received in evidence without further proof being required.[83] A copy of the document is placed on file and can be inspected by the public. Notices as to the discharge of a recorded charge must be given to the FCA on another part of the same form as for registration.

The FCA has power to direct that any errors be rectified or that the recording period be extended.[84] However, the powers of the FCA are limited to circumstances where it appears to the FCA that errors in an application or a late application were 'by reason of inadvertence or other sufficient cause' and an application must be made to the FCA by the society or by another person 'claiming the benefit of the instrument'. The FCA can direct that the error be rectified or the application period extended on such terms as it thinks fit. Where the FCA is satisfied as to the reasons it is likely to follow the practice of making the recording of a charge outside the 21-day period subject to the priority obtained by any later chargee who recorded their charge within the statutory time limit applicable to their charge.

Since no right of appeal from the decision of the FCA is provided on this issue in the legislation, its decision could be challenged only by way of an application for judicial review of its administrative act in granting or refusing the application for rectification or an extension of the recording period or making a direction subject to particular terms or under s 415 of FSMA 2000.

The procedure under the Act does not apply to the registration of a debenture registered under the Agricultural Credits Act 1928, which lays down a similar procedure.[85]

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81 CCBSA 2014, s 59(2).
82 CCBSA 2014, s 59(3) and the current FCA Guidance on the Notification of Charges.
83 CCBSA 2014, s 148.
84 CCBSA 2014, s 60.
85 CCBSA 2014, s 59(6).

8.4.4.2. Floating charges in Scotland

CCBSA 2014 applies the relevant provisions of the Companies Act 1985 and the Insolvency Act 1986 to allow societies to create floating charges as if they were companies.[86]

Registration is with the FCA. It should be within a period of 21 days beginning with the day of execution of the charge and must be accompanied by the same information and fee as is required for English charges. However, in contrast to the position in England as to a charge over chattels, the Scottish provision lays down that, if this is not done, the charge is void only against a liquidator, administrator or a creditor of the society, i e it is not void against the society itself.[87] The power to allow late registration or correction of any registration is conferred on the FCA as it is to English charges. Section 63(4) provides for the acknowledgement and public inspection of the registered details.

A floating charge is effective in relation to heritable property without registration under the Land Registration (Scotland) Act 1979 or being recorded in the Register of Sasines.[88] The effect and priority of a floating charge granted by a Scottish society are as set out in ss 463–465 of the Companies Act 1985.

8.4.5. Rights of lenders and holders of debt security

Lenders and the holders of debt security are creditors of a society and not, as such, members of the society. They have none of the rights given to members by the Act and by society rules such as the right to nominate their holdings or to vote in society general meetings.

If they are 'persons interested in the funds of the society' for the purpose of certain sections of CCBSA 2014, they may have the right to inspect their accounts and the register and to have a copy of the annual return. It is doubtful whether they do have such rights.

Other than this, the rights of the lender are to be found in the society's rules and in the agreement between the lender and the society or the terms on which the debt security was issued.

In the case of secured creditors such as banks, the remedies available to them in the case of default by the society can be so extensive as to give considerable power at times when a society is in any financial difficulty.

Any unpaid creditor has the possibility of applying for the society to be wound up subject to the application of the new administration and other similar powers.[89]

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[86] CCBSA 2014, s 62 applies Companies Act 1985 Pt 18 and Insolvency Act 1986, s 122(2) to societies with some modifications.

[87] Companies Act 2006, s 889 as applied by CCBSA 2014, s 62.

[88] Companies Act 1985, s 462(5).

[89] See Section **12.9**. below for a fuller discussion of insolvent societies.

8.5. DEPOSIT TAKING[90]

In principle, there is no prohibition on a society that does not have withdrawable shares from accepting deposits. In practice, societies do not do so as they would be subject to the full FSMA 2000 regime including authorisation by the PRA and regulation by the FCA.

A society with withdrawable share capital is prohibited from engaging in the business of banking.[91] Accepting deposits up to the amount of £400 in total from any one depositor or amounts of not more than £400 is deemed not to be banking.[92] The rules of a society must permit such a 'penny bank' scheme and few exist. If such a scheme is run, withdrawable share capital may not be withdrawn if any payment due in respect of a deposit is unsatisfied.[93]

If a society without withdrawable share capital carries on any banking business other than a 'penny bank', a statement as set out in CCBSA 2014 must be made out and displayed in a conspicuous position at its registered office and at every office and place of business where the society's banking business is carried out. The statement must be renewed on the first Monday of February and of August each year so as to show the society's capital, liabilities and assets as at the previous 1 January or 1 July respectively.[94]

For the purpose of CCBSA 2014 'banking' appears to amount to receiving money on deposit and allowing it to be withdrawn at will.[95]

Sums received in consideration for the issue of the society's own 'debt securities' are excluded from treatment as 'deposits'.[96] Although issuing withdrawable shares falls within the scope of accepting deposits for the purposes of FSMA there are exemptions from the regulatory implications that would otherwise apply for registered societies other than credit unions.[97]

8.6. SURPLUS DISTRIBUTION

8.6.1. Co-operatives

The return paid to capital by co-operatives is required by Co-operative Principle to be strictly limited. In the case of debt capital this is likely to mean that a market rate (or lower) is paid. In the case of share capital the rules will limit the return to a similar or lower level.

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90 See Section **8.7.** below for a fuller treatment of financial services regulation as it deals particularly with registered societies.

91 CCBSA 2014, s 67(1).

92 CCBSA 2014, s 67(2).

93 CCBSA 2014, s 67(3).

94 CCBSA 2014, ss 69 and 70.

95 *Re Bottomgate Industrial Co-operative Society* (1891) 65 LT 712.

96 Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, SI 2001/544, (Regulated Activities Order 2001) art 9.

97 Ibid art 5 and Financial Services and Markets Act 2000 (Exemption) Order 2001, SI 2001/1201, art 4 and Sch 1, para 24.

In addition s 2(3) of CCBSA 2014 excludes from the expression 'co-operative society' for the purpose of s 2(2) societies that carry on or intend to carry on business with the object of making profits mainly for the payment of interest, dividends or bonuses on money invested or deposited with or lent to the society or any other body.

Consequently, in order to be a bona fide co-operative, on registration of the rules of a society or amendments to the rules the FCA will insist that the return on capital is limited.

These provisions have a clear impact on the reward available to capital invested in societies, or, seen another way, the distribution of the surplus that they generate. The rules of a society must provide for the way in which its profits will be applied.[98] This covers any surplus generated by the society. The provision may be that all such profits will be reinvested in the society. If provision is made for distribution it should be on the basis of transactions with the society. For co-operatives this is the only permissible rule.

Any application of profits by a society must be within its rules. If it is outside the objects rule and the provisions of any rule specifically listing permitted uses of surplus, it will be void and of no effect even if it was authorised by a general meeting. A change in the rules will be needed to authorise such distributions in the future.[99]

The distribution of surplus to members in accordance with transactions with the society will involve different criteria for different types of co-operative. For an agricultural marketing co-operative it will be according to sales to the society. In the case of a consumer co-operative the relevant criterion will be purchases from the society and for worker co-operatives the work contribution is the relevant factor.

Credit unions may give rebates to borrower members subject to the statutory limits and FCA/PRA Guidance in the *CREDS Sourcebook* on how they deal with any surplus.[100]

There is no obligation for co-operatives to distribute surplus to individual members at all. They may reinvest in the business or provide collective benefits or facilities for members.

8.6.2. Community benefit societies

In the case of community benefit societies the FCA Note on the Mutual Societies Application Form states that the society's rules must not permit either the profits or the society's assets to be distributed to the members.

Community benefit societies may also include 'asset-lock' provisions.[101]

The fact that a community benefit society may have rules preventing 'trading at a profit' and prohibiting any distribution to members does not prevent it from meeting the definition of an 'investment company' under s 1218B of the Corporation Tax Act 2009

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98 CCBSA 2014, s 14(12).

99 *Warburton v Huddersfield Industrial Co-operative Society Ltd* [1892] 1 QB 817 and see Section **4.5.** below on rule changes.

100 See Section **13.10.** below.

101 See Sections **1.3.3.**, **4.3.3.1.** and **12.7.** for details.

and obtain the tax benefits available to such companies if its actual activities, history and plans demonstrate that its business is wholly or mainly in the making of investments in assets to produce a profitable return.[102]

Societies that are private non-profit registered providers of social housing (in England) or registered as social landlords (in Wales and Scotland) are subject to limitations on their ability to pay money to members beyond interest on money lent to the society or subscribed as share capital.[103]

8.7. FINANCIAL SERVICES REGULATION AND INDUSTRIAL AND PROVIDENT SOCIETY CAPITAL

8.7.1. The general framework

8.7.1.1. Scope

The Financial Services and Markets Act 2000 (FSMA 2000) has been dealt with above as it affects the registration and regulation of societies. However, the main purpose of FSMA 2000, and the main role of the Financial Conduct Authority (FCA) is the regulation of the whole range of financial services businesses and the Stock Market alongside the Prudential Regulation Authority (PRA).

Those functions will apply to some registered societies or their groups because of their activities. That wider FCA role is beyond the scope of this book.

Credit unions are, by definition, financial services organisations and, as such are subject to prudential regulation by the FCA and PRA (as appropriate). Their special regulatory rules, which are found in the CRED Sourcebook (CREDS), are dealt with in **Chapter 13**.

This section brings together some of the financial services provisions applicable to societies raising share or loan capital. The scope of this section is limited to those provisions dealing with societies that do not operate a business regulated by the FCA or PRA under FSMA 2000.

Societies considering raising capital by means of issues of shares or debt instruments should consider carefully the territoriality of what they are doing, to ensure that it is covered by UK law and not also subject to the law of other jurisdictions such as the United States.

8.7.1.2. The regulatory regime in outline

The regime introduced by FSMA 2000 involves a 'general prohibition', in s 19 of the Act, on any person carrying on, or purporting to carry on, a 'regulated activity' unless they have either been authorized to do so in accordance with Part 4A of FSMA 2000 (or certain predecessor provisions) or exempted by the legislation from the need for authorisation.

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[102] *Cook (Inspector of Taxes) v Medway Housing Society Ltd* [1997] STC 90.

[103] Housing and Regeneration Act 2008, s 122; Housing Act 1996, s 7 and Sch 1, para 1; and Housing (Scotland) Act 2001, s 63 and Sch 7, para 1.

Sections 38 and 39 of FSMA 2000 and Orders made under s 38 govern whether a person (or class of persons) is exempt from the 'general prohibition'. The principal order dealing with exemption is the Financial Services and Markets Act 2000 (Exemption) Order 2001, SI 2001/1201.

Whether an activity is 'regulated' is governed by s 22 and Sch 2 of the Act, and the orders made under the Act. These list in detail those activities covered and include deposit-taking and specified types of activity relating to investments. The principal order is the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, SI 2001/544 as amended.

For the purpose of FSMA 2000, s 22 co-operative and community benefit society and credit union shares are included in the definition of an 'investment' only if they are transferable but their debt securities are included in the absence of some other specific exemption.[104]

In addition, certain activities are regulated under the FSMA 2000 in the interests of investor protection. This includes restrictions on 'financial promotion' communicating an invitation or inducement to engage in investment activity by advertising and other means of communication.[105] It also includes the role of the FCA as the United Kingdom Listing Authority (UKLA) of laying down and amending, enforcing and policing the obligations of issuers of securities to provide information to potential investors in the form of listing particulars or prospectuses and later releases of relevant information.[106]

In carrying out its functions, the FCA has extensive powers to make enforceable rules and to issue guidance; to investigate and decide matters; and to bring civil and criminal proceedings in the courts.

8.7.1.3. Regulation of societies raising capital

It is within this structure that provisions affecting registered societies raising capital are located. Four specific areas are particularly relevant to such societies when raising loan or share capital:

- deposit-taking;
- prospectus requirements;
- financial promotion;
- dealing in and arranging investments.

Each area is now dealt with in turn.

8.7.2. Deposit taking

In the absence of specific provisions to exempt societies, the definition of deposit-taking would be wide enough to catch withdrawable share capital and certain forms of loan

[104] Regulated Activities Order 2001, SI 2001/544, arts 73, 76 and 77.
[105] FSMA 2000, s 21 and the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (Financial Promotion Order) 2005, SI 2005/1529.
[106] FSMA 2000, Pt VI and Schs 7, 8 and 9.

capital issued by societies.[107] The definition includes money paid, in a business context, on terms that it will be repaid on demand or in agreed circumstances and used by the recipient either to lend to others or to finance to a material extent any of its other activities. It is not necessary for the definition that there is any payment of or promise of interest or a premium.

Without an exemption, this would probably mean that a society raising capital by the use of withdrawable share capital or certain forms of debt security would have to be authorised as a deposit-taker and meet the strict prudential and other requirements imposed on banks.

The legislation exempts industrial and provident societies (other than credit unions) from the FSMA 2000 general prohibition (and as a result authorisation by the PRA and FCA regulation) in respect of accepting deposits in the form of withdrawable share capital.[108]

Sums received in consideration for the issue of the society's own 'debt securities' are excluded from treatment as 'deposits'.[109] This exclusion covers a wide range of instruments creating or acknowledging indebtedness such as loan stock, debentures, debenture stock and certificates of deposit. Such securities are not regarded as deposits so long as they are not given in return for supplying goods or services or in respect of money borrowed to 'defray the consideration payable' under a contract for such things. Cheques, bills of exchange, banknotes or insurance contracts are also outside the exclusion.[110] However, a debt security classed as 'commercial paper' due to having a maturity of less than one year after the date of issue is only excluded if issued to professional investors and if at least £100,000 worth is issued and is to be repaid in tranches of at least £100,000.[111]

A sum paid by an authorised deposit-taker, such as a bank, is outside the definition of a 'deposit' because of the identity of the payer/lender regardless of the terms of the deal.[112]

8.7.3. Prospectus requirements

In principle, shares and loan securities of registered societies can be listed on the 'official list' on the London Stock Market.

Where a society issues 'listed' securities in its own name the rules governing both prospectuses and listing particulars and the continuing obligations of businesses with listed securities would apply as they apply to companies with listed securities. These are set out in Part VI of FSMA 2000 and the statutory instruments issued under it. The FCA is the 'competent authority' for the UK markets under the European Union legislation governing these matters. It operates as the UK Listing Authority (UKLA).

In practice, the restrictions on the nature of returns to shareholders of registered societies means that their shares are unlikely to be listed in this way but they may list

[107] Regulated Activities Order 2001, SI 2001/544, art 5.
[108] FSMA 2000 (Exemption) Order 2001, SI 2001/1201, arts 4, 6 and Sch 1, para 24.
[109] Regulated Activities Order 2001, SI 2001/544, art 9.
[110] Regulated Activities Order 2001, SI 2001/544, art 77.
[111] Regulated Activities Order 2001, SI 2001/544, art 9(2).
[112] Regulated Activities Order 2001, SI 2001/544, art 6(1)(a)(ii).

debentures or other loan securities if the society is large enough to make the process economically viable. The Co-operative Group Ltd, The Housing Finance Corporation Limited and a number of the larger housing associations such as London & Quadrant Housing Trust have issued listed debentures although others have established PLC subsidiaries as treasury vehicles to issue such securities instead.

However, the regulations relating to 'offers' are not limited to such 'listed' securities. If 'transferable securities' are to be 'offered to the public' in the UK for the first time, a prospectus must be submitted to the FCA, in its role as UK Listing Authority (UKLA), for approval of the document.[113] This applies whether or not the relevant 'transferable securities' are going to be listed, but see the discussion as to what is 'transferable' below.

The prospectus requirements only apply if a society 'offers transferable securities to the public' for the purpose of the FSMA 2000.[114] If a situation falls outside the definition of that phrase, there will be no requirement for a prospectus to be issued in respect of those securities.

A society can issue securities without the need for a prospectus in a number of situations:

- **The securities issued are not 'transferable'** and so are outside the prospectus requirement, whoever issues them, and whether they are shares or debt securities. Securities transferable only by operation of law on the insolvency or death of the holder or by nomination of a successor to hold the security after the holder's death under the CCBSA statutory regime are clearly not 'transferable' under this definition.

  In addition, since the definition requires that they be 'negotiable on the capital market', any form of share or loan security not 'negotiable on the capital market' would not be subject to the prospectus requirement. Some model rules operate on the basis of a 'closed' group of people eligible to be transferees. The reference to 'the capital market' is not restricted by reference to the 'official list' or other regulated markets and care needs to be taken in drawing up any scheme permitting trading of the securities to ensure that they are not capable of being traded 'on the capital market' unless an approved prospectus is issued or one of the other exemptions applies.[115]
- **Although 'transferable', the securities are not offered 'to the public'.** The concept of an 'offer to the public' is defined so widely that if there is a communication to any person who gives sufficient information on the securities and the terms of the offer to allow an investor to decide whether to buy them, there is an offer to the public.[116]

  However, there is a related category of exemption where offers are made only to qualified investors (or with certain other related restrictions).[117] This is the exemption most frequently used by companies and is also used by registered societies seeking to raise funds through the 'private placement' of debt securities (often loan notes) with a single institutional investor or a select group of

[113] FSMA 2000 ss 85 to 87R, Prospectus Regulations 2005, SI 2005/1433, and see FCA Handbook Prospectus Rules PR http://fshandbook.info/FS/html/handbook/PR.

[114] FSMA 2000, s 102B and Sch 11A.

[115] FSMA 2000, s 102A(3), which defines 'transferable securities' by reference to Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on Markets in Financial Instruments (MiFID), Art 4.1(18), see also the Glossary to the FCA Handbook.

[116] FSMA 2000, s 102B.

[117] FSMA 2000, s 86.

institutional investors. In practice, such investors will often require a memorandum covering similar material to a prospectus although these will not require approval by the UKLA.

- A special exemption applies to **securities (whether shares or debt securities) issued by a registered society registered as a benefit of the community society or any housing association** within the meaning of the relevant housing legislation so long as the **proceeds** of the issue of the security will be **used for the purposes of the issuer's objectives**.[118] There is also an exemption for charities that could apply to some societies, but is not required given the broad terms of the exemptions for community benefit societies.[119]
  This exemption does not apply to a co-operative as the purpose of this provision is to exempt issues where the proceeds are to be used for altruistic purposes under the constitution of the issuer. A co-operative exists to benefit its own members rather than the wider community notwithstanding the concern for the community embedded in the co-operative principles.
- **The total consideration for transferable securities included in the offer is less than 5 million euros** but offers of securities of the same class open at any time within the previous 12 months that used this exemption are added to those on offer now.[120]

If none of the exemptions applies then a prospectus complying with the requirements laid down by the prospectus rules will have to be prepared and approved by the UKLA before it is issued.[121]

8.7.4. Financial promotion

Under FSMA 2000 there is a prohibition against anyone, other than a person authorised by FCA under FSMA 2000, communicating, in the course of business, any 'invitation or inducement to engage in investment activity' unless the content of the communication has been approved by an authorised person.[122] The detailed definitions and exemptions applicable to this section are to be found in the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005, SI 2005/1529. Broadly, the concept of a communication applies to any medium and 'promotion' includes any inducement or invitation. In addition to a printed advertisement, the prohibition extends to visits, and any form of electronic communication.[123]

There is no exemption for a society's *transferable* shares.[124] Non-transferable shares in a society are outside the definition of a 'controlled investment' for the purpose of the financial promotion rules.[125]

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[118] FSMA 2000, Sch 11A paras 7(1) and 7(2)(c) and (d).
[119] FSMA 2000, Sch 11A para 7(2)(a) and (b).
[120] FSMA 2000, Sch 11A para 9(1) and (2).
[121] See FCA Handbook Prospectus Rules PR http://fshandbook.info/FS/html/handbook/PR, which includes relevant UK and EU legislation.
[122] FSMA 2000, s 21(1) and (2).
[123] Financial Services and Markets Act 2000 (Financial Promotion) Order 2005, SI 2005/1529, (Financial Promotion Order) arts 5–8A.
[124] Financial Promotion Order, para 14(2)(b) of Sch 1.
[125] Financial Promotion Order, art 35 and para 14(3)(c) of Sch 1.

A limited exemption from the requirement that a communication otherwise needs to be issued, or approved, by an approved person applies to registered society debt securities.[126]

The exemption for debt securities only covers certain types of communication. Communications outside the limit would still have to be made or approved by an authorised person.

The limits of the debt securities exemption are:[127]

- The communication must be **communicated by the society**.
- The communication must **relate to a debt security of the society** and not one issued by some other body.
- A **'debt security' includes a wide range of instruments creating or acknowledging indebtedness such as loan stock, debentures, debenture stock, bonds and certificates of deposit** so long as they are not given in return for supplying goods or services or in respect of money borrowed to 'defray the consideration payable' under a contract for such things. Cheques, bills of exchange, banknotes or insurance contracts are also outside the exclusion.
- The **communication must be a 'non-real time' communication** (ie **not** an interactive dialogue other than by letter or email) **or a 'solicited real-time' communication** (ie it can be an interactive dialogue other than by letter or email but only when initiated by, or, if a visit, expressly requested by, the recipient).

8.7.5. Dealing in and arranging investments

FSMA 2000 regulates people who deal in investments as principal or who arrange deals in investments.

A society, like any other business, which issues its own debt securities or shares is excluded from regulation as someone dealing in investments as a principal or arranging deals in investments.[128] In addition, non-transferable shares in a society are outside the definition of an 'investment' for the purpose of FSMA 2000.[129]

8.7.6. Collective investment vehicles (UCITS)

Special regulatory provisions apply to collective instruments including any company that operates as an 'open-ended investment company'. A registered society is exempt as a society from this form of regulation although it may be regulated as a participant in any such schemes it undertakes.[130] If it is operating in that way, it will be regulated under these provisions.

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[126] Financial Promotion Order, art 35 and paras 15 and 15A of Sch 1.
[127] See Financial Promotion Order arts 7, 8 and 35 and paras 15 and 15A of Sch 1.
[128] Regulated Activities Order, arts 18, 28 and 34.
[129] Regulated Activities Order, arts 73 and 76.
[130] Financial Services and Markets Act 2000 (Collective Investment Schemes) Order 2001, SI 2001/1062, art 3 and para 21 Sch 1.

8.8. MONEY LAUNDERING

The Money Laundering Regulations 2007, SI 2007/2157, impose obligations on those conducting certain business in the United Kingdom. Broadly, they cover financial services, currency exchange, the provision of credit, collective investment and high value dealing (over 15,000 euros).[131] They apply to all credit unions.[132]

The anti-money laundering obligations imposed by the regulations apply to laundering the proceeds of crime, financial transactions where a terrorist link is suspected and suspicions surrounding politically exposed persons. In particular organisations covered by the Regulations must ensure that they apply customer due diligence procedures such as verifying a customer's identity, ongoing monitoring of customer transactions and systems for reporting suspicious transactions internally and to the police. There are also record-keeping obligations

Issues by societies of withdrawable share capital within the £100,000 statutory limit and the acceptance of deposits by them within the £400 limit are exempt.[133]

It is important to consider whether any of a society's other activities bring it within the regulations. If they do, systems must be established to comply with the regulations. It may be necessary to register the business with the appropriate supervising authority.

8.9. THE MODEL RULES

In this chapter, Sections **8.9.1.** to **8.9.6.** provide details of provisions on capital from the model rules used throughout the book. However, Section **8.9.7.** deals with some examples of innovative rules on capital which may be of interest to readers.

8.9.1. Consumer Co-operatives Co-operatives UK 12th Edition Model Rules (amended 2012)

Shares – The CUK 12th edition Model Rules amended in 2012 determines that shares of the society shall have a nominal value of £1 and all members should hold at least one share. All shares must be paid for in full on application. The maximum number of shares must not exceed the limit allowed in law. Shares are allotted to members as applied for, and to the trustee of any employee share scheme as the board decides in its absolute discretion. Shares transferred to the trustee shall only be transferable by the trustee to employees or former employees who are already individual members or are then admitted as individual members, by a transfer document in a form approved by the board. All other shares can only be transferred on death of a member.

The board may apply money for which they cannot find profitable investment in repaying to members the amounts paid up on their shares, as long as the members' meeting has approved this, and the repayment does not cause the number of shares held by any member to fall below the minimum number required. Repayments should be

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[131] Money Laundering Regulations 2007, SI 2007/2157, reg 3.
[132] See Section **13.12.** below.
[133] Money Laundering Regulations 2007, SI 2007/2157, reg 4(1)(a).

made by paying back to the member who holds the largest number of shares the amount by which their shareholding is greater than the next largest shareholding.

Shares may also be withdrawn giving one week's notice to the society. All withdrawals should be paid in the order in which the notices were received by the society. The Board may waive any notice required for a withdrawal and unless the Board agrees, not more than one-tenth of the paid up share capital at 1 January each year shall be withdrawable during that calendar year (from 1 January) and no member is entitled to withdraw during any year more than one-tenth of the share capital standing to their credit unless the member withdraws from the society entirely. However, the right to withdraw may be suspended by the board, wholly or in part, indefinitely or for a fixed period. The exception to this rule is that a deceased member's shares may be withdrawn by their legal personal representative upon giving the required notice to the board.[134]

Borrowing powers extend to a maximum of 50% of the society's revenue reserve as stated in the society's last published accounts. The interest payable on advances, other than advances on a bank overdraft or loan secured by mortgage or charge is limited to the higher of: 3% above the Co-operative Bank plc base rate as it was at the time of agreeing or renewing the loan or within the previous two years; or 5%.[135]

8.9.2. Worker co-operatives: Co-operatives UK Worker Co-operative Model Rules

Shares The CUK Worker Co-operative Model Rules offer two options to individual co-operatives. The first option is that one non-transferable and non-withdrawable fully paid £1 share with no right to interest is issued to each member on joining. It is forfeited and cancelled on cessation of membership and no member can hold more than one share.[136]

The second option allows the society to allot more than one share per member. The shares still have a nominal value of £1.00 but the board, or the terms of a particular issue of shares, can fix a minimum shareholding required of members. If not fixed at a higher level, that is one share.[137] Members may then apply for shares in tranches smaller than the minimum shareholding. Members must however achieve the minimum shareholding within 12 months of their first payment. Failure to do so means the board may decide to expel the member. Any member ceasing to be a member in that way has the value of their shares when they ceased to be a member returned to them. Those shares are then cancelled.[138] All shares must be paid for upon allotment and the maximum total holding for any member is the amount fixed by law.[139]

An innovative and, in the UK, unusual rule allows the value of members' shares to be reduced when the co-operative is in difficulty. If the auditors or other independent accountants certify that the values of co-operative's aggregate liabilities plus its total issued share capital exceed its assets the board can decide to reduce the value of members' share holding pro rata. That is done in proportion to the nominal value of

[134] CUK Consumer Model Rule 7.
[135] Rule 15.6(c).
[136] CUK Worker Model Rule 26.
[137] Rule 27.
[138] Rule 28.
[139] Rule 29.

each member's shares as long as no-one's holding is reduced below the minimum shareholding. The process is based on the value of the shares paid up and held by each member at the close of business on the day of the board's decision.[140]

Shares are withdrawable but non-transferable except on death or bankruptcy or (in the case of an unincorporated organisation or partnership) on change of nominee(s) and then only to the new nominee(s).[141]

Shares may be withdrawn by members giving three months' notice to the co-operative but the Board may waive any notice required for a withdrawal. All withdrawals should be paid in the order in which the notices were received by the society. However, the right to withdraw may be suspended by the board, wholly or in part, indefinitely or for a fixed period. The exception to this rule is that a deceased member's shares may be withdrawn by their legal personal representative upon giving the required notice to the board. Interest is payable on a share after notice of repayment has been given until the date of repayment. The amount paid up or credited on the shares is paid to a member on withdrawal of the shares unless the shares are subject to a reduction in their value in times of difficulty under r 36. Additionally, the co-operative may deduct a reasonable sum to cover administrative costs of withdrawal from the monies payable to a member on withdrawal of shares.[142]

If a member has to withdraw from membership under the rules, is unable to transfer their shares while the right to withdraw shares has been suspended, their shares are converted into loan stock on terms agreed between the board and the member. The agreement must require the repayment of the loan within three years.[143]

Borrowing powers extend to a maximum of £10,000,000.[144] The rate of interest on money borrowed, except on money borrowed by bank loan or overdraft or from a finance house or on mortgage from a building society or local authority, is limited to the higher of 5% per annum or 2% above the Co-operative Bank's base rate at the commencement of the loan.[145]

8.9.3. Society for the benefit of the community – sponsored by Co-operatives UK

Shares The CUK Society for the Benefit of the Community Model Rules provide that the shares have a nominal value of £1.00. Each member may hold only one share and these shares must be fully paid prior to issue. The shares are not transferable except on death or bankruptcy or from one nominee to another. They are not withdrawable and carry no right to interest, dividend or bonus and are forfeited and cancelled on cessation of membership, when the amount paid up on them becomes the property of the society.[146]

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[140] Rule 36.
[141] Rule 31.
[142] CUK Bencom Model Rule 32.
[143] Rule 30.
[144] Rule 7.
[145] Rule 9.
[146] Rule 21.

Borrowing powers extend to a maximum of £10,000,000.[147] The rate of interest on money borrowed, except on money borrowed by bank loan or overdraft or from a finance house or on mortgage from a building society or local authority, is limited to the higher of 5% per annum or 2% above the Co-operative Bank's base rate at the commencement of the loan.[148]

8.9.4. National Housing Federation – Model Rules 2011 (version 2)

Under the National Housing Federation Version 2 model rules shares have a nominal value of £1.00 and carry no right to interest, dividend or bonus.[149] They are non-withdrawable and only shares held by the nominee of an unincorporated body (alone or jointly with other nominees) can be transferred, and then only to a new nominee of that unincorporated body.[150] Upon ceasing to be a member, these shares will be cancelled and the capital paid up shall be the property of the association.[151]

Borrowing powers Total borrowings up to £500,000,000 are permitted but the general meeting can increase the limit. The exchange rate applicable to any hedging instrument entered into at the time of foreign currency borrowing applies to assess the sterling value of those loans.[152] The interest rate on loans is limited only to the rate of interest that the board (or the person or committee to whom the power is delegated) believes to be reasonable having regard to the terms of the loan.[153]

8.9.5. Agricultural Co-operative (IPS) – Agency Model Rules sponsored by Co-operatives UK & Scottish Agricultural Organisation Society

The agency model rules for agricultural co-operatives as sponsored by the CUK & Scottish Agricultural Organisation Society provide that the share value is nominal but leaves the value open to the individual co-operative. Each member may hold only one share and these shares must be fully paid prior to issue. The shares are not transferable or withdrawable and carry no right to interest, dividend or bonus and are forfeited and cancelled on cessation of membership, whatever the cause. The amount paid up on the cancelled shares becomes the property of the society.[154]

Borrowing powers extend to a maximum of £10,000,000.[155] The rate of interest on money borrowed, except on money borrowed by bank loan or overdraft or from a finance house or on mortgage from a building society or local authority, is limited to the higher of 5% per annum or 2% above the Co-operative Bank's base rate at the commencement of the loan.[156]

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147 Rule 6.
148 Rule 8.
149 NHF Version 2 Model, Rule C2.
150 Rule C3.
151 Rule C4.
152 Rule F12.
153 Rule F13.
154 CUK/SOAS Agency Model Rule 25.
155 Rule 6.
156 Rule 8.

8.9.6. Social Clubs – Model Rules for a Working Men's Club – sponsored by Clubs and Institutes Union

Shares Under the Club and Institute Limited Model Rules, each member will holds only one share in the club, valued at 10p. This share is non-transferable and non-withdrawable. Upon ceasing to be a member, the share is cancelled and the amount paid on it is forfeited.[157]

Borrowing powers Borrowing is limited to £500,000.[158] No limit on the interest payable on loans is included in the rules

8.9.7. Some examples of innovative approaches to capital

8.9.7.1. Renewable Energy Societies (Baywind Version 2)

Under the Renewable Energy Model Rules Version 2 sponsored by Baywind Energy Co-operative Ltd, shares are par shares with a nominal value of £1.00. Each member must hold at least the minimum number of shares as required by the board and a maximum as outlined by the law. Shares should usually be paid for in full upon allotment but the board has discretion to waive this requirement.[159]

Shares are transferable, but only to those who are members or qualified to be a member. Shares cannot be transferred if the member has reached the maximum holding allowed by CCBSA 2014. Transfers are not valid unless the consent of the board has been obtained and the Secretary has recorded them, making appropriate entries in the register of members. The member should pay any reasonable cost incurred by the co-operative in effecting such transfers.[160]

Members have a no general right to withdraw share capital but can do so if the board agrees in accordance with any procedures or conditions announced by the board. If the board permits withdrawal, the amount paid to the member is the amount subscribed for the shares less the co-operative's reasonable costs in dealing with the withdrawal. Should a renewable energy co-operative find itself holding capital in excess of its needs, the co-operative may return such capital to members in the proportion in which they provided it. In that case, the board can require a member to withdraw a pro rata proportion of their share capital.[161]

This withdrawal provision contrasts with the withdrawal rules included in Version 1 of Baywind Rules. Under those rules, members could withdraw their shares on six weeks' notice subject to the approval of the board but only at least five years after the first generation of electricity by the co-operative's assets and only 5% or less of the society's total issued share capital at 1 January each year could be withdrawn during the following year. If more withdrawals were requested they were dealt with on a 'first come, first served' basis. The right to withdraw could be suspended, wholly or in part, indefinitely or for a fixed period.

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157 CIU Model Rule 6.
158 Rule 23.
159 Baywind v2 Rule 15.
160 Rule 16.
161 Rule 17.

Borrowing powers are limited to £20,000,000 and the interest rate on loans is limited only to the rate of interest that the board reasonably believes to be necessary to obtain and retain the capital needed to carry out the co-operative's business.[162]

8.9.7.2. Renewable energy societies: Sharenergy

Under the Sharenergy Model Rules, shares are par shares with a nominal value of £1.00. Each member must hold at least the minimum number of shares as required by the board and a maximum as outlined by the law. Shares should usually be paid for in full upon allotment but the board has discretion to permit a member to defer payment.[163]

Shares are transferable, but only to those who are members or qualified to be a member. Shares cannot be transferred if the member has reached the maximum holding allowed by CCBSA 2014. Transfers are not valid unless the consent of the board has been obtained and the Secretary has recorded them, making appropriate entries in the register of members. Any costs incurred by the co-operative in effecting such transfers shall be deducted from the proceeds payable to the transferring member.[164]

Members do not have the right to withdraw share capital but the board of the co-operative has the power to permit shares in the co-operative to be withdrawn by agreement between the board and the member holding those shares in accordance with any procedures and other conditions the board may announce. If the board does permit shares to be withdrawn the member who is withdrawing shares receives the amount subscribed for the withdrawn shares less any costs incurred by the co-operative in relation to the withdrawal.

The board of the co-operative has the ability to reduce the value of its shares in the event that the co-operative's liabilities and the value of its issued shares have become more than the value of its assets. The board can require that share capital be withdrawn by members proportionately to each member's shareholding.[165]

Borrowing is limited to £20,000,000 and the interest rate on loans is limited only to the rate of interest which the board reasonably believes to be necessary to obtain and retain the capital needed to carry out the co-operative's business.[166]

8.9.7.3. Community ownership Plunkett Version 2[167]

Shares Under these rules the shares have a substantial value, and are paid for in full on application. Applications for shares are made to the management committee and are subject to the maximum permitted number of shares by law as well as a minimum shareholding as determined by the society. Shares are only transferable on death or bankruptcy.

Shares are withdrawable if the member has held the shares for a minimum period of three years or such other minimum period as the management committee may decide.

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[162] Rule 19.1.
[163] Sharenergy Model Rule 15.
[164] Rule 16.
[165] Rule 17.
[166] Rule 19.
[167] See generally Rule 8 on shares and Rule 9 for the borrowing power.

Additionally, the member must give not less than three months' notice on a form approved by the management committee. The committee may also impose a maximum amount of withdrawal per financial year. All withdrawals are at the absolute discretion of the committee and must be funded from trading profits, reserves, or new share capital raised by members. Should the withdrawal be funded from the reserves, the management committee must be satisfied that this will not cause the society to be found to be unable to pay its debts or to be unable to pay its debts as they fall due in the year immediately following the withdrawal. The management committee may suspend the right to withdraw, wholly or in part, indefinitely or for a fixed period. During this suspension, a deceased member's representatives may withdraw their shares if the management committee consents. The management committee may, for all withdrawals, deduct a reasonable sum for the administrative costs of withdrawing the shares.

The society may, but is under no obligation to, pay interest on the shares at the discretion of the management committee. The interest must be paid out of trading profits and the percentage is to be resolved at the annual members meeting and must not exceed 2% above base rate of the Bank of England. The management committee may also choose not to provide interest to those members below a threshold share value.

If a member resigns or is expelled the shares become a loan repayable by the society to the former member.

Borrowing These rules permit unlimited borrowing and contain no explicit limit on interest on loans.

CHAPTER 9

ACCOUNTS, AUDIT AND FCA POWERS

9.1. ACCOUNTS

9.1.1. Outline

The legislation governing societies lays down a number of requirements concerning accounts. They deal with the accounts to be maintained and their contents, the availability of financial information to both members and the FCA, and the auditing of accounts. However, it should be noted that the detailed statutory rules about the format and specific content of accounts applicable to companies do not apply to societies. It is only in respect of the group accounts of societies that anything like that amount of detail is laid down and even those rules do not require any particular format. The reason for this discrepancy is that requirements concerning accounts for companies largely reflect applicable European Union legislation. The European Union has not imposed any requirements as to the accounts of societies.

The accounts prepared for societies will often, however, take a form virtually identical to those of a company. The conventions followed by the accountancy profession to ensure that accounts show a true and fair view of the society's business and financial position reflect some provisions of the Companies Acts and the accountancy standards laid down by the supervisory bodies charged with that function under the Companies Act 2006. Societies operating within particular business sectors may be required to comply with additional or substituted accounting requirements – see, for example, the Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 2008, SI 2008/565 in respect of societies operating in the insurance industry and the modifications applicable to registered social landlords found in the Housing Act 1996, Sch 1 Part III (England and Wales) and the Housing (Scotland) Act 2010, Part 6. This chapter deals only with the rules laid down by the co-operative and community benefit societies legislation.

In line with previous legislation the CCBSA 2014 contains provisions intended to ease the burden on certain societies. Societies other than holding or subsidiary societies, credit unions, housing associations and those that take deposits (other than in the form of withdrawable share capital) with a balance sheet total of not more than £2.8 million and an annual turnover in the preceding year of less than £5.6 million are allowed to opt out of appointing an auditor.[1] Subject to this, a so-called 'small society' may also choose to appoint a qualified auditor or instead have its accounts and balance sheet audited by

[1] See Section **9.2.2.** below.

two or more persons who are not qualified auditors.[2] A society will qualify as a 'small society' if the total amount of the assets received in the preceding year is less than £5,000, it had less than 500 members and its total assets do not exceed £5,000. All societies enjoy a seven-month period after the end of their accounting period for the submission of an annual return. A parent society is responsible for submitting its group accounts and a copy of the auditor's report on the group society together with its annual return for the relevant year.

9.1.2. The general requirements

Section 75 of CCBSA 2014 imposes two obligations on all societies. First, every society must ensure that proper books of account are kept to deal with both its transactions and its assets and liabilities. This requirement includes a duty to ensure that the books give a true and fair view of the society's state of affairs and explain its transactions.[3] Societies must also establish and maintain a satisfactory system of control of its books, cash holdings, receipts and remittances.[4] This is intended to ensure that fraud is avoided or detected and that both those running the society and those dealing with it have adequate information.

If the question of whether a society's accounting system meets the requirements of CCBSA 2014 reached the courts, it would probably be resolved by applying the criteria developed by the accountancy profession.

Systems of accounts other than bound books are permitted providing that adequate precautions are taken against falsification of the accounts and to facilitate the discovery of such problems.[5] The use of well-established computerised or manual systems that are in common use will meet this requirement.

Sections 79 and 80 of CCBSA 2014 reinforce the requirement that the revenue accounts and balance sheet of a society must accurately reflect the society's affairs. Every society must prepare for each accounting year either one revenue account dealing with the affairs of the society as a whole for that year or two or more such accounts which deal separately with particular businesses conducted by the society.[6] In each case revenue accounts must give a true and fair view of the matters with which they deal. In the case of a single account for the whole society, that must be of 'the income and expenditure of the society as a whole'. In the case of accounts dealing with particular businesses operated by one society, each account must give such a view of the 'income and expenditure of the society in respect of that business'. In each case the view must relate to the period covered by the accounts. Where a number of separate revenue accounts are prepared for different businesses carried out by the society they must together give a true and fair view of the income and expenditure of the society as a whole in the year to which they relate.[7]

The provision for separate revenue accounts to be made up for each business of a society is quite distinct from the rules governing groups of societies. Where different societies

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2 See Section **9.2.1.** below.
3 CCBSA 2014, s 75(2).
4 CCBSA 2014, s 75(3).
5 CCBSA 2014, s 76.
6 CCBSA 2014, s 79.
7 CCBSA 2014, s 80.

form part of a group, consolidated group accounts must be produced in addition to the accounts for each of the societies in the group. In the case of accounts for separate businesses run by one society there is no explicit requirement for a consolidated revenue account, but the obligation to ensure that the accounts give a true and fair view of the income and expenditure of the society as a whole demands a similar approach. A society's balance sheet must deal with the affairs of the society as a whole and give a true and fair view of its affairs at the date of the balance sheet.[8] It must deal with all of the society's businesses in a consolidated way.

9.1.3. Group accounts and subsidiaries

A society that has one or more subsidiaries at the end of a year of account must ensure that group accounts are prepared for that year.[9] As with revenue accounts for a society, these group accounts must give a true and fair view of the state of affairs and income and expenditure of the group as whole so far as the members of the society are concerned.[10]

9.1.3.1. Defining a subsidiary

To decide whether a society has a subsidiary, CCBSA, s 100 lays down tests applicable to companies and other societies that are to be used to decide whether, in each case, the body is a subsidiary. In the case of a company, it will be deemed to be a subsidiary of a society if the society is (1) either is a member of the company and controls the composition of its board or (2) holds more than half of the nominal value of the company's equity share capital.[11] To decide whether a company is a subsidiary of a society each of these two criteria should be examined.

To decide whether the society controls the board of the company the first question is whether it is a member of the company. It will be a member if it has a shareholding of any size or, in the case of a company limited by guarantee, has been accepted as a member in accordance with the company's articles of association. Being registered as a member in the company's register of shareholders will be prima facie evidence of membership. Additionally, subject to the next paragraph, shares held by any person as a nominee for the society will be attributed to the society. It is therefore possible for a society to be a member of a company limited by shares without its name appearing on the register of shareholders.

Certain shares are deemed not to be held by the society.[12] These are: shares held by the society in a fiduciary capacity (eg as a bare trustee), shares held by virtue of a debenture of the company or a trust deed securing the issue of a debenture of the company or where the ordinary business of the society includes lending money and shares are held by the society or a nominee as security for a transaction in the ordinary course of that business.

The next question is whether the society controls the composition of the company's board of directors. The basic test of this is whether the society by the exercise of some

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8 CCBSA 2014, s 80(3).
9 CCBSA 2014, s 98(1) and (2).
10 CCBSA 2014, s 98(3).
11 CCBSA 2014, s 100(1).
12 CCBSA 2014, s 100(4)(c) and (d).

power, which it can use without the consent or concurrence of any other person, can appoint either all or a majority of the directors of the company.[13] In such a case the company is deemed to be a subsidiary of the society without proof of any other factor. The power to appoint a director is deemed to exist in the case of any given place on the board if a person cannot be appointed without the exercise by the society of such an unfettered power, if the society itself holds the directorship or if appointment as a director of the company follows necessarily from appointment as a committee member of the society.[14] In other circumstances, it might be possible to prove that the society had power to fill a particular board place as CCBSA 2014, s 100(3) does not specify that power is deemed to exist only in these cases.

To decide whether a society holds more than half of the nominal value of a company's equity share capital it is necessary to look at its holding as a proportion of the company's total issued share capital (as opposed to its authorised or called up share capital) excluding any part of it which, as to dividend and capital, only carries a right to participate in a distribution up to a specified amount.[15] This means that shares (eg preference shares) with such a restricted right to participate in a distribution of dividend and capital are excluded but those that allow an unlimited right to participate in one of the two are included. Although, in most companies, ordinary shares (or 'equity') will be the only class of voting share capital, the statutory definition could make a company a subsidiary of a society because of the society's holding of non-voting shares if those shares had an unrestricted right to participate in either capital or dividend and the society held more than 50% of the issued share capital of the company when assessed by nominal (as opposed to market) value.

A further oddity of these provisions is that by virtue of the definition of 'company' in CCBSA 2014, s 102, the rules for deciding on whether a company is a subsidiary of a society are to be applied to any body corporate other than registered societies. Thus, for example, a building society's relationship with a society could be judged by the wholly inappropriate criteria that are aimed at dealing with companies.

Slightly different rules apply to decide whether a society has another society as a subsidiary. The first test to be applied is identical to the one applicable in the case of a company in which a society has an interest. That is, that the society is a member of the other society and controls the composition of its committee.[16] If this is not proved to be the case the societies do not form a group on the basis of that test.

Membership of another society is proved in the same way as for a company – shareholding or membership in accordance with the rules. Since CCBSA 2014, s 100(4) applies to shares held by one society in another, those held as fiduciary or as a result of loans in the course of business or the enforcement of a debenture will not count and shares held by nominees for the society will. Control is deemed to exist (and can only be shown to exist) where the society can appoint or remove all or a majority of the members of the committee by the exercise of a power that does not require the consent or concurrence of any other person or is itself a member of the committee and by the use of such a power can appoint or remove either the remaining members or enough for it to have a majority including its own vote.[17] Power to appoint a person is deemed to exist

[13] CCBSA 2014, s 100(2).
[14] CCBSA 2014, s 100(3).
[15] CCBSA 2014, s 102.
[16] CCBSA 2014, s 101(1)(a).
[17] CCBSA 2014, s 101(2).

where he cannot be appointed to the board without the exercise in his favour of a power of that kind by the society or if his appointment to the board of the subsidiary society follows necessarily from his appointment to the board of the other society[18] – but such a power could be proved to exist in other ways.

The other test is one of control of the votes to which members are entitled under its rules. If a majority can be cast by another society then the society is a subsidiary of that society. In a secondary co-operative in which the principle one person one vote does not apply, it is possible for another society to hold control.[19]

In deciding whether either a company or a society[20] is a subsidiary of a society, CCBSA 2014, s 100(4) applies to both the shareholdings of the society and the powers it can exercise. A society cannot avoid the need to prepare group accounts by using a nominee holding. It also ensures that a society does not have to treat a company or other society as a subsidiary just because the society holds shares or has power to appoint directors under a debenture or as security for a loan made to the company or other society in the ordinary course of business or because of its fiduciary status in relation to some other person. A society that does not control a majority of board seats in a company through its power to appoint directors is not regarded as having that company as a subsidiary unless it holds, directly or through a nominee, more than half of the nominal value of the equity. De facto control of a company can sometimes be exercised with less than 50% of the voting rights if other shareholdings are widely dispersed.

9.1.3.2. The group accounts requirement

If the accounting year of the subsidiary society does not coincide with that of the parent society, the parent society is under an obligation to prepare group accounts that deal with the subsidiary's income and expenditure and its affairs as at the accounting year that ended during the accounting year for which the parent society is preparing its accounts. However, the FCA can, on the application or with the consent of the committee of the parent society, direct that some other basis is used to decide which of the subsidiary's accounts are to be used.[21]

The group accounts must submitted to the parent society's auditors who must report on whether the accounts comply with any applicable legislation.[22] That report, the annual return and a copy of the accounts must be sent to the FCA and must be supplied free of charge to members who apply for them.[23]

A society is exempted from the obligation to prepare group accounts even if it has one or more subsidiaries if it is itself a wholly owned subsidiary of another body corporate incorporated in Great Britain (ie England and Wales or Scotland).[24] It will only be a wholly owned subsidiary if it has no members except the other body corporate and wholly owned subsidiaries of that body or their nominees.

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18 CCBSA 2014, s 101(3).
19 CCBSA 2014, s 101(1)(b).
20 CCBSA 2014, s 101(4).
21 CCBSA 2014, s 98(5).
22 CCBSA 2014, s 98(6) and (7).
23 CCBSA 2014, ss 90(1) and (2) and 98(8).
24 CCBSA 2014, s 99(2).

Subject to the FCA's, and if applicable the PRA's, approval, group accounts are not required to deal with a particular subsidiary if in the opinion of the controlling society's committee the value to members or the businesses of the societies are so different that they cannot reasonably be treated as one undertaking. Alternatively, exemption can be claimed on the ground that the result of requiring group accounts would be misleading, or harmful to the business of the society or the subsidiary or otherwise that, given the expense or delay involved in preparing the accounts or the insignificant amounts involved, it is impractical or of no real value to the members to produce such accounts.[25] It is clearly worth seeking such an exemption if the subsidiary has a very small turnover. If these factors apply to all the subsidiaries of a society, the parent society need not produce group accounts.[26]

A society that, in the previous year of account, was exempt from producing group accounts in respect of a particular subsidiary with the FCA's approval under CCBSA 2014, s 99(3) can continue to benefit from the relevant exemption in subsequent years. Continuing exemption depends on the auditor certifying that the society committee and auditor agree that the reason given by the society's committee to get FCA approval the previous year (and the grounds for it) continued to apply throughout this year of account. However, such an auditor's certificate contained in an annual return submitted outside the statutory time limit is disregarded.[27]

This eases the workload of the FCA and obviates the need for annual applications when circumstances have not changed. If group accounts are again necessary in respect of a particular subsidiary after an earlier period of exemption, any later exemption will have to be sought from the FCA for the first year but may then continue on the basis of an auditor's certificate in subsequent years. Exemption without a new application will only be possible while the reason for exemption in respect of any particular subsidiary is unchanged. A change of reason or grounds for a reason will result in a new application to the FCA as the auditor will not be able to certify agreement that the last reason (and ground) given to the FCA continued to apply in the year in question.

9.1.3.3. The content of the group accounts

The specific content of group accounts is prescribed by HM Treasury in the Group Account Regulations.[28] They lay down the general rule that the group accounts should comprise a consolidated balance sheet and consolidated revenue account dealing respectively with the state of affairs of the society and all those subsidiaries forming part of the group and their income and expenditure.[29] These accounts should combine the information contained in the separate balance sheets and income and expenditure accounts of the separate societies and companies in the group. However, the committee of the parent society can make adjustments that it considers necessary to this format.[30]

The fundamental principle embodied in CCBSA 2014, s 98(3) that the group accounts should give a true and fair view of the affairs of the group as a whole so far as concerns members of the parent society overrides anything in the Group Account Regulations.

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25 CCBSA 2014, s 99(3).
26 CCBSA 2014, s 99(4).
27 CCBSA 2014, s 99(5) and (6).
28 Industrial and Provident Societies (Group Accounts) Regulations 1969, SI 1969/1037 ('Group. Accounts Regulations').
29 Group Accounts Regulations, reg 2(1).
30 Group Accounts Regulations, reg 3.

However, the regulations give detailed guidance in their schedule about the content of both the consolidated balance sheet and the consolidated income and expenditure account. They will be consulted by those preparing the group's accounts.

To prevent excessive rigidity and ensure that necessary information will be provided in a form accessible to users of the accounts, the Group Account Regulations allow a society to prepare group accounts in a form different from the one that they lay down. However, the committee may only prepare the group accounts in a different form if it believes that the alternative form is better for presenting the same or equivalent information and ensuring that members can appreciate it.[31] This condition is in addition to the overriding requirement that the accounts present a true and fair view. The detailed provisions of the schedule to the Group Account Regulations are also applied to such an alternative presentation in the sense that the same or equivalent information must be provided.[32]

The examples of alternatives to the consolidated balance sheet and consolidated income and expenditure accounts which are permitted include more than one set of consolidated accounts with the accounts of the society and some subsidiaries in one and the other subsidiaries in the other; separate accounts for each subsidiary and statements expanding the information about subsidiaries in the society's own accounts or any combination of these methods.[33] However, in every case, if a balance sheet is prepared dealing with the society and one or more subsidiaries but not others, the aggregate of the society's assets that consist of shares in or amounts due from the subsidiaries not dealt with in the balance sheet and of the society's indebtedness to those subsidiaries must be shown separately from all other assets and liabilities.[34] This ensures that members have the global picture of the society's financial relationship with its subsidiaries in all cases.

In practice the board or committee of a society should be guided by the advice of their accountants in deciding on the form of both the group accounts and the society's own accounts. Such advisers should follow the detailed provisions of the legislation as well as appropriate accountancy standards issued by the authorised bodies.

9.1.4. Publication and availability of accounts

Annual returns must be sent to the FCA by all societies within seven months of the end of the period to be covered by the return[35] The FCA, or if applicable the PRA, can impose requirements about the form, authentication and delivery of documents sent in electronic form and facilitate the use of that medium but cannot require electronic submission.[36] It is common to engage an accountant or financial adviser to help prepare a society's accounts and annual returns. However, it should be noted that the committee of management is responsible for ensuring that those engaged are competent. They are also responsible for ensuring that the documents are submitted by the due date.[37]

The annual return must always contain the revenue accounts and balance sheet for the year of account to which it relates. No other accounts may be included unless they have

[31] Group Accounts Regulations, reg 2(2).
[32] Group Accounts Regulations, reg 4.
[33] Group Accounts Regulations, reg 2(2).
[34] Group Accounts Regulations, reg 5.
[35] CCBSA 2014, s 89(1).
[36] CCBSA 2014, s 144.
[37] CCBSA 2014, ss 89(1) and 127(1).

been subject to an auditor's report or any accountant's report required in the case of the particular society.[38] The FCA in consultation with the PRA where applicable, issues a form to be used for annual returns.[39]

If the society is required to have its accounts audited under CCBSA 2014, s 82, the annual return must also be accompanied by the auditor's report on the accounts included in the return. If the society has taken advantage of its right to disapply the audit requirement and its turnover did not exceed £90,000, only the annual return itself (including balance sheets and revenue account(s)) need be submitted. If the society has used its right to disapply the audit requirement but has to obtain an accountant's report rather than a full audit because its turnover was over £90,000 but under £5.6 million, a copy of that report must be sent in with the annual return.[40]

A society's year of account will depend on its year of registration. For societies registered on or after 8 January 2012 their first year of account comprises the period of 6 to 18 months that begins with the date of the society's registration and ends with its accounting reference date. Each subsequent year comprises the period immediately after the end of the previous year and ends with the next accounting reference date.[41] Normally the accounting reference date is the anniversary of the society's registration, but the society may notify the FCA of a new accounting reference date, stating whether it is extending or shortening the year of account. Any notification given less than five years since the end of an accounting year was extended or which would have the effect of extending a society's year of account to more than 18 months is invalid.[42]

For societies registered on or before 7 January 2012 the period to be covered by the annual return of a society begins immediately after the end of the previous year of account. It ends with the date of the society's last published balance sheet as long as the balance sheet was published between 31 August and 31 January (inclusive). Otherwise, it ends on the 31 December that falls within that period.[43] As with societies registered on or after 8 January 2012 it is possible to alter a society's accounting reference date by notifying the FCA and stating whether the accounting year is being shortened or extended. Any notification that was given less than five years since the end of an accounting year was extended or which would have the effect of extending a society's year of account to more than 18 months.[44]

The society must supply a copy of its latest annual return, and any auditors' report or group accounts that may be required (see below), free of charge to members and others interested in the funds of the society (for example, creditors) who apply for it.[45] This requirement can be complied with by making these documents available via a website so long as certain conditions are satisfied. The person supplied with the document by this means must have agreed to the use of the website and not have revoked that agreement. He or she must also have been notified by the society of the website address, the fact that the documents are on it and how and where on the website to access them. The documents must be present on the website for the whole period from the day on which

38 CCBSA 2014, s 89(2).
39 CCBSA 2014, ss 143 and 144.
40 CCBSA 2014, s 89(2) and see Section **9.2.5.** below.
41 CCBSA 2014, s 77(2)–(4).
42 CCBSA 2014, s 77(5)–(7).
43 CCBSA 2014, s 78(2) and (3).
44 CCBSA 2014, s 78(6).
45 CCBSA 2014, s 90(1).

notification was given of their presence there (or, if later, the day on which it first appeared there) to the day on which the documents ceases to be the society's latest return, subject only to disregarding any period during which the return was absent due wholly to circumstances that the society could not reasonably have been expected to prevent or avoid.[46]

In line with the general policy on the use of electronic means this provision permits but does not compel societies to display their annual returns on their websites and requires each person being supplied with a copy in that way to consent to that method of supply. In the case of members, that could easily be achieved, together with the notification of how to access the return by communication with them. However, in the case of creditors, the consent may need to be incorporated, together with the notification of how to access the return, in the contract leading to the society's debt to them. It is also noteworthy that the society need not display the return on its own website, only 'a' website and that the whole procedure is simply a substitute for the supply of the return on request. It does not impose any general obligation always to supply the return to members or others through a website or otherwise.

As mentioned above, every copy of the annual return supplied must be accompanied by group accounts and the relevant auditor's report (if any) in respect of the accounts and balance sheet included in the return.[47] This reflects the policy that any accounts published by a society must include all relevant information to provide a true and fair view of the society's affairs.

This requirement applies to societies that are required to have a full audit and exempt societies required to obtain only a more limited report in under s 85(2)(a) of CCBSA 2014. Section 82 of CCBSA 2014 sets out the requirements in tabular form. It provides that it is permissible to publish year-end accounts in these circumstances without a full audit report but with any report that is required and makes similar provisions in respect of the publication of interim revenue accounts or balance sheets during the course of an accounting year.[48] Where an interim revenue account and balance sheet are published together with the latest year-end revenue account and balance sheet and are clearly marked as 'unaudited', it is not necessary to include a report in respect of the interim documents.[49] All published revenue accounts and balance sheets must be signed by the society secretary and two committee members on behalf of the committee.[50]

Every society must keep a copy of its latest balance sheet on display in a conspicuous position at its registered office.[51]

9.1.5. Inspection of accounts

A member of a society and any person having an interest in its funds may inspect his or her own capital, loan or deposit accounts and other parts of the register of members not showing details of the financial interests of other members.[52] In addition, society rules can allow the inspection of other books or accounts of the society by members so long as

[46] CCBSA 2014, s 90(3) and (4).
[47] CCBSA 2014, s 90(1) and (2).
[48] CCBSA 2014, s 82(1) rows 2–6 of Table.
[49] CCBSA 2014, s 82(2).
[50] CCBSA 2014, s 82(1) row 1.
[51] CCBSA 2014, s 81.
[52] CCBSA 2014, s 103(1).

only an officer of the society or someone authorised by resolution can inspect the loan or deposit account of another person without their written consent.[53] It is unusual for the rules of societies to extend the rights of members in this way but it might, for example, be a useful provision in the rules of a small workers' co-operative run on collective lines. The financial information available to members is normally only that presented to the general meeting and that which is contained in the annual return available for public inspection at the FCA – a copy of which must be furnished to a member free of charge by the society on request.[54] Outside these provisions the Act specifically states that members have no rights of inspection of a society's books or accounts.[55]

9.1.6. Corporate governance and financial information

The corporate governance code for consumer co-operative societies published by Co-operatives UK deals with a number of matters relevant to the accounting practices of societies. The accuracy, content and timing of the financial information available to members is an important aspect of corporate governance. The availability of such information is a necessary condition for the effective scrutiny by members of the performance of both the directors and the senior executives of a society. It is also relevant to the effectiveness with which the board control and monitor senior managers.

The Corporate Governance Code draws on best practice from a wider business setting, including the UK Corporate Governance Code[56] applicable to listed companies, but reflects the distinctive characteristics of consumer co-operatives. Certain societies may feel that complying with the entire code is inappropriate considering their size and amount of turnover. However, the principles contained in the code are worthy of consideration by all societies.

In respect of the annual report, it is important to ensure that it represents a fair, balanced and understandable assessment of the society's activities.[57] It is for the board to ensure that the report and accounts contain a coherent statement of the society's performance and prospects which also contains areas of poor performance and success in clear language.[58] The annual report is to contain a statement of how the board operates, including which types of decision are to be taken by the board and which ones are delegated to management executives. It should also include details of how the board has identified risk and managed it.[59]

The Code recommends the use of an audit committee to deal with: matters involving the audit or the auditors; financial statements; and the society's internal control and risk management.[60] This should help to ensure that directors are fully apprised of these matters and monitor and control senior managers in an appropriate way. The audit committee should at least annually conduct a review of the effectiveness of the society's system of internal control and risk management processes, where there is no internal

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53 CCBSA 2014, s 104.
54 CCBSA 2014, s 90.
55 CCBSA 2014, s 108 and 109.
56 Financial Reporting Council, *The UK Corporate Governance Code*, September 2012.
57 Co-operatives UK, *Corporate Governance Code for Consumer Co-operative Societies,* November. 2013 ('CUK Code 2013') High Level Principle T.
58 CUK Code 2013 Supporting Principle T.
59 CUK Code 2013, paras 163 and 164.
60 CUK Code 2013, paras 123–152.

audit function the society should consider annually whether an internal audit function is necessary and make the appropriate recommendation to the board.[61]

The Code recommends that the independence of the auditors should be bolstered by changes in the audit partner dealing with the society at least once every five years and the audit committee should develop a policy for the engagement of the external auditor to supply non-audit services. And any fees paid to the auditor for non-audit work should be disclosed in the annual report.[62]

9.1.7. Accounting and audit offences under CCBSA 2014

CCBSA 2014 provides for the enforcement of the accounting and audit requirements as part of its creation of general criminal offences of failing to comply with the legislation.[63]

Any person, including a registered society, a society officer or a member, commits an offence if they fail to do or to allow to be done anything, including giving a notice or sending a return that CCBSA 2014 requires them to do or allow.[64] Similarly, wilfully neglecting or refusing to do anything, including providing information, required for the purpose of the Act by the FCA, the PRA or anyone authorised under the CCBSA 2014; doing anything forbidden by the Act; or making a required return or providing information that is false or insufficient are all offences.[65] Those general offences apply to requirements concerning accounts and returns.

In addition, a separate offence is created for any registered society that contravenes or fails to comply with any provision (other than certain listed provisions) of CCBSA 2014 Part 7, which deals with accounts, audit and annual return.[66] The CCBSA 2014 provisions listed as not leading to a separate offence are those concerned with definitions eg ss 77 and 78 on year of account, and failures covered by the general offence: s 81 (not displaying the balance sheet at the registered office); s 89(1) (not submitting an annual return to the FCA in time); and s 90(1) (not providing an annual return to a member on demand). Any other a failure to comply with a duty concerning accounts, audits and annual returns amounts to an offence by the society and, potentially, by officers or committee members under s 128 of CCBSA 2014.

That section provides that if a society commits any offence under CCBSA 2014, the offence is treated as also having been committed by every officer of the society who is bound by its rules to fulfil the duty of which the offence is a breach, or if there is no such officer, every member of its committee. However, it is a defence for an officer or committee member to prove that they were ignorant of, or attempted to prevent, the commission of the offence.[67] That extension of criminal liability to officers and committee members applies to offences concerning Part 7 obligations and all other offences by societies except those that create their own separate offences for officers.[68]

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61 CUK Code 2013, paras 145, 147 and 148.
62 CUK Code 2013, paras 136–140.
63 See Section **10.2.1.** below.
64 CCBSA 2014, s 127(1) (a) and (b).
65 CCBSA 2014, s 127(1) (c), (d) and (e).
66 CCBSA 2014, s 127(2).
67 CCBSA 2014, s 128(1) and (2).
68 CCBSA 2014, s 128(3) referring to CCBSA 2014, ss 12 and 50(2) and (3).

It is a specific separate offence to make, remove or omit entries in balance sheets accounts and returns with intent to falsify the document or to evade a provision of CCBSA 2014. It is also an offence to order or allow others to do so.[69]

Any committee member or director who fails to take all reasonable steps to ensure that the accounts give a true and fair view of the society's affairs is guilty of another specific offence. It is, however, a defence if such a person shows that he had reasonable grounds to believe and did believe that some other person was charged with that duty and that the person responsible was competent and reliable.[70] This defence will apply in cases in which the board has given responsibility to a chief executive or other officer providing there was no evidence available to the board that would lead a reasonable director to believe that the duty was not being carried out. The production by the person responsible for financial management of accounts that were obviously inaccurate or inadequate or a failure to produce accounts at all could provide such evidence. Similarly, the appointment of an obviously incompetent or inexperienced person to carry out the function could make directors liable. In a case in which extra information available to a particular director in fact led him or her to believe that the accounts did not provide a true and fair view, there could also be liability. In the case of a prosecution for this offence, it would be for the prosecutor to establish beyond a reasonable doubt that the director had failed to take reasonable steps to secure compliance with the Act but the defence of delegation would have to be established on the balance of probabilities by the accused.

A failure to prepare accounts and to operate a financial control system appropriate to the size of the society and the extent of its business and, as a minimum, for all societies to comply with the accounting requirements of CCBSA 2014 may result in a court order imposing liability on the directors of a society for wrongful trading should the society go into insolvent liquidation.[71] Such failures may also lead to disqualification from participation in the management of a business for directors responsible under the Company Directors' Disqualification Act 1986.[72]

9.2. AUDIT

9.2.1. Rationale and outline

An important safeguard for the members of societies and others who deal with them is the general rule requiring a properly qualified and independent auditor to report on the society's accounts. Subject to the exceptions discussed below, only accounts so audited can be submitted to the FCA with the annual return. The society's rules will provide for the receipt of audited accounts by the society's annual general meeting. Generally, an auditor is required to report to the society.[73] This implies that a report must be presented to a general meeting and the rules of all societies must provide for the appointment of an auditor and, subject to the two exceptions discussed in the next paragraph, every society

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69 CCBSA 2014, s 131.
70 CCBSA 2014, s 80(4), (5).
71 Insolvency Act 1986, s 214 and *Re Produce Marketing Consortium Ltd* (1989) 5 BCC 569.
72 Company Directors Disqualification Act 1986, ss 22E and 3, and Sch 1, paras 1 and 4 read in the light of s 22E.
73 CCBSA 2014, s 87(2).

must appoint an auditor.[74] These provisions underline the central role of the audit process in the financial aspect of the corporate governance of societies.

This general rule is, however, subject to two exceptions. One is the possibility of an audit by an unqualified lay auditor in the case of any society with receipts and payments of no more than £5,000 in the preceding year of account; assets no greater than that amount at the end of that year and no more than 500 members.[75] This exception applies to any society and could therefore be used by a society not permitted to use the other exception because it is, for example, a deposit taker or is or has a subsidiary. However, it is unlikely that a society meeting the £5000 threshold for a lay audit would be in those categories.

The second exception to the requirement of a professional audit permits certain societies to choose to 'disapply' the audit requirement altogether.[76] The purpose of this deregulation measure is to ease the burden on small businesses for which the cost of an auditor's report may be very significant. If the vast majority of the owner members of such a business do not regard an audit as necessary, it seems perverse to insist on such a measure. The auditors, after all, report to the members in general meeting and if those members are content to forgo this right in return for a significant cost saving, it can be argued that they should not have it forced upon them by the legislation. Of course, the audited accounts contained in a society's annual return are available on the public record to employees, creditors or others dealing with the society and the absence of an audit may affect the interests of those parties. However, the time lapse between the period covered by the accounts and the date on which they become available for public inspection is such that this safeguard is likely to be of theoretical rather than practical value.

Section 84 of the CCBSA balances the interests involved by limiting the range of societies that may disapply the audit requirement by reference to turnover and asset value as well as excluding deposit-taking societies and others subject to close regulation such as housing associations or insurance businesses. It requires an 80% majority of members actually voting to favour disapplication and less than 10% of the society's total membership to vote against it. A general discretion also remains with the FCA to insist that a society has its accounts audited either at the end of the current year or for earlier years when a disapplication was in force.

9.2.2. Opting out of an audit

A society can decide to free itself from the audit requirement providing three conditions are satisfied:[77]

- the financial criteria;
- excluded societies; and
- the decision.

The resolution to disapply the audit requirement will have no effect and therefore not apply to the year's accounts if the society is, at any time during the year of account, a

[74] CCBSA 2014, s 83(1).
[75] CCBSA 2014, s 83(2).
[76] CCBSA 2014, s 84.
[77] Ibid.

subsidiary or holding society, a deposit-taker or otherwise prohibited from opting out. The resolution also has no effect if, during the year of account, the FCA gives notice to end it.[78]

The criteria are now considered in turn.

9.2.2.1. The financial criteria

A co-operative of community benefit society can decide to dispense with a full audit for a year of account only if, at the end of the year of account immediately preceding that year, it met criteria about the scale of its turnover and the size of its assets. For a non-charitable society the criteria are that turnover did not exceed £5.6 million and assets amounted to £2.8 million or less.[79] In the case of a charitable society, the assets must have amounted to £2.8 million or less and 'gross income' must not have exceeded £250,000.[80] A society that opts out of a full audit having met the conditions for doing so and which had a turnover of £90,000 or less in the preceding year of account need commission no report on its accounts. A society that has disapplied the full audit requirement but had a turnover in excess of £90,000 in the preceding year of account has to obtain an accountant's report.[81]

'Turnover' is calculated for a year of account by totalling all amounts derived from the provision of goods and services falling within the activities of the society and deducting from the resulting figure trade discounts, VAT, and any other taxes based on turnover.[82] This definition also applies in deciding whether an accountant's report is required under CCBSA 2014, s 85.

A society's 'year of account' depends on whether it was registered before or on or after 8 January 2012.[83]

9.2.2.2. Excluded societies

Apart from the financial criteria, the range of societies allowed to disapply the audit requirement excludes those seen as requiring full disclosure and regulation because of their business or status.

9.2.2.2.1. Holding and subsidiary societies

Both holding and subsidiary societies are excluded from the power to disapply the audit requirement. This ensures that the accounts of any society which is part of a group (as either a holding society or a subsidiary), and which is therefore subject to the rules governing group accounts, are always audited. This assists in ensuring both that the society's accounts conform with accounting requirements and, unless an exemption applies, that group accounts are available to provide clear information about the group as a whole so as to avoid a misleading fragmentation of the group's accounts. However, the ban on subsidiaries and holding societies disapplying the audit requirement applies

78 CCBSA 2014, s 84(5).
79 CCBSA 2014, s 84(1).
80 CCBSA 2014, s 84(6).
81 CCBSA 2014, s 85(1) and see Section **9.2.4.** below.
82 CCBSA 2014, s 102.
83 See CCBSA 2014, ss 77 and 78 and Section **9.1.3.** above.

whether or not group accounts are in fact required in a particular case. Even a society that is part of a group, all of whose members are exempt from the group account requirements under s 98 of CCBSA 2014, has to meet the audit requirement.

Any society with either another society or any other corporate body as a subsidiary and any society that is a subsidiary of a society or any other corporate body must meet the full audit requirement.[84] In each case, the concept of 'another corporate body' includes but is not limited to a company.

9.2.2.2.2. Credit unions and deposit-takers

The right to opt out of an audit does not apply to credit unions within the meaning of the Credit Unions Act 1979.[85] This excludes all credit unions without reference to their specific activities.

Any society that has held a deposit,[86] other than in the form of withdrawable share capital, since the end of the previous year of account is also required to meet the full audit requirement.[87] Unlike a credit union, which is excluded by virtue of its registration as such, other societies may fall in and out of the deposit-taking category depending on whether they have in fact held any deposits within the Regulated Activities Order definition[88] since the end of the preceding accounting year.

The importance of prudential supervision and the protection of investors and depositors justifies the exclusion of these societies from the right to opt out of audit provisions.

9.2.2.2.3. Housing and insurance societies

Those societies subject to their own particular rules on accounts are excluded from opting out of a full audit on the basis that this would deny necessary information to the regulator and the public. Thus societies registered as registered social landlords in Scotland and societies required to prepare accounts under the Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 2008, SI 2008/565 cannot opt out of the audit requirements.[89]

9.2.2.3. The decision

A society wishing to exercise its power to disapply the audit requirement must pass a resolution at a general meeting at which less than 20% of the total votes cast are against it **and** less than 10% of the members entitled to vote under the society's rules at that time cast their votes against it.[90]

It appears that for the purpose of the first test, which refers to 'total votes cast', the proportion cast against opting out would be calculated on the basis of voting rights

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84 CCBSA 2014, ss 84(3), 100 and 101.
85 CCBSA 2014, s 84(3)(a).
86 CCBSA 2014, s 102 applies FSMA 2000, s 22 and Sch 2 and orders made under them to define 'deposit'.
87 CCBSA 2014, s 84(3)(d).
88 See Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, SI 2001/544, art 5.
89 CCBSA 2014, s 84(3)(e) and Insurance Accounts Directive (Miscellaneous Insurance Undertakings). Regulations 2008, SI 2008/565, reg 14.
90 CCBSA 2014, s 84(2).

conferred by the rules. Thus if a secondary co-operative gave each member votes linked to transactions with the society one would analyse the proportion of votes on that basis as the member 'casts' a certain number of votes. However, for the purpose of the second '10%' test the reference to '10% of the members of the society for the time being entitled under the society's rules to vote' might result in an analysis of the members' votes on the basis of one member one vote in calculating the proportion of the total membership which 'cast their votes against the resolution' to disapply the audit requirement. In the case of societies with a 'one member one vote' rule this distinction would make no difference to the outcome but the issue could be important in the context of a federal or secondary co-operative.

Since a new resolution is required for each year for which the audit requirement is disapplied, if a large minority of members wish there to be an audit for a particular year of account the necessary majority will not be found for the resolution for that year.[91] Dissatisfied members who seek an audit can also request the FSA to use its powers to require a full audit for the current year or earlier years.[92]

A decision to opt back in to the full audit requirement for a particular year will necessarily involve the appointment of an auditor in accordance with the society's rules. If an auditor was in place for the previous year she is not subject to automatic reappointment once the society has decided to disapply the audit requirement in relation to the current year of account.[93]

9.2.3. Appointment and removal of an auditor

Where the audit requirement applies to a society, a qualified auditor must be appointed – subject only to the exception for very small societies.[94] Where a society has disapplied the audit requirement but has to obtain an accountant's report, that report must be made by a qualified auditor eligible to audit that society's accounts.[95] An auditor must be eligible for appointment as a company auditor.[96]

An auditor must be a member of a recognised supervisory body and be eligible for appointment under the rules of that body.[97] The following bodies have been recognised by the Department of Business Innovation and Skills (BIS) for this purpose:[98]

- the Institute of Chartered Accountants in England and Wales;
- the Institute of Chartered Accountants in Scotland;
- the Institute of Chartered Accountants in Ireland;
- the Chartered Association of Certified Accountants;
- the Association of Authorised Public Accountants; and
- the Association of International Accountants.

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91 CCBSA 2014, s 84(1).
92 CCBSA 2014, ss 84(4) and 86.
93 CCBSA 2014, s 93(2)(c).
94 CCBSA 2014, s 83.
95 CCBSA 2014, s 85(2).
96 CCBSA 2014, s 91 and Companies Act 2006, Pt 42.
97 Companies Act 2006, s 1212.
98 *Palmer's Company Law*, para 9.545.

The exception for small societies applies in any accounting year in which a society has both turnover and assets worth less than £5,000 and fewer than 500 members.[99] In such circumstances a society may appoint two or more unqualified auditors – although this requires a resolution of the general meeting or the incapacity, ineligibility or resignation of a qualified auditor if he or she is to be replaced by the unqualified auditors.[100] The FCA has power to direct an exempt society to appoint a qualified auditor either in respect of the current year or an earlier year.[101] The figures for turnover, assets and membership defining a small society can be varied by HM Treasury in regulations that may also define the receipts and payments to be taken into account to determine those figures.[102]

In addition to the professional qualifications required of auditors, the Act demands a degree of independence from the society and its officers. No officer or employee of a society or their partner, employee or employer may act as auditor. The prohibition also extends to people with such relationships with the society's subsidiary and holding societies or subsidiary companies.[103] These provisions avoid the most obvious difficulties about influence on auditors. It is, however, common with societies as with companies for a firm of accountants who act as auditors to advise the society between audits or for other arms of the firm to offer other services such as management consultancy to audit clients. While the professional rules of accountants and the practices of firms seek to deal with this situation by segregating different functions within the firm, it is perhaps unsatisfactory if the firm auditing accounts and reporting to members are beholden to management for the allocation or continuation of lucrative contracts. The Co-operatives UK corporate governance code for consumer co-operative societies deals with this problem by requiring full disclosure of non-audit fees paid to the auditing firm in the society's annual report and recommending that the co-operative's board should have an agreed policy for retendering the provision of the external audit at least every 10 years.[104] An auditor may be a corporate body, an individual, or a partnership firm.[105]

The rules of societies must lay down how an auditor is to be appointed.[106] The rules normally confer this power on the general meeting. Such power must be limited to the appointment of people who are qualified to act as auditors.

To ensure that auditors cannot be removed by management without the agreement of the members to whom the auditors report, CCBSA 2014 lays down detailed rules about the procedures to be followed to remove an auditor. It provides for the automatic reappointment of a qualified auditor who is already in place unless he or she resigns in writing, or becomes incapable or ineligible because of a connection with the society or by ceasing to be a qualified auditor. Otherwise only a general meeting resolution can prevent reappointment by disapplying the audit requirement (if the society qualifies to do so)[107]; appointing another auditor; or expressly stating that there should be no reappointment of the retiring auditor.[108] For resolutions to remove or replace the

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99 CCBSA 2014, s 83(4).
100 CCBSA 2014, ss 83(2)(b) and 93.
101 CCBSA 2014, s 83(3).
102 CCBSA 2014, s 83(5).
103 CCBSA 2014, s 92.
104 Co-operatives UK, *Corporate Governance Code for Consumer Co-operative Societies* (November 2013) paras 140–141.
105 Companies Act 2006, ss 1173 and 1212.
106 CCBSA 2014, s 14(10).
107 See Section **9.2.2.** above.
108 CCBSA 2014, s 93.

existing auditor, 28 days' notice of the intention to move the resolution must be given to the society and it must serve notice of that resolution on the members and the retiring auditor. If possible, the society should give members notice of the resolution at the same time as the notice of the meeting at which it is to be discussed. If that is not done, notice must be given to members at least 14 days before the meeting either by notice in a newspaper or in some other way allowed by the society's rules.[109]

If a resolution to replace a retiring auditor cannot be proceeded with because the proposed new auditor is disqualified, incapable or states in writing that he does not wish to be appointed then a resolution reappointing the former auditor or appointing someone else will be valid without notice regardless of the provisions of the society's rules.[110] The retiring auditor always has the right to make written representations that the society must make available to members. It must notify them that they can obtain copies of the representations and must send them out on request. If conditions equivalent to those applicable to displaying a society's annual return and consolidated accounts on a website are met, a society may meet its obligation to send a member a copy of the auditor's representations by displaying them on its website for at least 28 days. The auditor may also make representations at the meeting and insist that his written representations are read out.[111]

9.2.4. The audit

The auditors of a society must make a report to the society on the accounts examined by them and on the revenue account and balance sheet of the society for the year of account in respect of which they were appointed.[112] The report must state whether the accounts comply with the legislation and whether they give a true and fair view of the society's affairs. This obligation applies principally to the revenue accounts and the balance sheet but where the report relates to other accounts, it must state whether those accounts give such a view of the matters to which they relate.[113]

In preparing their report, the auditors have a duty to carry out such investigations as will enable them to form an opinion on whether the society has kept proper books of account and maintained a satisfactory system of control over transactions and whether the revenue account, other accounts to which the report relates and the balance sheet are in accordance with the society's books of account. Having gathered this information, the auditors will form an opinion. If they take the view that the society has failed to comply with the accounting provisions of the Act or that the revenue accounts and balance sheet are not in accord with the books they must state this in their report.[114] They perform the same function in respect of group accounts.[115]

This process will involve checking the society's system of financial controls and its system of stock control – often by means of spot checks. A failure by the auditor to investigate matters giving rise to suspicion in the manner to be expected of a reasonably

[109] CCBSA 2014, s 94.
[110] CCBSA 2014, s 93(4).
[111] CCBSA 2014, ss 95(2) and (4) and 96.
[112] CCBSA 2014, s 87(2).
[113] CCBSA 2014, s 87(3).
[114] CCBSA 2014, s 87(5).
[115] CCBSA 2014, s 98(7).

competent auditor may make him liable to pay damages under the tort of negligence to the society, but not normally to individual members, creditors or members of the public.[116]

The auditors of a society have a right of access at all times to the books, deeds and accounts of the society and to all other documents relating to its affairs. They are entitled to insist that the officers of the society provide any information or explanation that the auditor considers necessary for the audit. If the auditors are denied any information or explanation that they believe to be necessary for the purpose of the audit, they are to refer to the fact of non-compliance in their report.[117]

In addition, the auditors are entitled to attend any general meeting of the society and to receive all notices of, and communications about, general meetings that are available to members. They have a right to be heard on any of the business that concerns them as auditors at any general meeting which they attend.[118]

The society is responsible for the payment of the auditor's fee and, although CCBSA 2014, s 97 provides for the Treasury to lay down a maximum fee, this has not been done.

9.2.5. Accountant's report under s 85 CCBSA 2014

Where a society has opted out of a full audit of its accounts for a particular year of account but its turnover in the preceding year of account exceeded £90,000, it must obtain an accountant's report.[119] Thus even if the turnover in the later year (to which the report primarily relates) was less than £90,000, a report is required if turnover exceeded that figure in the preceding year and, conversely, no report is needed for a later year (regardless of the size of turnover) if turnover in the preceding year was under the £90,000 threshold.

If a report is required, a person qualified to audit the society's accounts must be appointed within 28 days of the end of the year of account to make it. The report examines the preceding year of account only to confirm that the financial criteria for disapplying the audit requirement were met. Its primary role is to deal with the revenue and other accounts and balance sheet of the society for the last year of account to examine whether they are in agreement with the society's books of account and whether they and the books of account comply with the requirements of CCBSA 2014.[120] This is somewhat less demanding than the full audit requirements, which expressly require both an analysis of whether the accounts, books and balance sheet give a 'true and fair view' of the society's position and an investigation of the existence of control systems as well as the veracity of the accounts and balance sheet.

Section 88 of CCBSA 2014 gives the person appointed to prepare the s 85 report all the powers of an auditor to obtain access to books, deeds, and documents as well as

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[116] *Caparo Industries plc v Dickman* [1990] 1 All ER 568.
[117] CCBSA 2014, s 87(6) and (7).
[118] CCBSA 2014, s 87(8).
[119] CCBSA 2014, s 85(1).
[120] CCBSA 2014, s 85(2).

information and explanations from the society's officers. She is also given access to the general meeting and a right to be heard there on matters relevant to the report.[121]

The provisions about the remuneration of auditors by the society also apply to reporting accountants.[122]

9.3. THE FCA'S POWERS UNDER COMPANY LAW

9.3.1. Legal basis of powers

To provide the FCA with powers equivalent to those available to Department for Business Innovation and Skills (BIS) in respect of company inspections and investigations, CCBSA 2014 gives HM Treasury power to make regulations to apply Parts 14 of the Companies Act 1985 to registered societies.[123] The existing power was used to make the Co-operative and Community Benefit Societies and Credit Unions (Investigations) Regulations 2014, SI 2014/574 ('The Investigation Regulations') which gave the FCA most of those powers with necessary modifications from 6 April 2014. At the time of writing those regulations seem likely to continue in force after 1 August 2014.[124]

The Investigation Regulations repealed s 48 of the IPSA 1965, which allowed the FCA to require a society to produce documents and provide it with information.[125] Instead the FCA has gained a far less blunt and much more specific toolkit of powers.[126] In deciding whether and how to exercise those powers, the FCA must adopt an approach based on the principle that its powers should be exercised only to the extent necessary to maintain confidence in societies.[127] This underlines that in so far societies do not carry on regulated activities under financial services legislation, the FCA is not a supervisory authority but a registrar with extended powers to ensure compliance with the requirements of CCBSA 2014.

Part 14 of the Companies Act 1985 contains powers in three categories:

- power to appoint investigators and direct them (ss 432–434, 436, 437, 439, 441, 446A–446E Companies Act 1985);
- powers to obtain and share information (ss 447, 447A, 448A–452 Companies Act 1985); and
- powers to enter and remain on premises (ss 448, 453A–453D Companies Act 1985).

They are now dealt with in turn.

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121 CCBSA 2014, s 88(4).
122 CCBSA 2014, s 97.
123 CCBSA 2014, ss 135 and 136 replacing Co-operative and Community Benefit Societies and Credit Unions Act 2010, ss 4, 6 and 7.
124 By virtue of CCBSA 2014, s 151 and Sch 5, paras 1 and 5.
125 Co-operative and Community Benefit Societies and Credit Unions (Investigations) Regulations 2014, SI 2014/574 (The Investigation Regulations), reg 3.
126 The Investigation Regulations, reg 2(3).
127 The Investigation Regulations, reg 3.

9.3.2. Appointment and direction of inspectors

The FCA must appoint one or more inspectors to investigate the affairs of a society and have the inspectors report any findings to it if the court orders an investigation.[128]

The FCA may also use that power on its own initiative if it appears to the FCA that there are circumstances suggesting that:[129]

- the society's affairs are being or have been conducted for a fraudulent or unlawful purpose, or in a manner that is unfairly prejudicial to some part of its members or the society's affairs have been conducted with an intention to defraud its own creditors or the creditors of any other person; or
- a particular act or omission would unfairly prejudice some part of its members or that the society was formed for any fraudulent or unlawful purpose; or
- persons concerned with the society's officers or founding members have in connection with the society been guilty of fraud, misfeasance or other misconduct towards it or towards its members; or
- the society's members have not been given all the information with respect to its affairs that they might reasonably expect.

The inspectors must issue a final report on the conclusion of their investigation.[130] However, this does not prevent the FCA from requesting interim reports or asking to be kept informed of any information that comes to the inspector's knowledge during the investigation. The FCA may specify the manner and form in which reports should be made and the date by which it requires them.[131]

The FCA has a discretion to decide whether to print and publish the report and whether or not to share the report with the society itself or, upon payment of a fee, with any person who is referred to in the report, auditors, members of the society or any other person whose financial interests appear to be affected by the matters dealt with in the report.[132] However, the FCA may also decide from the outset that the report is not intended for publication, in which case the FCA is not required to share it with anyone.[133]

An inspector's report and any opinion it contains is not a legal decision and therefore not binding on any person in the way that a court decision or a formal decision by the FCA could be. It only represents the facts, conclusions and opinions of the inspector but can provide sufficient material, if unchallenged, on which to base a winding up order on the 'just and equitable' ground.[134] This position has been criticised because it means that the person subject to a report has no means of defending himself if the report makes unjust findings. There is no right of appeal against the outcome of a report and, more importantly, it is not possible to prevent its publication. While there is no certainty that proceedings are going to follow from an investigation by an appointed inspector, a copy

[128] Companies Act 1985 (CA 1985), s 432(1).
[129] CA 1985, s 432(2).
[130] CA 1985, s 437(1) and (1A).
[131] CA 1985, s 446A(3)(c) and (d).
[132] CA 1985, s 437(3).
[133] CA 1985, s 432(2A).
[134] See *Re SBA Properties Ltd* [1967] 1 WLR 799, 806.

of any report is admissible in any legal proceedings as evidence of the opinion of the inspectors in relation to any matter contained in the report if the report is certified by the FCA to be a true copy.[135]

When appointing an inspector and throughout her ongoing investigation the FCA may, on its own behalf or when requested by the inspector, direct the inspector in respect of the subject matter of the investigation or to take or refrain from taking a specified step. This allows the FCA effectively to steer the investigation to a specific area of the society's operations, a specific transaction or a period of time.[136] The FCA has extensive expertise in carrying out investigations as part of its functions under the relevant financial services legislation. The FCA's enforcement and financial crime division is staffed with forensic accountants, investigators and solicitors. The FCA could therefore appoint one or more of its own employees as inspectors under CA 1985, s 432. However, it is also possible, depending on the scope of the investigation, for an inspector with a particular set of skills and experience to be appointed. In those circumstances, the FCA can direct the inspector to include their views on a specific matter in the report or to omit any reference to a particular matter.[137]

An appointment under s 432 of the Companies Act 1985 allows an inspector not only to investigate the affairs of a society itself but also the affairs of the society's subsidiaries as defined in CCBSA 2014, s 100.[138] Inspectors have power to report on the affairs of any subsidiary in so far as the inspector thinks that the results of the investigation into the subsidiary are relevant to the investigation of the society.[139]

All officers of the society (including bankers, solicitors and persons employed by the society) and, if applicable, any of its subsidiaries have a duty to produce to the inspectors all documents of or relating to the society that are in their custody or power. They must also attend before the inspectors when required to do so and generally provide all the assistance they reasonably can to help the inspectors with the investigation.[140] However, where the inspector believes that an officer of the society, or a subsidiary if applicable, or any other person may be in possession of information relevant to the investigation, the inspector can require that person to produce any documents in his custody, to attend before the inspector or otherwise assist with the investigation as far as may be reasonably possible. For the purposes of the investigation the inspector may examine any person on oath and administer oaths accordingly and the offence of perjury applies.[141] For this purpose, a document includes information recorded in any form and an inspector may take copies of or extracts from a document produced in pursuance of his investigation.[142] This power is subject to two exceptions. First, an inspector cannot compel disclosure of legally privileged information.[143] Second, information or documents subject to an obligation of banking confidentiality owed to someone other than the society under investigation (or one of its subsidiaries) cannot be

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135 CA 1985, s 441.
136 CA 1985, s 446A(1) and (2).
137 CA 1985, s 446A (3)(a) and (b).
138 Investigation Regulations, reg 2, and see Section **9.1.3.** above for the definition of a subsidiary.
139 CA 1985, s 433.
140 CA 1985, s 434(1) and (4).
141 CA 1985, s 434(2), (3) and (5B).
142 CA 1985, s 434(6) and (8).
143 CA 1985, s 452(1).

disclosed unless the person to whom the obligation of confidence is owed consents and the requirement to disclose the information or documents is specifically authorised by the FCA.[144]

Any answers received by the inspector from a person may be used against that person as evidence only in civil or non-criminal proceedings.[145] Where a person fails or refuses to co-operate with the inspector by not providing documents required, not answering questions or not providing assistance, the inspector may certify the failure or refusal in writing to the court. If, after hearing any witnesses and any statement offered in defence, the court is satisfied that that the offender failed without reasonable excuse to comply, it may deal with the failure or refusal as contempt of court.[146]

If an inspector dies, or resigns, or if the FCA revokes her appointment, the FCA must appoint a replacement inspector so that at least one inspector continues the investigation.[147] However, the FCA may at any point direct an inspector to take no further steps in the investigation, without appointing a replacement inspector, if matters that have come to light in the course of the investigation suggesting that a criminal offence has been committed have been referred to the prosecuting authorities. In those circumstances no final report is required unless either the FCA directs the inspector to make one or the inspector was appointed by court order.[148]

Where the FCA terminates an investigation, an inspector resigns, or the FCA revokes the inspector's appointment, the FCA can direct the former inspector to produce to the FCA or a new inspector any documents and information generated by the inspection.[149]

Any expenses of an investigation are initially met by the FCA. However, the FCA can recover the expenses from the society in whole or in part to the extent that it considers it just to do so.[150] Where a person is convicted as a result of the investigation the court can determine their liability for the costs of the investigation and order payment accordingly. The order can also indemnify others who have already paid in accordance with an FCA decision. For example, a convicted officer or director could be ordered to indemnify the society if it had already paid. Where inspectors were appointed by an order of the court, the report can include a recommendation about liability for the expenses of the investigation. The FCA may direct the inspector to include such a recommendation.[151]

9.3.3. Investigation under s 447 of the Companies Act 1985

This provision allows the FCA to embark on an investigation on its own initiative to gather information using extensive powers but without appointing an inspector under s 432 of the Companies Act 1985.[152] Section 447 provides a less costly and more flexible power under which FCA employees are likely to be used. An inspector will often be an outside appointee.

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144 CA 1985, s 452(1A).
145 CA 1985, s 452(5).
146 CA 1985, s 436.
147 CA 1985, s 446D (3).
148 CA 1985, ss 446B (1)–(4) and 446D(4).
149 CA 1985, s 446E.
150 CA 1985, s 439(4) and (4A).
151 CA 1985, s 439(6).
152 See Section **9.3.2.** above.

The FCA, or its authorised investigator, can require a society to provide such documents and information as the FCA or the investigator specifies.[153] An investigator may also require the production of documents and provision of information as he may specify from any other person.[154] The person on whom the requirement is imposed may require the investigator to produce evidence of their authority.[155] This power is subject to limits to protect information or documents that are subject to legal privilege or banking confidentiality.[156]

Documents or information must be produced at a time and place specified by the FCA or by the investigator.[157] The FCA or the investigator is entitled to take copies of or extracts from the document produced and, for this purpose, a document includes information recorded in any form. The power to require production of a document includes the power, in the case of a document not in hard copy form, to require the production of a copy of the document in hard copy form, or in a form from which a hard copy can be readily obtained.[158]

These powers allow the FCA to receive information from a society on an ad hoc basis in addition to any periodic accounting information that must be submitted. As a general principle of administrative law a requirement for information under s 447 of the Companies Act 1985 must not be excessively wide, unfair and not be made in unreasonable terms. For example, it would seem unreasonable to ask the society to provide a large number of documents in a very short period of time or in a format that would require the society to incur disproportionate costs. The FCA would be entitled to act on any information received from the society, for example to determine whether a society continues to meet the condition for registration. Any statement that is made by a person in compliance with a s 447 requirement may be used as evidence against him in civil and other non-criminal proceedings.[159]

If a person fails to comply with a requirement of the FCA or an investigator, the FCA or investigator can certify this fact in writing to a court. If, after hearing any witnesses and hearing any statement that may be offered in defence, the court is satisfied that that the offender failed without reasonable excuse to comply, it may deal with him as if he had been guilty of a contempt of court.[160]

Anyone who makes a disclosure to the FCA in the context of an inspection or investigation under the Companies Act 1985 is protected from liability for breach of confidence even if they were not ordered by the FCA to provide it.[161] To qualify for this protection, the disclosure must satisfy all of the following conditions:[162]

- it must be a disclosure to the FCA, which could have required the person to make it under its Companies Act 1985 powers;
- it must be made in good faith and in the reasonable belief that it could assist the FCA to exercise its functions;

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153 CA 1985, s 447(2).
154 CA 1985, s 447(3).
155 CA 1985, s 447(4).
156 CA 1985, s 452(2) and (3).
157 CA 1985, s 447(5).
158 CA 1985, s 447(5) and (7)–(9).
159 CA 1985, s 447A(1).
160 CA 1985, s 453C(2) and (3).
161 CA 1985, s 448A(1).
162 CA 1985, s 448A(2).

- the information disclosed must not be more than is reasonably necessary to help the FCA in that way; and
- the disclosure must not be prohibited by any legislation, or made in breach of a banker or lawyer's professional obligations of confidence.

Information obtained by the FCA or an inspector or investigator under these powers cannot be disclosed other than to listed bodies for particular purposes. Listed bodies added by the Investigations Order for societies include the Charity Commission, the Office of the Scottish Charity Regulator, the Homes and Communities Agency, the Scottish Housing Regulator, and the Welsh Assembly Government. Purposes justifying disclosure include allowing public bodies to discharge functions under particular legislation, mainly concerned with regulatory functions or the investigation or prosecution of offences. Disclosure of information obtained during an inspection or investigation to anyone not listed is an offence unless the information is or has been publicly available from another source.[163]

It is an offence for an officer of a society to destroy, mutilate, falsify or make a false entry in any document concerning the property or affairs of the society, or to be privy thereto, unless the officer proves he had no intention of concealing the society's state of affairs or of defeating the law.[164] It is also an offence for anyone to knowingly or recklessly provide information that is false in a material particular in purported compliance with a requirement of an investigator under these provisions.[165]

9.3.4. Powers to enter and remain on premises

An investigator can enter any premises and conduct a search in connection with an investigation if a warrant is issued by a justice of the peace or, in Scotland, a sheriff. The justice or sheriff must be satisfied on the basis of information given on oath by or on behalf of the FCA, or a person authorised to exercise powers under these provisions, that there are reasonable grounds for believing that there are documents on the premises whose production has been required and which have not been produced in compliance with the requirement.[166]

A warrant can also be issued if the magistrate or sheriff is satisfied that there are reasonable grounds to believe that an offence carrying at least a two-year prison term has been committed, and that documents on the premises are relevant to the offence. The FCA, or the investigator, must also show that they have power to require the production of the documents and that there are reasonable grounds to believe that if production were required without a warrant the documents might be removed from the premises, hidden, tampered with, or destroyed rather than being produced.[167]

A warrant authorises a constable and any other person named in the warrant to enter the specified premises (with force if necessary), search the premises, seize and copy documents and to demand explanations of the documents or information about where they can be found.[168]

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[163] CA 1985, s 449 and Schs 15C and 15D and Investigations Regulations 2014, SI 2014/574, reg 2(3).
[164] CA 1985, s 450(1).
[165] CA 1985, s 451.
[166] CA 1985, s 448(1).
[167] CA 1985, s 448(2).
[168] CA 1985, s 448(3).

Any documents seized can be kept for three months or until any criminal proceedings end.[169] Anyone who intentionally obstructs the execution of a warrant or fails without reasonable excuse to comply with any requirement is guilty of an offence.[170]

The separate power to enter and remain on premises under CA 1985, s 453A differs from a warrant under s 448 in that it allows an FCA authorised investigator to require entry without a court order if they believe the premises are used for the society's business. The investigator can remain there for as long as she thinks is necessary to exercise her functions.[171] Whilst both sections achieve similar outcomes, the power under s 448 is wider. It allows entry using reasonable force and the seizure of information and documents. Under s 453A(2), once the investigator has entered the premises, she must use her other powers under Part 14 of the Companies Act 1985 to obtain documents and information. She cannot search the premises and seize documents.

When exercising powers to enter and remain on premises, an inspector or investigator can be accompanied by anyone else she thinks appropriate. Intentional obstruction of the investigator is an offence. The inspector and people accompanying her must each produce evidence of their identity and authorisation.[172]

The inspector or investigator must, as soon as practicable after obtaining entry, give to an 'appropriate recipient' a written statement of information about her powers under s 453A and the rights and obligations of all concerned. The detail of the statement must be in line with the requirements of the Companies Act 1985 (Power to Enter and Remain on Premises: Procedural) Regulations 2005, SI 2005/684. If no-one appropriate is present, a notice of the time of the visit and a copy of the statement must be sent to the society as soon as reasonably practicable after the visit.[173]

The inspector or investigator must prepare a written record of the visit and, if requested to do so by the society, give it a copy of the record. If the society is not the sole occupier of the premises, she must give the occupier a copy of the record, on request.[174]

9.4. THE FCA'S POWERS UNDER CCBSA

9.4.1. Inspection of documents and accounts

Anyone authorised by the FCA can inspect the society's register of members or officers.[175] This will, however, be of limited use as it will provide little financial information and the powers under the Companies Act 1985 will be of much more use to the FCA or society members.

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169 CA 1985, s 448(6).
170 CA 1985, s 447(7) and (7A).
171 CA 1985, s 453A(2) and (3).
172 CA 1985, ss 453A(2), (3) and 453B.
173 CA 1985, s 453B(4) and Investigation Regulations, reg 2.
174 CA 1985, s 453B(6).
175 CCBSA 2014, s 30(8).

9.4.2. Accountant's inspection of books

The two other powers available to the FCA in this area are only exercisable on the application of members of a society. An application by at least 10 'qualifying' members (all of at least one year's standing) gives the FCA power, if it thinks fit, to appoint an accountant or actuary to inspect the books of the society and prepare a report on them.[176] The accountant or actuary appointed then has power to copy the society's books and accounts and take extracts from them at all reasonable hours. They have no power to question officers of the society nor to require any other information if the society does not agree to provide it. The FCA is required to communicate the results of the inspection to those members that applied for the inspection and the society.[177] The appointment of investigating accountants is unusual as the members who make the application must deposit funds as security for the costs of inspection in the amount as the FCA may require. The FCA also has the power to direct in what proportions and how the expenses of the inspection are to be met by the applicants, the society's funds and current and past members and officers. Since the CCBSA 2014 stipulates that the deposit must be made and that it is to be as security for costs, the discretion of the FCA to fix the sum to be deposited is not unlimited.[178] The FCA could hardly demand a purely token amount that bore no relation to the likely cost of the inspection in order to encourage members to apply. It is unfortunate that the FCA is not permitted to act on its own initiative in this matter and it seems wrong that members are required to deposit a substantial amount when there is no right to have an inspector appointed unless the FCA agrees.

An investigation under s 447 of the Companies Act 1985 gives the FCA a more helpful power when it needs information to decide whether to exercise its CCBSA 2014 powers.

9.4.3. Inspection of society's affairs and special meetings

Further powers are available to the FCA if the appropriate number of members apply for them to be used. In this case application must be made to the FCA by one-tenth of the total membership of the society or, in the case of a society with more than 1,000 members, 100 members. If such an application is made, the FCA may either appoint one or more inspectors to examine and report on the affairs of the society or call a special meeting of the society.[179] The FCA will require notice of an application to be given to the society.[180] The applicants must support their application with such evidence as the FCA directs showing that the applicants have good reason for requiring the inspection or meeting and that they are not activated by malicious motives.[181] All the expenses of the meeting or the examination are to be met by the society, the applicants or the present or former members or officers of the society in the proportions that the FCA directs. The FCA may, but is not obliged to, require the applicants to give security for the costs of the proposed examination or meeting before acceding to the application.[182] That contrasts with an application for the inspection of books where the FCA must demand security for costs.

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[176] CCBSA 2014, s 105(1).
[177] CCBSA 2014, s 105(4).
[178] CCBSA 2014, s 105(3).
[179] CCBSA 2014, s 106(1).
[180] CCBSA 2014, s 106(4).
[181] CCBSA 2014, s 106(3).
[182] CCBSA 2014, s 106(5).

The scope of an examination under CCBSA 2014, s 107 is more extensive than that of an inspection under CCBSA 2014, s 105. The former extends to all the affairs of the society while the latter is limited to its books and accounts. This is reflected in the fact that a s 107 inspector is not only entitled to demand the production of all the books, accounts, securities and documents of the society but also has power to question on oath any members, officers, agents or servants of the society about its business.[183]

If a meeting is to be called as a result of a CCBSA 2014, s 107 application, it is for the FCA to give directions about the time and place of the meeting and its agenda. Such a meeting has all the powers of a meeting called under the rules of the society but will have the power to appoint its own chairman regardless of any rule to the contrary.[184]

9.4.4. Requiring an audit

Where a society has opted out of an audit the FCA retains the power to insist that auditors are appointed.[185] To exercise its power, the FCA must issue a notice to the society during the course of the year of account for which a full audit is to be required. Thus the power of societies with turnover of no more than £5.6 million and aggregate assets not exceeding £2.8 million and otherwise qualified to disapply the audit requirement is subject to a general discretion on the part of the FCA to insist on a full audit. Use may be made of this power if the FCA suspects that some form of accounting irregularity justifies a full audit despite the decision of the necessary majority of the society's members that the audit requirement should be disapplied. It might also be used in a case in which a society, having satisfied the financial criteria in the last year of account and so being qualified to disapply the audit requirement in the current year, enjoyed a massive increase in turnover such that it exceeded the relevant thresholds.

Where a society within the definition of a 'small society' chooses to have a lay audit or has opted out of an audit, the FCA has the power to direct it to have the accounts of any previous year audited and to submit audited accounts with the annual return for that year (or a further annual return if one has already been submitted). A direction under this section can be made by the FCA after the end of any year in which the society has appointed unqualified auditors or opted out of an audit. There is no limit to the number of years in respect of which directions could be made or on how long after the end of a particular year the direction can be issued.[186]

These powers allow the FCA to insist on an audit of the accounts of a society with a low turnover by either ensuring that there will be no disapplication of the general audit requirement in the current year or by retrospectively overriding the legal exemption for small societies and opt outs agreed by the society's members in one or more previous years.

[183] CCBSA 2014, s 107(2).
[184] CCBSA 2014, s 107(4).
[185] CCBSA 2014, s 84(4).
[186] CCBSA 2014, s 86.

CHAPTER 10

DISPUTES AND PROCEEDINGS

CCBSA 2014 provides for the resolution of disputes affecting societies. Its provisions facilitate the use of arbitration – usually a cheaper, quicker and more private means of resolving disputes than resort to the courts. In addition, certain CCBSA 2014 provisions allow for proceedings in the county court, sheriff's court or magistrates' court rather than the higher courts.

This chapter deals first with CCBSA 2014 provisions about internal disputes and then those that deal with external disputes involving the society – whether they involve civil or criminal proceedings.

10.1. INTERNAL DISPUTES: ARBITRATION

10.1.1. Disputes between a society and its members

10.1.1.1. The parties

Section 137 of CCBSA 2014 provides machinery for the settlement of disputes. That machinery may be used when the party on one side of the dispute is a society or an officer of the society. This includes all committee or board members, the treasurer, the secretary, a manager and any employee except one appointed by the committee but it excludes the auditor of the society.[1]

The party on the other side must be:

- a member of the society; or
- a person aggrieved who has ceased to be a member within the previous six months; or
- a person claiming through a member or such an aggrieved person; or
- a person claiming under the rules of the society.

A 'person aggrieved' is one who has suffered a legal loss or liability or who has been deprived of some right by the fault of another or made to bear some burden or detriment.[2] Although one might think that expulsion was a grievance, the courts have decided that an expelled member cannot use this heading even if the parties agree that he or she was a member within the six months required by the Act.[3] Other disputes

1 CCBSA 2014, s 149.
2 *Robinson v Currey* [1881] 7 QBD 465.
3 *Judson v Ellesmere Port Ex-Servicemen's Club* (1948) 2 KB 52 CA.

between a former member and a society could fall under this heading so long as the membership terminated within the last six months and the ex-member could show a sufficient legal interest.

A person 'claiming through' a member includes an heir, an executor or administrator, an assignee or a nominee.[4] This allows both disputes about the devolution of a member's shares after his or her death and problems arising from a transfer of shares during the member's life to be dealt with. The party may be an administrator or executor of a member's estate or a person nominated to take the shares. The s 149 definition is not exhaustive so anyone whose rights are derived from the membership of others can use this provision. Similarly, those claiming through a person aggrieved are included – for example, the executors or administrators of a former member.

A person 'claiming under the rules' covers non-members or members whose disputes with the society are in some other capacity. Thus a holder of loan capital that is dealt with under the rules could fall into this category.[5] Similarly, someone refused membership under the rules might be able to challenge that decision by the use of this procedure if the wording of the rules could be interpreted as conferring a clear and unconditional right to membership in the circumstances of their case.

This last point is important in the context of protecting the Co-operative Principle of open membership and might arise in a workers' or housing co-operative if the rules provided that all employees or all tenants were entitled to membership.

10.1.1.2. The disputes to which the Act applies

Although s 137(1) of CCBSA 2014 provides that every dispute between the parties described above is to be settled as provided in the rules, the machinery is meant to apply to disputes arising out of the rules of the society and the relationship between the member and the society. Thus it applies to questions as to whether an officer has been properly removed from office, whether the nomination of a candidate for the board has been properly accepted or rejected and other matters affecting the procedure adopted at meetings and for elections. The test is whether the dispute affects a member as such in the sense that the rights being enforced are those derived from membership. A dispute as to the payment of surplus to a member or the amount or form of the payment should be within this provision as it is a right peculiar to members and laid down in the rules. Equally, a dispute about the terms of employment of an employee of a consumer co-operative or a social club or about purchases by an employee member of a workers co-operative are clearly outside this provision.

There is doubt as to whether a dispute between a society and a member customer of a consumer co-operative or a member employee of a worker co-operative about the separate sale of goods contract or employment contract would fall within this procedure. Others may be employees or consumers and the existence of a separate sale of goods or employment contract may be evidence that the dispute does not arise out of the rules or the relationship between the member *as* member and the society. If the rules provide for the arbitration of such disputes then this may not be a provision contemplated by s 137 of CCBSA 2014 but a separate arbitration clause that takes effect under the Arbitration Act 1996.

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4 CCBSA 2014, s 149.

5 *Judson v Ellesmere Port Ex-Servicemen's Club (1948)* 2 KB 52 at p 60 per Somervell LJ.

The courts have held that a dispute between a director or official who is also a member on one hand, and a society on the other, as to the embezzlement of funds is not a dispute with 'a member' as it applies to those individuals in their capacity as officers.[6] More contentiously, they have also ruled that a dispute between a former member and a society as to whether an expulsion was valid was not within these provisions and could thus be heard by the courts without first being subjected to arbitration.[7] The reasoning behind this was that the dispute must relate to the person as a member and not to the termination of membership. The case followed earlier decisions on the friendly societies legislation, which has since been amended to allow such cases to be dealt with. The ruling still seems to stand, however, for co-operative and community benefit societies.

A dispute that concerns the validity of the rules themselves or the question of whether the society has acted beyond its powers cannot be dealt with by the arbitration process but must be resolved by the courts. This is so even if it is a dispute between the society and a member about whether the member is bound by the rules and involves the interpretation of the rules.[8]

10.1.1.3. Who decides?

A dispute of the kind referred to in the Act should be decided in accordance with the society's rules.[9] If a society's rules have the effect that the Financial Conduct Authority (FCA) or, less commonly, the Prudential Regulation Authority (PRA) would have to decide disputes, the dispute will be referred to the county court in England or the sheriff in Scotland.[10] This provision applies both in the unusual situation where the rules expressly name the FCA or PRA as arbitrator and where old rules confer that role on the former Chief Registrar or Assistant Registrar of Friendly Societies. The provision consolidated in s 137(3) of CCBSA 2014 was introduced by s 83 of the Friendly Societies Act 1992 and later amended to refer to the FSA and the FCA or PRA by the Mutual Societies Orders 2001 and 2013 respectively. However, to allow for the use of the Financial Ombudsman scheme by people to whom they apply, s 137(7) of CCBSA 2014 stipulates that nothing in s 137(1) of that Act prevents the use of such a scheme by any person before or instead of the arbitration system provided by the society's rules. References to the courts by virtue of s 137(1) of CCBSA 2014 exclude the operation of s 139(3) of CCBSA 2014 to allow a party to apply to the magistrates' court.

The county court (or sheriff in Scotland) can also deal with the dispute so long as both parties consent even if the society's rules contain some other provision.[11] If the rules of a society refer to the justices or the magistrates' court as the body to determine disputes, the magistrates' court (or, in Scotland, the sheriff) will decide the dispute.[12] Where a society's rules do deal with dispute resolution but no decision is made within 40 days after an application has been made to the society for a reference under its rules, the other party can apply in England to either the magistrates' court or the county court or, in Scotland, to the sheriff, which can then decide the dispute.[13]

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6 *Municipal Permanent Investment Building Society v Richards* (1888) 39 Ch D 372 CA.
7 *Judson v Ellesmere Port Ex-Servicemen's Club* [1948] 2 KB 52 CA.
8 *McEllistrim v Ballymacelligot Co-operative Agricultural and Dairy Society* [1919] AC 548.
9 CCBSA 2014, s 137(1).
10 CCBSA 2014, s 137(3).
11 CCBSA 2014, s 137(6)(a) and (b).
12 CCBSA 2014, s 137(4) and (5).
13 CCBSA 2014, s 138.

10.1.1.4. Settlement under the rules

Subject to s 137(3) if the rules of a society provide a procedure for the settlement of disputes covered by these provisions then that procedure is to be followed so long as the rules do not provide for decision by the FCA or the PRA.[14]

Most society rules make provision for arbitration so this is the most common method of dispute resolution. The rules of a society may provide for the election of arbitrators by the members or for the use of mediation. They may lay down that arbitrators are to be appointed by a sponsoring organisation covering the appropriate sector such as Co-operatives UK Ltd or other bodies that provide model rules and central services for particular types of society. No one with an interest in the dispute – such as the officers of the society involved – may be appointed.

If a court action is brought against a society concerning a matter that could be settled by the procedure laid down in the rules, the society may seek an order of the court staying the action so that the machinery provided for by the rules can be used to deal with the case. So long as the dispute is within the scope described above, the court will make such an order.

10.1.2. Arbitration and mediation in the Model Rules

10.1.2.1. Consumer co-operatives: 12th Edition Model Rules (amended 2012) sponsored by Co-operatives UK

Rule 15.13 of the 12th edition Model Rules for consumer co-operatives sets out that any disputes between the parties referred to in s 137 of the Act shall be submitted to an arbitrator agreed by the parties. If the parties are unable to agree, the arbitrator shall be nominated by the Secretary General of Co-operatives UK Limited. The arbitrator's decision will be binding and conclusive. Any person bringing a dispute must, if so required, deposit with the society a reasonable sum (not exceeding £100) to be determined by the board. The arbitrator will decide how the costs of the arbitration will be paid and what should be done with the deposit.

10.1.2.2. Worker co-operatives: Co-operatives UK Worker Co-operative Model

Rule 101 of the Worker Co-operative Model Rules provides for disputes to be resolved by independent arbitration – the arbitrator being appointed by the agreement of both parties. If the parties are unable to agree, the arbitrator shall be nominated by the Secretary General of Co-operatives UK (or any role or body that succeeds to its function). The arbitrator's decision is binding but if independent arbitration proves impossible, then the dispute is referred to the county court or, in Scotland, the sheriff. Any person bringing a dispute must, if so required, deposit with the society a reasonable sum (not exceeding £100) to be determined by the board. The arbitrator will decide how the costs of the arbitration will be paid and what should be done with the deposit.

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[14] CCBSA 2014, s 137(1) and (3) and see Section **10.1.1.3.** above.

10.1.2.3. Society for the benefit of the community – sponsored by Co-operatives UK

Rule 82 of the Co-operatives UK Society for the Benefit of the Community Model Rules provide for the reference of disputes to an independent arbitrator appointed by and acceptable to both sides. If the parties are unable to agree, the arbitrator shall be nominated by the Secretary General of Co-operatives UK (or any role or body that succeeds to its function). The arbitrator's decision is binding but if the dispute cannot be concluded the matter is to be referred to the county court or, in Scotland, the Sheriff.

10.1.2.4. National Housing Federation – Model Rules 2011 (version 2)

Rule G3 of the National Housing Federation Model Rules 2011 provides for any dispute on a matter covered by the rules to be referred by either party to a suitably qualified independent mediator. If the parties cannot agree on a mediator, the mediator shall be appointed by the Centre for Effective Dispute Resolution. Where the dispute remains unresolved by mediation, any claim shall be dealt with in the county court.

10.1.2.5. Agricultural Co-operative (IPS) – Agency Model Rules sponsored by Co-operatives UK & Scottish Agricultural Organisation Society

Rule 89 of the IPS Agricultural Co-operative Agency (MTS) Model Rules provides for the reference of any dispute between the society or its board and a member or former member to an independent arbitrator acceptable by both parties. If the parties are unable to agree, the arbitrator shall be nominated by the Secretary General of Co-operatives UK (or any role or body that succeeds to its function). The arbitrator's decision is binding and, in the event that a dispute cannot be concluded by reference to an arbitrator, the matter may then be referred to the county court (or in Scotland, to the sheriff).

10.1.2.6. Social Clubs – Model Rules for a Working Men's Club – sponsored by Clubs and Institutes Union (CIU)

Rule 32 of the CIU Model Rules distinguish between two types of dispute. Disputes between a member and an officer of the club are to be settled by the committee unless it chooses to refer the matter directly to a special meeting. The committee's decision is final unless a person aggrieved by the decision produces a requisition for a special meeting within seven days of the decision.[15] The requisition must satisfy the conditions for such documents and must be supported by the signatures of 50 members or 25% of the total membership entitled to attend and vote at general meetings (whichever is less).[16] The requisition must state the purpose of the special meeting.

[15] Rule 32(1).
[16] Rule 15(2)(b).

If a dispute is between the club or the committee and a member or person aggrieved or those claiming through them the executive of the CIU or those appointed by them are to act as arbitrators.[17] No reference is made in the rules to disputes between one member and another.

The procedure involving a decision by the committee or a special meeting is likely to apply where a decision is made by a steward or individual officer or committee member and the member objects to it. A decision by the whole committee will be subject to reference to the executive of the CIU as will any dispute that involves a person who is not currently a member but was a member within six months or a person claiming through a member, since decisions under Rule 32(1) can only refer to members. If the decision is dealt with under Rule 32(1) the decision of the committee is final subject only to review by a special meeting. It is not possible for such a dispute to be converted at that stage into a dispute to be dealt with under Rule 32(2).

10.1.3. Conduct of arbitration

The conduct of an arbitration under the rules will be governed by the provisions of the Arbitration Act 1996 (AA 1996) unless those provisions are inconsistent with the Act or the rules of the society. It is advisable for an arbitrator who is not legally qualified to take advice as to the conduct of the arbitration.

In outline, the procedure to be followed at an arbitration is that laid down in the AA 1996 since the CCBSA 2014 lays down no rules of its own on this. The rules in the AA 1996 and those developed by the courts can usually be varied by contrary agreement – for example, in the rules of the society.

An arbitrator has powers to make orders to ensure the smooth running of the proceedings.[18] He or she can call on the parties to give sworn evidence, produce documents and do anything else that will facilitate the hearing of the dispute. The arbitrator can 'enforce' his orders by issuing a peremptory order with a time limit. Failure to comply can either lead to enforcement through the court or to a decision by the arbitrator on the information he has and/or a reflection of the party's failure in an order on costs.[19]

After the appointment of the arbitrator in accordance with the rules, he or she should indicate willingness to act – expressly or by beginning to do so. Some statement should be made at this stage as to the identity and status of the parties and the nature of the dispute to clarify the issues to be decided. This should include a statement of which rules of the society provide for the reference to the arbitrator so that he or she can be sure of his or her right to act.

Other preliminary matters such as orders to produce documents and decisions about the process of arbitration itself (such as whether there is to be a hearing and, if so, how long it is expected to last) may be dealt with before the hearing.

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17 Rule 32(2).
18 AA 1996, ss 38, 40 and 41.
19 See generally AA 1996, ss 41–44.

The important principle in any arbitration is that each party should be given the opportunity to present their case. So long as this is done there need not necessarily be any hearing – a decision purely on the basis of documents and written submissions is permissible. If there is a hearing it must be conducted fairly so as to ensure an equal opportunity to each side to present arguments and evidence and to hear and answer the case against them. Subject to this overriding rule, the detail of the procedure to be used is a matter for the arbitrator.

After hearing the dispute the arbitrator makes an award. This is binding on the parties under s 140 of the CCBSA 2014. The power to decide who should pay the costs of the arbitration is given to the arbitrator.[20]

In England and Wales, a decision made under s 137(1) of CCBSA 2014 is binding and conclusive on all parties without appeal.[21] The decision is not removable into any court of law or restrainable by injunction and application for the enforcement of the decision may be made to the county court.[22]

The same rules apply in Scotland except that the words 'the decision is not removable into a court of law or restrainable by injunction' do not apply and application for enforcement is made to the sheriff.[23]

10.1.4. Settlement in the courts

If the rules of a society direct that any disputes are to be referred to justices, the disputes are to be determined by a magistrates' court.[24] The magistrates' court has power to require a party to list the relevant documents in his or her possession and to make them available for inspection by the other.[25]

Under s 139(1)–(2) of CCBSA 2014 the county court or (in Scotland) the sheriff may deal with a dispute by the agreement of both parties or because there is no provision as to disputes in the rules of the society in question. If a society's rules would result in a dispute being referred to the FCA or PRA the dispute is to be referred to the county court or the sheriff in Scotland.[26]

If the rules of a society contain no directions as to the settlement of disputes, or where no decision is made on a dispute within 40 days after application to the society for a reference under its rules, a party may apply to either the county court or the magistrates' court (or the sheriff in Scotland) who may hear and determine the dispute.[27] In such a case the dispute will be dealt with in accordance with the normal procedure applicable in the court.

In addition the magistrates' court can, for the purpose of hearing or determining any dispute under CCBSA 2014, make any order for the discovery or inspection of

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20 AA 1996, s 61 and see generally AA 1996, ss 59–65.
21 CCBSA 2014, s 140(1)(a).
22 CCBSA 2014, s 140(1)(b).
23 CCBSA 2014, s 140(1)(c).
24 CCBSA 2014, s 137(4).
25 CCBSA 2014, s 140(3)–(4).
26 CCBSA 2014, s 137(3).
27 CCBSA 2014, s 138.

documents that it considers necessary for the just and expeditious disposal of the dispute.[28] The county court has such powers under its own rules.

If the rules of a Scottish society direct that any disputes are to be referred to justices, a justice of the peace court or a court of summary jurisdiction, the dispute is to be determined by the sheriff.[29]

10.1.5. Statement of case

The higher courts have a limited role in the arbitration process so that the speed and cheapness of the process is not undermined by recourse to the slower and potentially more expensive procedures applicable in the higher courts. Where a magistrates', county or sheriff's court is deciding a case under CCBSA 2014, the court has power to state a case referring a point of law to the High Court (England) or the Court of Session (Scotland) for their opinion at the request of either party.[30] This provision overrides s 45 of the AA 1996 by stating a contrary intention.

If a dispute is dealt with by someone other than the magistrates', county or sheriff's court under s 137(1) of CCBSA 2014 in accordance with the society's rules, s 45 of the AA 1996 applies to allow references to the High Court or the Court of Session. Such an application can only be made either by the consent of all the parties without the consent of the arbitrator or by the arbitrator with the consent of one party. In addition, the High Court must be satisfied that its decision may result in substantial savings of costs and that a question of law is involved such that the right of one or more parties to the arbitration will be affected by the way it is decided.

10.1.6. Disputes between members

Sometimes the rules of a society require certain disputes between members to be settled by the decision of the society of which they are members. Section 137 of CCBSA 2014 has no application to such disputes and any problems to which they give rise are subject to AA 1996.

Where the rules of a society require members to bring disputes of defined classes to the society for settlement, such rules constitute a contract between the society and each member and among the members themselves.[31] If a dispute arises and falls within the appropriate rule, one party can require the other to submit the dispute to the society for arbitration so long as the dispute does not arise out of an agreement that is unlawful or unenforceable – for example, because it is an unlawful restraint on trade. If the arbitration is properly conducted the award is conclusive and there is no right of appeal.

Such an award will generally remain in force as long as both parties remain members of the society unless the award itself or the rules provide to the contrary. However, if one party withdraws from membership the award ceases to have effect.[32]

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28 CCBSA 2014, s 140(3).
29 CCBSA 2014, s 137(5).
30 CCBSA 2014, s 140(5).
31 CCBSA 2014, s 15.
32 *Bellshill and Mossend Co-operative Society Ltd v Dalziel Co operative Society Ltd* [1960] AC 832.

10.2. EXTERNAL DISPUTES

10.2.1. Criminal offences by the society – general rules

As a legal person a society can be guilty of a criminal offence. In the case of crimes for which no element of intention or recklessness is required, it can be vicariously liable for crimes committed by employees in the course of their employment. In the case of crimes that do require some element of knowledge or intention the society can only be guilty through the knowledge or intention of a sufficiently senior person.

For this purpose the courts consider who is the directing will and mind of the society and attribute the knowledge and intention of those individuals to the society. Directors and senior managers will fall into this category but others may also be classified in this way if they have sufficient control of the necessary elements of decision-making for the offence in question. A store manager who operates under strict instructions from head office will not fall into this category but one who has a large amount of discretion may do so.[33] For many purposes, a combination of the society's rules and the general law of agency will be sufficient to attribute the state of mind or acts of a person to the society as a legal entity without the need to find the person who is its 'directing mind and will'. Since *Tesco Supermarkets Ltd v Nattrass*, the courts have suggested that the latter test may be additional to the more usual agency test discussed in **Chapter 11** which has always applied to the contractual rights and obligations of companies and societies.[34] The choice of tests to be used may depend on the purpose and context of the provision being interpreted by the court and its policy objective.

The criminal liability of individuals will depend on their own state of mind and behaviour. The fact that something was done on behalf of the society will not protect the individual from criminal liability as limited liability extends only to civil matters.

10.2.2. Offences under CCBSA 2014

CCBSA 2014 creates a number of offences by way of regulating societies. Many of them are dealt with in the appropriate sections of this handbook.

Section 127 creates a general offence dealing with most of the obligations imposed by CCBSA 2014 on societies and their officers. It covers failure to give any notice, to send any return or other document or to do anything or allow anything to be done which a society member, officer or other person is required by the Act to do, give, send or allow to be done. In addition, wilful neglect or refusal to do any act or provide information required by any person authorised by the FCA or PRA for the purpose of the Act is an offence. In the case of offences in which the word 'wilful' is used, the prosecution must prove deliberate intention to obtain a conviction. Those in which 'failure' to do something is the offence do not require this mental element. Section 127(1)(d) also creates the offence of doing anything prohibited by CCBSA 2014.

Every act or default under the Act constituting an offence is a new offence in every week during which it continues.[35]

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[33] *Tesco Supermarkets Ltd v Nattrass* [1972] AC 153.
[34] *Meridian Global Funds Management Asia Ltd v Securities Commission* [1995] 2 AC 500.
[35] CCBSA 2014, s 129.

These offences can be committed by a society or any officer or member of it or any other person.[36] Anyone on whom the Act imposes obligations can thus be guilty of an offence but in the case of offences that require knowledge or intention the general rule will apply to determine who can be convicted. This will apply to any of the offences created by s 127(1)(c), which have to be committed 'wilfully' but will not affect liability for those offences under s 127(1)(a) and (b), which require no knowledge or intention but only a failure to do something. The administrative nature of most of these offences may lead to the society's guilt depending on the agency test in *Meridian Global Funds,*[37] rather than the 'directing mind and will' test in *Tesco Supermarkets Ltd v Nattrass*,[38] so that the society can commit an offence if the necessary knowledge and intention is proved on the part of any individual who, by a combination of the provisions of the legislation, the society's rules and the law of agency, has the function of complying with the requirement.

Since liability on the part of the society can only lead to a fine – ultimately met from members' funds the Act seeks to make penalties more effective by imposing liability on individuals who are involved in the management of the society. This is why s 127 offences can be committed by officers and others. To this end s 128 lays down that whenever a society commits an offence under CCBSA 2014 some individual can be convicted. It does this by laying down that every officer of a society who is bound by its rules to fulfil the duty of which the offence is a breach, or, if there is no such officer, every committee or board member, is deemed to have committed the offence committed by the society. The only defence available is that a committee member made liable in the absence of an allocation of responsibility by the rules can prove himself or herself either to have been ignorant of the commission of the offence or to have tried to prevent it.

Section 149 of CCBSA 2014 defines an officer of a society so as to include the secretary, treasurer, committee member and manager or employee (except an employee appointed by the committee). A liquidator who fails to send the FCA or PRA a copy of a resolution for the voluntary winding up of the society under s 123(a) CCBSA 2014 is also treated as a society officer for this purpose[39]

More specific offences created under the Act include:

Any officer or other person acting on a society's behalf who:

(i) issues or authorises the issue of any notice, advertisement, official publication, business correspondence or other business documentation in which the name of the society is not mentioned in legible characters; or

(ii) signs on behalf of the society any bill of exchange, promissory note, endorsement, cheque or order for money or goods in which the name of the society is not mentioned; or

(iii) causes or authorises the appearance on the internet of a website in which the name of the society is not mentioned in legible characters

is liable to a fine and may be made personally liable to the holder of such a document for the amount specified in the document if the society does not pay.[40]

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36 CCBSA 2014, s 127(1).
37 [1995] 2 AC 500.
38 [1972] AC 153.
39 CCBSA 2014, s 128(4).
40 CCBSA 2014, s 11(4).

Section 131 of CCBSA 2014 makes it an offence to make, order or allow entries, erasures or omissions from any balance sheet, contribution or collection book of a society or any document or return that has to be sent or produced or delivered for the purposes of the Act. The person must act with the intention of falsifying the document or evading any provisions of the Act.

Under s 127(2) of CCBSA 2014 it is an offence for a registered society to contravene or fail to comply with any provision of Part 7 of CCBSA 2014 on accounts except:

- those defining a year of account;[41]
- the duty to display its latest balance sheet in a conspicuous position at its registered office;[42]
- the duties to submit its annual return to the FCA and to give any member who requests it a copy of the annual return.[43]

These exclusions from the offences created by s 127(2) of CCBSA 2014 are explained by the fact that s 127(1) covers a failure to display the balance sheet, supply the annual return to a member, or to send it to the FCA and the definitions of years of account in ss 77 and 78 do not involve separate duties.

Section 19 of CCBSA 2014 creates an offence of giving someone a copy of the rules other than the current rules of the society on the pretence that they are the current or only rules. This is committed if rules are handed over that do not have all registered amendments incorporated or handed over with them. In addition, it is an offence to give to another person a copy of the rules of an unregistered society on the pretence that they are the rules of a registered society. In each case the act must be done with intent to mislead or to defraud, although it would seem that that intention need not be directed at the person to whom the rules are given.

Any society that, having withdrawable share capital, carries on the business of banking commits a summary offence.[44]

If, in connection with the winding up of the affairs of a society by the FCA on the grounds that it is not a bona fide co-operative or community benefit society which can remain registered under s 2 of CCBSA 2014, a person fails to comply with any directions that the FCA may give for that purpose, s 7(6) and (7) of CCBSA 2014 makes him or her liable to a fine or up to three months' imprisonment.

Section 105(5) and (6) of CCBSA 2014 imposes similar penalties in respect of the failure of any person to produce books, accounts or documents of the society to the FCA, or any information that the FCA requires in connection with proceedings to cancel the registration of a society or to wind up its affairs on that same ground under ss 5, 7 or Sch 3, para 15(1) of CCBSA 2014.

Similar offences apply if the FCA uses its powers to inspect or investigate a society under the Companies Act 1985 as applied by the Co-operative and Community Benefit Societies and Credit Unions (Investigation) Regulations 2014, SI 2014/574. Those

[41] CCBSA 2014, ss 77 and 78.
[42] CCBSA 2014, s 81.
[43] CCBSA 2014, ss 89(1) and 90(1).
[44] CCBSA 2014, s 66(4).

offences include obstructing an inspector which is punishable as contempt of court, disclosing certain information obtained during an inspection or investigation, destroying or mutilating documents or making false entries in them, furnishing false information, and failing to comply with an inspector's requirements.[45]

10.2.3. Punishing fraud or misappropriation

Section 130 of CCBSA 2014 lays down that it is an offence for any person to obtain possession of any property of a society by false representation or imposition or to withhold or misapply or wilfully apply any part of property in his possession to purposes not authorised by the society's rules or not in accordance with CCBSA 2014. Apart from liability to a fine for this criminal offence, an order may be made that property be delivered up to the society or money repaid to it – in default of which a fine or imprisonment may be imposed.[46] Even a person not proved to have acted with fraudulent intent may be ordered to deliver up property and repay money and costs and expenses to the society.[47] This provides a cheap and effective way of recovering property that has been misappropriated in breach of fiduciary duty by employees, officers or others.

10.2.4. Institution of proceedings

A fine due from a member under the rules of a society can be recovered in summary proceedings instituted by the society itself.[48] The society or a member authorised by either the society or the FCA can bring proceedings on the basis of fraud or misappropriation to recover property or money wrongfully dealt with.[49] Otherwise, only the FCA or a person aggrieved has power to prosecute offences under the Act in England and Wales. In Scotland, only a person aggrieved or the Lord Advocate can bring such proceedings.[50] There is a time limit of one year after the discovery of an offence or three years from the commission of the offence (whichever is shorter) if the proceedings are brought by the FCA or (in Scotland) the Lord Advocate.[51]

Any costs or expenses ordered by the FCA or PRA to be paid by any person under the Act are recoverable summarily (or, in Scotland, as recoverable) as a civil debt.[52]

A summons or other process in proceedings against a registered society to recover a fine under the Act is sufficiently served by leaving a true copy at the society's registered office or, if it is closed, by posting that copy to the outer door of the office.[53]

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45 CA 1985, ss 436, 449, 450 and 453C and see Section **9.2.1.** above.
46 CCBSA 2014, s 130(3).
47 CCBSA 2014, s 130(4).
48 CCBSA 2014, s 20.
49 CCBSA 2014, s 130.
50 CCBSA 2014, s 132.
51 CCBSA 2014, s 132(4).
52 CCBSA 2014, s 141.
53 CCBSA 2014, s 133.

10.2.5. Civil actions

A registered co-operative or community benefit society is a body corporate that can sue and be sued in its own name.[54] In addition certain provisions of the Act give rise to specific forms of civil action involving societies.

A society can appeal to the High Court (or the Court of Session for a society with its registered office in Scotland) against a decision of the FCA to refuse registration of its rules on a ground other than its failure to comply with s 2(2) of CCBSA 2014 (not a bona fide co-operative or community benefit organisation). The right of appeal also applies to a decision to refuse to register an amendment to the rules, a decision to cancel registration (other than for non-compliance with s 2(2)) or a decision to renew a suspension of registration.[55]

A society that granted a registrable charge or a person claiming the benefit of the charge can apply to the FCA for the extension of the 21-day time limit within which the charge must be recorded with the FCA or the rectification of an omission or misstatement in the application to record it. This will only be granted if the failure to record the charge in time or the omission or misstatement was by reason of inadvertence or other sufficient cause.[56]

All money due to a society from a member is treated as a debt due to the society and is recoverable in the county court (or, in Scotland, sheriff's court) for the area in which the society's registered office is located or in which the member resides at the society's option.[57] This allows the society to use its local county court and to sue in the county court even if the sum in question is beyond the usual financial limits for actions in that court.[58] Even if the person sued has ceased to be a member the section still applies as long as the debt was incurred while he or she was a member.

10.3. SECURITY AND ACCOUNTING BY OFFICERS

The rules of a society can require every officer of the society having receipt or charge of money to give security in a sum decided by the society's committee before taking office. The security is to cover his or her duty to render an account for all money that he or she handles when required to do so by the rules or the committee. It then covers the payment of sums payable to the society.[59] Few large societies use this procedure now as other forms of insurance cover are available for such eventualities and good accounting and financial control procedures should prevent problems from arising in the first place.

Where the procedure is used, the security can consist of a bond with or without surety (i e backing by some other person) and that may either be in one of the forms set out in Sch 1 of CCBSA 2014 or some other form agreed by the committee of the society. Alternatively, the security may be given by a guarantee society.[60]

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54 CCBSA 2014, s 3(3) and (4).
55 CCBSA 2014, s 9.
56 CCBSA 2014, s 60.
57 CCBSA 2014, s 35(1).
58 *Gwendolen Freehold Land Society v Wicks* [1904] 2 KB 622.
59 CCBSA 2014, s 41.
60 CCBSA 2014, s 41(3).

Society officers and employees who have receipt or charge of money must render such accounts to the society as it may require for examination and to be allowed or disallowed.[61] The time at which such an account is required is to be set by the rules, or by a demand or on notice in writing left at the person's last or usual place of residence. The society may also require an officer to pay over all money and deliver all property in his hands or custody to a person nominated by the society or its committee. This obligation can be imposed either by a demand or by notice to the officer at his or her residence.

This procedure applies to officers who do not have a special agreement with their society covering their duty to account to it. If such an agreement exists the duties laid down in the agreement must be fulfilled and the powers of the committee or the society to impose particular obligations by demand, notice or otherwise will be those conferred by the agreement.

The advantage of using s 42 CCBSA 2014 rather than a separate contract as the basis for the duty to account is that a neglect or refusal by an officer or employee to fulfil their obligation under the section allows the society to sue on any bond or security provided under s 41 CCBSA 2014 (in the case of an officer) or to apply to either the magistrates' or county court (in Scotland the sheriff's court) for an order that is final and conclusive against the officer or employee in question.[62]

The duty imposed by s 42 on an officer or employee of a society is imposed on that person's personal representatives after his or her death.[63]

These provisions arise from the Victorian origins of the legislation governing societies but may be useful to smaller societies if they use unsophisticated contracts to govern their relationships with officers and employees.

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61 CCBSA 2014, s 42.
62 CCBSA 2014, s 42(5) and (6).
63 CCBSA 2014, s 42(4).

CHAPTER 11

A SOCIETY'S CONTRACTS AND INVESTMENTS

11.1. INTRODUCTION

As corporate bodies, societies are subject to certain special problems in connection with contracts:

- Rules about contracts apparently made on behalf of a society before it is registered ('pre-incorporation contracts') – **Section 11.2.**
- How societies formally contract or enter deeds, and the rules about the society seal – **Section 11.3.**
- Issues about a society's 'objects' and the 'ultra vires' rule that, at common law, limits its capacity to do anything outside the list of objects set out in its rules – **Section 11.4.**
- Questions about the circumstances in which an agent may make a contract that binds a society and how that is affected by any limits laid down in the society's rules – **Section 11.5.**
- Special legislative provisions, applicable to societies, about particular investments – **Section 11.6.**
- Relevant provisions in the Model Rules of a range of societies – **Section 11.7.**

For many years the law applicable to societies on the first three points was different from the law applicable to companies. Societies had been left behind when reforms were introduced. This was rectified by the Co-operatives and Community Benefit Societies Act 2003 which, with effect from 1 April 2004, put societies in virtually the same position as companies in respect of: pre-incorporation contracts; official seals and the execution of documents; the 'ultra vires' doctrine about the society's own capacity to act; and the effect of limitations in the society's rules on the powers of its committee or board.

This means that much of the discussion of these issues to be found in the standard company law texts is now applicable to societies. For example, *Palmer's Company Law* is regarded as a particularly authoritative source. In this chapter these issues are outlined and the special problems applicable to societies are discussed. Readers are referred to the relevant paragraphs of *Palmer's Company Law* at each point in the discussion.

11.2. PRE-INCORPORATION CONTRACTS

See: *Palmer's Company Law*, paras 3.001–3.014.

11.2.1. Contracts made before 20 October 2003

Under the general law of contract any person making a contract must have the legal capacity to do so. A society is a 'person' in law. To be able to make a contract a person must exist. In the case of a corporation, such as a registered co-operative or community benefit society, existence dates from the time of incorporation. The date of the FCA's formal acknowledgement of the society's registration will be the date on which it comes into existence.[1]

This gives rise to the problem that those planning to establish a society may have attempted to enter contracts and make the society party to them before the date of the society's 'birth'. The rules applicable to such 'pre-incorporation contracts' have been developed in the context of companies and, since 2004, have been applicable to societies in exactly the same way.

At common law, it is impossible for a contract to bind a society or company that has not yet been incorporated since the non-existent society or company cannot give any authority to a person to make a contract on its behalf.[2] Even after it is in existence, it is not possible for the society to ratify an agreement that purported to bind the society but that was made before it was incorporated.[3]

As a result there is no liability on the contract on the part of the society. Similarly, the society, not being a party to the contract, cannot sue on it unless those who were party to it specifically gave it that right in the contract or the contract confers a benefit on the society. In those circumstances s 1 of the Contracts (Rights of Third Parties) Act 1999 may confer rights or liabilities on the society.

This leads to the question of whether the person who attempted to make the contract on the society's behalf can be liable on the contract or can enforce it. At common law the general rule applicable to companies was that neither the company, when formed, nor a person who, for example, signed a contract on behalf of a non-existent company would be liable on the contract or able to sue on it.[4] This would also seem to have been applicable to societies unless, in a particular case, the facts pointed to the existence, before registration, of an unregistered society on behalf of which individuals contracted as agents or trustees for the other members. Section 3 of the CCBSA 2014 with its reference to a secretary and members who are to sign the application for registration implies that this can be the case and Lewison J in *Boyle v Collins*[5] confirmed that interpretation of the equivalent provision in the Industrial and Provident Societies Act 1965.

This suggests that the status of any pre-incorporation contract as a contract with individuals acting on behalf of themselves and other individuals making up the existing unregistered society (or unincorporated association[6]) would depend on the facts. If, as is often the case with companies, there was no intention to create any organisation before registration, the rules applicable to company pre-incorporation contracts would apply.

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1 Co-operative and Community Benefit Societies Act 2014 (CCBSA 2014), s 3(2) and (7) and see *Queensbury Industrial Society v Pickles* (1865) LR 1 Exch 1.

2 *Re National Motor Mail Coach Co Ltd, Clinton's Claim* [1908] 2 Ch 515.

3 *Kelner v Baxter* (1866) LR 2 CP 174.

4 *Newborne v Sensolid (Great Britain) Ltd* [1954] QB 45.

5 [2004] EWHC 271 at para 18.

6 See Section **1.2.3.1.** above.

If, however, there had been a history of a functioning organisation with rules, a committee and members before registration, a contract might exist with the members of that unincorporated association with property being held on trust for them and contracts made on their behalf by the committee or others acting as agents. The case law applicable to companies would mean that such a contract did not bind the registered society as a separate legal person and that there would be no possibility of the registered society adopting the contract by unilateral ratification. However, a contract between the members of the unregistered society and the other party might well exist.

It would be necessary for the unregistered society's members to assign the benefit of the contract to the registered society (through agents or otherwise) or for the unregistered society and the other party to the contract to agree to discharge the contract by agreement and to replace it with a contract between the registered society and the other party. The latter would be the preferable approach as the assignment of the benefit of a contract cannot transfer its burden. The members would therefore remain liable on the contract while the registered society would obtain the benefits assigned to it. This would defeat the purpose of establishing a registered society with limited liability although the registered society could agree as part of the new contract or the assignment arrangements to indemnify the members of the unregistered society in respect of any loss or liability they incurred.

Under the common law rules applicable to companies, it was possible for the person who appeared to act as 'agent' for the unincorporated company to be liable on the contract on the basis that he or she in fact intended to contract as principal rather than as agent.[7] This was the case in *Kelner v Baxter*[8] since the court found that the agent had intended himself to be a party to the contract. In *Newborne v Sensolid*[9] this was not the case as the contract was found by the court to have been made only as agent for the non-existent company and without any intention that the agent should be personally liable – his signature merely authenticated the company's agreement.

11.2.2. Contracts made on or after 20 October 2003

Section 57 of the CCBSA 2014 applies to contracts or deeds made, or obligations undertaken, on or after 20 October 2003. It makes the 'agent' who purports to make a contract on behalf of a society before the society is registered a party to the contract with all the rights and obligations that the society would have had if it had been a party to the contract. The section is, in its effects, the same as s 51 of the Companies Act 2006.

The section does **not** make it possible for the contract to bind the registered society as a legal person without the 'novation' of the contract at common law so as to make the society a party to a new contract on the same terms and with the same other parties. *Cyprotex Discovery Ltd v University of Sheffield*[10] is an example of novation by the continuing behaviour of both the person who signed on behalf of the non-existent company and the company itself on and after the date of the company's incorporation and the implied acceptance of that behaviour by the other party to the contract. That other had intended all along to deal with the company that bought out a particular division of a different company and, once formed, the company in question did this. All

7 *Phonogram Ltd v Lane* [1982] QB 938 per Oliver LJ at 945.
8 (1866) LR 2 CP 174.
9 [1954] QB 45.
10 [2003] EWHC 760.

parties acted as if that were the case and carried out the agreement made, originally, between the person signing for the non-existent company and the other party. This led to novation and made the company a party to the contract from the date of its incorporation.

In cases in which there is no 'novation' of the contract the society itself will not be a party to it. The original contract is treated 'as one made with the person purporting to act for the society or as agent for it'.[11] The contract imposes or confers on that person all the obligations and rights that the contract purported to confer on the society.[12] This elaborates the idea that a contract which purports to be made by or on behalf of a society not yet registered 'has effect … as one made' with that person. By conferring rights as well as obligations, CCBSA 2014, s 57(2) explicitly writes in the interpretation of what is now Companies Act 2006, s 51, given by the Court of Appeal in the case of *Braymist Ltd v Wise Finance Company Ltd*.[13]

One issue that arises in deciding whether this section applies to a particular contract so as to make someone else a party to it is whether, as s 57(1) requires, the contract 'purports to be made by or on behalf of' an, as yet unregistered, registered society. This is a matter of the intention of the parties and the circumstances of the particular case. In *Cotronic (UK) Ltd v Dezonie,*[14] dealing with s 35C of the Companies Act 1985, this condition was not met as everyone believed, at the time that the 'contract' was being made with a company that had in fact been struck off years earlier, that the company still existed. The defunct company was not formed after the purported contract, as the section requires, and, equally, the contract could not 'purport to be made' with a company that actually was formed later since noone had that company in mind at the time of the 'purported contract'. Thus there was no contract under the section with the promoter of the company. Similarly, where an existing company traded under a business name and misdescribed its name on its notepaper s 36C could not apply to make the promoter liable as the company existed and was a party to the contract.[15]

Finally, it is possible for the person purporting to contract on behalf of the non-existent society to agree that they will not be a party to the contract as liability is 'subject to any agreement to the contrary'.[16] This has been interpreted as requiring more than the signature of a person on a written contract stated to be signed on behalf of the unregistered society.[17] There must be evidence of an actual agreement with the other party that there is to be no personal liability on the part of the person purporting to act for the, as yet unregistered, society.

It is important to emphasise that some new act, either of novation of the existing contract, or by the creation of a completely new agreement is needed for the society itself to become a party to a contract if it did not exist at the time at which the person acting for it purported to contract for it. CCBSA 2014, s 57 only deals with the liability of the agent.

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11 CCBSA 2014, s 57(1).
12 CCBSA 2014, s 57(2).
13 [2002] EWCA Civ 127.
14 [1991] BCLC 721.
15 *Badgerhill Properties Ltd v Cottrell* [1991] BCLC 805.
16 CCBSA 2014, s 57(1).
17 *Phonogram v Lane* [1982] QB 938.

The above rules apply to deeds in English Law and to the undertaking of an obligation under Scots Law as they apply to contracts.[18]

11.3. CONTRACTUAL FORMALITIES

See: *Palmer's Company Law*, paras 3.101–3.136 and 3.216.

11.3.1. The position in England and Wales

The fundamental provisions about how societies, as legal persons, can make contracts are to be found in ss 53, 54 and 56 of the CCBSA 2014 and s 1 of the Corporate Bodies Contracts Act 1960, which applies to societies since they are corporate bodies. Section 1 of the Corporate Bodies Contracts Act 1960 reads as follows:

> '(1) Contracts may be made on behalf of any body corporate, wherever incorporated, as follows:
> (a) a contract which if made between private persons would be by law required to be in writing, signed by the parties to be charged therewith, may be made on behalf of the body corporate in writing signed by any person acting under its authority, express or implied, and
> (b) a contract which if made between private persons would by law be valid although made by parol only, and not reduced into writing, may be made by parol on behalf of the body corporate by any person acting under its authority, express or implied.
>
> (2) A contract made according to this section shall be effectual in law, and shall bind the body corporate and its successors and all other parties thereto.
>
> (3) A contract made according to this section may be varied or discharged in the same manner in which it is authorised by this section to be made.
>
> (4) Nothing in this section shall be taken as preventing a contract under seal from being made by or on behalf of a body corporate.
>
> (5) This section shall not apply to the making, variation or discharge of a contract before the commencement of this Act but shall apply whether the body corporate gave its authority before or after the commencement of this Act.'

This section applies to societies. Companies are governed by s 43 of the Companies Act 2006, which has broadly the same effect.

Since 20 October 2003, a society has been able to choose not to have a common seal and to validly execute documents by the signature of certain officers rather than by the use of a seal.[19]

English societies are treated, so far as the form of their contracts is concerned, as if they were private persons. If the law requires an individual to make a particular kind of contract in writing, or to evidence it in writing, a registered society must do that. If an individual can make a particular contract 'by parol' (ie by word of mouth) an agent of

[18] CCBSA 2014, s 57(3).
[19] CCBSA 2014, ss 50–56. Transitional provisions are found in s 150 and Sch 3.

the society can make such a contract by parol on behalf of the society. Similarly, if a deed is required in the case of an individual it will be required from a society.

The main group of contracts or transactions that need to be made by deed or in writing or evidenced in writing are those relating to land, consumer credit, or guarantees of debts. The use of a deed also has the advantage that its provisions will be enforceable by a party who has not provided the 'consideration' or value that is otherwise necessary to make a promise binding under the law of contract. Hence, a 'deed of gift' is used to make a promise to make a gift legally enforceable.

Most contracts are not required by law to be either in writing or in the form of a deed and so they can be made by word of mouth. In the case of a society, the words will be those of an agent of the society. For important agreements involving high value transactions or complex terms, it is desirable to use writing and perhaps to have the document signed by the parties to minimise uncertainty and the risk of later disputes. However, as a matter of law most contracts do not require writing or the use of a deed as a condition of validity. Contracts made in a particular form can usually be varied or discharged only in the form in which they were made.

Deeds were traditionally validated by the use of a seal. However, the law has increasingly moved away from such formal requirements and that process was fully completed for societies by s 5 of the Co-operatives and Community Benefit Societies Act 2003, now in CCBSA 2014, s 53. Those provisions placed societies in the same position as companies in respect of the formalities required for contracts and deeds.

A registered society need not have a common seal but, if it has one, the society's registered name must be engraved on it in legible characters.[20] In addition, the society's rules must provide for the custody and use of the seal, if it is to have one, but there is no longer a general requirement that society rules make such provision.[21] It seems that an inaccuracy in the name of the society on its seal will not necessarily make a contract made using that seal void or unenforceable as the legislation does not explicitly provide that this is the case and, in the only recent case on the point that dealt with identical provisions of the Companies Act 1985, the public policy factors relevant to determining the validity of the contract were considered to weigh against its invalidity.[22]

Societies that choose to have a common seal can also have an 'official seal' for use in places outside the UK. The 'official seal' has the same effect as the society's common seal, when duly affixed to a document with the date and place of sealing certified.[23] This seal must be a facsimile of the common seal with the addition on its face of the names of all the places in which it is to be used. A society has this power so long as the society's objects 'require or comprise' transactions in foreign countries and its rules authorise it to have an 'official seal'.[24] Presumably, the authorisation of such transactions by the objects rule would be sufficient even in the absence of a requirement that they be carried out or an objects rule that comprises solely of such transactions.

Any society needing to use an official seal abroad will have to opt to have a common seal in the UK as well. Authorisation for agents to use the official seal must be given in

[20] CCBSA 2014, s 50(1) and (2).
[21] CCBSA 2014, s 14(13).
[22] *OTV Birwelco Ltd v Technical and General Guarantee Co Ltd* [2002] EWHC 2240 paras 46–59.
[23] CCBSA 2014, s 51(4).
[24] CCBSA 2014, s 51(1).

writing under the society's common seal and, as between the society and a person dealing with such an agent, lasts for the period mentioned in the authorisation or, if no period is mentioned, until notice of revocation of authority has been given to the person dealing with the agent.[25]

The 'execution' (or formal creation by signature or the use of the seal) of documents by societies whether or not they have a common seal can be carried out as follows:

- A society that has a common seal can execute a document by affixing its seal to it and any contract that would be legally required to be in writing and under seal if made between individuals can be made, varied, or discharged by a registered society in writing under its common seal.[26]
- Whether or not a society has a common seal, a document signed by two committee members of the society or by one committee member and the society secretary, and expressed, in any words, to be executed by the society has the same effect as if it had been executed using the common seal.[27]
- Whether or not a society has a common seal, a document executed in either of the above ways that makes it clear on its face that it is intended to be a deed has effect as a deed and is presumed to be 'delivered' (and so effective) when it is executed unless a contrary intention is proved.[28]
- In all cases, in favour of a purchaser in good faith for valuable consideration, the document is deemed to be executed if it purports to be signed as above and is deemed to be a deed if it is clear on the face of the document that the people making it intended it to be one.[29] This protects such 'purchasers' if, for example, the procedure followed were not in accordance with the society's rules. Sections 43, 45 and 46 of the CCBSA 2014, discussed below, might also operate to protect the 'purchaser' and a wider range of parties in such circumstances.

A promissory note or bill of exchange (including a cheque) is deemed to be made, accepted, or endorsed on behalf of a society if those things are done in its name or on its behalf or its account by someone acting under its authority.[30]

11.3.2. The position in Scotland

The rules about which documents require execution as a deed, signature or writing under Scots law have the combined effect of the various common law and statutory rules in England and Wales discussed above.[31]

Scots societies, like English societies, need not have a common seal but may have an official seal for use outside the UK, in which case, in Scots law, authorisation for its use can be given without the use of the common seal by using the provisions of the Requirements of Writing (Scotland) Act 1995.[32]

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25 CCBSA 2014, s 52.
26 CCBSA 2014, ss 53(2) and 54(1).
27 CCBSA 2014, s 53(3) and (6).
28 CCBSA 2014, s 53(4).
29 CCBSA 2014, s 53(5).
30 CCBSA 2014, s 58.
31 Requirements of Writing (Scotland) Act 1995, s 1 and Sch 2 para 5.
32 CCBSA 2014, ss 50 and 52(2)(a).

Similarly, CCBSA 2014 deals with the use of a common seal or the other methods of executing a document in the case of Scots law by providing that a document can be executed either by the society affixing its seal or by compliance with the provisions of the Requirements of Writing (Scotland) Act 1995 for the signature of documents.[33] Broadly that requires the signature of only one member of the body's 'governing board' (by whatever name it is known) or of its secretary or of any other person authorised to sign on behalf of the society.[34]

11.4. OBJECTS, POWERS AND THE SOCIETY'S CAPACITY

See: *Palmer's Company Law*, paras 2.601–2.635.

11.4.1. Summary of key issues

A society can only be registered if it is for 'carrying on any industry, business or trade (including dealings of any description with land)'.[35] Section 14 requires that the rules of a society must provide for the objects of the society.[36] The objects rule (sometimes together with other rules) lays down the range of activities in which the society may engage and, by implication, limits the powers of the society and those acting for it. The society's objects may not contravene CCBSA 2014 or the general law.

Before 1 April 2004 the full rigour of the ultra vires rule applied to societies so that transactions outside the society's objects were void and of no effect. Since that date, the protection afforded to those who are party to ultra vires transactions with societies is equal to that applicable in the case of companies and provide extensive protection in the case of non-charitable societies and more limited protection in the case of charitable societies. Section **11.4.2.** of this chapter deals with the issues involved in drafting an objects clause and then with the law applicable to acts or transactions falling outside the society's objects.

11.4.2. Drafting the objects rule and the society's powers

A well-drafted objects clause is still important despite the fact that, since 1 April 2004, societies and those dealing with them have enjoyed the same level of protection as is provided for companies against the invalidity of contracts or other acts going beyond the objects and powers provided in the rules of the society.[37] Since 1 April 2004, the consequences of actions outside the objects listed in the society's rules can still be significant as, in the case of charitable societies (as with charitable companies) the protection is limited and, for all societies, any official or director who causes a society to act beyond its objects or powers can be liable in damages to the society for that failure despite the protection afforded to outsiders involved in the transaction.

Unlike companies, societies do not have unrestricted objects if no objects are specified.[38] As a result, a substantive objects rule has to be adopted in the case of most societies.

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33 CCBSA 2014, s 55.
34 Requirements of Writing (Scotland) Act 1995, ss 7(7) and 12(1) and Sch 2, para 5.
35 CCBSA 2014, s 2(1).
36 CCBSA 2014, s 14(2).
37 CCBSA 2014, ss 43, 46, 47 and 49.
38 Companies Act 2006, s 31.

Credit unions are an exception as the precise content of the objects rule they have to adopt is laid down by legislation.[39] In the case of a housing association wishing to qualify as a registered provider of social housing in England, the objects must include the provision of social housing under the Housing and Regeneration Act 2008. In Wales, the objects of a registered social landlord must comply with the requirements of the relevant legislation and are prescribed exactly.[40] Because the wording of this rule remains important, this section begins with a brief discussion of the issues that arise in drafting an objects rule before proceeding to deal with the statutory provisions that provide some protection where the objects of the society are exceeded.

A number of techniques are available to give the widest possible scope to the objects rule of a society. As many business activities as possible can be listed so as to cover all of the activities in which the society may wish to engage. Each activity can be said to be an independent main object of the society so that the courts will not interpret certain objects as merely ancillary to others that are interpreted as its 'main' objects.[41] In addition, a provision may be inserted to allow as an object any activity that the board believes can be advantageously carried on in connection with any of the listed activities. This allows for a decision to engage in additional activities on the basis of the subjective judgment of the board, which will not be challenged by the court so long as the views of the directors are honestly held.[42] Even before 1 April 2004, these practices, when combined with the decision in *Rolled Steel Products (Holdings) Ltd v British Steel Corporation*[43] that a misuse of an existing power (as opposed to the purported use of a non-existent power) will not be an act beyond the company or society's capacity, meant that the validity of most transactions could be upheld.

In addition to stipulating the objects of the society, the same rule or others will confer power on the society to do certain things such as entering contracts, providing pensions to employees, borrowing money, and so on. These 'powers' are used to achieve the 'objects'. Even if a society or company's constitution makes no explicit reference to any powers or omits certain powers, the courts will 'imply', or read in to the document, those powers reasonably incidental to the society's objects.[44] An example of such an implied power and of the application of this company law rule to a society involved a court implying a power to employ people for the purpose of the business in which the society was engaged.[45]

Most society rules will explicitly provide that the society is to have power to do all things necessary or expedient for the accomplishment of its objects or all things subjectively considered necessary or expedient by the society. A list of specific powers will often then be added 'without prejudice' to the generality of the wider formulation. After the *Rolled Steel* case, many societies and companies explicitly added a power or object of guaranteeing the debts of other societies or companies and the addition of an explicit power or object of providing a pension scheme for employees is common. These provisions are intended to put the validity of such acts beyond doubt. The issue of the relationship between objects and powers is considered in the next section.

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39 Credit Unions Act 1979, s 1(3).
40 Housing Act 1996, s 2.
41 *Cotman v Brougham* [1918] AC 514.
42 *Bell Houses Ltd v City Wall Properties Ltd* [1966] 2 QB 656.
43 [1984] BCLC 466.
44 *Attorney General v Great Eastern Railway* (1880) 5 App Cas 473.
45 *Burnley Equitable and Co-operative Industrial Society v Casson* [1891] 1 QB 75.

An issue that applies to societies but not to most investor-controlled companies is the extent to which the nature of the particular society, as either a co-operative or a community benefit society, is reflected in its objects rule. To succeed in gaining charitable status, the objects will have to be within the range of those classed as charitable. To be registered as a community benefit society, the rules as a whole will have to show that the society is operating in the interests of people other than its own members and that is likely to be reflected in the objects rule.

In the case of a co-operative society other issues arise. It is helpful for the objects rule to make clear the adherence of the society to co-operative principles and to the nature of the organisation as a co-operative. This facilitates decision-making by the board on the basis of the co-operative's particular approach of prioritising services to members and the maintenance of its co-operative structure over profits to investors. However, it is important that the range of activities and transactions that the society can carry out is not limited inadvertently by reference to the co-operative nature of the business. This balance can be achieved by adding the provision about co-operative business practice to the traditional list of objects geared to particular types of business activity and perhaps by requiring the society to 'have regard' to those principles rather than to always adhere to them literally and strictly in every situation. The Co-operative Principles are open textured but it is wise to avoid the possibility of challenge on the grounds of a possible violation of them in the context of a business transaction.

11.4.3. Capacity at common law

Before 1 April 2004, a society had no capacity to act as a legal person outside the powers and objects stated in its rules.[46] Such an act was 'ultra vires' and no legal consequences flowed from it.[47] Ultra vires contracts were unenforceable by or against the society and, in the case of a purchase, ownership of the asset did not pass. Even the members in a general meeting could not ratify such ultra vires actions, although they could, by using the correct procedure, amend the society's rules to change its objects for the future.

The full effect of this rule was mitigated somewhat by the case law dealing with the relationship between the objects of companies and societies and the powers they might exercise to achieve those objects. If a power (for example to guarantee a debt or to enter into a contract) was used for an ultra vires purpose but was one that could equally have been used intra vires, the transaction would not be outside the capacity of the society but would be outside the capacity of its agents (eg the board if it decided to use the power). This meant that the other party to the transaction could enforce it so long as they were unaware of the breach of duty by the society's agents in misusing the power.[48] That decision relieved outside parties from some of the dangers that they faced before 1 April 2004 in dealing with a society acting ultra vires and it might still be useful in cases in which the 2004 reforms (discussed below) do not provide relief – for example, charitable societies.

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46 *Ashbury Railway Carriage and Iron Company v Riche* [1875] 7 HL 653.
47 *Warburton v Huddersfield Industrial Co-operative Society Ltd* [1892] 1 QB 817.
48 *Rolled Steel Products (Holdings) Ltd v British Steel Corporation* [1984] BCLC 466.

If a community benefit society with charitable objects needs to guarantee the obligations of a non-charitable society or company without receiving any benefit in return it is important that this specific power is explicitly set out. The courts will be slow to imply such a power if that is not done.[49]

Cases directly involving societies after *Rolled Steel* illustrated the application of the principles in that case. In *Halifax Building Society v Chamberlain Martin Spurgeon*[50] a housing association registered as an industrial and provident society bought land for development and borrowed from the Halifax Building Society as part of the deal. 16% of the space and 18% of the value of the development was for office space to be let commercially. The rest was residential accommodation. Without the commercial element, the development would not have been economically viable.

In fact the development did not go ahead and the society went into receivership. At this point the issue of the society's capacity to enter into the relevant contracts was raised in litigation. The Halifax sought either to enforce its contract with the society or to sue its own solicitors if the transaction were ultra vires the society. The object set out in the society's rules was 'to carry on the industry business or trade of providing housing or any associated amenities'. It was given power by its rules 'to do all things necessary or expedient for the fulfilment of its objects'.

Arden J in the Chancery Division of the High Court had to decide whether the transactions were within the capacity of the society. She decided that so long as the society was proposing to provide housing and the provision of office accommodation of some kind (eg a caretaker's or warden's office) might be necessary or expedient to fulfil the object of providing housing, the court could hold that the transactions dealing with the office accommodation were within the society's powers. Once this was established, factors such as the proportion of the development taken up with office space and the element of risk involved in that part of the development could be ignored. She followed the approach taken in the *Rolled Steel* case and showed that the courts were willing to do their best to minimise the problems facing societies as a result of the law as it was before the Co-operatives and Community Benefit Societies Act 2003.

In the *Halifax* case, the possibility that the outside contractor was a party to a misuse by the society's board of their powers did not arise. In the Court of Appeal decision in *Alliance and Leicester Building Society v Marland*,[51] that question was considered. The Court of Appeal in that case overturned a summary judgment entered against the guarantors of the debts of an insolvent society on the ground that they had an arguable ultra vires defence. The court applied the *Rolled Steel* principles in the context of a society whose objects contemplated the building of houses by the members' own labour when, possibly to the knowledge of the lender, all of the building work was to be contracted out and some, at least, of the members entered the arrangement as a speculation. If the lender knew of this discrepancy when it lent it might be a party to the misuse of a power being exercised for a purpose outside the objects clause. The case shows that the ultra vires doctrine remained a live issue so far as societies were concerned up to 1 April 2004. The principles developed in the case law are still relevant in the context of breach of duty by directors or others and in the case of charitable societies in respect of which the statutory protection is more limited.

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[49] *Rosemary Simmons Memorial Housing Association Ltd v United Dominions Trust Ltd* [1986] 1 WLR 1440.
[50] [1994] 2 BCLC 540 [1994] EGCS 41.
[51] 17 February 1995, LexisNexis CA.

Similarly, the rules developed by the case law governing the use of the surplus of a society are now subject to the statutory provisions discussed below but might remain relevant if a breach of director's duty were alleged. In *Warburton v Huddersfield Industrial Society Ltd*[52] it was decided by the Court of Appeal that a donation to a strike fund authorised by a society's general meeting was void because, although the rules of that society provided for the application of surplus by a general meeting 'for any lawful purpose' (the words also used in s 12(7) of IPSA 1876), the reference to 'any lawful purpose' in the society's rules was qualified, in that particular case, by more specific purposes explicitly mentioned in the same sentence in the same rule. In two later cases payments to the Co-operative Party by societies were found to be permissible so long as the rule dealing with the issue was properly worded. Both cases referred to s 10(6) of IPSA 1893, which replaced s 12(7) of the IPSA 1876 and stated that the rules of any society 'shall provide for the profits being appropriated to any purposes stated therein or as determined in such manner as the rules direct'.[53]

The combination of ss 2(2)(c) and 14(12) of the CCBSA 2014 are sufficient to achieve the same result. In addition, it would seem that the implicit acceptance in the pre-1893 Act *Warburton* case both that an appropriately worded rule could achieve both the result of permitting distribution for any lawful purpose and that an 'object' of a society can be found in any of its rules and not only the one labelled 'objects rule' allows for the use of surplus for political and other purposes as long as rules are correctly drafted. In the absence of such rules, such uses of funds could alternatively be justified on the basis that they are made in pursuit of the society's business objectives if they are made to organisations, such as the Co-operative Party in the case of a co-operative society, that represent or promote the interests of societies of the type in question. The presence in the objects rule of a co-operative society of an object or power involving compliance with or promotion of the ICA Co-operative Principles or pointing to the society's identification with the co-operative sector would also be of assistance in this respect.

The area of benefits to employees is one in which discrepancies remain between company law and the position of industrial and provident societies. These issues are not specifically addressed by the CCBSA 2014, which contains no provision equivalent to s 172 of the Companies Act 2006, which requires directors to have regard to the interests of employees (but provides no means for the employees to enforce that duty). Similarly, the statutory provisions permitting company shareholders to decide to provide for employees or former employees on the cessation or transfer of the company's business do not apply to societies.[54] As a result, benefits to people or organisations other than members or others specifically referred to in the rules, including employees if the society is not a workers' co-operative, will have to be justified by reference to furthering the society's objects. This will not be a problem in the case of employees while a society is a going concern. Payments and benefits to employees can then be argued to make recruitment easier, or to provide incentives, and so indirectly to benefit the business operation and the society's members or the cause to which it is dedicated. However, if the society is being wound up and its final surplus after the payment of debts is being distributed or passed to another organisation in accordance with the society's rules, the rule in *Parke v Daily News*[55] will apply to prevent any donation not expressly permitted

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52 [1892] 1 QB 178.

53 *Lafferty v Barrhead Co-operative Society* (1919) 1 SLT 257 and *Cahill v London Co-operative Society Ltd* (1937) Ch 265.

54 Companies Act 2006, s 247 and Insolvency Act 1986, s 187.

55 [1961] 1 WLR 493.

by the society's rules. For this reason, the rules of many societies explicitly provide for the establishment of a superannuation fund for employees.

The difficulties caused for societies by the operation of the common law rules outlined above were greatly reduced by the Co-operatives and Community Benefit Societies Act 2003 which placed them in largely the same position as companies.

11.4.4. Statutory protection from lack of capacity: the general rules

Many societies use the terminology 'board' and 'director' to refer to those with the main power to make decisions outside general meetings of society members. However, the CCBSA 2014 refers to the committee of a society and members of the committee and does not refer to boards or directors. The discussion in this chapter of these issues uses either term. It also assumes that the body referred to is the 'board' in the sense usually applied to companies. It will not usually include bodies with limited local or functional roles within a society which are not the main decision making body for the society as a whole. The terminology used does not affect the legal rules that are applicable. The organ to which CCBSA 2014 provisions apply will generally be clear from a society's rules.

The ultra vires rule discussed in the last section is effectively inapplicable to non-charitable societies, unless the other party to a transaction entered into by a society in excess of capacity is a member of society's committee.[56]

Section 43(1) of CCBSA 2014 provides that: 'The validity of an act done by a registered society shall not be called into question on the ground of lack of capacity by reason of anything in the society's registered rules.' This is a clear and unconditional statement modelled on s 39(1) of the Companies Act 2006.

CCBSA 2014, s 43(1), unlike the provision in s 45(1) about the powers of the society's committee, is not stated to operate only in favour of a person dealing with the society and does not depend on the good faith of such a party. Section 43 applies whether the issue of capacity is raised by the society or by the other party and regardless of issues of good faith – although bad faith on the part of a party might well give rise to other issues. The unconditional and clear operation of the subsection confirms the validity of any act or transaction carried out by the society's organs or agents.

Later subsections qualify this protection only by retaining the right of a member to litigate to prevent, before it is carried out, an act that would be ultra vires but for CCBSA 2014, s 43(1) and confirming the liability of a society's committee members or directors to the society itself for a failure to act within the limits imposed by the society's rules.

A member can bring proceedings to 'restrain' the doing of an act which, but for CCBSA 2014, s 43(1), would have been ultra vires. However, even this is not permitted if the act in question is to be done to fulfil a legal obligation which the society by a previous act, undertook. The classic example of such an act would be the transfer of the ownership of property that the society has already contracted to sell. In such a case, even if the contract or the transfer were outside the society's capacity, it cannot be restrained on the

[56] CCBSA 2014, ss 43(9), 47 and 48.

application of a member. A more significant limitation on the effective power of a member to restrain an act is likely to be the absence of information about what is about to happen. How often will an ordinary member be aware of a proposed transaction before it has been carried out? How many such members will then have the resources to go to court to stop it? The answer is probably very few other than in small societies in which a member of the committee is in dispute with the majority and stands to gain financially from restraining the act. This could arise in a jointly owned society whose members were themselves businesses and, for there to be a financial gain, it would probably have to be a co-operative rather than a community benefit society in which distribution of surplus to members will be prohibited.

It remains the duty of committee members (or directors) to observe any limitations on their power flowing from the society's rules. An act that was formerly an ultra vires act remains a breach of duty by directors for which the society could sue despite the fact that the action's validity cannot be questioned under CCBSA 2014, s 43(1).

This gives rise to the question of whether, and if so, how, the society's members in general meeting can ratify the act and the relationship between a resolution to do this and a resolution to prevent the society from taking any action against the committee members as a result of their breach of duty. The purpose of a ratification might be to permit the society to sue on the basis of an act which, although it cannot be questioned on the basis of the absence of capacity on the part of the society, might be argued by the other party to have been outside the authority given to the committee or some other agent and so to be unenforceable by the society. A special resolution is required to ratify such an action.[57] However, a separate special resolution is required if the members want to relieve a director or anyone else of their liability to the society for their breach of duty.[58] The ratifying special resolution is not enough on its own.

A special resolution for this purpose must be passed by not less than 75% of members voting in person or by proxy (if the society's rules allow proxy votes) at a general meeting of which at least 21 days' notice was given in accordance with the rules and specifying the intention to propose the resolution.[59] This provision effectively imports the Companies Act definition of a special resolution rather than using the definition in s 111(2) of the CCBSA 2014, which applies to amalgamations of and transfers of engagements by societies. Thus the majority required is 75% (as for conversion into, transfer of engagements to or amalgamation with a company under CCBSA 2014, s 113), there is a statutory requirement of 21 days' notice regardless of the provisions of the rules about notice and only one meeting need be held to pass the resolution. The question of how notice is given – individually by post or by notice in shops, for example, – is left to the society's rules. However, the special resolution only takes effect once a copy, signed by the chairman of the meeting and the society secretary, has been registered with the FCA.[60]

The 2004 reforms also abolished the doctrine of constructive notice as a difficulty that could cast doubt on the society's capacity or its agents' authority. No party to a transaction with a society is bound to enquire about whether the transaction is permitted by the society's rules or about any limitation on the power of the society's

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57 CCBSA 2014, s 43(5).
58 CCBSA 2014, s 43(6).
59 CCBSA 2014, s 44(2).
60 CCBSA 2014, s 44(4) and (5).

committee to bind the society or to authorise others to do so.[61] This means that no-one can argue that, because the society's rules are available for public inspection at the FCA and because information about limits on the society's capacity or on the powers of the committee would have been discovered had the other party read them, that party is taken to have had that information. This effectively reverses, for parties to transactions with the society, the rule developed in the context of companies in the case of *Ernest v Nicholls*.[62] Persons who are not parties to transactions with the society might, however, still be affected by the old rule.

As a result of these reforms, subject to the rules applicable to charitable societies discussed in the next section, it is unlikely that any act of a society will be void or ineffective simply because the act is outside the society's objects. The implications of these reforms for the powers and duties of the society's board or committee and so for the powers of its other agents are discussed in Section **11.5.** below.

11.4.5. Statutory protection from lack of capacity: charitable societies

Palmer's Company Law, paras 2.633–2.634 and 3.323–3.324.1.

The limitations on the protection available to people dealing with charitable societies concern both the capacity of the society itself and any limitations in the society's rules on the power of the committee to bind the society or to authorise others to do so. Both aspects of the provisions are dealt with here.

They apply to a registered society defined as a charity. That is one established exclusively for charitable purposes in accordance with the law and subject to the supervision of the High Court (or Sheriff Court in Scotland) under the jurisdiction to supervise charities or designated by the Charities Commissioners to be a separate charity.[63] In such a case, the same protection as everyone enjoys in the case of a non-charitable society is available only to someone who gives full consideration in money or money's worth in relation to the act which proves to be beyond the capacity of the society or the power of its committee under its rules; and either:

– did not know that the act was not permitted by the society's rules; or
– did not know, at the time that the act was done, that the society was a charity.[64]

'Full consideration in money or money's worth' does not mean that there has to be an exact equivalence of value on both sides of the transaction but rather payment of more than a token or seriously inadequate amount. As Lord Sterndale MR put it in *A G v Earl of Sandwich*,[65] the way to answer the question of whether there was full consideration:

> 'is not necessarily to estimate the value of the thing granted and the consideration and ascertain whether they exactly agree, but to look at the nature of the transaction and to consider whether what is given is a fair equivalent of what is received'.

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61 CCBSA 2014, s 46.
62 (1857) 6 HL Cas 401.
63 Charities Act 2011, ss 1 and 7.
64 Charities Act 2011, s 47(1).
65 [1922] 2 KB 500, 517.

In the same case he said[66] that 'money's worth' included a right to possess property and to be free from the legal claims of others. Presumably, anything of economic value can be said to be 'money's worth'.

The section, having limited the effect of the provisions of CCBSA 2014, ss 43 and 45 in protecting people dealing with charitable societies, provides certain limited safeguards for those not clearly satisfying the above two conditions.

One safeguard arises from the burden of proof laid down by the section. The burden of proving, either that a person knew that the act was not permitted by the society's rules or that she knew, at the time of the act, that the society was a charity, is imposed the person seeking to show that.[67] This means that the starting point in the absence of evidence either way is a presumption that the person seeking protection was unaware of the provisions of the society's rules and of its charitable status. However, if a society has complied with s 12 of CCBSA 2014 and included a statement of its charitable status in all its correspondence and other published documents, someone's assumed ignorance of that fact might be more easily disproved.

Ignorance of the provisions of the rules is likely to be more difficult to disprove – especially since a person who is a party to a transaction is not obliged to enquire as to either a limitation on the society's capacity or a limitation on the committee's powers.[68] In dealing with knowledge of both the society's charitable status and the provisions of its rules it is clear that proof of actual knowledge ('does not know'[69]) on the part of the person is required before they lose protection. Constructive notice on the basis of what they would have learnt from enquiries they ought to have made will not be enough.

The other major safeguard applicable in connection with the transactions of a charitable society applies to anyone who *subsequently* acquires either property or any interest in it.[70] That person's title to the property or to their interest in it is not affected by the problem with society capacity or the powers of the committee providing two conditions are met. They are that:

- the property or interest in it was acquired by them for full consideration; and
- they had no actual notice of the circumstances affecting the validity of the society's act.

This means that the protection does not apply to a person involved in a transaction outside the society's capacity or the committee's powers, eg someone who buys the property from the society or who takes security over the society's property for a loan to it. That acquisition is not 'subsequent'. Such a person would need to have provided full consideration and not known either about the problem in the rules or about the society's charitable status to gain protection.

A person who 'subsequently' acquires the property by, for example, buying from the person who bought from the society or lending on the security of it at that later stage, must have provided 'full' consideration. That means that providing something worth

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66 Ibid.
67 CCBSA 2014, s 47(3).
68 CCBSA 2014, s 46.
69 CCBSA 2014, s 47(1)(a)(ii) and (b).
70 CCBSA 2014, s 47(2).

significantly less than market value will not be sufficient.[71] The subsequent purchaser must also be free of actual notice of the problem with the provisions of the society's rules which affected the earlier transaction involving the society. 'Actual notice' is a question of fact to be decided on the basis of evidence about what the person knew. In the case of a company or a society, its own 'actual knowledge' is found by attributing the knowledge of particular officials or directors to the body corporate as a legal person on a basis determined by reference to the policy objectives of the statutory provisions being interpreted.[72] In the case of this provision, the courts may be slow to attribute the knowledge of officials at a low level in the hierarchy to a corporate purchaser as the objective of the statutory provision is to protect innocent later parties.

As long as both of these conditions are satisfied, the title to the property will be free of the defect caused by the society's lack of capacity or by the constitutional limitations on the powers of its committee.

11.5. THE POWERS OF AGENTS OF THE SOCIETY

See: *Palmer's Company Law*, paras 3.336–3.350.

The question of the capacity of the society itself as a legal entity to enter into a contract or to carry out any other act is now largely governed by statute[73] – see Section **11.4.** above. The separate question of whether the society is legally bound by the actions of a particular agent is resolved, in general, by applying the rules of agency law as developed by the courts for any person, whether human being or corporation. However, certain particular problems may arise from provisions in a society's rules. The rules may limit the powers of the committee or board or of other agents. There is then the question of whether people are to be taken to have knowledge of the provisions of the society's rules because they could have read the copy filed with the FCA. Those issues are all governed by CCBSA 2014. In this section the common law rules are dealt with first and then the relevant provisions of the CCBSA 2014 are considered.

11.5.1. Common law agency rules

As a corporation with legal personality, rather than a human being, a society's contracts and other legally effective acts will always be carried out by individual human beings. To bind the society, the transaction or act must be within the powers of the individual who acted on its behalf. That involves deciding whether or not the individual in question had the authority to engage in the activities in question so as to bind the society. A person's level of authority will vary according to their position in the society. A chief executive will have authority to enter a wide range of transactions. Other employees will have a degree of authority that depends on their role, their contract of employment, and the power that has been conferred on them.

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71 *Bayoumi v Women's Total Abstinence Education Union Ltd* [2004] Ch 46, 64 per Chadwick LJ at para 47.

72 *Morris v Bank of India* [2005] EWCA Civ 693 and *Meridian Global Funds Management Asia Ltd v Securities Commission* [1995] 2 AC 500.

73 See Section **11.4.** above.

In agency law, an agent can have three forms of authority. As long as one of them is present in a particular case, the act or transaction will bind the society as the agent's principal. Authority can be express, implied or apparent.[74]

Express authority is actually conferred either orally or in writing. The ultimate source of such authority will be the society's rules. The rules of most societies confer extensive powers on the board – enabling it to manage the society's business and allowing it to delegate its powers to subcommittees or individuals who can, in turn, delegate authority to other employees or officers. Sometimes the rules will directly confer particular functions and powers on, for example, a chief executive or particular committees such as an audit committee or an education committee. To discover the extent of express authority, the rules and any contract of the individual in question can be consulted. The written or verbal instructions given by those with authority to other employees can also be a source of such powers.

Implied authority consists of those powers necessary or incidental for a person to carry out their function. It may exist because a person holds a particular office, because it is usual for those powers to be exercised by someone in the position of that person, or because of previous dealings in which that person exercised those powers and the society accepted the resulting contract. However, implied authority cannot contradict an express limit on a person's authority. In the case of both express and implied authority, the power has actually been conferred on the person in question – hence these forms of authority are sometimes referred to as actual authority.[75]

By way of contrast, apparent authority will be held to create a contract when a person with actual authority makes a representation on behalf of the society to the other party that a person has a certain level of authority. This may occur by virtue of the title the person was given or because of something said or done. The court will not then permit the society to deny that the person had that authority against the other party who relied on that representation. The court will thus hold the society to a contract within the scope of the authority suggested by the representation. In such cases no actual authority is conferred on the agent but the society is still bound by the contract with the other party to whom the representation was made.[76] It is when this form of authority is relied on that the statutory protection against problems with the authority of the board or committee in the society's rules, discussed in Section **11.5.3.**, is likely to be most relevant.

11.5.2. Ratification by the society of an agent's unauthorised act

Under the old common law of ultra vires, no act beyond the society's capacity could bind it regardless of the authority of the agent involved in purporting to make the contract. However, since the 2004 reforms the validity of an act or contract can never be called into question on the ground of ultra vires.[77]

Under the present law, an act outside the society's objects clause remains one for which the society's board or committee can have no actual authority and so one for which they cannot confer actual authority to other agents. However, from the point of view of the

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74 *Criterion Properties plc v Stratford UK Properties LLC* [2004] UKHL 28 at paras 28 and 29.
75 See *Hely-Hutchinson v Brayhead* [1967] 3 WLR 1408.
76 See *Freeman and Lockyer v Buckhurst Park Properties (Mangal) Ltd* [1964] 2 WLR 618.
77 CCBSA 2014, s 43(1) and see Section **11.4.4.** above.

other party to such a contract or act, CCBSA 2014, ss 45 and 46 together with the concept of apparent authority are likely to allow them to enforce it.[78]

In all cases in which something is done beyond the authority of an agent of a society, it is possible for the society to choose to ratify the act so as to be able to enforce the contract or benefit from the act in question. Generally, this would require a decision by another agent with actual authority to ratify. For example, if a more junior employee exceeds his or her authority a more senior employee or the society's board could cause the society to ratify the act as long as they had actual authority to do that.

In the case of the board itself acting beyond its authority, ratification would have to be agreed by the members in general meeting. This would usually involve an ordinary resolution unless the society's rules required a greater majority for a particular decision.[79] However, a special resolution will always be required if the act in question was outside the society's objects.[80] In the case of a charitable society registered in England and Wales, such a special resolution (as well as one ratifying a transaction between the society and a committee member/director or a connected person), would only be valid if approved in advance in writing by the Charity Commission.[81]

11.5.3. Statutory protection and apparent authority: protecting outsiders

See: *Palmer's Company Law*, paras 3.301–3.352.

Because of the artificial nature of the legal personality of a company or society a number of problems can arise about the authority of agents – especially about apparent authority. If the rules of the society define or limit the level of actual authority of its agents, and if the contents of the rules were taken to be known to all since they are publicly available and could have been read, how could anyone ever rely on a representation that an agent had a level of authority denied by the provisions of the rules?

The common law dealt with this problem by use of the rule in *Royal British Bank v Turquand*.[82] The modern law deals with it by the provisions of CCBSA 2014, ss 45 and 46. Both sources seek to protect third parties dealing with agents whose actual authority is limited in some way because of provisions in the rules.

The rule in *Turquand*'s case provided that, even if a person dealing with someone purporting to act on behalf of the company had notice that a certain procedure or process had to be followed to allow something to be done, they were not generally obliged to check whether or not it had been followed. They would only be expected to do that if the information about whether the procedure had been followed was public in the same way that the rules were and so was subject to constructive notice. Thus if the board, under the rules, was only allowed borrow an amount above a certain limit if the general meeting had passed an ordinary resolution authorising the borrowing, the outsider need not check whether or not the resolution had been passed. However, if the

78 See Sections **11.5.3.** to **11.5.5.** below.
79 *Grant v United Kingdom Switchback Railways Co* (1889) LR 40 Ch D 135.
80 CCBSA 2014, s 43(5).
81 CCBSA 2014, s 43(7).
82 (1856) 6 E and B 327; [1843–60] All ER Rep 435.

resolution required were one which had to be registered in the same way as the rules (eg a rule amendment) the person would have constructive notice of whether or not it had in fact been passed.

This would arise in the case of an agent who was alleged to have apparent authority as the outsider could not argue that the 'agent' had been represented to have authority if the outsider's constructive notice of the rules, or of whether or not a procedure had been followed, meant they were taken to know of the constitutional problem. The *Royal British Bank v Turquand* case gave protection where the issue was whether some procedure needed to give authority had or had not been followed. This common law doctrine is still available and could be used in a case in which the statutory provisions did not provide protection – for example if the issue was about whether or not a person was ever properly appointed or elected to the committee itself.

The modern law on this issue gives two additional bases on which the apparent authority of the 'agent' can be upheld where the representation on which apparent authority is based is contradicted by the rules of the society.

First, no party to a transaction with a society is bound to enquire as to whether the transaction is permitted by the society's rules or about any limitation on the power of the society's committee to bind the society or to authorise others to do so.[83] This means that no-one can argue that, because the society's rules are available for public inspection at the FCA and because information about limits on the society's capacity or on the powers of the committee would have been discovered had the other party read them, that party is taken to have had that information. So, if the problem relates either to a limit in the rules on the committee's own authority to bind the society or to such a limit on its power to authorise others to do so, there is no constructive notice of anything in the rules – whether that is an outright limitation on the power or a requirement that some particular procedure be followed to confer authority.

In addition, CCBSA 2014 gives protection in favour of people dealing with the society in good faith.[84] The protection, when it applies, frees the powers of the board from any limitations contained in the rules on their ability to bind the society or to authorise others to do so. This means, at least on a literal interpretation of the section, that the power must be conferred in the first place before the section can operate to free those powers from limitations. Thus in *Smith v Henniker-Major & Co*[85] a board meeting that was inquorate and so invalid, could not be deemed to have been validly held by the use of the equivalent Companies Act provision – according to the first instance judge and one court of appeal judge – as the problem did not concern a limit on the powers of the board. In that case, the other reason for the Court of Appeal's refusal to uphold a transaction agreed at the inquorate meeting, was that the claimant was the chairman and so had a duty to ensure that the company constitution was followed and that the section's reference to a person 'dealing with' the company, while it could include a director in principle, did not include this claimant who was seeking to uphold a decision which was invalid due to his own mistake.[86]

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83 CCBSA 2014, s 46.
84 CCBSA 2014, s 45.
85 [2002] EWCA Civ 762.
86 See *Palmer's Company Law,* para 3.309.

The section can be used by any person dealing with a registered society in good faith.[87] The phrase 'deals with' covers both being a party to a transaction with the society and being a party to any other act to which the society is party.[88] This means that the section can apply to a contract or to a unilateral act of a society but the Court of Appeal has held that, in the case of shareholders receiving a bonus issue of company shares in respect of which no payment of any consideration is required, there is no 'dealing' with the company.[89]

To add further to the level of protection conferred, the person using the section is presumed to have acted in good faith unless the society proves that this was not so and even the fact that the person knew that the act in question was beyond the powers of the committee does not, of itself, mean that the person is necessarily to be taken to be in bad faith.[90]

The protection given by the section extends beyond the contents of the society's rules themselves. Limitations on the committee or board's powers deriving from a resolution passed by the general meeting or a meeting of a class of members or from an agreement between the members of the society or the members of any particular class of members will also be covered.[91] Limitations found somewhere other than in these listed sources might not be subject to the protection of the section although the list in the subsection is not exhaustive.

However, s 45 does lay down some restrictions on the protection that it provides. CCBSA 2014, s 45(4) and (5) echo the equivalent provision of s 43 about acts outside the society's capacity by preserving the right of a member of the society to sue to restrain an act that is beyond the powers of the committee unless it is done to fulfil a legal obligation that arises from a previous act of the society. This is, however, just as unhelpful to members not aware in advance of planned acts by the board or committee as the similar right found in CCBSA 2014, s 43(2) and (3). The liabilities of committee members or directors to any person as a result of an act outside their powers still remain.[92] This is most likely to be a liability to the society itself for a breach of their duty to obey the rules.

Many commentators take the view that the acts of agents of the society other than the board itself may not be covered by the protection conferred by this provision (or the equivalent Companies Act provision) – except in so far as the problem arises with limitations on the power of the board to authorise others to act for the society.[93] If that is correct, in that case only common law agency principles would be available.

In the case of societies, there is the additional problem that, while the Companies Act provisions were enacted to conform with the UK's obligations under the First Company Law Directive of the EU,[94] the ones applicable to societies, although identical to the earlier Companies Act provisions, were not. This may mean that the wording of the

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87 CCBSA 2014, s 45(1).
88 CCBSA 2014, s 45(2)(a).
89 *EIC Services Ltd v Phipps* [2004] EWCA Civ 109.
90 CCBSA 2014, s 45(2)(b) and (c).
91 CCBSA 2014, s 45(3).
92 CCBSA 2014, s 45(6).
93 See *Palmer's Company Law*, para 3.329.
94 First Council Directive 68/151/EEC of 9 March 1968 Official Journal L 065 English special edition: Series I Chapter 1968(I) P 0041 'First Company Law Directive'.

directive and the teleological approach to interpretation to be applied to implementing provisions will not apply to these provisions. So, for example, the impact of the words 'organs of the company' to be found in the Directive would not apply to broaden what would otherwise be the meaning of the words used in the UK provision to deal with the directors of a company or the committee members of a society.[95] If the wider meaning were given to the words, they might be taken to include, for example, limitations in the rules on the powers of a CEO of a society if those powers were stated in the society's rules – assuming this made that officer an 'organ' of the society with powers directly conferred by the rules, rather than an agent with powers conferred by an organ of the society. One might argue that the enactment by Parliament of almost identically worded provisions for societies after the enactment of the provisions applicable to companies shows that Parliament intended the same interpretation to apply to both sets of provisions – including interpretation to make them consistent with the implementation of the Directive obligation.

This would suggest a liberal approach, in favour of upholding transactions or acts of the society, to the interpretation of the UK provisions. As Browne-Wilkinson J remarked, of the first Companies Act provision which implemented the Directive, in *TCB v Gray*:[96]

> 'Section 9(1) of the Act of 1972 was passed to bring the law of England into line with article 9 of Council Directive 68/151/EEC. In approaching the construction of the section, it is in my judgment relevant to note that the manifest purpose of both the directive and the section is to enable people to deal with a company in good faith without being adversely affected by any limits on the company's capacity or its rules for internal management. Given good faith, a third party is able to deal with a company through its 'organs' (as the directive describes them) or directors. Section 9(1) achieves this in two ways: first it 'deems' all transactions to be authorised; second, it deems that the directors can bind the company without limitations. The second part of the subsection reinforces this by expressly abolishing the old doctrine of constructive notice of the contents of a company's memorandum and articles. It being the obvious purpose of the subsection to obviate the commercial inconvenience and frequent injustice caused by the old law, I approach the construction of the subsection with a great reluctance to construe it in such a way as to reintroduce, through the back door, any requirement that a third party acting in good faith must still investigate the regulating documents of a company.'

Those dealing with charitable societies are not given the full protection of CCBSA 2014, s 45 but only the more limited rights provided by s 47. The protection provided for those 'dealing with the society' from limitations on board or committee powers is also denied to the society's own directors or committee members and those connected with them and they are subject to a different regime.[97]

11.5.4. Statutory protection: charitable societies

Section **11.4.5.** above deals with this.

11.5.5. Transactions between a society and its own directors or connected persons

See: *Palmer's Company Law*, paras 3.314–3.320.

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[95] First Company Law Directive, art 9.2.
[96] [1986] Ch 621, 635.
[97] CCBSA 2014, s 45(7).

11.5.5.1. The provision

These rules apply to any transaction by a society which has a director/committee member or a person connected to (or company associated with) a director or committee member as a party and in which the committee exceeds any limitation on its powers under the society's rules.[98]

They deny protection to director/committee members and persons connected to them as persons dealing with a society but seek to protect others involved in the transaction. The right of the society to a remedy for wrongs done to it is also preserved. In addition, according to the Court of Appeal decision in *Smith v Henniker-Major*,[99] on the equivalent Companies Act provisions, a committee member who is party to a transaction between themselves and the society, may, in some circumstances, be outside CCBSA 2014, s 45 and so outside the scope of s 48. That would leave the common law to determine the outcome. Section 48 makes the transaction voidable. The common law may make it void and wholly invalid.

A 'transaction' for the purpose includes an 'act' of the society and the reference to limitations on committee powers under the society's rules includes resolutions and agreements by or between members or classes of member.[100]

11.5.5.2. Remedies

These provisions make any transaction with directors or others affected by a problem with board authority voidable at the instance of the society.[101] In principle, this permits the society to set the transaction aside if that is beneficial to it or to go ahead with the transaction if that is better for the society. In addition, the society can claim any other remedies it may have, such as damages for any loss the society suffers or an account of profits made by a director/committee member in breach of their duty to the society. The section itself outlines the scope and effect of the society's remedy of 'avoiding' the transaction or act.

Any committee member/director or connected person who is a party to the transaction and any committee member who authorised the transaction is liable to account for any gain they made directly or indirectly by the transaction and to indemnify the society for any loss or damage it suffers as a result of the transaction.[102] This is so whether or not the society chooses to avoid the transaction. In addition, CCBSA 2014 explicitly preserves the operation of any other legislation (primary or subordinate and made by the UK Parliament or Government or the Scottish Parliament or Executive or the Welsh Assembly) or other rule of law that puts the validity of the transaction in question or gives rise to liability to the society.[103] Thus any breach of the duties of a director/committee member or liability of another person as constructive trustee due to their involvement in or knowledge of such a breach of duty will still apply in a case covered by CCBSA 2014, s 48.

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98 CCBSA 2014, s 48(1).
99 [2002] EWCA Civ 762.
100 CCBSA 2014, s 48(3) and (4).
101 CCBSA 2014, s 48(2).
102 CCBSA 2014, s 48(3).
103 CCBSA 2014, s 48(4).

The possibility that the society might avoid the transaction is limited in a way that resembles the approach taken by the courts to voidable contracts.[104] The transaction ceases to be voidable if the restitution of money or some other asset that was the subject-matter of the transaction becomes impossible.[105] The rationale for this provision is that it would then no longer be possible to return the parties to the transaction to the position they were in before it. This might apply if an asset had been consumed or radically changed since it was handed over. Since a court order 'avoiding' the transaction will require both parties to be returned to their previous position, such a limitation is only fair.

Similarly, if the rights of a person who is not a party to the transaction would be affected by avoidance, the transaction ceases to be voidable – as long as that person acquired their right in good faith, for value, and without actually knowing that the committee exceeded its powers.[106] This ensures that the property rights of those who give value in good faith and are not aware of the problem are protected. This provision is in line with the rules applicable to voidable contracts under judge-made law.

Since s 48 of CCBSA 2014 is concerned with problems about the powers of the board or committee of the society, it acknowledges that a decision by the society's members in general meeting to ratify the transaction in question will mean that it is no longer voidable.[107] The majority required in the general meeting effectively to ratify the transaction will depend on the society's rules and the circumstances of a particular case. It is clear that if the limitation on the powers of the board or committee arises because the transaction is outside the society's objects, a special resolution, as defined in CCBSA 2014, s 44, will be required for its ratification.[108] Otherwise, it would seem that an ordinary resolution will suffice unless a society's rules expressly require a larger majority in a particular case.[109]

The society's right to be indemnified for any loss or damage it has suffered as a result of the transaction applies whether or not the transaction is avoided and does not exclude a possible claim under any other legal rule.[110] However, at the time when the society is in fact indemnified for any loss or damage resulting from the transaction, the transaction ceases to be voidable.[111]

Section 48 of CCBSA 2014 affects the position of a number of different people or companies. There are directors or committee members, persons connected to them, and associated companies who are parties to the transaction that exceeded the board's powers. There are also the directors or committee members who are not parties to the transaction but who 'authorised' it.

11.5.5.3. Remedies and 'innocent' parties

The transaction may have other parties who are neither director/committee members nor connected persons/associated companies. Those 'innocent' parties are still protected by

[104] CCBSA 2014, s 48(5).
[105] CCBSA 2014, s 48(5)(a).
[106] CCBSA 2014, s 48(5)(c).
[107] CCBSA 2014, s 48(5)(d).
[108] CCBSA 2014, ss 43 and 44.
[109] *Grant v United Kingdom Switchback Railways Co* (1889) LR 40 Ch D 135.
[110] CCBSA 2014, s 48(3) and (4).
[111] CCBSA 2014, s 48(5)(b).

s 45 of CCBSA 2014.[112] The court has discretion, on the application of such an 'innocent party' or of the society, to affirm, sever or set aside the transaction on terms the court sees as just.[113] This deals with the unfairness to the innocent parties of an absolute right on the part of the society to set aside the whole transaction. Severance would allow some parts of the deal to be enforced while others are set aside – for example, to deprive the committee member/director or connected parties of benefits but maintain the position of the innocent parties.

11.5.5.4. Who is covered: director/committee members, connected parties and associated companies

Actual director/committee members: The society's right to set aside the transaction, to be indemnified for loss and to take profits, discussed above, will apply to directors/committee members who are parties to, or who authorise, the transaction and to connected persons or associated companies who are parties to the transaction.

The question of who is a director/committee member will be one of fact. Those who have been duly elected or appointed in accordance with the rules will clearly be within this category.

De facto directors? In addition, the courts might well, in connection with societies, be willing to apply the concept of a 'de facto' director/committee member which they apply in the case of companies. This would involve deciding that any person who behaved as if they were a director/committee member and held themselves out as such would be regarded as one. In societies in which a chief executive officer is not a member of the board/committee, that person might be found to have behaved in such a way as to fall into this category.

The starting point in analysing whether a person is a 'de facto' director is *Re Hydrodam (Corby) Ltd*[114] where Millett J described a de facto director as:

> 'a person who assumes to act as a director. He is held out as a director by the company, claims and purports to be a director, although never actually or validly appointed as such. To establish that a person was a *de facto* director of a company it is necessary to plead and prove that he undertook functions in relation to the company which could probably be discharged only by a director. It is not sufficient to show that he was concerned in the management of a company's affairs or undertook tasks in relation to its business which can probably be performed by a manager below board level.'

In *Secretary of State for Trade and Industry v Tjolle*[115] Jacob J concluded:

> 'It may be difficult to postulate any one decisive test. I think what is involved is very much a question of degree. The court takes into account all the relevant factors. Those factors include at least whether or not there was a holding out by the company of the individual as a director, whether the individual used the title, whether the individual had proper information (eg management accounts) on which to base decisions, and whether the individual had to make major decisions and so on. Taking all these factors into account, one asks "was this individual part of the corporate governing structure?"'

[112] CCBSA 2014, s 48(7).
[113] CCBSA 2014, s 48(8).
[114] [1994] BCC 161, 163.
[115] [1998] 1 BCLC 333, 343.

Virtually all chief executives of societies, even if they are not formally members of the board, take part in the corporate governance structure and undertake functions that in companies are typically carried out by directors.

It has been held that a de facto director will, in principle, owe the same duties to the society or company as those formally appointed as directors.[116]

While the case law concept of a 'de facto' director is capable of applying to societies as it applies to companies, it would seem that the concept of the 'shadow director' is purely statutory.[117] On this basis it will not apply to societies except when specific provisions of the Insolvency Act 1986 are applied to them through the operation of s 123 of the CCBSA 2014.

Connected persons and associated companies: To decide whether a person is connected to a society director/committee member and whether a company is associated with him or her, s 49(5) of CCBSA 2014 applies ss 252–255 of the Companies Act 2006 as if any reference to a director of a company were a reference to a committee member of a society. The Treasury is also empowered to make regulations adapting or modifying the Companies Act provisions but, up to March 2014, no such regulations appear to have been made.

When ss 252–255 of the Companies Act 2006 are applied in the way indicated by s 49 of CCBSA 2014, it leads to the conclusion that, in addition to the director/committee members and de facto directors of a society the following are covered by s 48:

(a) *Relatives of director/committee members as follows* – their spouse; civil partner; any other person they live with in an 'enduring family relationship'; a child or step child; their parents; as long as that person is not himself or herself a committee member of the society are all 'connected persons' to a society's committee member.[118] This covers a person to whom the director is legally married; their partner under a same sex civil partnership; and children and stepchildren under 18. It does not cover a grandparent or grandchild, sister, brother, aunt or uncle, or nephew or niece. Although the list of people within this provision is limited, the courts when applying common law duties would operate on a more flexible basis to decide whether a director had an interest in a transaction or had breached their general duty on the basis of a relationship with another human being.

(b) *Body corporate with which the director/committee member is associated* applies directly to a transaction to which both the society and a director/committee member's associated corporate body are parties.
Section 254 of the Companies Act 2006 defines whether or not a corporate body is associated with a director/committee member. Broadly, being interested in one-fifth of its equity share capital or controlling one-fifth of the votes at its general meeting, in each case either alone or together with persons connected to him, make the director/committee member 'associated' with a body corporate.[119]

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[116] *Ultraframe (UK) Ltd v Gary Fielding, Northstar Systems Ltd, Seaquest Systems Ltd, Alan Clayton, Jeffrey Naden ('The Leeds Consolidated Action')* [2005] EWHC 1638 (Ch) at para 1257.
[117] *Secretary of State for Trade and Industry v Deverell* [2001] Ch 340.
[118] CA 2006, s 253.
[119] CA 2006, s 254(2).

In deciding whether voting power is controlled by a director/committee member, voting power controlled by a corporate body that he or she controls is included as controlled by him or her.[120]

The detailed provisions of CA 2006, s 255 apply to decide whether or not the director/committee member controls a corporate body for this purpose.

(c) *Trustees* – A person – either human being or corporate body – acting as trustee of a trust (other than an employee share scheme or pension scheme) which has the director/committee member, a relative within (a) above or a body corporate with which the committee member is associated as either a beneficiary of the trust or of a power it confers.[121]

(d) *Business partners* – A person acting as a business partner of the director/committee member or of anyone covered by paragraphs (a) to (c) above (including a body corporate with which the committee member is associated).[122]

(e) *Firms in which the director/committee member is participating* – where the director/committee member is a partner, or anyone covered by paragraphs (a) to (c) is a partner, or where a partner in such a firm is itself a firm of which a director/committee member, or a person covered by paragraphs (a) to (c), is a partner.[123]

11.5.6. Directors' duties not to breach society rules: a summary

Under the statutory provisions designed to protect outside parties dealing with societies, the liability of director/committee members to the society for their failure to follow its rules are preserved. Under CCBSA 2014, s 43(1), the validity of an act outside the matters listed in its rules and so outside society's capacity cannot be questioned on that ground. However, the duty of director/committee members to observe the limits imposed on their powers by the rules remains, and the ratification of such acts to allow the society to sue on them, requires one special resolution of a members' meeting to be passed by a 75% majority of those voting and duly registered by the FCA. Any decision to relieve the directors of liability for their breach of duty requires a separate additional special resolution complying with the same requirements.[124]

The liability of director/committee members arising from the fact that the committee exceeded its powers remains, despite the protection afforded to outside parties acting in good faith where the rules limit the powers of the committee/board.[125]

Apart from the breach of any other duty a director/committee member acting in breach the society's rules might well amount to the use of a power for an improper purpose.[126]

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120 CA 2006, s 254(4).
121 CA 2006, s 252(2)(c).
122 CA 2006, s 252(2)(d).
123 CA 2006, s 252(2)(e).
124 CCBSA 2014, ss 43(4) and (5) and 44.
125 CCBSA 2014, s 45(6).
126 *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821 and see **Chapter 7**.

11.6. SPECIAL STATUTORY RULES ABOUT LOANS AND INVESTMENTS BY SOCIETIES

A society can invest in 'or upon' any security authorised by its rules.[127] This suggests that the funds invested can be used either to provide some form of 'secured' loan or to buy or invest in a 'security' such as a share or debenture. In addition to that range of investments, a society may, unless its rules specifically provide to the contrary, invest in local authority securities, mortgages, bonds, debentures, rent-charges, the shares of other societies, building societies or companies, or in trustee investments.

It might be argued that the power that may be conferred by the society's rules to invest 'in or upon' any security that they authorise cannot cover investments that are neither 'in' nor 'upon' any security. A security 'in' which one invests is likely to be a chose in action such as a share or loan stock. One 'upon' which one invests is more likely to be a mortgage or charge or, at least, an unsecured personal guarantee. It seems unclear how seriously this wording may limit the scope for a society's rules to permit investments. The narrower the range of 'securities' 'in or upon' which a society may invest with the authority of its rules, the more important the definition of 'invest' becomes. Is a current bank account an 'investment'? What of a deposit account? Both represent a disposal of part of the society's funds. Are they investments? If so, neither can comfortably be described as a 'security' in either of the above meanings. How might the section apply to the use of the overnight money markets and more sophisticated financial devices?

The answer, it is submitted, is that devices such as bank accounts or more complex deposits or financial arrangements involve means of effectively doing business as well as, or rather than, 'investments'. As a result, they should be justified as an exercise of a power 'necessary or expedient' or 'reasonably incidental' to carrying out the objects of the society and so permitted explicitly under the society's rules or implicitly on the basis of the decision in *A-G v Great Eastern Railway*.[128] The difficulty with this argument arises if a particular use of funds can only be seen as an investment and is not made 'in or upon' a security in any sense of the word. It is to be hoped that, should this issue arise, the courts and the regulator will take a liberal view of CCBSA 2014, s 27 and of the scope of society powers so as to meet the needs of large and complex businesses in the modern world of corporate finance despite the age of the legislation consolidated in 2014[129] and its implicit assumption of relatively small-scale operations by societies.

11.6.1. Proxy voting by societies

A registered society, which has invested any of its funds in the shares or on the security of another corporate body, can appoint as proxy any one of its own members, whether or not he or she is personally a member of the other body corporate. The proxy is, during the continuance of the appointment, to be taken as holding the society's shares in that body for all purposes except the transfer of those shares or giving a receipt for dividend on them.[130]

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[127] CCBSA 2014, s 27.
[128] (1880) 5 App Cas 473.
[129] The wording of CCBSA, s 27(1) is little changed from Industrial and Provident Societies Act 1893, s 38(1).
[130] CCBSA 2014, s 28.

11.6.2. Advances to members

The rules of a registered society may provide for advances of money to members on the security of real or personal property or, in Scotland, of heritable or movable estate. If the society is registered to carry on the business of banking, an advance may be made in any manner customary in the conduct of such business.[131] 'Real' property is land and 'personal' property is any other property. The terms 'heritable' and 'movable' estate are the corresponding terms in Scotland.

This means that even loans to members on security must be authorised by the rules if they are to be permitted and that such loans not secured by a mortgage or charge are, as a rule, not permissible. In addition to the provision about banking societies in s 34, there are two exceptions to this rule. Unsecured loans by horticultural, forestry or agricultural societies to their members for those purposes are permitted.[132] The societies involved are defined as those whose members are mainly horticultural or agricultural producers, foresters, or organisations of such bodies with a sole or main object of lending to members for those purposes. Unsecured loans may be made by credit unions to their members.[133]

Investments by societies in land are allowed, unless the society's own rules direct otherwise. Land can be held, bought, sold, exchanged, mortgaged, or leased either to or from a society and buildings can be erected altered or demolished. Those dealing with a society in connection with land are protected from the need to enquire as to the authority for any dealing in land by a society and the society's receipt is to be a discharge for all moneys arising from or in connection with its dealings in land.[134]

Societies that are housing associations need the consent of the Regulator of Social Housing[135] (or, in Wales, of the Welsh Ministers[136]) for any disposals of land. In Scotland, the permission of the Scottish ministers is required.[137] Apart from interests in land necessary for making or enforcing secured loans to members, credit unions are only allowed to hold land for use as a place of business.[138]

11.6.3. Discharge of mortgages

When societies lend money to members or others on the security of a mortgage or charge, it is necessary for the security to be discharged when the loan is repaid.

On payment of all the money owed to a society and secured on property, the debtor or his successor or representative is entitled to a receipt in a form that varies between England and Wales, and Scotland.[139]

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131 CCBSA 2014, s 34.
132 CCBSA 2014, s 22.
133 Credit Unions Act 1979, s 11(1) and see Section **13.9.1.** below.
134 CCBSA 2014, s 26.
135 Housing Associations Act 1985, s 9 for unregistered housing associations and Housing and Regeneration Act 2008, s 172 for registered providers.
136 Housing Act 1996, s 9.
137 Housing (Scotland) Act 2010 asp 17, ss 107–108.
138 Credit Unions Act 1979, s 12(1) and (3), and see Section **13.9.3.** below.
139 CCBSA 2014, s 74.

In England and Wales, forms of receipt A and B in CCBSA 2014, Sch 2, Part 1 or some other form set out in the society's rules signed by two committee members and the secretary (or the liquidator described as such if the society is in liquidation) and annexed to or endorsed on the mortgage will fully discharge the mortgage under the Law of Property Act 1925, s 115 where the land is unregistered.[140] This formally ends the society's rights against the property that was subject to the mortgage or charge so long as the person whose property was mortgaged is named as having paid the money. In the case of registered land, the appropriate procedures to vacate the registration of the charge at the Land Registry under the Land Registration Act 2002 will have to be followed.

In Scotland receipts in forms C or D (depending on the form of the document creating the heritable security) should be used to discharge security over land and form E is applicable to discharge security over other types of property. However, in the case of land, registration in the General Register of Sasines is necessary to give effect to a discharge and to disburden the land.[141]

11.7. THE MODEL RULES

11.7.1. Consumer Co-operatives CUK 12th Edition Model Rules (amended 2012)

These rules deal with the purpose, objects and powers of the society. The business objects are wide, although based on retailing. They include a subjective provision of the kind upheld by the court in the context of company objects in the case of *Bell Houses Ltd v City Wall Properties Ltd*,[142] which extends the clause to cover 'engaging, as principals or agents, in any other business, trade, industry or activity which seems to the Society directly or indirectly conducive to carrying out the functions above'.[143]

However, those objects are subject to the society's purpose 'to carry out its objectives and functions as a co-operative'.[144] In addition, the rules commit the society to:

- following the Co-operative Values and Principles;
- respecting the rights and diversity of its members, employees and people dealing with the Society, treating them fairly and not discriminating on any grounds;
- conducting its business in an open and honest way' in the conduct of its affairs and to use its net profits in accordance with co-operative principles.[145]

The usual general formulation of the society's powers 'to do all things necessary or expedient for accomplishing any of its functions' is included.[146] Additional powers refer to transactions involving land, power to enter block discounting arrangements and guarantees, the establishment of pension or superannuation schemes, accepting deposits

[140] CCBSA 2014, s 71.
[141] CCBSA 2014, s 72.
[142] [1966] 2 QB 656.
[143] CUK Consumer Model Rule 4.1(b).
[144] Rule 2.
[145] Rule 3.
[146] Rule 15.5.

within legal limits and setting up an employee share scheme. The power to invest is limited to the securities or shares specified in s 27 of CCBSA 2014 and secured loans.[147]

11.7.2. Worker co-operatives: Co-operatives UK Worker Co-operative Model Rules

These model rules state that the objects of the co-operative 'shall be to carry on the business as a co-operative and to carry on any other trade, business or service and in particular to …'[148] with the space left to be completed by the co-operative using the rules. In addition the purpose of carrying out the society's functions as a co-operative and abiding by the internationally recognised co-operative values and principles of co-operative identity as defined by the International Co-operative Alliance are entrenched in a rule that can only be amended by an extraordinary resolution.[149]

The usual general formulation of the society's powers 'all such lawful things as may further the Co-operative's objects' is included and a general borrowing power is specified.[150] The society's power to invest is limited to the securities or shares specified in s 27 of CCBSA 2014 and secured loans.[151]

11.7.3. Society for the benefit of the community – sponsored by Co-operatives UK

These rules leave the society using them to insert its own detailed business objects to be pursued for the benefit of the community.[152] This reflects the wide range of possible activities that may be carried out by a society operating for the benefit of the community. The usual general formulation of the society's powers 'all such lawful things as may further the Co-operative's objects' is included and a general borrowing power is specified.[153] The society's power to invest is limited to the securities or shares specified in s 27 of CCBSA 2014 and secured loans.[154]

11.7.4. National Housing Federation – Model Rules 2011 (version 2)

The objects of these Model Rules emphasise that the association is formed for the benefit of the community. Its objects are, to that end, to provide and manage and housing and social housing and provide assistance to help house people and other associated facilities and amenities or services. An option applicable to charitable societies is available for use. That limits the general function by referring to provision for poor people or the relief of aged, disabled or chronically sick people. Other objects that can be carried out by a community benefit society registered as a provider of social housing are added but for a charitable society they are limited to charitable objects. The rule also provides that the association shall not trade for profit and that nothing is to be paid or transferred by way of profit to its shareholders.[155]

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147 Rules 15.6. and 15.7.
148 CUK Worker Model Rule 5.
149 Rule 4.
150 Rule 6.
151 Rule 13.
152 CUK Bencom Model Rule 4.
153 Rule 5.
154 Rule 11.
155 NHF Version 2 Model Rules A2 to A4.

Powers are given to do anything, not expressly prohibited by the society's rules, that a natural or corporate person can lawfully do which is necessary or expedient to achieve the society's objects. Powers listed indicatively as being included in the general power are: dealing with land; supporting housing charities; borrowing and issuing loan instruments; using derivatives to manage risk; lending; and investing as the board determines.[156]

11.7.5. Agricultural Co-operative (IPS) – Agency Model Rules sponsored by Co-operatives UK & Scottish Agricultural Organisation Society

These Model Rules state the society's objects as being to carry on, for the benefit of members, any trade, business or service. That is said to include, in particular, as a co-operative association of agricultural producers: marketing members' products; supplying members with goods or services that they need for agricultural production; and providing any other services or facilities in connection with their agricultural businesses. Lending to members for agricultural purposes is specifically included as an object. In carrying out its objects, the co-operative is to abide by the internationally recognised co-operative values and Co-operative Principles as defined by the International Co-operative Alliance.[157] As a result, this one set of rules provides a framework for marketing, buying and service co-operatives and allows the development of value added production facilities such as dairies or other processing facilities for agricultural producer members. They cover all the traditional functions of agricultural co-operatives.

The usual general formulation of the society's powers 'all such lawful things as may further the Co-operative's objects' is included and a general borrowing power is specified.[158] The society's power to invest is limited to the securities or shares specified in s 27 of CCBSA 2014 or the society's own rules as well as secured or unsecured agricultural loans or advances to members.[159]

11.7.6. Social Clubs – Model Rules for a Working Men's Club – sponsored by Clubs and Institutes Union

The CIU rules have rules dealing with the matters discussed in this chapter. The objects of the club, although expressed to be the business of a club, also refer to the intangible benefits, such as social interaction, mutual help and mental and moral improvement, to be conferred on members as a result of this business.[160] They confer the usual wide powers with only the capacity of the club to deal with land referred to in detail.[161]

The rules contain the usual provisions about the seal of the society, but limit the agency powers of committee members and officers by stipulating that appointment alone is not sufficient to confer power to order goods or dispose of club funds.[162] This ensures that other acts are necessary to confer actual authority on such persons to make contracts on

[156] Rules B1 and F15.
[157] CUK/SAOS Agency Model Rule 4.
[158] Rule 5.
[159] Rule 12.
[160] CIU Model Rule 1.
[161] Rule 5.
[162] Rules 3 and 19.

behalf of the club. The society's power to invest extends to the securities or shares specified in s 27 of CCBSA 2014, lending on the security of land, and trustee investments.[163]

[163] Rule 28.

CHAPTER 12

THE TRANSFORMATION AND DISSOLUTION OF SOCIETIES: SOLVENT AND INSOLVENT

12.1. INTRODUCTION

The processes involved in transforming a solvent society may either be those governed by the CCBSA 2014 (amalgamation, transfer of engagements or instrument of dissolution), a members' voluntary winding up, or a winding-up order of the court made on the 'just and equitable' ground. Both types of winding up are governed by the Insolvency Act 1986.

In the case of an insolvent society, the procedures set out in the Insolvency Act will apply. These include creditors' voluntary winding up by resolution of the society in general meeting, a winding-up order of the court, a voluntary arrangement with creditors or an administration order with a moratorium on the enforcement of debts and claims. However, the creditors' voluntary arrangement, administration procedure, and Companies Act arrangement or compromise provisions do not apply to societies that are registered providers of social housing or registered social landlords.[1]

When a society granted a floating charge over its assets (often in the form of a single 'debenture' granting a fixed and floating charge), the lender would usually be given power under the charge document to appoint a receiver over the whole undertaking of the society. The power would usually arise on a default on the part of the society under the debenture or the occurrence of events such as the winding up of the society or the levy of execution against its property by other creditors. The receiver was usually stated in the debenture to operate as the agent of the society but owed her primary duty to the creditor who appointed her and whose security she was appointed to enforce. Such a receiver would take over virtually all the functions of the board of the society and complete control of the society's business while acting as its agent.

The main difference between a society and a company is that the receiver of a society was not, and for many purposes is still not, an administrative receiver and the provisions of the Companies Act 2006 and the Insolvency Act 1986 which deal with receivers do not apply. The receivership is governed by the powers contained in any relevant charge document and the rules developed by the courts without any additions or variations contained in those statutes. From 6 April 2014, this position was changed for 'relevant societies' by the ARA Order. In summary, that Order applies Parts 1 and 2 of the Insolvency Act 1986 and Part 26 of the Companies Act 2006 to societies with certain modifications. A floating charge holder whose charge was created after that date must, and others probably will, appoint an administrator. However, the position remains

[1] CCBSA 2014, s 118(3) and the Industrial and Provident Societies and Credit Unions (Arrangements, Reconstructions and Administration) Order 2014, SI 2014/229 ('The ARA Order'), arts 1(2) and 2.

completely unchanged for societies that are not relevant societies, meaning societies that are registered providers of social housing or registered social landlords.[2]

12.2. RESOLUTIONS AND PROCEDURES

12.2.1. CCBSA special resolutions

The CCBSA 2014 sets out the procedures needed to pass the special resolution (called here a 'CCBSA special resolution') required for an amalgamation of, or a transfer of engagements between, two or more societies.[3] In the case of an amalgamation with, transfer of engagements to, or a conversion into a company, different procedures are necessary to pass a CCBSA special resolution.[4] In the case of a special or extraordinary resolution required for a winding up under the Insolvency Act 1986, the definitions in the Companies Act 2006 apply.

A CCBSA special resolution has to be passed at a meeting of the society of which notice, stating the intention to pass the resolution, has been given in accordance with the society's rules. It must be passed by a special majority of those members entitled to vote and actually voting in person (or by proxy if the rules allow that) at that meeting.

In the case of an amalgamation or transfer of engagements between societies the special majority is two-thirds of such members.[5] In addition to being passed at the first meeting, such a resolution must also be confirmed by a simple majority of members entitled to vote and voting either by proxy or in person at a subsequent general meeting of which notice was duly given and which was held not less than 14 days nor more than one month after the first one.[6]

In the case of an amalgamation with, transfer of engagements to or a conversion into a company, the special majority is 75% of members entitled to vote and actually voting in person or by proxy at the first meeting and at least 50% of all eligible members must also vote on the resolution. The first resolution must also be confirmed by a simple majority of members entitled to vote and voting either by proxy or in person at a subsequent general meeting of which notice was duly given and which was held not less than 14 days nor more than one month after the first meeting.[7]

The effect of the statutory wording about the necessary majority in the case of a society, such as a federal or secondary co-operative, in which members have a variable number of votes (perhaps depending on transactions) has over the years been the subject of debate. Section 111(2) of CCBSA 2014 refers to a resolution that is passed by 'at least two-thirds of the eligible members who vote' and then 'confirmed at a subsequent general meeting by over half of the eligible members who vote'. Section 113(2) contains similar wording, although the majority required at the first general meeting is 75%. There has been some debate about whether the majorities referred to should be read as counting the number of votes members can cast under the rules rather than counting individual members entitled to vote. Adopting the latter approach requires a count for

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2 See Section **12.8.** below.
3 CCBSA 2014, s 111(2).
4 CCBSA 2014, s 113(2).
5 CCBSA 2014, s 111(2)(a).
6 CCBSA 2014, s 111(2)(c)–(e).
7 CCBSA 2014, s 113(2)(a),(b) and (d)–(f).

that purpose to be on the basis of one member one vote regardless of voting entitlement under the rules. This is the approach that successive registrars have taken previously. However, the society's rules should be checked and in so far as they contain provisions (including weighted voting provisions) that are not consistent with the provisions of the CCBSA 2014, they too should be complied with to ensure that both the requirements of the CCBSA 2014 and the rules have been met.

CCBSA 2014 requires the second meeting to be held not less than 14 days after the first. That means 14 clear days. Thus if the first meeting were held on the first day of the month the second meeting could not be held before the 16th of the same month.[8] The words 'one month from' exclude the day on which the event occurs, ie the date of the first meeting.[9] The word 'month' in all statutes passed after 1850 means 'calendar month' unless the statute expressly states a contrary intention.[10] The period of a calendar month expires on the day in the succeeding month corresponding to the date on which the period starts. Here the starting date will be the date of the first meeting. Consequently, if the first meeting is held on the 12th of the month, the second one can (subject to not being held less than 14 days after the first one) be held on any day up to and including the 13th of the next month but not as late as the 14th.

At each of the meetings the Act lays down that the chairman's declaration that the resolution has been passed is conclusive.[11] Within 14 days of the second meeting a copy of the resolution signed by the chairman of the second meeting and the secretary of the society has to be sent to the FCA for registration at which point it takes effect.[12] Although the society is under an obligation to send the special resolution for registration within 14 days after the second meeting, failure to do so does not invalidate the resolution.[13]

'Within 14 days' excludes the day from which the period runs (the day of the second meeting) which is not counted.[14] The period runs up to midnight on the last day of the period (the 14th day).[15] In all such calculations weekends and holidays count as days.[16]

These requirements of the CCBSA 2014 cannot be varied by the rules of a society.

Additional provisions apply to societies that are registered as providers of social housing.[17] The FCA may only register a resolution passed by such a society to amalgamate with or transfer engagements to another society, or to amalgamate with or convert into a company if the social housing regulator (currently the Homes and Communities Agency in England) has given consent. Consent is given under the seal of the regulator and must be sent to the FCA with the special resolution before the FCA can register it and thus give effect to it.

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8 *Re Hector Whaling Ltd* [1936] Ch 208.
9 *Dodds v Walker* [1981] 2 All ER 609.
10 Interpretation Act 1978, s 5 and Sch 1.
11 CCBSA 2014, ss 111(4) and 113(4).
12 CCBSA 2014, ss 111(5) and 113(5).
13 CCBSA 2014, ss 111(6)–(8) and 113(6)–(8).
14 *Goldsmiths Co v West Metropolitan Railway Company* [1904] 1 KB 1.
15 *Manorlike Ltd v Le Vitas Travel Agency and Consultancy Services Ltd* [1986] 1 All ER 573.
16 *Wheeler v Green* (1839) 7 Dowl 194.
17 Housing and Regeneration Act 2008, s 163(2).

A credit union is only permitted to amalgamate with or transfer its engagements to another credit union and a special resolution to achieve this will only be registered if the FCA, after consultation with the PRA believes that the resolution does not breach either the Credit Unions Act 1979 or the CCBSA 2014.[18]

12.2.2. Companies Act 2006 special resolution

Companies Act special resolutions are used when a society is being wound up under the Insolvency Act 1986 and when a company wishes to convert itself into a society.[19] The provisions set out about the winding up of companies apply equally to societies under s 123 of the CCBSA 2014.

A Companies Act special resolution is one passed by members representing not less than 75% of the eligible members who vote at a general meeting, having received notice that the resolution being passed is a special resolution[20] and at least 14 days' notice (ie 14 clear days) of the meeting.[21] No second meeting to confirm the special resolution is required. Under the Companies Act 2006 a private company can pass resolutions, special or ordinary, by a written resolution procedure.[22] That procedure is not available to a plc. The procedure may apply to a society passing a special resolution under section 123 of the CCBSA 2014, despite the fact that such a society is not classified as either a private company or a plc, but it is safer to use the meeting procedure because of that uncertainty.

A majority in number of the members of a company having the right to attend and vote at a meeting called to pass a special resolution and together holding not less than 90% of the nominal value of shares giving that right can agree to a notice period of less than 14 days. A company's articles may provide a higher percentage than this for approval to short notice, but this cannot exceed 95%.[23]

If there is unanimous agreement on the part of all members to a decision it is possible to dispense with the holding of a meeting even when the decision amounts to the passing of a special resolution. As long as the agreement is unanimous there is no need for it to be reduced to writing or for any other formality although to prove its existence writing is desirable.[24] This case law principle developed in the context of companies is applicable to societies as corporations.

In the case of companies, any Companies Act special resolution and any resolution or agreement of all of the members which, if they had not been so agreed, would have only been effective for their purpose if they had been special resolutions, must be sent to Companies House within 15 days of being passed or made.[25] In the case of a society they must be sent to the FCA and not Companies House.[26]

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18 Credit Unions Act 1979, s 21.
19 CCBSA 2014, ss 115 and 123 and see Section **3.10.** above.
20 Companies Act 2006, s 283.
21 Companies Act 2006, s 307(1).
22 Companies Act 2006, ss 281–283 and 288–300.
23 Companies Act 2006, s 307(4)–(6).
24 *Cane v Jones* [1980] 1 WLR 1451.
25 Companies Act 2006, s 30(1).
26 CCBSA 2014, s 123(1).

12.2.3. Winding-up petitions

In the case of an application to the court for the winding up of a society, the petitioner must make out one of the grounds set out in s 122 of the Insolvency Act 1986. In the case of a solvent society the most likely ground will be 'the court is of the opinion that it is just and equitable that the [society] should be wound up'.[27]

The petitioner is likely to be a member or group of members as this ground is most commonly used as a means of redress for minorities who consider that they have been unjustly treated in the way that the society has been run and that no other remedy is available. It is a drastic step as it ends the existence of the society and results in the distribution of surplus assets at the end of the winding-up process. Resort should be had to the FCA powers found in ss 103–107 of CCBSA 2014 first.

An order for winding up cannot be made if the court is of the opinion that there is another remedy available to the petitioners and that they are acting unreasonably in seeking to have the society wound up instead of pursuing that other remedy.[28] In the case of companies the winding-up remedy has effectively been replaced by the power of members to seek redress on the basis of unfair prejudice.[29] Company members also have the possibility of using the statutory derivative action to seek a remedy in the name of the company for a breach of directors' duties.[30] However, the unfair prejudice remedy is not available to society members and derivative actions are subject to the rule in *Foss v Harbottle*.[31] As a result a just and equitable winding-up petition is the only effective remedy available to a minority of members of a society.

In *Re Surrey Garden Village Trust Ltd*[32] the court held that a petition on the just and equitable ground would be refused on the basis that there was no evidence of lack of probity on the part of the committee or that the society had ceased to fulfil any useful function. In that case the petitioning members had an indirect reason for seeking the order. They wished to sell their individually owned plots to a builder for development and wanted the dissolution of the society as it opposed the planning permission needed if the deal was to proceed and could enforce restrictive covenants preventing development. This was held to make the petition an abuse of the process of the court. The judge observed that while a failure by a society to continue as a bona fide co-operative or a community benefit society can be taken into account by the court in considering a petition, they do not oblige the court to grant the petition on the grounds that the society has no 'substratum' or continued reason for existence. In this case, while certain trading activities had ceased, some members continued their smallholding activities and this maintained a useful purpose for the society in retaining the character of the area.

It is possible for the FCA to petition for the winding up of a society that was registered or deemed to be registered under the IPSA 1893 before 26 July 1938 on the ground that the society fulfils neither the bona fide co-operative nor the community benefit conditions under and that its winding up would be in the interests of those who have

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27 Insolvency Act 1986, s 122(1)(g).
28 Insolvency Act 1986, s 125(2).
29 Companies Act 2006, ss 994–999.
30 Companies Act 2006, ss 260–269.
31 See Section **7.4.10**. above.
32 [1964] 3 All ER 962, 970–1.

invested in it or deposited money with it or any other person.[33] In the case of a society registered at a later date, a cancellation or suspension of its registration under ss 5 and 8 of CCBSA 2014 is the only remedy for such a problem. The only exception to this is the power to apply for the winding up of a credit union under s 20(2) of the Credit Unions Act 1979, which is conferred on the FCA in consultation with the PRA as part of its regulatory function in relation to those bodies.[34]

In the case of an insolvent society the most likely petitioner for the winding up of a society is one of its creditors although possible petitioners include the society itself, its directors, the official receiver if it is already in voluntary liquidation, and (as a result of information obtained under a fraud investigation) the FCA.[35] Members may only petition if the society is solvent and they are likely to gain a significant amount on its dissolution.

The ground most likely to be used to petition for the liquidation of an insolvent society is its inability to pay its debts.[36] This can be established either on the basis of 'balance sheet' insolvency (the value of its assets is less than the amount of its liabilities taking into account its contingent and prospective liabilities) or 'cash flow' insolvency, which is an inability to pay debts as they fall due.[37] The latter is normally proved either by the failure of the society to satisfy process of execution issued on a judgment in favour of a creditor or by the service of a statutory demand by a creditor owed at least £750 and the society's failure to satisfy it within the three weeks allowed.[38]

12.3. AMALGAMATION OR TRANSFER OF ENGAGEMENTS BETWEEN SOCIETIES

When two or more societies amalgamate they create an amalgamated, or merged, society in which the historical identities of each are consolidated. The register of each society is updated to show that the amalgamation has taken place.

When one society transfers its engagements to another the transferor society usually loses its separate legal existence but the transferee society continues unchanged.

Whenever a transfer of engagements or an amalgamation is in prospect advice should be taken on the impact of each method of fusion on the tax liability of the societies and the choice of date for the fusion.

12.3.1. Amalgamations

12.3.1.1. Procedure

If two or more societies are to be amalgamated as one society, each society passes a special resolution as defined in the CCBSA 2014.[39] The result of this is that the property

[33] CCBSA 2014, s 150 and Sch 3 para 15.
[34] See Section **13.14.2.** below.
[35] Insolvency Act 1986, ss 124 and 124A.
[36] Insolvency Act 1986, s 122(1)(f).
[37] Insolvency Act 1986, s 123(1)(e) and (2).
[38] Insolvency Act 1986, s 123(1)(a)–(c).
[39] CCBSA 2014, s 109.

of each of the amalgamating societies becomes vested in the amalgamated society without the need for any form of conveyance other than that contained in the special resolution. It is possible to achieve this with or without any dissolution or division of the funds of all or any of the societies. In effect the amalgamated society steps into the shoes of the amalgamating societies as if it had always been there.

The most common situation is that two or more societies amalgamate to form a single combined society in such a way that all of the assets and liabilities of the two separate societies vest in the amalgamated one. The members of the amalgamating societies may become members of the amalgamated society holding nominal share capital of the same value in the amalgamated society as they held in the merging entity. However, it is also possible to provide for an alteration to the membership arrangements either as part of the resolution to amalgamate or within the rules that are adopted as part of the amalgamation. It would also be possible to use the resolution for amalgamation to divide some or all of the funds of the amalgamating societies so as to pay cash to some or all of their members.[40] This could presumably be used to give members the option of cash or shares in the amalgamated society or to provide for cash or other assets to be handed over to members as part of the amalgamation.

If members were to be paid cash, care would have to be taken to ensure that the amalgamated society was solvent and that creditors would not be at risk through the payment to the members. An amalgamation does not prejudice the right of any creditor of any of the societies that are amalgamating.[41] A secured creditor (such as a bank with a fixed and floating charge) that considered its security to be in jeopardy could seek the appointment of a receiver or administrator to protect its interests. This might be sought in court or, if the document creating the security permitted, be done outside court. In any event, in practice the need to maintain satisfactory business relations with major creditors would require a society to keep major lenders in touch with restructuring plans before they were formally implemented.

The assets and liabilities of the merging entities vest in the amalgamated society without the need for any conveyancing of land held or without the need to novate or assign contracts.

In relation to the vesting of land assets, the Land Registry will update the proprietorship details in the land register rather than dealing with it as a transfer or conveyance of the land. No transfer of land under the Land Registration Act 2002 is necessary. This updating can be achieved by submitting a Land Registry AP1 form (application to change the register) together with copies of the resolutions to amalgamate and the FCA's certificate of registration.

In terms of how rights and liabilities under contracts are treated, this was considered in the case of *Co-operative Group (CWS) Ltd v Stansell Ltd*.[42] The point was considered within the context of a statutory transfer of engagements under s 51 of the Industrial and Provident Societies Act 1965 (the predecessor to s 110 of the CCBSA 2014). However, it is accepted that this provides authority for a statutory amalgamation also since similar resolutions and provisions regarding the vesting of assets apply in each case.

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40 CCBSA 2014, s 109(2).
41 CCBSA 2014, s 109(4).
42 [2006] EWCA Civ 538.

The *Stansell* case considered the position of a contract that contained a clause prohibiting assignment without consent. The case held that the self-evident purpose of the transfer of engagements provision was to enable or authorise a society to vest its property with the minimum of formality and that the natural and ordinary meaning of the wording of the Act was broad enough to include the liabilities of a society to its members and to third parties as well as its rights against members and third parties. That covers a contract not ordinarily transferable without the other party's consent.

Notwithstanding the *Stansell* case, it would be prudent for any amalgamating society to consider whether it would be appropriate to inform contractors, especially those that are critical to the society's business, of the amalgamation.

The name of the amalgamated society should be checked for availability before the special resolution is passed.

The rules that the amalgamated society will operate by should also be considered and agreed. Any special provisions about the rights and duties of the members of the amalgamating societies can be included in those rules. The rules do not have to be included in the special resolution but, in practice, the rules that will apply on amalgamation will usually be referred or attached to the resolution.

The societies should also agree who the board of management for the amalgamated society will be since if this is not agreed, and if there are no provisions in the rules adopted on amalgamation, it is arguable that the board members of each society will become board members of the amalgamated society.

Since it is not possible for a society to make provisions within its rules that are inconsistent with the provisions of CCBSA 2014, its requirements cannot be replaced by any rules of a society to different effect. Thus, if the rules of a society required the question of amalgamation to be settled by a referendum of members or a resolution passed by a three-fourths majority, compliance with the CCBSA 2014 would still be necessary. Compliance with the provisions of the rules will also be required if the resolutions are to be passed in accordance with the society's constitutional requirements, providing such requirements are not inconsistent with the CCBSA 2014.

12.3.1.2. Wording of the resolution

In the absence of any special conditions on which societies have agreed to amalgamate and where no special circumstances arise which need mention in the resolution for amalgamation, the following resolution is suitable:

> **'First Meeting**
>
> That in accordance with Section 109 of the Co-operative and Community Benefit Societies Act 2014, this Society shall amalgamate with Limited to form an amalgamated society (Amalgamated Society) on the conditions following:
> (1) The name of the Amalgamated Society shall be Limited.
> (2) The registered office of the Amalgamated Society shall be at
> (3) The rules of the Amalgamated Society shall be [the rules of Limited] OR [the rules attached to this resolution].
> (4) All members of each of the amalgamating societies when this resolution is passed shall be members of the Amalgamated Society, each of whom shall respectively be credited

in the books of the Amalgamated Society with the like amounts of shares, share capital, loans, deposits, dividend and interest, as are standing to his or her credit in the books of the amalgamating society of which he or she is a member at the date on which this resolution is registered by the Registrar.

(5) The board members of the Amalgamated Society shall be: [enter names] OR [as provided for in the rules referred to above].

(6) The whole of the stock, property, and other assets and all engagements of the Society shall become vested in the Amalgamated Society and the Amalgamated Society shall undertake all the obligations affecting the Society.'

'Second confirming meeting

That the resolution adopted on the day of for the amalgamation of this Society with Limited is hereby confirmed.'

12.3.1.3. Forms

Application for registration must be made on the appropriate FCA forms which include a declaration made by each society's secretary before a justice of the peace, a commissioner of oaths, a notary public or a solicitor.

12.3.1.4. Effective date of amalgamation

The effective date of amalgamation is, ordinarily, the date of the registration of the last of the resolutions received by the FCA from the amalgamating societies and not a date fixed by the societies if that date is earlier.[43] However, arrangements can usually be made with the FCA if a special date for the adoption of the resolutions is required for accountancy or other purposes. When the last special resolution is registered, the FCA will issue an acknowledgement of registration of the amalgamated society.

12.3.1.5. Accounts and annual returns

On amalgamation, a merged entity will result and, if it can be arranged, the accounts of the societies who amalgamated should be made up to the date of the amalgamation.

In the case of a large society amalgamating with a small one, however, it is not always practicable to make up the accounts to the date of amalgamation and, while it is preferable that amalgamating societies should make up their accounts to that date and furnish returns covering the period from the date of the last annual return to the date of amalgamation, the FCA is prepared to consider accepting returns made up to such dates as are convenient to the amalgamating societies where the date of amalgamation does not coincide with the usual dates for making up accounts, provided that the returns furnished by them and by the new society contain particulars of all the transactions and of all the assets and liabilities.

For example, suppose Society A and Society B amalgamate on 1 November. Society B is a large society effectively absorbing the smaller Society A. Society A usually makes up its accounts to 30 September and Society B to 31 December. Society A could either send in an annual return made up to 30 September and a supplemental return from 1 October to 31 October or it could extend its annual return to cover 13 months to 31 October.

[43] CCBSA 2014, s 111(7).

Society B could, instead of closing its accounts at 31 October send in its annual return made up to 31 December, provided the return showed the assets and liabilities taken over from Society A on 1 November and included the transactions of the amalgamated society from 1 November to 31 December. In such a case the first return of the amalgamated society should cover a period of 12 months from 1 January following.

For a second example, suppose the same amalgamation took effect from 1 June. Society A could furnish a return from 1 October to 31 May and Society B could furnish a return made up to its half yearly balancing date of 30 June, including the assets and liabilities taken over and the transactions of the new society from 1 June to 30 June. The first return of the amalgamated society would then cover a period from 1 July and would be for six months if 31 December were adopted as the year end.

For a third example, suppose the date of the amalgamation were 14 February. Society A could adopt either of the alternatives given in the first example with the closing date 14 February. Society B could furnish an annual return made up to 31 December previous. The first annual return of the amalgamated society would then cover a period from 1 January previous to 31 December and would include the transactions of Society B from 1 January to 13 February.

12.3.1.6. Rights of creditors

An amalgamation of societies does not prejudice the rights of creditors of the societies amalgamating.[44] This preserves in full their rights to security, their priority and their right to sue for debts. In the unlikely event that the amalgamation involves any distribution of assets or cash payment to members they may seek to protect themselves by using any security that they have.

12.3.2. Transfer of engagements

12.3.2.1. Procedure

A registered society may by special resolution transfer its engagements to another registered society that undertakes to fulfil them.[45] If, and to the extent that, the resolution approves the transfer of the whole or part of the transferring society's assets to the transferee society, it vests those assets in the transferee without any other conveyance or transfer.[46]

A transfer of engagements usually transfers all of the transferring society's property to the transferee society. The registration of the transferor society is then cancelled at its own request, after it certifies to the FCA that all its assets have been transferred to those entitled to them.[47] The dissolution of the transferring society is not strictly necessary but partial transfers are unusual as agreeing exactly which assets to transfer is complex and expensive. The CCBSA 2014 only refers to a partial transfer of assets but seems to contemplate a transfer of all engagements.[48] Any society looking to undertake a partial transfer of assets should approach the FCA in advance.

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44 CCBSA 2014, s 109(5).
45 CCBSA 2014, s 110.
46 CCBSA 2014, s 110(2).
47 CCBSA 2014, s 5(2) Condition A and s 126.
48 Compare CCBSA 2014, s 110(1) with s 110(2).

The concept of 'engagements' and the effect of s 51(1) of the Industrial and Provident Societies Act 1965[49] was discussed in *Co-operative Group (CWS) Ltd v Stansell Ltd* where Mummery LJ said:[50]

> 'The self-evident purpose of the provision was to enable or authorise one registered society to transfer to another society its engagements (its business undertaking) and its property with the minimum of formality-simply by passing a special resolution, which would have the stated statutory consequence of vesting the transferor's property without the need for a conveyance or assignment. The language of "a transfer of engagements" is broad enough to include the liabilities of a society to its members and to third parties and the rights of a society against its members and against third parties; and to cover contracts which would not ordinarily be transferable without the consent of the other party, such as contracts of service with employees of the transferring society.'

So 'engagements' means 'business undertaking' and includes all liabilities to and rights against both members and third parties. The transfer of property appears to be optional as CCBSA 2014 permits property transfers to be approved in the resolution and provides that if that is done property vests in the transferee society.[51] The agreement of the transferee society to the transfer of engagements and its agreement to fulfil them is necessary as a precondition to passing a valid resolution as only 'any other registered society which may undertake to fulfil those engagements' can be a transferee.[52]

The meaning of a 'transfer of engagements' is important. The powers of the board are defined in the rules of most societies so as to enable it to exercise any power of the society. This enables the board to sell the assets of the society or any businesses owned by it (with both assets and liabilities). However, CCSBA 2014 lays down statutory rules and procedures requiring a special majority of the members and two general meetings to decide on a 'transfer of engagements' either to another society or a company. The power to do that therefore cannot be exercised by the board alone, whatever society rules may say.

That limits the power of the board and provides an important protection for society members. That protection is particularly important in the absence of a provision in the CCBSA 2014 allowing members who establish that a society has been run in a manner unfairly prejudicial to their interests to obtain a remedy from the courts.[53] Only an application by a member for a just and equitable winding up or application for FCA intervention is available to a minority of members unhappy with a board decision that radically changed the business and nature of a society.[54]

Even in the case of a transfer of engagements by, or an amalgamation of, a society involving another society, members must agree by a two-thirds majority of those voting and so are protected from change without their direct consent. Where such a decision (or a conversion of legal form) involves a company it requires a special majority of a 75% majority of those voting and a 50% turnout.[55] The sale of a large proportion of the society's assets by decision of the board is not subject to a vote by members at all. That gives the definition of a 'transfer of engagements' its importance. While a sale by the

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[49] Now consolidated CCBSA 2014, s 110(1) and (2) without any substantive change.
[50] [2006] EWCA Civ 538 at [53].
[51] CCBSA 2014, s 110(2).
[52] CCBSA 2014, s 110(1).
[53] Compare Companies Act 2006 ss 994–999.
[54] See Sections **9.3.** and **9.4.**, and **12.8.** (all on FCA powers) and **12.2.3.** (on just and equitable winding up).
[55] CCBSA 2014, s 113(2).

directors for the full market value of assets puts other assets (cash or otherwise) in the hands of the society, the whole nature of the society's operation would be changed if the assets sold were a large proportion (eg 75% or 90%) of its total net assets. At what level might such a sale amount to a transfer of engagements? Indeed, if the transaction involves the transfer of even the society's whole business in return for consideration handed over to the society (as opposed to an issue of shares to its members as is usually to be found in the case of a transfer of engagements) is this a transfer of engagements or a sale of the whole undertaking by the directors in accordance with their powers?

The statutory provision on transfers of engagements makes the transfer of obligations or liabilities a central part of the concept. Thus a transfer of assets alone may be outside s 110 CCBSA 2014. A transfer of only some of a society's obligations or liabilities may also be outside it if the phrase 'transfer of its engagements' refers to all of 'its' engagements.

If greater member control is required this can be achieved in society rules that are free to allocate powers and functions between the board and the general meeting so as to require member consent for acquisitions or disposals of a certain size or type. Similarly, there is no statutory requirement for the transferee society to gain member approval for the transfer in unless the rules provide for that. However, in practice, rule amendments are often needed as part of the transaction and that effectively gives members a vote on the question, normally with a special majority needed to pass the amendments. Unwise business acquisitions can be just as lethal as disposals for inadequate value.

Any board contemplating a sale of the whole, or substantially the whole, of the society's business would be well advised to ensure that a members' meeting agrees to the transaction. It is possible that the transaction could be held by a court to be a transfer of engagements subject to the special arrangements set out in CCBSA 2014. In addition, any imprudent disposal for obviously inadequate consideration, given the market value of what was sold, could lead to proceedings against those responsible for breach of their duties of care and skill or even of their fiduciary duties to the society. The receipt of any benefits by those making the decision could well amount to a breach of fiduciary duty as would any failure to decide on the transaction in the best interests of the society (for this purpose its members) after taking expert advice on valuation and the merits of the deal. In addition, if the decision were found to be an act outside the objects of the society and thus a misuse of the directors' powers there might be liability on the part of those involved on that basis.[56]

In deciding whether to recommend a transfer of engagements to the members of the transferor society, its board should consider the value of the price paid to those members – usually one share in the transferee society for each share held in the transferor society. However, the value need not be precisely equivalent and the members of the transferring society could agree to transfer the engagements for no consideration at all, if they chose to do so on the basis of full information. This may involve examining the net value of the transferor society's assets as established by a full and independent valuation considering value on break up and sale of assets after payment of debts and sale as a going concern of the society's whole business. Only with such information can an informed decision be made on the offer made by the transferee society.

[56] See Section **7.4.** above.

The number and value of shares in the transferee offered to transferor shareholders can only be judged by a comparison of the value they represent with the value of the assets and business acquired by the transferee. Directors should advise members on this issue although, ultimately, it is decided by the votes of members in general meeting after the board decides to put the resolution. Without a 'break up' and 'going concern' valuation of both the shares offered in the transferee society and those held in the transferor society, it is hard to see how members of the transferor society or the board of either society can make an informed decision on a transfer of engagements. In the past, concern has tended to focus on issues of democratic structure in the transferee society rather than the fair valuation of the business transferred and the price paid for it. If more than one share in the transferee were to be offered for each share held in the transferor, loan stock or cash to the same value might be given to the extent that shares would take the holding of a member above the statutory maximum.

The absence of the protection of the Takeover Code,[57] which is available to shareholders in plcs, might make the courts jealous to guard the rights of society members by the use of directors' duties or by the definition given to a 'transfer of engagements'.

The Co-operatives UK Corporate Governance Code contains the following paragraph on transfers of engagements:

> 'A board considering a transfer of engagements to another co-operative must satisfy itself that members' interests are safeguarded in transfer of engagements negotiations, and it must provide members with all the information they need to make an informed choice as to whether or not to approve the transfer.'[58]

This provides a benchmark for the conduct of these transactions. The Code also recommends that societies proposing acquisitions, disposals or other transactions involving 25% or more of the society's members' funds should report to members at a consultative meeting and suggests that co-operative societies may wish to go further and invite member approval before such transactions go ahead.[59]

A co-operative society that became nothing more than a vehicle for holding shares in a company to which it had sold its business as its sole activity could hardly be said to be 'carrying on any industry, business or trade' so as to be registrable under s 2(1) of CCBSA 2014. That would certainly be the case if the society held less than a controlling interest in one company as its sole asset. If it held a controlling interest it could be argued that it was carrying on business through that subsidiary company.

These arguments lead to the conclusion that any sale of all or almost all of the business of a society could be regarded as a 'transfer of engagements'. Alternatively, if sale of all or almost all of a society's business by board decision is possible, the question of the distribution of surplus on the dissolution of a society becomes very important. The rules about final surplus distribution for a co-operative society that is wound up other than by instrument of dissolution and without any express provision in its rules do not satisfactorily protect adherence to Co-operative Principles.[60] Community benefit

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57 Panel on Takeovers and Mergers, The Takeover Code (11th edn, 2013).

58 Co-operatives UK, Corporate Governance Code for Consumer Co-operative Societies, November 2013 ('CUK Code 2013') para 23 on p 8.

59 Ibid, para 24 on p 8.

60 See Insolvency Act 1986, ss 107 and154, which apply by virtue of CCBSA 2014, s 123 and see Section **12.7.** below.

societies are required to have a rule preventing any distribution to members as a condition of registration so, for them, the issue of value goes to the interests of the community served by the society. Even if the instrument of dissolution method is used there is apparently no statutory limit on the method of distribution that may be agreed in the instrument. It is only if the rules lay down a method that breaches Co-operative Principles that intervention by the FCA to refuse to register the rules or an offending amendment to can ensure adherence to principle.

On a transfer of engagements the assets and liabilities transferred vest in the receiving society without the need for any conveyancing of land held or without the need to novate or assign contracts.[61] Rights and liabilities under contracts are transferred regardless of any prohibition on assignment in the contract.[62]

12.3.2.2. Wording of resolution by the transferor society

If the members of the transferor society are to receive shares in the transferee society to the full value of their shares in the transferor society, the following wording of the special resolution is appropriate:

> **'First Meeting**
>
> That this meeting of members of A Society Limited hereby resolves to transfer the whole of the stock, property, assets, liabilities and all other engagements of A Society to B Society Limited in consideration of B Society Limited issuing to each member of A Society Limited paid up shares equal to the amount standing to the credit of each member in the share ledgers of A Society Limited on the date when the transfer of engagements becomes effective.'
>
> **'Second confirming meeting**
>
> That the resolution adopted on the day of transferring the engagements and assets of A Society Limited to B Society Limited is hereby confirmed.

12.3.2.2.1. Resolution by the receiving society

A simple resolution of the board of directors, if they have power by rule to receive engagements, or, failing that, of the members, is sufficient in the case of a receiving society. A special resolution is not required. The following is a suitable form of resolution:

> 'That this meeting of the Board of Directors [members] of B Society Limited hereby agrees in consideration of this society receiving the whole stock, property, assets, liabilities and all other engagements of A Society Limited, to discharge the liabilities and engagements of A Society Limited in full and to issue to each and every member of that society paid up shares equal to the amount standing to the credit of each such member in the share ledgers of A Society Limited on the date when the transfer of engagements becomes effective.'

The resolution should be adopted by the board or members of the receiving society by not later than the date on which the confirming resolution was passed by the transferring society.

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[61] CCBSA 2014, s 110(2).

[62] *Co-operative Group (CWS) Ltd v Stansell Ltd* [2006] EWCA Civ 538.

12.3.2.3. Forms

Forms for use in a transfer of engagements are provided by the FCA.

12.3.2.4. Effective date of transfer

The effective date of the transfer is the date of registration of the special resolution by the FCA.[63] If a special date for registration is requested the FCA will require two or three weeks' notice so that it can hold the special resolution until that date.

12.3.2.5. Accounts and annual returns

The accounts of the transferring society must be made up to the date of the transfer and the final annual return must cover the period from the last annual return to the date of transfer.

12.3.2.6. Rights of creditors

A transfer of engagements does not prejudice the rights of a creditor of a society.[64]

12.3.2.7. Certificate of transfer

If registration of the transferor society is to be cancelled following the transfer of engagements a certificate must be lodged with the FCA by the society to show that all the property of the society has been transferred.[65]

12.4. CONVERSION OF A SOCIETY INTO A COMPANY, AMALGAMATION WITH/ TRANSFER OF ENGAGEMENTS INTO A COMPANY

12.4.1. Procedure

A registered society can, by special resolution, convert itself into, transfer its engagements to, or amalgamate with, a company.[66]

A resolution to convert a society into a company can serve as the memorandum and articles of association of the new company.[67] In practice the memorandum and articles of association of the company should be drafted in advance and approved at the meeting passing the resolution to convert the society into a company. It would be possible to achieve the same result by forming a new company and transferring all the assets and liabilities of the society to it by a transfer of engagements or by amalgamating the society with it. The issue of defining a transfer of engagements discussed above would be even more pertinent in such a case.

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63 CCBSA 2014, s 111(7).
64 CCBSA 2014, s 110(4).
65 CCBSA 2014, s 126(2).
66 CCBSA 2014, s 112.
67 CCBSA 2014, s 114(2).

The particulars to be contained in the memorandum of association are laid down in the Companies Act 2006.[68] The articles of association can be based on one of the models to be found in the legislation with appropriate adaptations.[69]

The conversion procedure can be used to convert a society into a company with the same structure (eg for a co-operative, one which has articles of association that implement Co-operative Principles). In other cases, the transfer of engagements, amalgamation or conversion might represent the 'demutualisation' of the society involving its transformation into a private sector company, whether public limited company or private company and, in the former case, with or without shares listed on the Stock Market.

To prevent this, a benefit of the community society can apply an asset lock.[70] In the case of a co-operative, the 50% turnout requirement presents a substantial obstacle to demutualisation for societies with a large membership. In addition, it is possible to include society rules or devise contractual arrangements requiring members to pay any windfall they receive as a result of any demutualisation to a charity or another co-operative. However, the statutory procedure for passing a demutualisation resolution cannot be overridden by any provisions of society rules.

Section 112 CCBSA 2014 does not provide for a resolution for an amalgamation with, or transfer of engagements to, a company to operate to vest property in the company without any other form of conveyance or transfer.[71] This means that any necessary conveyances or assignments will have to be prepared and executed separately – in contrast to the position when another society is involved in such a transaction.[72] This will be particularly important to transfer the ownership of land.

In the case of the conversion of a society into a company no conveyance or assignment will be necessary as the property of the society will remain in the hands of the same legal entity that changes its own nature from society to company. As a result, conversion into a company may be the device most likely to be used for demutualisation or restructuring into a company form.

If the society is to transfer its engagements to or amalgamate with a company the company must exist before the resolution is passed.

In relation to the conversion of a society into a company, the society's registration must be cancelled by the FCA upon the society being registered as a company.[73]

12.4.2. Forms

The appropriate FCA forms must be used to register the CCBSA 2014 special resolution and submit a statutory declaration to support it. In the case of an amalgamation or a

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[68] CCBSA 2014, ss 8 and 9.
[69] Companies (Model Articles) Regulations 2008, SI 2008/3229.
[70] CCBSA 2014, s 29, Community Benefit Societies (Restriction on Use of Assets) Regulations 2006, SI 2006/264 and Section **4.3.** above.
[71] CCBSA 2014, s 112.
[72] CCBSA 2014, ss 109 and 110.
[73] CCBSA 2014, s 113(6).

transfer of engagements (but not in the case of a conversion) a statutory declaration by an officer of the company must be submitted to confirm the decision of the company to agree to the transaction.

Where a transfer of engagements has taken place and the registration of the transferor society is to be cancelled, a certificate must be lodged with the FCA by the society to show that all the property of the society has been transferred or conveyed to the company or to persons entitled.[74]

12.4.3. Rights of creditors

An amalgamation with or transfer of engagements to a company does not prejudice the rights of any creditor of the society.[75]

Registration of a society as a company after conversion does not affect any existing right or claim against the society and any civil or criminal liability incurred by the society before the conversion will continue as if that change had not been made. For the purpose of enforcing such a right, claim or penalty, the society can be subject to civil or criminal proceedings 'as if it had not become registered as a company' and its pre-conversion liabilities have priority against the company's property over all other rights or claims against the company.[76] Despite the wording of s 114(4) of CCBSA 2014, which suggests that the society is 'sued or proceeded against', it seems clear that the company will be the party to any proceedings. The registration of the society should have become void and have been cancelled by this time if it is registered as a company and so only the company will be available to sue.[77] The FCA seeks to prevent problems by liaising with Companies House throughout the conversion process.

For a discussion of the conversion of a company into a society see Section **3.10**. above.

12.5. SOLVENT DISSOLUTION

The processes that apply to insolvent societies are outlined in Section **12.8**. In this section we look at the dissolution of a solvent society.

12.5.1. Instrument of dissolution

A registered society can be dissolved by an instrument of dissolution approved by the signatures of at least 75% of the society's whole membership. If the society is dormant, the instrument of dissolution can be approved by two-thirds of those eligible members who vote on a CCBSA special resolution at a first meeting and a simple majority of such members at a second meeting instead of by being signed by 75% of the whole membership.[78] In the case of a dormant credit union, the approval of the PRA is also required.[79] A dormant society is one whose accounts for the current year of account and the two previous ones show no transactions apart from the payment of FCA or PRA fees

[74] CCBSA 2014, s 126(2).
[75] CCBSA 2014, s 112(5).
[76] CCBSA 2014, s 114(3)–(5).
[77] CCBSA 2014, s 112(2).
[78] CCBSA 2014, s 119(1)–(3) and s 120.
[79] CCBSA 2014, s 119(3)(c).

and interest or dividend. The society must also have notified the FCA that it is dormant.[80] Any alterations to the instrument of dissolution must be approved either by the signatures of 75% of all members (however the original was approved) or, alternatively, if it was originally approved by CCBSA resolution, in that way.[81]

The instrument must state the assets and liabilities of the society, how many members it has, their interest in the society, the claims of creditors and provision for their payment as well as how the society's funds and property are to be divided.[82] It is then sent to the FCA with a statutory declaration by three members of the society and the secretary (or both members if there are only two society members) and, after a final annual return has been filed, is registered in the same way as an amendment to the rules at which point it is binding on all members.[83]

The notice of dissolution is advertised in the Gazette and in a newspaper circulating in the locality of the society's registered office. Within three months of the advertisement it can be challenged and set aside in the county court (England) or sheriff court (Scotland) by a member or other person interested in, or having a claim on, the society's funds.[84] Notice of such proceedings must be sent to the FCA.[85]

The procedure results in dissolution from the later of the date of the advertisement or the date on which the society certifies to the FCA, under CCBSA 2014, s 126, that all property vested in the society has been properly dealt with.[86] It would be unwise to distribute property or submit the certificate until the end of three months from the date of the Gazette/ newspaper advertisement.

Where a society is to be dissolved by an instrument of dissolution, the cancellation of its registration and the dissolution of the society are not to take place until a certificate signed by the liquidator or the society secretary or some other society officer has been lodged with and approved by the FCA. The certificate must state that all property vested in the society has been duly conveyed or transferred by the society to the persons entitled to it.[87] This should ensure that there is no property left in the hands of the non-existent society after the instrument of dissolution has taken effect.[88] The CCBSA 2014 contemplates dissolution on the date of the Gazette and newspaper advertisement but in fact allows for the advertisement to be inserted so that the three months for a challenge can run before the society is dissolved on submission of the s 126 certificate unless the dissolution is set aside. A person challenging the dissolution must notify the FCA and, in the case of a credit union or other PRA-authorised society, the PRA, by the earlier of seven days after proceedings are started and the end of the three-month period after the date of the advertisement. The society must send the FCA any court order setting aside the dissolution within seven days of it being made.[89]

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80 CCBSA 2014, s 119(6).
81 CCBSA 2014, s 119(4).
82 CCBSA 2014, s 119(2).
83 CCBSA 2014, s 121(2)–(5).
84 CCBSA 2014, s 122(3).
85 CCBSA 2014, s 122(5).
86 CCBSA 2014, s 122(2).
87 CCBSA 2014, s 126.
88 As occurred in *Re Ruddington Land* [1909] 1 Ch 701 see Section **2.1.4**. above.
89 CCBSA 2014, s 122(5) and (6).

The last annual return of a society being terminated by an instrument of dissolution must be made up to the date of the instrument.[90] That document, the instrument itself and the statutory declaration should be submitted before the Gazette and newspaper advertisement appears. The s 126 certificate is best submitted when distribution has taken place. This will be three months after the date of the advertisement or after the outcome of any proceedings brought within that time limit is known.

The instrument of dissolution is the simplest way of dissolving a society. It can be used, however, only when the assets of the society are capable of realisation within three months of the appearance of the statutory statement in the Gazette/ newspaper. It is not appropriate for large societies or societies with inaccurate or obsolete membership records (unless they are dormant) as it is difficult to collect large numbers of signatures and the document must be signed by 75% of the entire membership. The requirement for resolutions to wind up a society or approve an instrument of dissolution for a dormant society is only for a super majority of those voting at a meeting of members.

The FCA has produced a form for the instrument of dissolution. It requires information on the assets and liabilities of the society, the provisions made for the claims of any creditors, and the intended division of the surplus funds unless this is left to the award of the FCA. The form must be signed in duplicate by 75% of the members of the society or approved by the dormant society procedure. It also contains a statutory declaration, which must be signed by three members and the secretary or, in the case of a society consisting of two registered societies, by two directors and the secretary of each society. The form must be sent to the FCA together with:

- the amount to cover the cost of an advertisement in the Gazette and a local newspaper;
- the final annual return covering the period from the last annual return to the date of the instrument of dissolution.

The FCA is prepared to advise societies whether the forms are in order if draft copies are first sent to the FCA for this purpose. It is obviously important to let the FCA see a draft of the instrument of dissolution itself before signatures are gathered or the resolution is passed as any alteration to the document made after it has been signed can, except for a dormant society using a CCBSA special resolution, only be made in another document in the same form, with the signatures of the same proportion of the society's members as the original. It would also have to be supported by a further statutory declaration.

On receipt of the final documents the FCA will register the instrument and insert the advertisements in the Gazette and the local newspaper.

If no proceedings are launched within three months, or if proceedings are begun but the court refuses to set the instrument aside, the officers must distribute the funds of the society in accordance with the instrument and, as soon as this process has been completed, send a s 126 certificate to the FCA.

12.5.2. Members' voluntary winding up

A society to be dissolved by being wound up by a court winding-up order or by a resolution made or passed as directed in the Insolvency Act 1986 and the provisions of

[90] CCBSA 2014, ss 77(8) and 78(7).

that Act apply to such an order or resolution as if the society were a company. The only modifications are that the FCA as the registrar of societies rather than the Registrar of Companies performs the registry function and that in Scotland the sheriff's court within whose area the society's registered office is located is given jurisdiction.[91]

A winding up under the Insolvency Act 1986 can be either a compulsory winding up started by a court order made on proof of grounds set out in the Act or a voluntary winding up. A voluntary winding up begins by resolution of the society and can either be a members' voluntary winding up or a creditors' voluntary winding up. A members' voluntary winding up is permitted only in cases in which the society is solvent and, while the other forms of winding up can apply to solvent societies, they are most commonly used in cases of insolvency.

In a members' voluntary winding up the members remain in full control of the process. The winding up is set in motion by the passing of a Companies Act special resolution to the effect that the society be wound up.[92] Before that resolution is passed a majority of the directors (or all of them if there are only two) must have made a statutory declaration at a directors meeting as to the solvency of the society. It must state that, after full inquiry into the society's affairs, the directors have formed the opinion that the society will be able to pay its debts in full within a period specified in the declaration, which must not exceed one year from the passing of the winding-up resolution.[93]

The declaration must also contain a full statement of the society's assets and liabilities at the latest possible date before it is made. The declaration should be made within five weeks before the resolution is passed.[94] A copy of the resolution and the declaration must be delivered to the FCA within 15 days of the passing of the resolution.[95]

It is vital that directors who make a declaration of solvency satisfy themselves as to the accuracy of its contents and that they have reasonable grounds for their belief that the society will be able to pay its debts in full within the period specified in the declaration. Failure to do so will amount to a criminal offence.[96] If a winding-up resolution is passed within five weeks of the date of the declaration and the society's debts are not paid or provided for in full within the period referred to there is a rebuttable presumption that the directors who made the declaration did not have reasonable grounds for their opinion.[97] If the resolution is passed more than five weeks later or if the declaration does not contain a statement of the society's assets and liabilities, the winding up must be conducted as a creditors' voluntary liquidation (see para 12.8.4.).

The liquidator in a members' voluntary winding up is appointed by the members' meeting.[98] There is no obligation to call any meeting of creditors during such a liquidation unless the liquidator decides that the society will be unable to pay its debts in full with interest at the statutory rate within the period laid down in the declaration of solvency. If the liquidator forms that opinion he is obliged to call a meeting of creditors and from then on the winding up is run as a creditors' voluntary liquidation.

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91 CCBSA 2014, s 123.
92 Insolvency Act 1986, s 84(1)(b).
93 Insolvency Act 1986, s 89(1).
94 Insolvency Act 1986, s 89(2)(a).
95 Insolvency Act 1986, ss 84(3) and 89(3).
96 Insolvency Act 1986, s 89(4).
97 Insolvency Act 1986, s 89(5).
98 Insolvency Act 1986, s 91(1).

From the passing of the resolution for the society to be wound up, the business of the society must be discontinued except in so far as may be required for a beneficial winding up.[99] The powers of the directors cease on the appointment of the liquidator unless either the society general meeting or the liquidator sanctions their continuation.[100]

The liquidator conducts the winding up by gathering and realising the society's assets and paying its debts. The surplus will then be distributed to the members. The detailed rules governing that process and the powers of the liquidator including his or her right to challenge transactions that took place before the liquidation began are dealt with in specialist books on corporate insolvency.

Those powers and that process will be similar in the case of a solvent company subjected to a winding-up order of the court at the petition of a member.

Through s 123 of the CCBSA 2014, ss 110 and 111 of the Insolvency Act 1986 can apply to a co-operative or community benefit society. This allows the transfer of the whole or part of the business or undertaking of a society being wound up or intended to be wound up to another society or a company in return for consideration in the form of 'shares, policies or other like interests in the transferee company',[101] which are for distribution among the members of the society. The members then enter a direct relationship (usually as shareholders) with the transferee company and are bound by the arrangement subject to their right to force the liquidator to buy them out if they voted against it.[102] The transferor society will be wound up and dissolved.

This process requires a Companies Act special resolution giving the liquidator either general authority or authority to carry out a particular arrangement as part of a members' voluntary winding up of the society. Such a resolution is normally passed at the same time as a resolution for the voluntary winding up of the society and one that appoints the liquidator. However, it can be passed before, concurrently with or after the winding-up resolution.[103] If the society is in creditors' voluntary winding up as being apparently insolvent the arrangement requires the sanction of either the court or the creditors' committee.[104]

Any member of the transferor society who did not vote in favour of the resolution conferring power on the liquidator can leave, at the company's registered office within seven days of the passing of the resolution, his or her written dissent addressed to the liquidator. The member will require the liquidator either to abstain from carrying the resolution out or to buy the member's interest at a price to be agreed with the liquidator or decided by arbitration.[105]

In practice ss 110 and 111 of the Insolvency Act 1986 are only likely to be used to carry out an arrangement agreed by the board and management of a society with the buyer. They allow members to be given shares in 'Newco' in return for a transfer of the society's assets to 'Newco' with the society wound up and dissolved after the transaction is complete. It is hard to see how these sections could be used to mount a hostile

[99] Insolvency Act 1986, s 87(1).
[100] Insolvency Act 1986, s 91(2).
[101] Insolvency Act 1986, s 110(1) and (2).
[102] Insolvency Act 1986, ss 110(5) and 111.
[103] Insolvency Act 1986, s 110(3) and (6).
[104] Insolvency Act 1986, s 110(3).
[105] Insolvency Act 1986, s 111.

take-over of a society's business although that may be legally possible. Like a members' voluntary liquidation, this process involves Companies Act resolutions and not special resolutions as defined in the CCBSA 2014. Thus a 75% majority of those voting is needed to pass resolutions of which the necessary notice has been given and there is no requirement for confirmation by a second meeting.[106]

To discourage the use of this mechanism to achieve demutualisation, a society's rules or a separate contractual arrangement could provide for the donation by members at the end of that process of any amount received beyond the nominal value of the member's shares or an equivalent amount to charity or another co-operative or community benefit society. It would also be important to entrench that rule.

12.6. DISTRIBUTION OF SURPLUS ON DISSOLUTION

12.6.1. The general law

When a solvent society is dissolved the key question is how to deal with any surplus assets left after the payment of all debts and the repayment to shareholders of the nominal value of their shares.

This issue is important and controversial. For community benefit societies that have applied an asset lock and for all credit unions, there will be no question of any distribution of surplus to members. The rule to that effect has statutory backing.[107] In the case of social housing providers, the same effect arises from the requirements of the housing regulator. However for other co-operatives the issue needs to be dealt with effectively in the rules.

Some co-operatives prefer a common ownership solution with no distribution to members allowed. Others see a co-operative as a form of co-ownership in which a distribution to members (and recent former members) is permitted on the basis of their transactions with the society in a fixed period before the dissolution.[108] Surplus distribution can depend on the form of dissolution involved but it is always vital to deal with the question in society rules.

If an instrument of dissolution is used, the destination of any surplus must either be stated in the instrument itself or be said to be left to the award of the FCA or the PRA.[109] In either case, the assets must be divided among those lawfully entitled to them under the society's rules or the general law and not given to some other person or cause.[110] The funds must be dealt with as the society's rules direct. If the rules make no provision about the distribution of a final surplus, the instrument of dissolution or the FCA will distribute the remaining assets among the members. From the approval of the instrument of dissolution, the society holds its assets on trust to carry out the distribution. If its dissolution occurs before the distribution takes place, anyone to whom its assets pass, other than a bona fide purchaser for value without notice of the

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106 Companies Act 2006, s 283.

107 See Sections **4.3.** above and **13.14.** below.

108 See e g CUK Worker Co-operative Model Rules in Section **12.6.2.** below, which offer a choice between these two options.

109 CCBSA 2014, s 119(2).

110 *Re Buckinghamshire Constabulary Widows and Orphans Fund Friendly Society (No 1)* [1978] 1 WLR 641.

trust, will hold them on the same trust.[111] The requirement of a certificate that all assets have been distributed before a society's registration is cancelled should prevent dissolution before distribution.[112] A distribution should be based on the position on the date on which the cancellation of registration took place and that is the date at which, for example, a person's status as a member will be assessed. That is because the society continues to exist until that date and, unlike an unincorporated association, does not spontaneously dissolve through inactivity.[113]

If the surplus on dissolution is to be passed to any person or organisation other than the society's members, the rules must lay this down. It will also be sensible for them to lay down how such a surplus is to be divided among members if that is to be its fate. If there is no provision the members can decide by inserting a provision as to how it is to be divided among them in the instrument. That might be by reference to transactions with the society or equally.

In the event of a provision in the rules for distribution that was contradicted by the instrument of dissolution, it is unclear which should prevail. If the rule could be amended by 75% or less the agreement of 75% of the members to a different distribution should perhaps prevail, but if that is the wish of the majority why not pass a rule amendment? If change to the rule is impossible or requires more than 75% agreement the rule should clearly prevail.

In the case of a community benefit organisation a provision in the rules to prevent surplus assets devolving on members will be required as a condition of registration.

If a society is wound up under the Insolvency Act 1986 as applied by s 123 of the CCBSA 2014, the distribution of any surplus will be in accordance with the society's rules or, if they make no provision, 'among the members according to their rights and interests in the [society]'.[114] In the context of companies this usually means proportionately to the value of their equity shareholdings, if the company is limited by shares.[115] If it is limited by guarantee it means distribution among members equally. The former will be unacceptable in the case of any society but in the absence of provision in the rules might be the outcome. In deciding whether the rules have any provision covering the situation it might be possible to argue that, in the absence of a rule dealing expressly with the distribution of surplus assets on dissolution, the rule about the application of profits year by year should be applied. This would be preferable to allowing a distribution according to shareholding in the absence of express provision dealing with dissolution. However, that approach was rejected on the facts of *Re Merchant Navy Supply Association*.[116] If no guidance can be found in the rules an equal distribution among the members of a bona fide co-operative would be preferable to a distribution according to shareholding. In the case of a community benefit society the problem should not arise if all such societies have an express provision in their rules.

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111 *Re Ruddington Land* [1909] 1 Ch 701, held that in those circumstances, the assets did not pass to the crown as bona vacantia.

112 CCBSA 2014, s 126.

113 *Boyle v Collins* [2004] EWHC 271 [34]–[37] but compare *Re Wimbledon and Merton Democratic Club Society Ltd* unreported 4 December 1998 discussed at [31]–[34].

114 Insolvency Act 1986, ss 107, 154.

115 *Re Merchant Navy Supply Association* [1947] 1 All ER 894.

116 Ibid.

The case of *Fletcher v South Leamington New Allotments Association Ltd*[117] dealt with the distribution of an ultimate surplus on the proposed dissolution of an allotment society (known as the 'clodhoppers'). In this case, the terms of a share issue entitled the shareholders to part of the net proceeds of the sale of the estate owned by the society (ie the land on which the allotments were established) 'in the proportion in which the sum paid by the holder bears to the total amount paid to the Association by its members in respect of the Estate'. It was accepted without argument that distribution should be in accordance with shareholding when the land was to be sold for development.

The issue in the case at Court of Appeal level involved the propriety of an attempt by the association to offer shares to all members so that they could have equal holdings and share the surplus equally. The plaintiff held a large proportion of the total issued share capital of the society. In the first instance proceedings the termination of the plaintiff's contract with the society some years earlier and the purported cancellation of his shares had been declared invalid but these matters were not in issue on appeal. The Court of Appeal held that the attempt to issue further shares to equalise the claims of members to the surplus amounted to the use of a power for an improper purpose and so a distribution on the basis of the existing unequal shareholding resulted. Because the society's rules contemplated that members could hold different amounts of share capital, the court rejected the argument that the nature of the society as a co-operative made the attempted equalisation a proper purpose of a new share offer.

This case suggests that the courts will be reluctant to accept that a society's co-operative identity precludes surplus distribution on the basis of the members' shareholdings unless the rules clearly prevent it – or at least require all members to hold the same number of shares (eg no more than one £1 share each). It may be possible to distinguish the 'clodhoppers' case from one in which there is no specific provision in a share issue to allow distribution in proportion to shareholding. However, s 107 of the Insolvency Act 1986 provides that the rights and interests of members are to determine the destination of a surplus on winding up in the absence of a provision in a society's rules stating a different distribution hat statutory provision seems likely to prevail, even if the society's objects apply a different outcome.[118]

The discussion of the model rules below illustrates which societies make provision for the destination of a final surplus arising on dissolution. In the case of those that do make provision in their rules, how easily can a rule requiring the transfer of surplus to a body other than the members of the society be changed by rule amendment? The procedure for rule amendment will be set out in the rules themselves.[119] This could require a larger then usual majority to change the rule dealing with asset distribution on dissolution. It may make that rule impossible to change, at least without unanimous member agreement. In either case the rules would have to insist on the impossibility of change or the special majority required for both the rule about distribution and the rule entrenching it. A society's rules prohibiting change to the rule about distribution on dissolution is entrenched in the case of a community benefit society if the statutory asset lock is used.[120] For co-operative societies that possibility is not available but there are

[117] CA 24.3.94 LEXIS (drawn to the author's attention by Ms V Havard-Williams of Linklaters LLP).
[118] *Re Merchant Navy Supply Association* [1947] 1 All ER 894 at 895.
[119] CCBSA 2014, s 14(5).
[120] CCBSA 2014, s 29, Community Benefit Societies (Restriction on Use of Assets) Regulations 2006, SI 2006/264 and Section **4.3.** above.

some legal limits on the possibility of amending society rules based on the interpretation of the rules themselves in the context of the founding of the society and its purpose.[121]

12.6.2. The Model Rules

The Model Rules discussed below all set out briefly the statutory methods whereby a society may be dissolved: the instrument of dissolution and a winding up. They also lay down a requirement about the destination of the surplus left after the repayment of all capital and the payment of all debts.

12.6.2.1. 12th Edition Co-operatives UK Model Rules (2012) – Consumer Co-operative ('CUK Consumer Model')

These Model Rules provide for amalgamations and transfers of engagements between the society and another society in accordance with the statutory provisions and specifically state that a resolution of either the board or a members meeting can accept the engagements of another society.[122]

For transfers of engagements to, amalgamations with, and conversion into, a company, more detailed provisions are set out to complement (but not contradict) the statutory provisions. In calling a general meeting to pass a resolution for those purposes, members must be given at least two months' notice of the meeting. The notice must be posted in a prominent place at the posted in a prominent place at the registered office and all trading premises of the society to which members (including employees) have access. The notice must also be accompanied by a separate statement giving the reasons for the proposal, stating whether it has board support, and setting out which alternative proposals were considered and the advice of a reputable financial advisor about why the proposal to demutualise rather than any other proposal should be supported. The statement must also give details of the number of shares in the society held by members of the board, senior executives, and persons connected with them. If the statement is contained in a document other than the notice of the meeting the notice must say where members can obtain a copy of it. In addition, on that resolution proxy votes are not permitted if they are allowed at all by the society's rules.[123]

These model rules set out the statutory methods of dissolution. They also provide that any surplus assets remaining after dissolution or solvent winding up must not be distributed to members but must be transferred to one or more societies which are members of Co-operatives UK or to Co-operatives UK itself. The surplus asset distribution rule is entrenched by a provision that its amendment is subject to the statutory procedure now found in s 113 of CCBSA 2014 with its 75% majority and 50% turnout requirement.[124]

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[121] See discussion in Section **4.6.1.** text to footnotes 82–88.
[122] CUK Consumer Model Rule 18.1.
[123] CUK Consumer Model Rule 18.2.
[124] CUK Consumer Model Rules 19 and 20.

12.6.2.2. Worker Co-operatives- Co-operatives UK Worker Co-operative Model Rules 2011 v.1

These rules largely follow the Co-operatives UK Consumer Model Rules in their treatment of transfers of engagements, and amalgamations with a society and their requirements for those procedures to transform into a company, including the additional notice and information requirements for the meeting to pass a resolution where a company is involved.[125] The only variation is that for a resolution in respect of a company the turnout requirement is the greater of 150 members or 50% of all members with an absolute minimum of three members. This takes account of the different size of worker co-operatives.

On dissolution, these rules refer to the two statutory methods to decide to dissolve.[126] They deal with surplus assets by providing two options: common ownership and co-ownership.

For a common ownership co-operative the rule states:

> 'The Co-operative is a common ownership enterprise. If on the winding up or dissolution of the Co-operative any of its assets remain to be disposed of after its liabilities are satisfied, these assets shall not be distributed among the Members, but shall be transferred to some other common ownership co-operative(s), or to Co-operatives UK (or any body that succeeds to its function). If such residual assets cannot be distributed in this manner they shall be transferred to some other organisation(s) whose purpose is to promote and support the co-operative movement and common ownership enterprises. This rule may only be amended by Extraordinary Resolution.'[127]

An extraordinary resolution requires 75% of votes cast. That option continues the approach of the Industrial Common Ownership Movement (ICOM), which merged with the Co-operative Union to become Co-operatives UK in 2001. This approach is legally recognised in the Industrial Common Ownership Act 1976.[128] It prevents any distribution to individual members on dissolution on the basis that assets will then cumulatively fall into common ownership over time.

The Co-ownership Co-operative option permits the distribution of surplus to members on dissolution. However, it ensures that the distribution, determined by the members in general meeting, is either equal or by reference to an 'equitable formula which recognises the relative contribution made by each Member and past Members to the business of the Co-operative' during the six years before the decision to dissolve the co-operative or wind it up. Anyone who was a member in the previous six years is included and there is a fall back provision for transfer to a common ownership co-operative or Co-operatives UK if distribution to members cannot take place.[129]

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[125] CUK Worker Co-operative Model Rules 105 and 106.
[126] CUK Worker Co-operative Model Rules 107.
[127] CUK Worker Co-operative Model Rule 108.
[128] See Section **2.1.6.** above.
[129] CUK Worker Co-operative Model Rule 109.

12.6.2.3. Co-operatives UK Society for the Benefit of the Community Model Rules 2011 v1 ('CUK Bencom Model')

These rules follow the Co-operatives UK Worker Co-operative Model Rules in their treatment of transfers of engagements, and amalgamations with a society and their requirements for those procedures to transform into a company, including the additional notice and information requirements for the meeting to pass a resolution where a company is involved and the variation on the requirement for 50% turnout to the greater of 150 members or 50% of members and a minimum of three.[130]

They set out the statutory options for the dissolution of the society.[131] For surplus assets, they offer the options of the statutory asset lock rule[132] or transfer by the members' decision to 'some other non-profit body or bodies subject to at least the same degree of restriction on the distribution of profits and assets as is imposed on this Society by virtue of these Rules …'.[133] In neither case is distribution to members permitted.

12.6.2.4. National Housing Federation Model Rules 2011 Version 2

These rules contain no explicit reference to transfers of engagements, amalgamations or conversions of the society. The CCBSA 2014 provisions apply regardless of rule provisions. For these societies they are subject to the restrictions in housing legislation requiring the regulator's permission for such restructuring.[134] That is to ensure that public money dedicated to social housing provision is protected.

On dissolution these rules refer to the possibility of dissolution by instrument of dissolution or winding up.[135] Surplus assets can be transferred, by members' decision, to a body with similar objects, which must be a charity if the society itself is charitable or, in the absence of such a body, the Housing Associations Charitable Trust. The rules also state that the transfer or gift must comply with the applicable social housing legislation if the society is a registered provider of social housing.[136]

12.6.2.5. Co-operatives UK and Scottish Agricultural Organisation Society Agricultural Co-operative – Agency Model Rules 2013 v1

These rules briefly set out the availability of the statutory procedures for transfers of engagements and amalgamations (to or with either a company or a society) and conversion to a company. They do not vary those provisions or add any requirements.[137] On surplus assets, they adapt the co-ownership option found in the Worker Co-operative Rules. This version includes anyone who was a member within the previous three years, deducts payments due under members' agreements, including any by way of allocated reserves, in calculating the surplus, and then provides for allocation in proportion to the person's contribution to the co-operative during the last three years.

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130 CUK Bencom Model Rule 87 and 88.
131 CUK Bencom Model Rule 89.
132 CUK Bencom Model Rule 86.
133 CUK Bencom Model Rule 90.
134 Housing (Scotland) Act 2010 asp 17, s 97 and Housing and Regeneration Act 2008, s 163.
135 NHF Model Rules G13.
136 NHF Model Rules G14.
137 CUK/SAOS Agency Model Rules 99 and 100.

The distribution is calculated on the basis of the person's use of the co-operative's services as a member during the last three years, subject to any specific provision of their member's agreement.[138]

12.6.2.6. Working Men's Club and Institute Union Ltd Model Rules (consulted 2014)

Rule 30 of the CIU rules simply refers to the statutory methods of dissolution and provides for any remaining assets to be distributed among the members in equal shares.

12.7. CANCELLATION OR SUSPENSION OF REGISTRATION

Section 16 of the CCBSA 2014 permits the FCA to cancel the registration of the society.

12.7.1. Grounds for cancellation of registration

The FCA can cancel the registration of a society in writing if any of the following five conditions listed in s 5 of CCBSA 2014 is met.[139]

12.7.1.1. Condition A: Society requests cancellation

If the society requests the cancellation of its registration, the FCA can require it to provide any evidence the FCA considers necessary and then, if the FCA considers cancellation appropriate, it will cancel the registration.[140] The practice of the FCA at the time of writing is to seek evidence that the society has ceased carrying on any business, has no assets and liabilities, and is not insolvent. To establish this, the society must submit a statement showing its current financial position and submit any outstanding annual returns. If assets remain to be distributed, the society must use the instrument of dissolution procedure. Any outstanding fees due to the FCA must have been paid in full and if the society had PRA or FCA authorisation under Part IV of FSMA 2000 that must have been cancelled before cancellation of the registration of the society is requested. If the decision to request cancellation of registration has not been made by the members in general meeting, the society must explain why that is the case.[141]

12.7.1.2. Condition B: Registration by fraud or mistake, too few members, or 'ceasing to exist'

This condition is satisfied if it is 'proved to the FCA's satisfaction' that any one of three statutory grounds exists[142]:

- that an acknowledgement of registration was obtained by fraud or mistake; or
- that the society has fewer than three members (and does not have two members both of which are registered societies); or
- that the society has ceased to exist.

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138 CUK/SAOS Agency Model Rules 101.
139 CCBSA 2014, s 5(1).
140 CCBSA 2014, s 5(2).
141 FCA, Request to Cancel Notes, pp 1–2.
142 CCBSA 2014, s 5(3).

In each case, the FCA will wish to have evidence sufficient to satisfy it of the ground.

12.7.1.2.1. Registration by fraud or mistake

The possibility of cancelling a society's registration when it was obtained by fraud or mistake provides a remedy for the FCA when the facts showing the fraud or mistake become known. Up to the cancellation of the registration, the society enjoys corporate status with limited liability of its members for debts, the right to hold property and to sue and be sued. Those rights all continue despite the fraud or mistake at the time of registration.[143] So does the legal effect of the society's rules as they were when the acknowledgement of registration was issued.[144] On registration being cancelled, the society loses corporate status and becomes an unincorporated association. However, that does not effect things done while the society was registered. Lord Tomlin summarised the effect of registration and of its cancellation in *Hole v Garnsey*:[145] 'The registration of a society may be cancelled or suspended. Such cancellation or suspension does not destroy the society, but only deprives it of and relieves it from the privileges and obligations which follow from registration.' Equally the cancellation is effective from the date of its advertisement and does not affect earlier actions[146]

12.7.1.2.2. Too few members

If the FCA is satisfied that the number of members is fewer than three (or two in the case of a society consisting wholly of registered societies) it can cancel the registration. The principles discussed under the first ground above will also apply here. Up to the point at which the cancellation takes effect the society is incorporated and enjoys all the privileges of a registered society. After cancellation of the registration, it becomes an unincorporated association.[147]

12.7.1.2.3. Society ceases to exist

This ground presents a logical conundrum because, as noted above, the corporate body exists while it remains registered. However, that has been resolved by accepting that the legislation makes a linguistic distinction between a society and a registered society. As Lewison J said in *Boyle v Collins*:[148]

> 'The … Act draws a linguistic distinction between a society and a registered society. As I have said, [s 3(1) of CCBSA 2014] presupposes that there is a society in existence (with members and a secretary) before it is registered. What does [s 5(3)(c)] mean when it speaks of the [FCA] being satisfied that 'the society has ceased to exist'? … the [FCA] must be satisfied that the purposes for which the society was formed have permanently ceased. If [it] is so satisfied, [it] may then cancel the registration. One of the effects of cancellation is to cancel the effect of incorporation, since a society is only incorporated "by virtue of" registration. Thus as from the date of cancellation of the registration the society (if it still exists) becomes an unincorporated association, to which the principle of spontaneous dissolution may apply. If the substratum of the corporation has ceased to exist before the cancellation, then the cancellation will terminate the existence of the corporation and there will be no putative

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143 CCBSA 2014, s 3(3)–(6).
144 CCBSA 2014, s 3(7).
145 [1930] AC 472 at 499.
146 CCBSA 2014, s 6(7).
147 See *Boyle v Collins* [2004] EWHC 271 [34].
148 [2004] EWHC 271 [34] modified to include references to CCBSA 2014 and the FCA.

> successor unincorporated association. What I do not think is possible is for the corporation to cease to exist unless either it has been dissolved by one of the methods prescribed by the … Act or its registration has been cancelled.'

This clarifies the position and would seem to be the only possible meaning of the concept of a society ceasing to exist while still being incorporated.

12.7.1.3. Condition C: Illegal purpose or wilful violation of CCBSA 2014

Proof to the FCA's satisfaction of one of two further grounds permits it to cancel the society's registration under this condition.[149]

12.7.1.3.1. The society exists for an illegal purpose

This may be a criminal purpose such as theft or fraud or it may be a purpose regarded at a given time as contrary to public policy such as prostitution (in 1980), which was held to be an illegal purpose in the context of the registration of a company.[150] The illegal purpose is to be established at the time of cancellation ('exists' is in the present tense). A provision in a society's rules that is void for restraint of trade will not make the whole purpose of the society illegal so as to satisfy this condition.[151] An ultra vires act that was not otherwise illegal was not sufficient to justify action.[152]

12.7.1.3.2. Wilful violation of CCBSA 2014

If the FCA is satisfied that a society has wilfully, after notice from the FCA, violated any provision of the CCBSA 2014, it can cancel the society's registration.[153] This is probably the most commonly used ground for cancellation as it is used by the FCA to enforce the obligation to file annual returns and failure to do so will result in notices and then cancellation of registration. Societies whose registration has been cancelled on this ground are listed on the FCA website. Notice of intention to cancel registration is usually given two months before cancellation and in recent years that has been done en masse in January for March cancellations and in July for September cancellations. There is no need for a society to have failed to submit more than one annual return for the sanction to be applied.

12.7.1.3. Condition D: Failure to meet co-operative or community benefit registration requirement

This condition applies differently to societies directly registered under CCBSA 2014 on or after 1 August 2014 and those registered before that date under the Industrial and Provident Societies Act 1965.

For societies registered under CCBSA 2014, the ground for cancellation is that it appears to the FCA that the condition under which the particular society was registered is not

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149 CCBSA 2014, s 5(4).
150 *R v Registrar of Companies ex parte HM Attorney-General* (1980) [1991] BCLC 476.
151 *Swaine v Wilson* (1889) 24 QBD 252, CA.
152 *Re Middle Age Friendly Society* (1915) 1 KB 432.
153 CCBSA 2014, s 5(4)(b).

met. For a co-operative society it will appear to have ceased to be a bona fide co-operative society. For a community benefit society it would have to appear to have stopped conducting business for the benefit of the community.[154]

The ground for cancellation of registration as a co-operative society will be made out even if, for example, a former co-operative now meets the registration condition for a community benefit society. However, the FCA is not required to cancel registration when any of the conditions are made out. It has a power and not a duty to take this step.[155] If a registered co-operative society seeks to register rule amendments that convert it into a community benefit society, there is no policy reason why it should not be re-registered as that kind of society if it meets the appropriate criteria. The members have chosen, by amending the rules, to dedicate the society to conducting business for the benefit of a community instead of for the benefit of the society's own members. More difficult issues arise if a registered community benefit society proposes rule amendments to convert itself into a bona fide co-operative so as to benefit its own members. If the community benefit society has an 'asset lock',[156] that will not be possible. If it has charitable status, that will also be the case. If it has no asset lock and is not a charity, the FCA will still be concerned that assets formerly dedicated to community benefit would now be available to the members of the new co-operative. A society can always transfer its engagements to a newly established society in the other category and then request the cancellation of the transferor society's registration under Condition A.

For pre-commencement societies registered before 1 August 2014, cancellation of registration is only possible if the society satisfies neither the community benefit nor the bona fide co-operative registration requirement.[157]

This condition does not apply to a society registered before 28 July 1938 unless it has invited persons to take up shares or lend it money or deposit money with it since that date, but a winding-up remedy is available to the FCA in such a case.[158]

12.7.1.4. Condition E: Agricultural, horticultural and forestry lending societies no longer qualifying as such

If it appears to the FCA that an agricultural, horticultural or forestry society whose object is lending money to its members for those purposes either no longer consists mainly of such members or no longer has as its principal activity such lending, its registration can be cancelled. This prevents the special concession to allow such societies to make unsecured loans to their members from being used more widely as a result of a change to its membership or principal activity.[159]

12.7.2. Procedure: General

The FCA must give any society whose registration it intends to cancel two months' notice of its intention unless the cancellation is:

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[154] CCBSA 2014, s 5(5)(a) and (b).
[155] CCBSA 2014, s 5(1).
[156] CCBSA 2014, s 29, Community Benefit Societies (Restriction on Use of Assets) Regulations 2006, SI 2006/264 and Section **4.3.** above.
[157] CCBSA 2014, s 5(5)(c).
[158] CCBSA 2014, s 150, Sch 3 para 2 and see Sch 5 para 15.
[159] CCBSA 2014, ss 5(6) and 22.

- at the request of the society;
- on the conversion of the society into or the transfer of its engagements to, or amalgamation with, a company under the Companies Act 2006;
- on the winding up of the society under the Insolvency Act 1986 or by instrument of dissolution or on amalgamation with, or transfer of engagements to, another society.

In these three cases cancellation is automatic.[160]

If before the expiration of the two months a society appeals against the cancellation, the cancellation does not take place until the appeal has been determined or abandoned but can be suspended in the meantime.[161]

Unless the proposed cancellation is on the ground that the society is not a bona fide co-operative or community benefit society, the society may appeal against the cancellation during the two-month period from the FCA's notice of its intention. In the case of an English society appeal is to the High Court; for a Scottish society it is to the Court of Session.[162]

Notice of the cancellation of the society's registration must be published as soon as practicable after it takes place in the Gazette and a local newspaper circulating in the locality of the society's registered office. Cancellation takes effect from the date of the publication of this notice but does not affect any liability of the society that may be enforced against it as if the cancellation had not happened.[163]

12.7.3. Condition D: Special procedures

If Condition D is used the FCA must consider any representations made to it by the society in writing or by being heard before its registration is cancelled.[164] If the cancellation of registration goes ahead, the FCA can give directions for the winding up of the affairs of the society. That power can be exercised if it appears to the FCA at any time after the end of a one-month period from giving notice of intended cancellation that reasonable steps have not been taken to dissolve or wind up the society, or convert it into, amalgamate it with, or transfer its engagements to a company. For a PRA-authorised society, the PRA must be consulted before a direction is given. It is a criminal offence for anyone to contravene or fail to comply with the FCA's direction.[165]

The FCA's powers under CCBSA 2014 and the Companies Act 1985 to demand information and documents about the society's business or to launch an inspection or investigation may well be available in connection with this ground for the cancellation of registration.[166]

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[160] CCBSA 2014, ss 6(1) and (2) and 126.
[161] CCBSA 2014, ss 6(3) and 8(3).
[162] CCBSA 2014, s 9.
[163] CCBSA 2014, s 6(6) and (7).
[164] CCBSA 2014, s 7(1)–(3).
[165] CCBSA 2014, s 7(4)–(7).
[166] See Sections **9.3.** and **9.4.** above.

12.7.4. Effect of cancellation of registration

On cancellation of its registration a society ceases to be entitled to any of the privileges of a registered society.[167] The practical implications of this depend on the circumstances of the cancellation of registration. If the society's business has been wound up in accordance with FCA directions or the society has transformed itself into a company or been dissolved, there will be no assets and no liabilities when cancellation takes effect and either no business will continue or it will be continued by the company that the society has become.

If activity continues after the cancellation of the society's registration, the unregistered society's members will no longer enjoy limited liability and the society itself can no longer claim corporate personality. This would create difficulties in respect of any transaction concerning the society's property, which will be held by the committee members or others on trust for the membership on the model of an unincorporated association. Members face the risk of being held liable for any debts incurred by the society after the date of the cancellation of its registration.[168]

CCBSA 2014 preserves 'any liability actually incurred by the society' so that it can be enforced against it as if the cancellation had not taken place.[169] There will in practice be difficulties for the society if it seeks to carry on any business after the cancellation of its registration. Lenders will be unwilling to deal with it as the privilege of granting new security over property will probably no longer apply, since the right to grant a floating charge is a privilege of registered societies. The power for the society to make contracts will have disappeared with legal personality and the individuals purporting to act as society agents will presumably be personally liable on any contracts they make after cancellation, subject to indemnity by some or all other members. The other party to the contract may be unwilling to deal with an organisation with a dubious legal status. If the cancellation of registration was on the ground that the society had ceased to exist, there will be no successor unincorporated association or general unregistered partnership as the substructure of association had disappeared before the cancellation of registration.[170]

An organisation carrying on a business with a view to profit may be an unregistered general partnership rather than an unincorporated association.[171] This would cover a body which had the characteristics of a co-operative in that it traded and did not exist for purely social, cultural or political (as opposed to business) purposes. On the other hand, a social club whose registration was cancelled could continue to operate as an unincorporated association because it existed for social rather than commercial purposes.[172] Adherence to co-operative principles does not prevent a body from being classed as a profit-making concern.[173]

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[167] CCBSA 2014, s 6(7).
[168] See Section **1.2.3.(a)** above.
[169] CCBSA 2014, s 6(7).
[170] See *Boyle v Collins* [2004] EWHC 271 [34] and quotation at Section **12.7.1.(c)** above.
[171] See Section **1.2.1.(b)** above.
[172] *Wise v Perpetual Trustee Co* [1903] AC 139 at 149.
[173] *English and Scottish Joint CWS Ltd v Assam Agriculture Income Tax Commissioner* [1948] AC 405.

12.7.5. Suspension of registration

The FCA can suspend the registration of a society for up to three months on any of four grounds.[174] The grounds are those in Conditions C to E: existing for an illegal purpose; wilfully violating CCBSA 2014; not being a bona fide co-operative or community benefit society; and being an agricultural lending society but no longer the meeting conditions for that status.

If notice of cancellation of registration is given to a society and the society lodges an appeal from the proposed cancellation, the FCA can suspend its registration from the date the notice of cancellation expires until the appeal is determined or abandoned.[175]

In any other situation, the FCA must give two months' notice to a society, briefly stating the grounds, before suspending its registration.[176]

There is no appeal from an initial suspension but if the suspension is renewed so as to run beyond three months the society may, if an English society, appeal to the High Court or, if a Scottish society, to the Court of Session.[177]

Notice of suspension or renewal of suspension must be published in the Gazette and in a local newspaper circulating in the locality of the society's registered office as soon as possible after it takes place.[178]

From the date of the publication of the suspension in the Gazette until the suspension ends, a suspended society is not entitled to any of the privileges given by the Act. Any liability incurred by the society before the suspension can be enforced against the society during and after the suspension.[179] The effect of this on the society's acts during its suspension is far from clear. The subsection seems to suggest that the society cannot operate as a corporate body to sue or contract or hold property but it is clear from the provision that it can be sued on its liabilities or otherwise have them enforced against it as if there had been no suspension.

If the society wishes to bring an action after the suspension is lifted on a contract entered into purportedly on its behalf during the period of the suspension, can it be faced with the argument that it had no contractual capacity at the time of entering the contract? In principle this argument would appear to be likely to succeed unless the court accepted that the society as principal could retrospectively ratify the act of its agent once the suspension was lifted. An alternative view would be that the lifting of the suspension should itself be treated as retrospectively validating all that was done during the period of suspension. It is hard to find support for that view in the wording of the Act. If the suspension period ends with the cancellation of the society's registration then the denial of privileges under the Act will presumably simply continue having begun at the beginning of the period of suspension.

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174 CCBSA 2014, s 8(1).
175 CCBSA 2014, s 8(3).
176 CCBSA 2014, s 8(2).
177 CCBSA 2014, s 9(1)(c) and (2).
178 CCBSA 2014, s 8(5).
179 CCBSA 2014, s 8(6).

These difficulties suggest that a suspension of the registration of a society should cause it to cease all new business transactions during the period of suspension. If this is so then this is a draconian step for the FCA to take as it could effectively kill the society's business. In the case of a PRA-authorised society, the FCA must consult the PRA before suspending, or renewing the suspension of, the society's registration.

12.8. INSOLVENT SOCIETIES

12.8.1. Available procedures: The history

This section deals with the application to societies of the procedures that apply to registered companies in financial difficulty. The details of the procedures can be found in standard company law and corporate insolvency textbooks. Here, only the special considerations applicable to societies are considered.

Since 6 April 2014,[180] the procedures available to deal with insolvent societies have been almost exactly the same as those applicable to insolvent companies. Before that date, the winding-up procedures under what is now s 123 of CCBSA 2014 were available for insolvent societies. The common law-based receivership process available to holders of floating charges was also available from 1967 when societies were first able to offer that form of security to lenders.

That meant that from 1967 to 1986 the same insolvency procedures were available for both societies and companies.

The Insolvency Act 1986 substantially reformed insolvency procedures for companies. It added statutory provisions for creditors' voluntary arrangements and introduced the court-based administration order rescue procedure with a temporary moratorium on debts. It also required all liquidators, administrators and receivers to be qualified insolvency practitioners. The 1986 reforms to winding up applied to societies through s 55 of the Industrial and Provident Societies Act 1965 (IPSA 1965). However, the new rescue procedures only applied to companies because the definitions in the Insolvency Act 1986 did not extend it to societies. For the same reason, the company director disqualification provisions introduced by the Company Director Disqualification Act 1986 as part of the same insolvency reform package did not apply to society directors.

The 1986 changes introduced an accidental and unplanned difference in approach between companies and societies. The Insolvency Act 2000 compounded that problem by replacing, in most cases, the procedure of administrative receivership for insolvent companies subject to a floating charge with the administration procedure. That legislation also removed the need for a court order to place a company in administration and introduced the voluntary system of undertakings by delinquent directors in disqualification cases, which made disqualification cheaper and easier to achieve.

That meant that the corporate rescue procedures available to companies, the disqualification of directors after an insolvency, and the replacement of a receiver with duties to an appointing creditor by an administrator with duties to all creditors did not

[180] Industrial and Provident Societies and Credit Unions (Arrangements, Reconstructions and Administration) Order 2014, SI 2014/229 ('ARA Order') came into force on that date.

apply to insolvent societies. A company might be rescued with the help of the moratorium available under the administration procedure and the public could be protected from a repeat of the misconduct of its directors. Only liquidation and the remedies of fraudulent and wrongful trading were available in the case of insolvent societies.

That anomaly was confirmed in a number of cases. It was held that a society is not to be wound up as an unregistered company but under the provisions applied by what is now s 123 of the CCBSA 2014.[181] Similarly, under the Insolvency Act 1986, a society is not a company for the purpose of the date at which the identity of its preferential creditors are ascertained.[182] The receiver appointed by a society's floating charge holder was not an 'administrative receiver' under the Insolvency Act 1986 but rather a receiver under common law rules applicable before 1986. Furthermore, the 2000 reforms replacing administrative receivers with administrators in most cases involving companies did not apply to societies. Ironically, the finding that the administration procedure did not apply to societies was supported by the argument that Parliament must have intended that since it had empowered HM Treasury to change the position by order under s 255 of the Enterprise Act 2002.[183] That power was not used until 2014.

The ARA 2014 was made under s 255 of the Enterprise Act 2002 and came into force on 6 April 2014. Section 118 of the CCBSA 2014 consolidated the power to make such regulations. The ARA 2014 continues to apply to societies after the 2014 consolidation by virtue of the CCBSA 2014 transitional provisions.[184] The application of the Company Directors Disqualification Act 1986 from 6 April 2014 is similarly continued by the CCBSA 2014.[185]

12.8.2. Receivership and administration procedure

A society, whether operating in England or Scotland, can give security by way of a floating charge, which can be 'recorded' (or registered) under CCBSA 2014 and a receiver can be appointed as one method of enforcing the charge.[186]

However, if the charge was created by the society on or after 6 April 2014, no administrative receiver can be appointed by the floating charge holder.[187] Instead they can appoint an administrator without applying to court.[188] An administrative receiver is defined in CCBSA 2014 (for the purpose of preventing their appointment) as a receiver or manager of the whole or substantially the whole of the society's property appointed by or on behalf of the holder of a floating charge, or a person who would be but for the appointment of some other person as the receiver of part of the society's property. That means a receiver of part only of the society's property can still be appointed under a fixed charge eg as a remedy for default where a mortgage is given over a building owned by the society.

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181 *Re Norse Self Build Association Ltd* (1985) 1 BCC 99,436.
182 *Re Devon and Somerset Farmers Ltd* [1994] Ch 77.
183 *Re Dairy Farmers of Britain* [2009] EWHC 1389 (Ch) [37].
184 CCBSA, s 150 and Sch 5 paras 1 and 5.
185 See Sections **2.1.9.** and **7.6.** above.
186 CCBSA 2014, ss 59–66 and see Sections **8.4.3. to 8.4.5.** above.
187 CCBSA 2014, s 65.
188 Insolvency Act 1986, s 8 and Sch B1, para 14 applied by ARA Order, art 2(2).

The administration procedure does not apply to a society that is a private registered provider of social housing or registered as a social landlord under Part 1 of the Housing Act 1996 or under Part 2 of the Housing (Scotland) Act 2010.[189] In the case of a social landlord, the old system applies and a receiver will be appointed even if they come within the administrative receiver definition. The policy behind that is to preserve borrowing for those societies at a lower interest rate reflecting the inability of an administrator to interfere with the rights of the charge holder in any way. A receiver has no such power and owes duties only to the appointing creditor. An administrator owes duties to all creditors.[190]

In the case of a floating charge created before 6 April 2014, the holder of the charge has a choice to appoint either a receiver or an administrator. Since administration is the commonest procedure for companies and has applied to them since 2000, it seems likely that most banks (the main holders of floating charges) with a floating charge over society assets will apply their usual procedures and appoint an administrator. Appointing a receiver in a few rare cases will involve increased costs since the procedure may well have become uncommon.

To add to the complexity, if a receiver is appointed, their powers would seem to be defined only by the document granting the floating charge. The receiver will not be an 'office-holder' and ss 230–237 of the Insolvency Act 1986 will not apply to him or her. Sections 28–49 of the 1986 Act dealing, among other things, with appointment procedures, the delivery of accounts, reports and returns and the powers of receivers and administrative receivers, are probably inapplicable to the receiver of a society. The only statutory provision specifically relevant to the receiver as such is s 66 of the CCBSA 2014, which requires him or her to notify the FCA of his or her appointment and to send returns every six months culminating in a final return at the end of the receivership. Section 255 of the Enterprise Act 2002 and its successor, s 118 of CCBSA 2014, do not give HMT power to apply Part III of the Insolvency Act 1986 to societies.

Many of the inapplicable provisions of the Insolvency Act 1986 will be replaced by similar provisions in the document granting the charge holder power to appoint a receiver. This will be particularly true of the status of the receiver as agent of the society and the powers he or she is likely to have to run the business and to sell it as a going concern or as separate assets to raise the amount needed to pay the debenture-holder. The duties of the receiver to the appointor, the society and the other creditors as laid down by the courts on the basis of his or her role as agent or fiduciary will be almost identical to those of the administrative receiver of a company as they depend on status, function and the terms of the document authorising the appointment and not on the statutory provisions of the 1986 Act.

In *Re Devon and Somerset Farmers Ltd*[191] it was decided that a society could not be regarded as a company for the purpose of receivership and that, as a result, s 40 of the Insolvency Act 1986 could not apply to give priority to preferential debts fixed by reference to the appointment of the receiver. In that case the society had gone into liquidation at a later date and it was decided that the preferential debts had to be fixed from that date. In many cases, these complications make the appointment of an administrator by a floating charge holder when the option is available even more likely,

[189] CCBSA 2014, s 65(4).
[190] Insolvency Act 1986, s 8 and Sch B1, para 3(2) applied by ARA Order, art 2(2).
[191] [1994] Ch 77.

unless the application of the anomalous rules applicable to society non-administrative receivership will benefit a creditor with the right to choose which procedure to use.

In addition to the floating charge holder, others can appoint an administrator. The appointment can be by court order on the application of the society, its directors or a creditor.[192] Out of court, the appointment can be made, as noted above, by a floating charge holder, but also by the society or its directors.[193] No appointment may be made when the society is already in liquidation and once the administrator is appointed the moratorium that prevents winding up and other enforcement measures begins and the control of the society is entirely in the hands of the administrator.[194]

12.8.2.1. Key adaptations of administration provisions for societies

For the general operation of administration, see company law or insolvency texts and refer to the Insolvency Act 1986 Sch B1. While the ARA order largely applies the rules about administration as they apply to companies, it is important to check the precise application set out in art 2 and Parts 1, 3 and 4 of Sch 1 of SI 2014/229 in the case of a society administration. Here only the main differences are noted.

12.8.2.1.1. Share of assets for unsecured creditors

This provision, which was first introduced by the Insolvency Act 2000, applies a formula to give limited priority to unsecured creditors over holders of a floating charge in respect of a 'prescribed part' of the funds available to creditors. In the case of a company, that applies on liquidation, administration and receivership.[195] For societies, it is applied to a society in administration but not to one subject to receivership.[196] It will apply to a society in liquidation by virtue of s 123 of CCBSA 2014.

Other provisions dealing with the relationship between administration and liquidation, such as the rights of preferential creditors, power to set aside transactions, the duty of society officials and others to co-operate with the administrator and liquidator, and the power to inquire into the society's dealings, are applied to societies in administration.[197]

12.8.2.1.2. Societies with FSMA authorisation

In the case of any society authorised under FSMA 2000, the rights of the Financial Services Compensation Scheme are protected as are the rights of the FCA and the PRA to place a society in administration or intervene in an administration and the duty of the administrator to report to the FCA and the PRA.[198]

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[192] Insolvency Act 1986, Sch B1 para 12 applied by ARA Order, art 2(2).
[193] Insolvency Act 1986, Sch B1 para 22 applied by ARA Order, art 2(2).
[194] Insolvency Act 1986, Sch B1 paras 42–44 and 59–64 applied by ARA Order, art 2(2).
[195] Insolvency Act 1986, s 176A.
[196] ARA Order, art 3.
[197] ARA Order, art 4.
[198] ARA Order, arts 5–10.

12.8.2.1.3. Appointment of an administrator by the court

The FCA can apply to court for an administration order as registrar of mutual societies under CCBSA 2014 and anyone applying for an administration order in respect of any society must notify the FCA of the application.[199]

12.8.2.1.4. The process of administration for societies

When a society is in administration, a key role of the administrator is to bring forward proposals for achieving the objective of the administration or an explanation of why it cannot be achieved.[200] The objective is fixed in the court order or out-of-court notice appointing the administrator. The objective can be: to rescue the society as a going concern; to achieve a better result for creditors as a whole than would be likely on winding up; or to realise property to distribute to preferential or secured creditors; or any combination of those purposes.[201]

The proposal must be sent to every creditor and member of the society. The provision applicable to companies is adapted so that the administrator may not propose anything that is contrary to the provisions of CCBSA 2014 or the Credit Unions Act 1979 (if applicable). In particular, unless the proposal is intended to have the effect that the society will cease to be registered under CCBSA 2014, any proposal that the society's rules be amended can be included only if the FCA has issued a statement to the effect that it would register the amendment as complying with CCBSA 2014. The copy of the proposal sent to society members must be accompanied by an invitation to a members' meeting to which the administrator's proposals will be presented. Just as 10% of creditors can insist on calling a creditors' meeting, so 10% of members can insist on calling a members' meeting.

The main adaptation of the administration procedure for societies is to give the members' meeting parity with the creditor's meeting in terms of approving varying or rejecting the administrator's proposals.[202] That, together with the requirement of FCA advance approval of suggested rule amendments, is intended to prevent the use of the administration procedure as a backdoor means of demutualisation. A society has to be insolvent to go into administration[203] and the rejection of the administrator's proposals by either members or creditors will not change that. However, the members have the chance to call 'foul' if, for example the administration appears to be a pre-pack already agreed with a waiting purchaser and initiated by society directors to that end.

If an administrator proposes to transfer its engagements, or amalgamate the society with either another society or a company or to convert it into a company, the procedures under ss 109–114 of the CCBSA 2014 apply and the same majorities are required as they would be for any other society. However, the confirmation by the second meeting of the resolution passed at the first one is treated as an approval of the administrator's proposal by a creditor's meeting for the purpose of the administration.[204]

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[199] ARA Order, art 2 and Sch 1 para 12.
[200] Insolvency Act 1986, Sch B1 paras 49–56.
[201] Insolvency Act 1986, s 8 and Sch B1 para 3.
[202] ARA Order, art 2 and Sch 1 para 18.
[203] Insolvency Act 1986, s 8 and Sch B1 paras 11, 16, 27 and 35(2).
[204] ARA Order, art 13.

12.8.2.1.5. Dissolution after administration

If after the administration of a society has run its course rescue has not been possible, the society may be placed in liquidation in which case it will be dissolved at the end of that process like a company.[205] However, if the administrator thinks there is no property to distribute to creditors he can issue a notice and trigger the dissolution of the society without prior winding up.[206]

12.8.3. Creditors' voluntary arrangements and schemes of arrangement

The procedures for a creditors' voluntary arrangement under Part 1 of the Insolvency Act 1986 provide a framework for creditors to agree an arrangement by special majority and make that binding on all the society's creditors. Without that statutory framework every single creditor would have to agree to vary their contractual rights. The society or its directors, or an existing liquidator or administrator of the society can make a formal proposal to launch a CVA.[207] However, if the proposal is made without the existing moratorium on the enforcement of debts that flows from liquidation or administration, it will in practice need to be accompanied by a moratorium under the Insolvency Act 1986 aimed at protecting smaller companies from the need to go into administration to seek a CVA.[208] Like an administration, this procedure is not available to societies operating as private registered providers of social housing or registered as social landlords.

Again, the procedures applied to societies by the ARA order are almost identical to those that apply to companies. The main adaptations are that any proposal for a CVA must enable the society to comply with its own rules and the provisions of the CCBSA 2014 and Credit Unions Act 1979 (if applicable) and must include as debts members' shares if the society is an authorised deposit taker and the shares are deposits.[209] The last point applies predominantly to credit unions. The moratorium without administration applies to any society not operating in the insurance or financial services fields (credit unions are excluded), which is not already in administration or liquidation, and, for societies, regardless of the size of the society or the scale of its business.[210]

Under the Part 26 of the Companies Act 2006, a procedure applies to companies permitting them, by a combination of court-ordered meetings of classes of shareholders or creditors, weighted voting by those groups at the meeting, and a final court approval of the scheme agreed, to make a binding compromise or arrangement between the company and its members or any class of them or the company and its creditors or any class of them. This can be used for corporate rescue or for restructuring. It applies to both solvent and insolvent companies. In the case of an insolvent society or company the CVA provides a faster and cheaper remedy if it is available and can achieve the desired results.

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[205] CCBSA 2014, s 123.
[206] CCBSA 2014, s 125 and ARA Order, Sch 1 para 31.
[207] Insolvency Act 1986, s 1.
[208] Insolvency Act 1986, s 1A and Sch A1.
[209] ARA Order, Sch 1 para 3.
[210] ARA Order, Sch 1 paras 6–8 applying a modified version of Insolvency Act 1986, s 1A and Sch A1 paras 1, 3 and 5.

Part 26 has applied to societies from 6 April 2014 with provisions to require FCA certification that it is not contrary to the society's rules or the provisions of CCBSA 2014 or CUA 1979 and to ensure that the FSCS, the PRA and the FCA are involved if the society is an authorised person.[211] Like administration and CVAs, this procedure is not available to societies operating as private registered providers of social housing or registered as social landlords.

This procedure is likely to be used only by large societies in complex situations in which no other procedure is available because it is expensive and slow.

12.8.4. Liquidation and dissolution

Section 123 of CCBSA 2014 provides for the winding up of a society either by a voluntary liquidation or by a winding-up order. A society is not wound up as an unregistered company but as a registered company using any of the procedures open to such companies.[212]

The liquidation (or winding up) of an insolvent society may be begun either by the society passing a resolution to begin a creditors' voluntary liquidation or by the court making a winding-up order on the petition of a creditor.[213]

Section 123 of the CCBSA 2014 provides that: 'A registered society may be dissolved on its being wound up in pursuance of an order or resolution made as is directed in the case of companies.' It then makes the necessary adaptations to achieve that:

- references to the registrar of companies are to be read as the FCA;
- a reference to a company registered in Scotland is to be read as a registered society with its registered office in Scotland;
- if the society is wound up in Scotland, the court having jurisdiction is the sheriff court whose jurisdiction contains the society's registered office;
- if a resolution is passed for voluntary winding up a copy must be sent to the FCA (and the PRA if the society is PRA authorised) within 15 days and a copy must be attached to every copy of the society's rules issued after it is passed;
- dissolution only occurs after the society's property has been dealt with and a certificate under s 126 of CCBSA 2014 submitted.

The liability of past and present members of a society wound up under the Insolvency Act 1986 is defined in s 124(2) of CCBSA 2014.

The most important provision is that no contribution can be required from a member in excess of any amount unpaid on his or her shares. Thus a member who has paid in full for the share capital that he or she holds can never have any liability for the debts of the society or the costs of the winding up. If there is such liability, then the other rules apply to protect former members from liability for debts incurred after their membership ceased (in the case of withdrawable share capital this is taken to be the date of application for its repayment) and from all liability once a year has lapsed from the cessation of membership.

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[211] ARA Order, art 2(3) and Sch 2.
[212] *Re Norse Self Build Association Ltd* (1985) 1 BCC 99, 436.
[213] See Section **12.2.** above.

As between current and former members, contributions must first be required from present members. In practice members will rarely be liable to make any contribution at all in a liquidation.

Subject to these modifications, the winding up of a society will follow the procedures applicable to a company and the powers, duties and role of the liquidator and of the creditors will be the same as they are in the case of a company. The liquidator can obtain a court order to set aside certain pre-liquidation transactions;[214] take proceedings against the directors or others for misfeasance, fraudulent or wrongful trading;[215] and the liquidator must be a qualified insolvency practitioner.[216]

[214] Insolvency Act 1986, ss 238–246.
[215] Insolvency Act 1986, ss 212–214 and see sSection **7.5.1.** to **7.5.3.** above.
[216] Insolvency Act 1986, ss 388–398.

CHAPTER 13

CREDIT UNIONS

A separate chapter is devoted to credit unions because they have their own special legislation in the form of the Credit Unions Act 1979 (CUA 1979). This is due to the need for special rules to ensure that these credit co-operatives adhere to rules that provide protection for their investor members and ensure that the special characteristics of credit unions are retained by organisations that use that name. The essential purpose of a credit union is to provide loans at modest interest rates to its members who are also its investors. This chapter deals only with credit unions registered in Great Britain and not with Northern Irish credit unions, which are subject to their own legislation but are also regulated under the FSMA 2000 regime.

13.1. LEGISLATION AND REGULATION

13.1.1. Credit union legislation

Credit unions are registered under CCBSA 2014 as applied to them by the CUA 1979. In addition, they are subject to the regulatory powers of the FCA and PRA under FSMA 2000 as amended by FSA 2012. The following list attempts to identify the main legislative provisions that apply to credit unions and gives the abbreviations used when referring to the legislation in the rest of this chapter.

13.1.2. The legislation listed

At the time of writing, in May 2014, the main legislation governing credit unions in Great Britain is as follows.

13.1.2.1. Primary legislation

- Credit Unions Act 1979 (CUA 1979):
  the main legislation governing the nature of credit unions as co-operatives;
- Financial Services and Markets Act 2000 (FSMA 2000):
  shifted the credit union registration function and their prudential supervision from the Registrar of Friendly Societies to the Financial Services Authority (FSA) and led to many specific provisions in CUA 1979 being replaced by rules and guidance made under powers conferred by this legislation;
- Financial Services Act 2012 (FSA 2012):
  transferred prudential regulation of credit unions to the Prudential Regulation Authority (PRA) and the registration function under CUA 1979 to the Financial Conduct Authority (FCA);

- Co-operative and Community Benefit Societies Act 2014 (CCBSA 2014):
  consolidated the law governing co-operatives and community benefit societies including credit unions, except to the extent that CUA 1979 and other specific legislation, provide to the contrary.

13.1.2.2. Secondary legislation

- Deregulation (Industrial and Provident Societies) Order 1996, SI 1996/1738 (1996 Deregulation Order):
  liberalised time-limits for annual returns and registration of charges;
- Financial Services and Markets Act 2000 (Mutual Societies) Order 2001, SI 2001/2617 (Mutual Societies Order 2001):
  transferred registration function to FSA;
- Financial Services and Markets Act 2000 (Consequential Amendments and Transitional Provisions) (Credit Unions) Order 2000, SI 2002/1501 (CATP 2002):
  implemented FSMA 2000 for credit unions;
- Regulatory Reform (Credit Unions) Order 2003, SI 2003/256 (2003 RRO):
  amended CUA 1979 to allow charges for ancillary services, change provisions on names and modify common bond provisions;
- Mutual Societies (Electronic Communications) Order 2011, SI 2011/2687 (Electronic Communications 2011) as amended by SI 2014/184 from 4 April 2014:
  facilitates electronic communication with the FCA and credit union members;
- Legislative Reform (Industrial and Provident Societies and Credit Unions) Order 2011, SI 2011/2687 (2011 LRO):
  relaxed the common bond requirements; permitted, within limits, corporate membership; permitted the use of deferred shares; clarified the rules governing share withdrawals by members with loans; permitted the issue of interest bearing shares; fees in excess of cost to be charged for ancillary services; and increased the limit on interest by way of dividend paid on member shares;
- Credit Unions New Sourcebook (CREDS);
  http://fshandbook.info/FS/html/handbook/CREDS: contains rules, guidance and evidential provisions issued by the FSA and issued by or adopted by the Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) under Part IXA of FSMA 2000 as substituted by FSA 2012;
- Financial Services Act 2012 (Mutual Societies) Order 2013, SI 2013/496 (Mutual Societies Order 2013):
  gave effect to the transfer of the registration function from the FSA to the FCA and of the prudential regulation function from the FSA to the PRA;
- Credit Unions (Maximum Interest Rate on Loans) Order 2013, SI 2013 /1276:
  increases the maximum permitted rate of interest that credit unions can charge on loans (set at 1% by s 11(5) CUA 1979) from 2% per month (which was the limit set from 2006 by SI 2006/1276) to 3% per month from 1 April 2014;
- Co-operative and Community Benefit Societies and Credit Unions (Investigations) Regulations 2014, SI 2014/574 (2014 Investigations Regs):
  brings FCA investigation powers in respect of co-operatives and community benefit societies into line with the powers of BIS in respect of companies;
- Industrial and Provident Societies and Credit Unions (Arrangements, Reconstructions and Administration) Order 2014, SI 2014/229 (ARA 2014):
  applied administration procedure, creditors' voluntary arrangements and reconstructions to co-operative and community benefit societies.

13.1.2.3. European legislation

- Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 on credit institutions (CRD):
  credit unions enjoy exemption under art 2;
- Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008:
  on credit agreements for consumers as applied in the UK provides 'light touch' regulation for credit unions under art 2.5.

13.1.3. Registration under CCBSA 2014 and Part 4A FSMA permission

As deposit-takers with permission under Part 4A of FSMA 2000 as amended by FSA 2012, credit unions are subject to rules and guidance from the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA). The FCA's regulatory role is in addition to its role as registrar of credit unions as co-operatives registered under CCBSA 2014. A credit union must have applied for permission to operate as a deposit-taker and both the FCA and the PRA must be satisfied that it satisfies, and will continue to satisfy, the FSMA threshold conditions, which ensure that all credit unions are and remain subject to the FSMA deposit-taking regime.[1]

Through the CATP 2002, much of the CUA 1979 was replaced with the rules and guidance to be found in the credit unions specialist source book of the Financial Services Authority (FSA) (CRED, later CREDS). After the role of the FSA was split between the PRA and the FCA by and under FSA 2012, CREDS was effectively adopted by the FCA and the PRA in their rule books and the rules and guidance contained in it continued in force with indications in CREDS of which agency is responsible for each provision.

In due course, CREDS may well be replaced by the PRA and the FCA but for the purpose of this chapter reference is made to the CREDS as issued by the FCA and the PRA in April 2014 as Release 148 taken from the Combined View section of the PRA and FCA online Handbooks produced to assist the transition from the FSA to the two separate agencies. That version is used for all references in this chapter.[2]

Some limits on, for example, lending by and shareholding in credit unions and requirements for reserves previously contained in CUA 1979 are now dealt with in CREDS and often offer greater flexibility than was permitted under CUA 1979. Such limits are only outlined in this chapter. More detail can be found in CREDS but the regulatory rules and guidance that make up CREDS are always subject to change by either the PRA or FCA and it is important to check the latest version of the PRA and FCA Handbooks when seeking information.

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1 CUA 1979, s 1(1)(d)–(f).

2 See http://fshandbook.info/FS/html/handbook/CREDS and was visited for the purpose of this chapter on 13 April 2014.

13.1.4. Version 1 and version 2 credit unions

With regard to lending limits and capital requirements, there are two types of credit union – version 1 and version 2. Version 2 credit unions are equivalent in many ways to the 'approved credit unions' created by the 1996 Deregulation Order that preceded the move to regulation under FSMA 2000.[3]

The version 1–version 2 distinction operates mainly for the purpose of the capital requirements and the permitted level of lending to members laid down by the PRA under FSMA 2000. The distinction between them is based on the ratio of their risk adjusted capital to their total assets and, for new credit unions, their initial capital. For a version 2 credit union the risk adjusted ratio must be at least 8% and the initial capital at least £50,000.[4] Version 1 credit unions are subject to provisions that vary according to their size and to transitional provisions running from 2011 to 2014 but, after transition, will be subject to a minimum ratio of 3%.[5] The risk-adjusted capital ratio excludes members' withdrawable share capital but includes reserves, subordinated debt and deferred shares, subject to detailed provisions set out in CREDS 5.2.

The main purpose of this classification system is to deal with liquidity issues by limiting loans by a version 1 credit union to a member to a fixed amount in excess of the share capital in her account. The exact limit depends on the capital to assets ratio achieved by the particular version 1 credit union. A version 2 credit union is permitted an alternative ceiling on loans related to its total non-deferred share capital. The period over which either a secured or an unsecured loan is repayable is also more liberal for a version 2 credit union.[6] In both cases, lending is also subject to the requirement that the credit union have an appropriate lending policy, makes suitable provisions for bad debts, and avoids large exposures to particular members.[7] For other provisions on credit union liquidity see CREDS 6.

Regulatory scrutiny is stricter for version 2 credit unions, but this is also the case for larger version 1 credit unions and those engaged in a broader range of activity – supervisory lines are not drawn on the basis of a credit union's version alone.

13.1.5. Liberalisation of credit union law

Credit unions are open to restricted groups of individuals and organisations, but there is no longer a requirement for all people qualifying for membership of a credit union to meet the same requirement of, for example, residence, employment or affiliation.[8]

This change to the common bond and admission of members to credit unions was one of a number of significant changes introduced by the LRO 2011. Other significant changes introduced by LRO 2011 included the removal of restrictions on corporate bodies becoming members of credit unions, provision for charges for ancillary services provided by credit unions, the introduction of new classes of shares such as deferred shares and

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3 CUA 1979, ss 11B to 11D inserted by 1996 Deregulation Order, art 7 and repealed by FSMA 2000, Sch 22, para 1.
4 CREDS 5.4.
5 See CREDS 5.3. and TP1.
6 See generally CREDS 7.3.
7 See CREDS 7.2, 7.4 and 7.5.
8 See Section **13.3.2.** below.

interest-bearing shares and clarification of the rules about attached shares. In addition, many of the changes to general co-operative and community benefit society law such as changes to the minimum age for membership, the publication of unaudited interim accounts and the dissolution of dormant societies also apply to credit unions. Those matters are dealt with below.

13.2. REGISTRATION AS A CREDIT UNION

13.2.1. Use of name

Section 3(2) and (3) of CUA 1979 contain restrictions on the use of the words 'credit union' or 'undeb credyd' the Welsh equivalent. Only three types of person are allowed to use a 'name title or descriptive expression' that contains the words 'credit union' or 'undeb credyd' or a cognate or derivative term or to represent themselves to be a credit union:

- a society registered under CCBSA 2014 as adapted by CUA 1979; or
- an officer or employee of a credit union using a title or description indicating his or her office or post within the society; or
- an association or group of credit unions using a name approved in writing by the FCA.

Every society registered as a credit union must have a name containing those words or, if its rules state that its registered office is to be in Wales, either those words or 'undeb credyd'.[9] The objects of a credit union are not to be regarded as wholly charitable or benevolent for the purpose of s 10(4) CCBSA 2014 so such a society can never be allowed to drop the word limited from its name.[10] Some credit unions choose to use a trading name (which must be approved by the FCA). This may not include the words 'credit union' and s 11 of CCBSA 2014, which requires the registered name to be displayed, applies.

13.2.2. Basic requirements for registration

The rules dealt with in **Chapter 3** apply to the registration of a credit union except where the CUA 1979 lays down a provision to the contrary.[11]

Section 1(1) of CUA 1979 lists the conditions to be met for the registration of a society as a credit union.

- the objects of the society must be those, and only those, of a credit union;[12]
- the society must have at least 21 members.[13]
- the requirements of s 1A (common bonds appropriate to a credit union) and, where applicable, s 1B (further requirements where common bond relates to locality) must be met;[14]

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9 CUA 1979, s 3(1).
10 CUA 1979, s 3(4).
11 CUA 1979, s 1.
12 CUA 1979, s 1(2) and see Section **13.4.1.** below.
13 CUA 1979, s 1(1)(aa) inserted by CCBSA 2014, Sch 4, para 2(b) and see Section **13.5.1.** below.
14 CUA 1979, s 1(2) and see Section **13.3.2.** below.

- the rules of a credit union must be in the form that the FCA lays down, deal with the matters mentioned in Sch 1 of CUA 1979 and contain any additional provisions required by the FCA;[15]
- the society's registered office is to be situated in Great Britain;[16]
- the society must have applied for permission under Part 4A of the FSMA 2000 to accept deposits;[17]
- both the FCA and the PRA must be satisfied that the society will satisfy and continue to satisfy the threshold conditions (within the meaning of s 55B(1) of the FSMA 2000) for which each regulator is responsible in relation to the regulated activity of accepting deposits.[18]

The FCA acts as the registrar, but the CUA 1979 has been updated to ensure that the PRA has its say on whether a credit union can be registered. Sections 1A–1D of CUA 1979, inserted by Sch 6, para 2(3) of the 2013 Mutual Societies Order, set out the process by which the FCA and PRA share information and liaise on the registration process.

The definition of a 'credit union' for the purpose of the CUA 1979 is a society that is registered under the CCBSA 2014 by virtue of s 1 of CUA 1979.[19] A society whose objects are wholly or mainly those of a credit union may be registered under the CCBSA 2014 only if it has complied with the requirements for registration as a credit union.[20] Section 2 of CUA 1979 makes necessary adaptations to CCBSA 2014 for the registration of credit unions.

As noted above in the discussion of version 1 and version 2 credit unions, CREDS also lays down minimum capital requirements for the registration of a credit union. The PRA, by legally binding rule, requires every credit union to have adequate initial capital taking into account the nature, scale and complexity of its business and expected early expenses.[21] For a version 1 credit union, an initial capital of less than £10,000 may be relied on by the PRA to establish a breach of that requirement. For a version 2 credit union the figure is £50,000.[22] 'Initial capital' broadly means assets less liabilities at the time at which the credit union is given Part 4A FSMA permission to accept deposits.[23]

There are four sets of Model Rules in circulation in Great Britain: the Association of British Credit Unions Ltd (ABCUL), ACE Credit Union Services (ACE), the Scottish League of Credit Unions (SLCU) and UK Credit Unions Ltd (UKCU). All produce Model Rules for their members' use. The Model Rules of ACE and UKCU are very similar and there are limited differences between all of the sets of rules. In later sections of this chapter their provisions are considered when relevant to the topic discussed.

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15 CUA 1979, s 4 and see Section **13.4.1.** below.
16 CUA 1979, s 1(1)(c).
17 CUA 1979, s 1(1)(d).
18 CUA 1979, s 1(1)(e)–(f).
19 CUA 1979, s 31.
20 CUA 1979, ss 2(3) and CCBSA 2014, ss 2(4) and 4(3).
21 CREDS 5.3.6.R and 5.4.3 R.
22 CREDS 5.3.7. and 5.4.3.
23 CREDS 5.2.1 R.

13.3. THE DEFINITIVE FEATURES OF CREDIT UNIONS

13.3.1. Objects

Unlike other co-operative or community benefit societies or companies registered under the Companies Act 2006, credit unions have objects fixed by the CUA 1979 that have to be followed by all credit unions. They cannot be reduced, added to or changed. It is a condition of registration that those objects and only those objects are stated in the rules of the society.[24] Since the common law ultra vires rule and the statutory rules about the effects of acting outside the objects apply to credit unions as they do to other societies (see **Chapter 11**), this effectively limits the scope of their activities, subject to protection for certain outsiders unaware of the breach of the objects rule.

The permitted objects are set out in s 1(3) CUA 1979. They are:

> '(a) the promotion of thrift among the members of the society by the accumulation of their savings;
> (b) the creation of sources of credit for the benefit of the members of the society at a fair and reasonable rate of interest;
> (c) the use and control of the members' savings for their mutual benefit; and
> (d) the training and education of the members in the wise use of money and in the management of their financial affairs.'

However, references to members in the objects do not include corporate members.[25]

Rule 3 of all the Model Rules set out the statutory object in full. Rule 5 of the ABCUL Model Rules and rule 4.2 of the ACE Model Rules set out the powers of the credit union so as to allow the society to do 'all things necessary or expedient for the accomplishment of its objects'. This follows the usual practice of co-operative and community benefit societies (see **Chapter 11** for a full discussion of powers and objects).

13.3.2. The common bond

This requirement is unique and sets credit unions apart both from other societies and other financial services providers. In the original version of CUA 1979 all members of a credit union were required to have something in common, such as residence, employment or membership of a specific association. Since art 13 of LRO 2011 added new ss 1A and 1B to CUA 1979, multiple common bonds have been permitted.

Credit union rules must restrict admission to membership to persons (individual or corporate) who fall within one or more of the common bonds and may lay down additional membership qualifications.[26]

Most of the common bonds within CUA 1979 prior to the introduction of the LRO 2011 still apply. But changes to the structure of common bonds have been introduced.

The common bonds are:

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[24] CUA 1979, s 1(2)(a) and 1(3).
[25] CUA 1979, s 3ZA inserted by LRO 2011, art 12(3).
[26] CUA 1979, s 1A(1) added by LRO 2011, art 13.

- following a particular occupation;
- being employed by a particular employer;
- residing or being employed in a particular locality;
- being a member of a bona fide organisation or being otherwise associated with other members of the society for a purpose other than that of forming a society to be registered as a credit union;
- any other common bond for the time being approved by the FCA.[27]

These can now be combined, for example, so that a credit union could serve people working in a particular trade as well as people living or working in a certain city. There is no limit to the number of common bonds that can be combined.

There are, however, limitations on the number of people who could potentially qualify for membership of any credit union with a common bond that has some connection to locality.

That was introduced at the same time as the relaxation in common bonds and was designed to ensure that credit unions would be allowed to grow, but would remain as membership organisations. The view was also taken that, without a restricted membership, credit unions could be viewed as more akin to co-operative banks, and be subject to far more onerous regulation from the European Union.

Where locality forms any part of the common bond, a credit union's potential membership is restricted to two million, or such higher figure as may be specified. It must also be 'reasonably practicable for every potential member to participate in votes of the society, serve on the society's committee and have access to all the services offered by the society'.[28]

These requirements can be extended to other common bonds. However, there is also some flexibility built in, with 'extraordinary circumstances' allowable to justify the registration of a society that exceeds these limits.[29] This has not been used in practice but could, perhaps, be used to justify the registration of a larger common bond where this would enable the rescue of a failing credit union.

Unlike the requirement about the objects of a credit union, some discretion is left to the FCA as it may approve a common bond other than those specifically listed in s 1A(2)(a)–(d).[30] In practice, the FCA relies on specimen wording published at the time of the introduction of the provisions by LRO 2011. The list under which the FCA approves common bonds has been pared down, with some of the narrower specific membership qualifications introduced since CUA 1979 was passed and before LRO 2011, for example to allow pensioners of companies to enjoy membership, or to include those who worship in a certain area, having been removed.

Much more stress is now placed on the flexibility given by the associational common bond. That common bond: 'Being a member of a bona fide organisation or being otherwise associated with other members of the society for a purpose other than that of

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27 CUA 1979, s 1A(2).
28 CUA 1979, s 1B (3).
29 CUA 1979, s 1B (2)(b).
30 CUA 1979, s 1A(2)(e).

forming a society to be registered as a credit union' was traditionally used by credit unions to register as a society for people joined together in, for instance a trade union or other pre-existing organisation.[31]

Individuals receiving a pension from a particular company, which was previously an approved common bond type of its own, can be brought into credit union membership by using the 'being otherwise associated'. There is no need for the individuals to be associated with other members of the credit union, or for this to be demonstrated. As long as a group of persons can be objectively identified as having an association, a membership common bond based on this can be added to the credit union membership rule, subject to FCA approval.

The FCA may accept a statutory declaration given by three members and the secretary of the society as sufficient evidence that the legal requirements as to common bonds have been met.[32] In particular, the FCA can also accept a statutory declaration as evidence that conditions have been met where the common bond relates to locality.[33]

Section 1A(4) outlines how different classes of corporate members qualify membership in each type of common bond and this is discussed in Section **13.5.3** below.

Rule 7 of ABCUL rules and rule 5 of the ACE rules allow for the common bond to be inserted, with map(s) if required.

13.3.3. No subsidiaries

A credit union cannot have any subsidiaries within the meaning of Part 7 of the CCBSA 2014 (see **Chapter 9** for that definition).[34]

13.4. CREDIT UNION RULES

13.4.1. Content of rules and examples from Model Rules

The CUA 1979 follows the pattern of CCBSA 2014 and previous legislation on co-operatives and community benefit societies by requiring the rules of any society registered as a credit union to deal with the matters set out in Sch 1 of the CUA 1979.[35] That schedule replaces the equivalent list in s 14 of the CCBSA 2014 and the FCA will only register a credit union if the listed matters are covered in the proposed rules.

Unlike s 14 of CCBSA 2014, the credit union list is not exhaustive. The FCA can decide that other provisions should also be included in the rules of a credit union.[36]

The text of the schedule is set out here in italics for ease of reference and is followed by brief remarks about each requirement, some discussion of the approach of the Model Rules and references to other parts of this chapter:

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31 CUA 1979, s 1A(2)(d) of.
32 CUA 1979, s 1A(5).
33 CUA 1979, s 1B(4).
34 CUA 1979, s 26.
35 CUA 1979, ss 1(1)(b) and 4(1).
36 CUA 1979, s 4(1)(b).

> 1. The name of the society which shall comply with section 3(1) above and with section 10(1) and (2) of the 2014 Act (name not to be undesirable and to end with the word 'limited').

Section **13.2.1.** above deals with the requirement of s 3 of the CUA 1979 that the words credit union form part of the name and **Chapter 3** deals with the provisions of the CCBSA 2014 on names. The effect of this paragraph is that societies registered as credit unions will almost invariably have a name containing the words 'credit union limited' or the Welsh equivalent.

This is covered by rule 1 of all the Model Rules.

> 2. The objects of the society

CUA 1979 lays down precisely what the objects of a credit union must be with virtually no scope for variation by individual societies.[37]

Rule 3 of all the Model Rules deals with this.

> 3. The place which is to be the registered office of the society to which all communications and notices to the society may be addressed.

This must be in Great Britain to comply with s 1(3) of CUA 1979. Separate legislation governs credit unions set up in Northern Ireland.

Rule 2 of ABCUL, ACE, UKCU and SLCU Model Rules deals with the initial location of the registered office and the power of the board or committee to resolve to change it with an obligation to register the change with the FCA as a rule amendment in accordance with s 16(3) CCBSA 2014.[38]

The Model Rules of ACE and UKCU also oblige credit unions to inform their national body of the change.

> 4. The qualifications for admission to membership of the society, including one or *more common bonds appropriate to a credit union*

This refers to the membership restriction and common bond rule and will be particular to each credit union.[39]

> 4A. The terms of admission to membership of the society, including any special provision for the insurance of members in relation to their shares.

In this area societies enjoy some flexibility about the content of their rules. The common bond qualification for the membership of the particular society, the procedures for admitting members, and a minimum shareholding requirement of a figure between £1 and £5 are all be dealt with in the society's rules.[40]

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37 See Section **13.3.1.** above.
38 See **Chapter 4** above.
39 See Section **13.3.2.** above.
40 CUA 1979, ss 5(2) and 7(1) and see Section **13.5.** below.

In common with other societies, the restriction on membership under the age of 16 was removed by the LRO 2011. Credit unions can now choose a minimum age for membership although officers must be over the age of 16.[41] This is provided for in rule 14 of the ABCUL Model Rules, rule 6.3 of the UKCU and ACE Model Rules and rule 9 of the SLCU Model Rules. For contractual and regulatory reasons, loans may not be made to persons under 18.

The question of insurance of members is addressed in each set of Model Rules, specifically rule 54 of the ABCUL Model Rules, rule 23 of the UKCU and ACE Model Rules and rule 25 of the SLCU Model Rules.

The issue of corporate members is dealt with in Section **13.5.4.** of this chapter. For Model Rule provisions on corporate members, see rules 8, 48 and 59 of the ABCUL Model Rules; rules 6.2, 16.3 and 27 of the UKCU and ACE Model Rules and rules 6.1, 22.2 and 30 of the SLCU Model Rules.

> 5. The mode of holding meetings, including provision as to the quorum necessary for the transaction of any description of business, and the mode of making, altering or rescinding rules.

This paragraph is similar to the equivalent provision in s 14 of the CCBSA 2014. For relevant CUA requirements see Section **3.6.1.** below and, subject to those differences, for the provisions governing societies generally see **Chapter 6**.

ABCUL Model Rules 78–97, ACE and UKCU Model Rules 40–50 and SLCU Model Rules 42–53 deal with meetings and rule amendments.

> 6. The appointment and removal of a committee, by whatever name, and of managers or other officers and their respective powers and remuneration.

This paragraph also resembles the equivalent provision of s 14 of CCBSA 2014. However, the provisions of credit union rules on this matter are subject to considerable regulatory oversight which is outlined in Section **13.6.2.** below.

The general rules dealing with officers, employees and the committee are to be found in ABCUL Model Rules 98–139, ACE and UKCU Model Rules 51–85 and SLCU Model Rules 54–84.

> 7. Determination (subject to any applicable rules made by the FCA or PRA under the 2000 Act) of the maximum amount of the interest in the shares of the society which may be held by any member.

This originally referred to limits within the Act but these limits became a matter for regulation in 2002. The current regulatory rules are outlined in Section **13.7.1.** below.

ABCUL Model Rule 47, ACE and UKCU Model Rule 19 and SLCU Model Rule 47 cover this, with reference other sums that may be agreed by the relevant authority (the PRA) to ensure any changes can be incorporated.

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[41] CCBSA 2014, s 31.

> 8. Provision for the mode of withdrawal of shares and for payment of the balance due thereon on withdrawing from the society.

The question of withdrawals of share capital is addressed by the 1979 Act and its provisions are discussed in Section **13.7.3.** below.

ABCUL Model Rules 51–3, ACE and UKCU Model Rule 18 and SLCU Model Rule 23 reflect these requirements.

> 9. The mode and circumstances in which loans to members are to be made and repaid, including any special provisions for the insurance of members in relation to loans made to them.

ABCUL Model Rules 56–68, ACE and UKCU Model Rule 25–32 and SLCU Model Rules 27–35 deal with these issues, which are now mainly covered by regulation. See paras 13.6.3. and 13.6.5. about loans and the insurance of loans.

In terms of governance safeguards in respect of lending, the ABCUL Model Rules proscribe the making of loans to officers, or their relatives, at a more favourable rate than is available to other members. The other sets of rules do not prohibit this specifically, but they do state that a loan policy must be developed which shall apply equally to all members. ACE/UKCU rules provide that a loan to an officer or employee cannot be made solely by a loans officer, and must be reported to the supervisor / supervisory committee within 14 days. ABCUL sets out similar processes in its rules.

On recovery, all the Model Rules give the credit union a lien over the shares of a member for debts due from that member and allow a set off of members' liabilities against all amounts standing to the member's credit. The rule extends s 35(2) of the 2014 Act to cover amounts due to members other than share capital.

Separate provisions apply for loans to corporate members, which are outlined in Section **13.9.2**.

> 10. Provision for the custody and use of the society's seal.

A seal is no longer a legal requirement so flexibility is given in ABCUL Model Rule 153, ACE and UKCU Model Rule 102, and SLCU Model Rule 99.

> 11. Provision for the audit of accounts by one or more auditors appointed by the society in accordance with the requirements of Part 7 of CCBSA 2014 and any applicable rules made by the FCA or the PRA under section 340 of the 2000 Act.

The rules governing society accounts and audits discussed in **Chapter 9** apply to credit unions as they apply to other societies but further requirements relating to credit unions now sit within regulation. CREDS 8.2 lays down the reporting requirements applicable to credit unions

ABCUL Model Rules 140–144, ACE and UKCU Model Rules 85–89 cover the appointment of an auditor, the auditor's entitlement to attend meetings, the availability of accounts and the filing of accounts.

> 12. Provision for the withdrawal of members from the society and for the claims of the representatives of deceased members or the trustees of the property of bankrupt members, or, in Scotland, members whose estate has been sequestrated, and for the payment of nominees.

This provision is similar to para 11 of s 14 of CCBSA 2014, with the exception that CUA 1979 appears not to contemplate a prohibition in the society's rules on the withdrawal of members. That is consistent with the nature of credit union shares as deposits.

ABCUL Model Rules 20–28 and 149–151; ACE and UKCU Model Rules 10–13 and 96–98; and SLCU Model Rules 11–15 and 94–95 deal with these issues.

> 13. Provision for—
> (a) terminating the membership of corporate members in order to comply with the limit on the number of corporate members (see section 5A above); and
> (b) the repayment of the shares held by a corporate member in any case where—
> (i) the membership is terminated to comply with the limit on the number of corporate members, or
> (ii) the shares must be repaid in order to comply with the limit on shares allotted to corporate members (see section 5A above).

To ensure that credit unions remain compliant with the limits set out in s 5A of CUA 1979, they must have procedures in place to bring the number of members, or the amount of non-deferred shares or loans, in line with the statutory requirements. The statutory rules are discussed in Section **13.5.4.** below.

ABCUL Model Rule 8 requires the board of directors to take all steps to reduce numbers below the statutory limit using a policy and procedure they should determine. It obliges the board to conduct an assessment of the impact to the credit union of expelling any particular corporate member when determining the policy for the expulsion of corporate members. SLCU Model Rule 6 is identical. ACE and UKCU Model Rule 10.3 takes a slightly different approach, requiring boards to bring the levels into compliance by expelling a sufficient number of corporate members, which were the latest to join and which only hold non-deferred shares.

> 13A. If the issue of interest-bearing shares is permitted, provision for converting such shares into shares which are not interest-bearing to comply with subsection (3) of section 7A above.

Interest-bearing shares must be converted to dividend-bearing shares if requirements in the Act (outlined in Section **13.7.5.3.** below) are no longer met or if the relevant annual report has not been submitted for two consecutive years. This is covered by ABCUL Model Rule 37, ACE and UKCU Model Rule 24 and SLCU Model Rule 18.3.

> 14. Provision for the dissolution of the society, including provision requiring any assets remaining after the payment of debts, the repayment of share capital and discharge of other liabilities –
> (a) to be transferred to another credit union; or
> (b) if not so transferred, to be applied for charitable purposes.

This provision ensures that any ultimate surplus remaining on the dissolution of a credit union is not distributable to individual members but must either be transferred to another credit union or used for charitable purposes. This contrasts with the position

under the CCBSA 2014 as no statutory limit is placed on the use of the surplus remaining on the dissolution of other societies.

ABCUL Model Rule 151, ACE and UKCU Model Rule 107, and SLCU Model Rule 104 make provision for this in line with CUA 1979.

13.4.2. The effect and status of credit union rules

The provisions of s 15 of CCBSA 2014 making the rules of a society contractually binding on all members and persons claiming through them apply to credit union rules.[42]

Section 23(2) of CCBSA 2014 also applies to credit unions. It provides that statutory requirements that the rules of a co-operative or community benefit society deal with particular matters do not affect the power of a society's rules to deal with any other matter, providing the rule is not inconsistent with any legislation or otherwise unlawful. This also applies to credit unions, but rules must be consistent with CUA1979, FSMA 2000, FSA 2012 or secondary legislation made under them.

13.5. MEMBERSHIP

13.5.1. Minimum number of members

The minimum number of members for a credit union is 21 rather than the three required for other co-operative and community benefit societies.[43]

13.5.2. Minimum age for membership

All the Model Rules also allow credit unions to specify a minimum age for membership, which has been permissible since the LRO 2011 removed the statutory minimum age for membership of co-operative and community benefit societies. However, due to restrictions on withdrawals of child trust funds and junior ISAs, the minimum age for membership is set at 18 for holders of these accounts.[44] The ACE and UKCU Model Rules specify, in addition, that the rights and privileges of membership shall be exercised by the young person's parent or guardian if they are below the age for membership.

13.5.3. Common bond membership requirement

The available common bonds are listed in Section **13.3.2.** above. Members must normally satisfy the qualification in the credit union's rules that defines the common bond applicable to that particular society.[45] However, an individual who lives in the same household as an existing member who is within the common bond and who is a relative of that member may become a member if the credit union's rules provide for this.[46] 'Relative' for this purpose means a spouse or civil partner of a member or a lineal

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42 See **Chapter 4**.
43 CUA 1979, s 6(1).
44 ABCUL Model Rules 13–15, SLCU Model Rule 9.
45 CUA 1979, s 1(2)(b).
46 CUA 1979, s 1A (3).

ancestor or descendant, sibling, aunt, uncle, nephew, niece or first cousin of the member or his or her spouse or civil partner and the spouse or civil partner of such a relative. In deducing these relationships illegitimate and step children are counted as legitimate children and former spouses or civil partners and reputed spouses or civil partners are counted as actual spouses or civil partners.[47]

Since the Deregulation (Credit Unions) Order 1996, SI 1996/1189 non-qualifying members (those who have left the common bond) have enjoyed the same rights as any other member. A statutory limit for non-qualifying members of 10% of total membership was repealed by the LRO 2011 and credit unions are now free to set their own limits within their rules.[48]

Where credit unions amalgamate or transfer engagements, the merged society or the one that accepted the engagements must count the non-qualifying members it receives as a result of the transformation as such if they do not fulfil the qualifications for membership of the new body.[49]

ABCUL Model Rules 11 and 12 and SLCU Model Rule 8 confirm the right of non-qualifying members to retain their membership and allow the credit union to specify a percentage limit. Model Rule 9 of the ACE and UKCU Model Rules defines a non-qualifying member and requires credit unions to specify whether non-qualifying members are allowed and, if they are, to what percentage limit.

Section 1A(4) of CUA 1979 sets out how corporate bodies, or people seeking membership of a credit union in the capacity of partner in a partnership or governing body member of an unincorporated association, qualify under different common bonds:

> In the case of an occupational common bond, the corporate body or other organisation is required to employ or otherwise engage people who follow that occupation or in fact relates to that occupation in some other way.
>
> For an employment common bond, the corporate body or other organisation must employ persons who qualify for membership or provide services or be otherwise related to their employer
>
> For a locality based common bond, it must have a place of business, or another significant connection with the locality
>
> For an associational common bond, it must be a member of the bona fide organisation or be otherwise associated with other members of the society for a purpose other than setting up a credit union.

13.5.4. Corporate members

Credit unions can accept corporate bodies as well individuals into membership if their rules provide for this.[50] Section **13.5.3.** (above) explains how the common bond requirement is applied to such members.

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47 CUA 1979, s 31(1).
48 SI 2011/2687, art 16.
49 CUA 1979, s 21(4).
50 CUA 1979, s 5A inserted by LRO 2011 SI 2011/2687, art 15(2).

A 'corporate member', in relation to a credit union, means:

(a) a body corporate that is a member of the credit union;

(b) an individual who is a member of the credit union in his capacity as a partner in a partnership; or

(c) an individual who is a member of the credit union in his capacity as an officer or member of the governing body of an unincorporated association.[51]

This allows unincorporated associations and general unregistered partnerships to be 'members' of a credit union through the credit union membership of an individual acting as a nominee and trustee for the individual or corporate members or partners who make up the association or partnership.

In the case of companies, building societies, incorporated friendly societies, co-operatives or community benefit societies and other entities with corporate personality, the legal person will be a member of the credit union. It will be represented at meetings or in voting by human agents but will be able to enter into loan contracts and hold shares itself. In the case of unincorporated organisations there is no legal person to hold shares, take loans or otherwise deal with the credit union and that will be done by individual or corporate members of the association or partnership acting as trustees or agents for the other partners or members. See **Chapter 1** for fuller explanation of the concept of incorporation.

Before LRO 2011, membership was restricted to individuals. There are limitations in place on corporate members: no more than 10% of members in a credit union can be corporate members and they must hold no more than 25% of non-deferred shares, as calculated from the most recent balance sheet submitted to the regulator.[52] Loans to corporate members must not exceed 10% of the aggregate of outstanding balances of all loans.[53] Those percentages can be changed by HM Treasury by order.

Model rule provisions creating mechanisms for a credit union to reduce the number of corporate members if the limit is breached are required by para 13 of Sch 1 to CUA 1979 and are discussed in Section **13.4.1.** above.

13.6. CREDIT UNION GOVERNANCE AND THE APPROVED PERSON AND SYSTEMS AND CONTROL REGIMES

13.6.1. Credit union meetings and voting

Chapter 6 deals with those issues for co-operative and community benefit societies in general and much of that discussion also applies to credit unions. As a result, apart from the fact that s 4(2) of the CUA 1979 requires a two-thirds majority for the amendment of the rules of a credit union (while CCBSA 2014 lays down no particular majority for other societies), credit unions have considerable freedom to lay down their own procedures for meetings.

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[51] CUA 1979, s 5A(6).
[52] CUA 1979, s 5A(2)–(4).
[53] CUA 1979, s 11(1A)(b).

CUA 1979 specifically lays down that every member should have a vote and (other than a chairman with a casting vote) not more than one vote.[54] This would, in any case, normally be an FCA requirement for the registration of any society claiming to be a bona fide primary co-operative society. CUA 1979 spells it out in statutory form.

13.6.2. Credit union committee or board: appointment, removal powers and regulatory issues

Chapter 7 deals with this for co-operative and community benefit societies in general and, again, much of that discussion applies to credit unions. However, for credit unions, unlike co-operative or community benefit societies outside the financial services sector, governance issues are also subject to the regulatory regime operated by the PRA and the FCA. The key areas relevant to a credit union's committee of management are the parts of the PRA and FCA Handbooks on approved persons (SUP10) and senior management arrangements, systems and controls (SYSC).

Under s 59 of FSMA 2000, credit unions must seek regulatory approval of the persons carrying out certain 'controlled functions'.[55]

In addition, CREDS 8.3. provides guidance for credit unions on how the functions referred to in SUP apply to them. Committee members are subject to the director and non-executive director functions and require approval accordingly for 'governing functions' (a type of 'significant influence function' under s 59 of FSMA 2000) within the organisation.[56] Anyone carrying out the chief executive role will require approval for that governing function, whatever title is used to describe their job.[57]

CREDS sets out the responsibilities of a credit union's 'committee of management' – which all the sets of Model Rules refer to as a 'board of directors'.

Under SYSC, credit unions are required:

> 'to have robust governance arrangements, which include a clear organisational structure with well-defined, transparent and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks it is or might be exposed to, and internal control mechanisms, including sound administrative and accounting procedures and effective control and safeguard arrangements for information processing systems'.[58]

More specifically:

> 'The committee of management should be competent to control the affairs of a credit union, and have an appropriate range of skills and experience relevant to the activities carried on by the credit union'.[59]

and:

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54 CUA 1979, s 5(9).

55 The detailed conditions and requirements for approval of persons carrying out such functions are to be found in the Supervisory Handbook SUP 10A (FCA) and SUP 10B (PRA) at http://fshandbook.info/FS/html/handbook/SUP.

56 CREDS 8.3.4G(1) and (2).

57 CREDS 8.3.4G(3).

58 CREDS 2.2.1G and see SYSC 4.1.1R.

59 CREDS 2.2.14G.

> 'it is the responsibility of each individual member of the committee of management to understand, and ensure that the credit union complies with, the requirements of all the relevant Acts, secondary legislation and rules.'[60]

SYSC 4.1.1R and CREDS 2.2.16G set out the responsibilities of credit union management committees in more detail.

All the Model Rules retain a similar wording regarding the suitability of persons to hold office. ABCUL Model Rule 104, ACE and UKCU Model Rule 54 and SLCU Model Rule 57 prohibit a person from acting as an officer, taking part in the management of the credit union or permitting their name to be put forward to election or appointment to office if: they know of any 'substantive' reason why they may not be regarded as fit and proper by the regulator; they are an undischarged bankrupt; are disqualified under the Company Directors Disqualification Act 1986; or have been convicted of any offence involving fraud or dishonesty.

All four sets of Model Rules take a slightly different approach to the governance structure of the credit union, with variations in the methods by which sub-committees are decided upon. ABCUL has a structure whereby a credit committee (if in existence) and supervisory committee is elected by the membership but the other models operate a more unitary board structure.

The credit committee was the traditional way in which credit unions made decisions about loans. In practice most credit unions now delegate these decisions, within policy, to loans officers – who are usually staff. All the Model Rules reflect this and do not require a credit union to have a separate credit committee in place.

Credit unions using ABCUL Model Rules are required to have a credit committee – which is elected by the members at AGM- unless a majority of members have supported a proposal at the AGM from the board of directors to disband it. The other Model Rules allow for the establishment of a credit committee but this need not be elected by the membership.

ABCUL Model Rules require a supervisory committee to be elected by the membership at the AGM. SLCU Model Rules require each credit union to have at least one supervisor – which is a committee if there are two or more – and for elections to determine who they are. The UKCU Model Rules are similar and allow for the election of either a single supervisor or supervisory committee.

The ACE Model Rules allow for a supervisory or supervisory committee to be elected, but give an extra option to the board, which is able to appoint either a supervisor or a supervisory committee without an election.

The Model Rules also deal with the responsibilities of directors and set out procedures for nominations, elections, meetings and establishing and running sub-committees.

In line with other societies, provisions in the Company Directors Disqualification Act have applied to credit unions from 6 April 2014.[61]

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[60] CREDS 2.2.15G.

[61] Company Directors' Disqualification Act 1986, s 22E inserted by Co-operative and Community Benefit Societies and Credit Unions Act 2010, s 3 commenced by SI 2014/183.

The provisions of s 27 of CUA 1979 preventing an undischarged bankrupt or a person with a conviction for an offence involving fraud or dishonesty from being a member of the committee of a credit union or involved in its management were repealed in 2002.[62] Since 2001 those matters have been dealt with under the approved persons regime now operated by the PRA.

13.6.3. Credit union accounts, audit, and reporting

The rules governing accounts and audits discussed in **Chapter 9** apply to credit unions as they apply to other societies but further requirements relating to credit unions now sit within regulation. CREDS 8.2 lays down the reporting requirements applicable to credit unions and should be consulted for full information about the reports required.

Regulation requires credit unions to have an internal audit function in place and this is reflected in all the Model Rules.[63] Each set of rules also stipulates that supervisors should be separate from the board of directors and not involved in the day-to-day running of the credit union, this being in line with regulatory requirements for the segregation of duties. How this is organised varies between the rules of the different trade associations and is the only area in which the rules of ACE and UKCU diverge.

13.7. SHARES AND DEPOSITS

13.7.1. Maximum limit on share accounts and junior saver deposits

Under the terms of CREDS, credit unions cannot accept more than £15,000 or 1.5% of the total non-deferred shares in the credit union, from any one member, with the higher figure applying in each case.[64] There is no limit on the amount of deferred shares that a member may hold. A member's interest in a joint account is, for this purpose, calculated on the assumption that each member owns an equal proportion of the joint account.[65] There are no limits on the number of people who may jointly hold an account with a credit union.[66] If the total of non-deferred shares in the credit union reduces so that an individual member holds more than the permitted maximum, there is no need for that member to reduce his or her shareholding.[67]

The limit for deposits from junior savers not held in a child trust fund is slightly lower, with each individual limited to saving a maximum of £10,000 or 1.5% of the total non-deferred shares in the credit union.[68]

13.7.2. Value of shares

Unlike other societies, the value of each share in a credit union is laid down by statute. Shares must be of £1 denomination and no share can be allotted until it is fully paid in

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62 Financial Services and Markets Act 2000 (Consequential Amendments and Transitional Provisions) (Credit Unions) Order 2002, SI 2002/1501, art 2(19).
63 See CREDS 2.2.8–2.2.11.
64 CREDS 4.1.2R.
65 CREDS 4.2.5R.
66 CREDS 4.2.4G.
67 CREDS 4.2.2R.
68 CREDS 4.3.1(2)R.

cash. However, the rules of a credit union may allow payment either in full or by periodic payments.[69] Rule 16.1 (ACE and UKCU) specifies that payment may be made be instalment. ABCUL and SLCU Model Rule are silent on this issue.

13.7.3. Withdrawal and attachment of shares

Non-deferred shares issued by a credit union are withdrawable but they must be subject to terms allowing the society to require not less than 60 days' notice of withdrawal.[70]

A member who, at the time of taking a loan, has paid up non-deferred share capital in a credit union equal to, or greater than, that member's total liability to the credit union as borrower, guarantor or otherwise, can apply to have the loan secured against her share capital.[71] If a member's shares are used as security for a loan in this way, the member must not be permitted to withdraw shares if her paid-up shareholding of non-deferred shares is, or following the withdrawal will be, less than her total liability to the credit union.[72]

The concept of 'attached shares' used as security for a loan to a member is also used to limit a member's outstanding loan balance. That is done by reference to the excess due on loans over the member's attached share capital. In the case of a version 1 credit union, the limit is £7,500 unless the credit union has a capital to asset ratio of at least 5% in which case the limit is £15,000.[73] In the case of a version 2 credit union, it is an excess of the greater of £15,000 or 1.5% of the credit union's total non-deferred share capital.[74]

Members are usually encouraged to continue to subscribe for shares while also repaying the loan that they have received.

These provisions are designed to protect credit unions from suffering collapse due to sudden large-scale withdrawals of capital. Section 11(1C) is intended to clarify the situation, as some credit unions were routinely allowing the withdrawal of shares. The definitions establishing whether shares are withdrawable allows the credit union and the regulator to assess the liquidity of the credit union.

Credit unions are required to report to the PRA on the level of shares which are attached, so that liquidity levels can be monitored.

As a general rule a credit union may not accept deposits except by way of subscription for its shares.[75] This again reflects the intention that credit union members should save by the purchase of shares and distinguishes credit unions from banks. Shares will be the most important source of funds for a credit union.

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[69] CUA 1979, s 7(1).
[70] CUA 1979, s 7(4).
[71] CUA 1979, s 11A.
[72] CUA 1979, s 7(5).
[73] CREDS 5.3.10R (1) and 7.3.2R.
[74] CREDS 7.3.6R.
[75] CUA 1979, s 8(1).

13.7.4. Deposits

For this purpose references to a deposit or accepting a deposit are to be read with s 22 and Sch 2 of FSMA 2000 and any relevant order made under that Act.[76] The most relevant brief definitions are to be found in FSMA and the Regulated Activities Order:

> 'a sum of money . . ..paid on terms:
> (a) under which it will be repaid with or without interest or a premium and either on demand or at a time or in circumstances agreed by or on behalf of the person making the payment and the person receiving it; and
> (b) which are not referable to the provision of property or services or the giving of security'.[77]

Apart from the possibility of receiving deposits by way of subscriptions for shares, it is possible for deposits to be accepted by a credit union from a person under the minimum age at which it is possible to join a credit union.[78] This age is determined by a credit union's rules. Limits on such deposits are no longer in the CUA 1979 and are now set by the regulator. CREDS 4.3.1(2)R sets the limit at the greater of £10,000 or 1.5% of the total of non-deferred shares in the credit union.

13.7.5. Classes of credit union share

A new class of shares – deferred shares – was introduced by the LRO 2011. Subject to certain conditions, credit unions can issue interest-bearing shares as well as dividend-bearing shares. Each class of shares is considered separately.

13.7.5.1. Non-deferred shares

These are the shares in credit unions that have always existed and are a particular type of the withdrawable share capital permitted by CCBSA 2014 and found in many co-operatives or community benefit societies as discussed in **Chapter 8**. In the case of credit unions those rules are subject to particular rules to accommodate the nature of these societies as savings and loans co-operatives.

Other than by nomination on the death of a member or transfer by operation of law on death or bankruptcy, non-deferred shares are not transferable and to prevent illicit transfers the issue of any share certificate is prohibited.[79] A credit union may to set a minimum shareholding requirement of not more than £5 for membership.[80]

CREDS 4.2.1R limits any member's interest in the total non-deferred shares of a credit union to the greater of £15,000 or 1.5% of that total.

ABCUL Model Rules 35 and 46, ACE and UKCU Model Rules 7 and 16, and SLCU Model Rule 10 allow an entrance fee of up to £5 to be charged and require a minimum fully paid shareholding of one £1 share.

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[76] CUA 1979, s 31(1A) as substituted by SI 2002/1501, art 2(20)(b).
[77] See FSMA 2000, Sch 2, para 22 and FSMA 2000 (Regulated Activities) Order 2001, SI 2001/544, art 5(2).
[78] CUA 1979, s 9(1).
[79] CUA 1979, s 7(2) and (3).
[80] CUA 1979, s 5(2).

Non-deferred shares are withdrawable subject to the safeguards described in Section **13.7.3.** above.

13.7.5.2. Deferred shares

Deferred shares were introduced by the 2011 LRO and the definition is broadly based upon that in the Building Societies Act 1986. The definition can be updated if it changes in the BSA1986.[81] Deferred shares are transferable to other members of the credit union but are withdrawable only in tightly defined circumstances.

An issue document must be provided to every applicant for shares and must contain the following information:

- a statement to the effect that the shares are deferred shares for the purposes of the Act;
- a prominent statement as to whether the shares are covered by the Financial Services Compensation Scheme;
- a term that prohibits the repayment of any principal to the shareholder except in case A or case B.[82]

The section then provides that case A is the winding up or dissolution of the credit union in circumstances where all sums due from the credit union to creditors claiming in the winding up or dissolution are paid in full.[83]

Case B is where the credit union applies to the PRA for consent to repay principal to the shareholder otherwise than in consequence of a provision in any of the issue documents that requires it to apply, grants it any benefit for applying or imposes a sanction against failure to apply, and the PRA grants consent.[84]

Because of the terms under which deferred shares are issued, they count as capital if they are subscribed for in full and the credit union must transfer a sum equal to the amount paid on those shares to its reserves.[85]

Deferred shares cannot count as security for loans.[86]

Because statutory and regulatory limits on the shareholding of both individual members and corporate members do not include deferred shares, they can offer a useful way for credit unions to bring more significant investment from corporate sponsors into a credit union. For instance, a start-up credit union could attract the investment needed to meet its capital requirements and its initial trading costs through deferred shares as an alternative to grant funding.

Deferred shares can be either dividend-bearing or interest bearing (see below), so there is scope for a holder of deferred shares to receive a return on their money.

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81 CUA 1979, s 31A(5).
82 CUA 1979, s 31A, added by SI 2011/2687, art 17(4).
83 CUA 1979, s 31A(2).
84 CUA 1979, s 31A(3).
85 CUA 1979, s 7(6).
86 CUA 1979, s 11A(1).

13.7.5.3. Interest-bearing shares

The power for credit unions to issue interest-bearing shares, in some circumstances, was also introduced by the LRO 2011. They offer a guaranteed return in the form of interest, rather than a share of any surplus as is the case with dividend-bearing shares, the traditional and usual form of credit union share capital. This allows credit unions to compete on a more level playing field with other savings providers and offer a more transparent savings offering to consumers.

A credit union must meet certain the requirements if it is to be able to issue interest-bearing shares and, if it fails to continue to meet the requirements, it must convert the interest-bearing shares to dividend-bearing shares.[87]

A credit union may issue interest-bearing shares if its rules permit it to do so and if:

- it has submitted its most recent year end balance sheet to the regulator and this shows that it holds reserves of at least £50,000 or 5% of its total assets, whichever is greater;
- it has submitted to the regulators a report on its balance sheet made by its auditors under s 87 of CCBSA 2014 on that balance sheet. The report must state that, in the auditors' opinion, the credit union satisfies conditions set out by the appropriate authority.[88]

The credit union must then submit an annual report from its auditors to the appropriate authority stating that the requirements continue to be fulfilled.[89]

Interest-bearing shares must be converted to dividend-bearing shares if these requirements are no longer met or if the relevant annual report has not been submitted for two consecutive years.[90]

The Treasury may vary the capital limits in this section by order.[91]

13.8. BORROWING BY CREDIT UNIONS

Credit unions have power to borrow money.[92] However, that power is subject to limits and constraints laid down by CREDS.

The borrowing of a version 1 credit union must not exceed, except on a short-term basis, an amount equal to 20% of the total non-deferred shares in the credit union.[93] If that limit is exceeded at the end of more than two consecutive quarters, that will be taken as evidence of a breach of that rule.[94] For a version 2 credit union the limit is 50% of the total non-deferred shares in the credit union without any qualification permitting

87 CUA 1979, s 7A, added by SI 2011/2687, art 19(1).
88 CUA 1979, s 7A(1).
89 CUA 1979, s 7A(2).
90 CUA 1979, s 7A(3).
91 CUA 1979, s 7A(4).
92 CUA 1979, s 10(1).
93 CREDS 3.3.3R.
94 CREDS 3.3.4E.

a higher level of borrowing on a short-term basis.[95] Subordinated debt counting as capital must not be counted towards these borrowing limits.[96]

To qualify as subordinated debt, a loan must meet a number of requirements including: the maturity of the loan must be more than five years from the date on which the loan is made; the claims of the subordinated creditors must rank behind those of all unsubordinated creditors including the credit union's shareholders; the subordinated debt must not become due and payable before its stated final maturity date except in defined circumstances and the debt must be unsecured and fully paid up.[97]

CREDS prohibits credit union borrowing from natural persons, except by subordinated loans qualifying as capital.[98]

Borrowing money, subject to regulatory limits, is listed as one of the responsibilities of directors in the ABCUL Model Rule 122s, ACE and UKCU Model Rule 67I and SLCU Model Rule 70s. Subordinated loans are not referred to separately.

13.9. LOANS, LAND, OTHER INVESTMENTS AND OTHER SERVICES

In addition to the provisions dealing with the sources from which the funds of a credit union may be obtained, there are rules on the uses to which those funds can be put.

13.9.1. Loans: the general rules

The limited objects imposed on credit unions by s 1(2)(a) and (3) of the 1979 Act restrict societies to only lending to their members who hold non-deferred shares. Detail within the Act on loan limits has been removed and now sits within CREDS. Each set of Model Rules requires the credit union to establish and maintain a loans policy and sets out what it should contain. This is in line with the requirements of CREDS 7.2.1A and 7.2.1B. The requirement that loans must be made 'for a provident or productive purpose' has been removed from the legislation but is retained within the SLCU rule book, though not within the Model Rules of the other trade associations.

Loans may be either secured or unsecured and the terms on which they are to be made are to be laid down in the society's rules.[99]

Section 11(1C) was inserted by art 18(2) of SI 2011/2687 (the 2011 LRO) to bring some clarity to the position of 'attached shares'. It provides that the terms of each loan not secured on 'attached shares' must contain provision as to whether, for the duration of the loan, shares can be withdrawn where the member's paid-up shareholding (excluding any deferred shares) in the credit union is, or following the withdrawal would be, less than his total liability (including contingent liability) to the credit union whether as borrower, guarantor or otherwise.

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[95] CREDS 3.3.5.R.
[96] CREDS 3.3.6R.
[97] CREDS 5.2.1(4)R.
[98] CREDS 3.3.1R.
[99] CUA 1979, s 11(1).

The original Act prohibited any withdrawals that would cause the member's liability to exceed his shareholding. The current provision was introduced in an attempt to introduce more certainty to the treatment of the shares of borrowing members, to reflect the changing business practices of credit unions, and to create a firmer base for assessing and reporting on the liquidity status of credit unions. Unattached shares, together with deposits from persons too young to be members, are counted as relevant liabilities for the purposes of calculating a credit union's liquidity ratio.[100]

The level of interest that may be charged on loans made by a credit union to its members is still subject to a maximum limit laid down in the Act. This remains within the Act at 1% a month on the reducing balance, or 'such other rate as may from time to time be specified'.[101] This limit has risen twice through secondary legislation: in 2006 to 2% a month on the reducing balance and in 2014 to 3% a month on the reducing balance.[102] The interest charged must include all administrative and other expenses incurred in connection with the making of the loan – so no separate charge can be imposed on borrowers that would mean the cost was more than the statutory maximum.[103]

The interest rate ceiling is one of the main factors that allows credit unions' main lending business to remain exempt from consumer credit regulation. So at the same time as the Credit Unions (Maximum Interest Rate on Loans) Order 2013, SI 2013/2589 raised the maximum rate that can be charged for a loan, the limit under which credit union borrower lender agreements are classed as exempt agreements for consumer credit purposes was also raised.

Credit union loans are not exempt in this way when they enter borrower–lender supplier agreements. That is when the loan is given to purchase an item from a supplier which is linked to the lender in some way. Some credit unions have a partnership with Co-op Electrical to supply goods to their members and credit unions offering this type of loan will need consumer credit permission from the FCA. Credit unions will also need consumer credit permission if they carry out other regulated activities, such as negotiating with creditors on their members' behalf.

13.9.2. Loan limits

Limits on loans were removed from CUA 1979 by FSMA 2000 and are now a matter for prudential regulation. Maximum loan terms are longer for version 2 credit unions (10 years for unsecured loans and 25 years for secured loans) than version 1 credit unions (5 and 10 years respectively).[104] In addition, the amount by which the member's liability on loans exceeds his or her attached share capital limits the amount that can be lent. In the case of a version 1 credit union, the limit is £7,500, unless the credit union has a capital to asset ratio of at least 5% in which case the limit is £15,000.[105] In the case of a version 2 credit union, it is an excess of the greater of £15,000 or 1.5% of the credit union's total non-deferred share capital.[106] Credit unions are also subject to maximum large exposure limits, both for single loans and aggregate loans.[107] Separate restrictions are in

[100] CREDS Appendix 1.1.
[101] CUA 1979, s 11(5).
[102] See SI 2006/1276, art 2 and SI 2013/2589, art 2.
[103] CUA 1979, s 11(5).
[104] CREDS 7.3.1. and 7.3.4.
[105] CREDS 5.3.10R(1) and 7.3.2R.
[106] CREDS 7.3.6R.
[107] See CREDS 7.4.

place for corporate members. Credit unions may only make a loan to a corporate member if the credit union's rules provide for this. Such a loan may not be made if it would increase the total of all loans to corporate members to above 10% of the outstanding balances of all loans made by the credit union.[108]

13.9.3. Land and other investments

Apart from the loans to members, which are the raison d'etre of credit unions, the regime governing these credit co-operatives restricts the forms of investment that they can make. In particular, their power to hold land is restricted by s 12 of CUA 1979. Such holdings are only permitted either to permit the credit union to conduct its business on the land in question or as a way of taking or enforcing security granted by members to whom loans were made.[109]

CREDS 3.2 restricts the possible investments permitted for the surplus funds of credit unions and funds serving liquidity purposes to cash, deposits with or loans to UK or EEA authorised deposit takers, and gilts with a short maturity date, subject only to exceptions for loans between credit unions. In addition, different limits in respect of the maximum permitted maturity period from the date of the investment apply to investments by version 1 credit unions (12 months) and version 2 credit unions (five years).[110]

Regulatory rules allow credit unions to make loans to other credit unions.[111] Regulatory restrictions on the length of investments also apply to inter-credit union loans, unless the loan is a subordinated loan.[112]

13.9.4. Ancillary services

Credit unions can charge a fee to a member or junior saver for providing an ancillary service or giving advice on those services.[113] An ancillary service is one that is ancillary to the activities of accepting deposits or providing loans.

Examples of such services are given in s 9A and include the making or receiving of a payment, issuing and administering means of payment and money transmission services. So, for example, while a credit union cannot charge a fee for allowing a member to withdraw shares, it can make a charge to a member for using a debit card. The range of ancillary services that can be provided is also limited by the statutory objects rule and the rule about the credit union's powers.[114]

The LRO 2011 relaxed this section so that, for members joining after 8 January 2012, a credit union can charge 'such fee as it considers appropriate for' an ancillary service, rather than charging only the cost price of providing that service.[115] Article 28 was

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[108] CUA 1979, s 11(1A) inserted by SI 2011/1687, art 15(3)(b).
[109] CUA 1979, s 12(1) and (3).
[110] CREDS 3.2.2R and 3.2.3R.
[111] CUA 1979, s 10(1).
[112] See CREDS 3.2.6G.
[113] CUA 1979, s 9A, inserted by RRO 2003, art 5.
[114] See Section **13.3.1.** and **Chapter 11** above.
[115] CUA 1979, s 9A(1) as amended by SI 2011/2687, art 20 and subject to art 28 transitional provisions.

added to limit increased charges to members who join after the LRO is in force as a result of concern expressed during the parliamentary scrutiny process.

13.10. PROFITS: COMPUTATION AND APPLICATION

Section 14 of CUA 1979 used to lay down detailed rules to be followed in the calculation and application of the profits of a credit union but all that remains is the maximum limit on the percentage dividend payable on the dissolution of the credit union. Calculations, provisioning and maintenance of reserves are all now dealt with in PRA rules.[116]

Credit unions Model Rules retain some of the repealed content of s 14 and also expand on the issue of the distribution of surplus. The sections all begin by stating that, in ascertaining the profit or loss of the credit union in any year of account, all operating expenses, including payment of interest, must be taken into account, and provision shall be made for depreciation of assets, for tax liabilities and for bad debts, which must be dealt with in line with PRA rules on provisioning in CREDS 7.5.

The rules all then expand on the powers of the credit union to distribute any surplus, once prudential requirements for the maintenance of reserves have been met, in line with the rules and guidance found in CREDS 5 on capital requirements.

Until the introduction of the 2011 LRO, credit unions were restricted to paying a maximum of 8% dividend to their members. This restriction now only applies to credit unions on dissolution and those credit unions which do not include a higher limit in their rules.[117] This change was made at the same time as the introduction of interest-bearing shares (see 13.7.5(c) above).

As there was no restriction on the payment of interest, it was considered unfair to retain the statutory 8% limit on dividend-bearing shares. Retaining the restriction in the event of credit union dissolution removes the risk that the committee or members of a well capitalised credit union could seek a dissolution in order to profit from the closure of the society.

Credit unions Model Rules retain some of the repealed provisions of s 14 and also expand on the issue of the distribution of surplus. So the committee may also recommend a rebate on interest paid on loans. For example, rules often provide that a credit union can distribute a payment for 'social, cultural or charitable purposes', so long as a dividend has been paid on dividend-bearing shares, a rebate on loan interest has been paid, and a voluntary contribution has been made to reserves.

All the rules state that any dividend or interest rebate may be placed to the credit of a member's share balance, and shall be so placed if there is any money due by them to the credit union in any way. Rules also state that a dividend or interest rebate cannot be paid if this payment would increase the shareholding above the maximum limit set by the regulator.

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[116] See CREDS 4.2.6R and 4.2.7G, CREDS 5 and CREDS 7.5.
[117] CUA 1979, s 14(4) as substituted by 2011 LRO, art 21.

Unless the committee has been given the authority by the members to declare interim dividends, members are asked to accept the recommendation from the committee at an AGM. The members cannot vote for a higher dividend than has been recommended by the committee.

All the Model Rules stipulate that dividends are only payable to those in membership at the time it is declared, and are paid in proportion to members who joined part way through the year in question.

The rules on computation and application of surplus are set out in ABCUL Model Rules 69–77, ACE and UKCU Model Rules 33–39 and SLCU Model Rules 36–41.

CREDS 4.2. allows credit unions to pay interim dividends but only permits the payment of different dividends on different accounts in certain circumstances.

A version 1 credit union may pay different dividends on different accounts only if it has a capital-to-total assets ratio of at least 5% and the payment of any of those dividends will not reduce the capital-to-total assets ratio to below 5% and may not pay interim dividends more than once a year.[118]

A version 2 credit union can pay different dividends on different accounts and pay dividends out of interim profits more than once a year.[119]

Junior account holders are not members of the credit union and their deposits are not classed as shares and so do not qualify for a dividend. They become adult members at the age specified in credit union rules

A lower maximum limit applies for junior savers than adult members under PRA rules. They can deposit a maximum of £10,000 or 1.5% of total shareholding in the credit union, whichever is the greater figure.[120]

13.11. INSURANCE, GUARANTEE FUNDS AND THE FINANCIAL SERVICES COMPENSATION SCHEME

Another requirement that has been removed from CUA 1979 and is now a matter for regulation is the insurance, usually referred to as fidelity bond insurance, that credit unions are required to have in place.

The insurance must cover losses and liabilities arising from the fraud or dishonesty of the officers or employees of the credit union up to prescribed limits.[121]

Credit unions may also offer insurance, either included in cost of the loan or at an extra cost, to individual members to provide some form of life insurance or protect against

[118] CREDS 4.2.6 R.
[119] CREDS 4.2.7G.
[120] CREDS 4.3.1 R.
[121] See CREDS 4.4.

their inability to repay the loan so long as the arrangements are approved by the regulator. That approval is conditional on the arrangements requiring further regulatory approval for any changes to them.[122]

Rules 23 and 31 of the ACE and UKCU Model Rules provide for the board of directors to enter into such arrangements. Rules 25 and 34 do the same in the SLCU Model Rules. The ABCUL rule book differs slightly as it talks about the requirement for boards to do this, for so long as it remains a condition of ABCUL membership. This requirement was removed from the ABCUL Association Rule Book in 2013 so, as with the other Model Rules, boards are not required to take up this insurance.

Credit union members and junior depositors are also protected by the cover (up to £85,000 at the time of writing) provided by the Financial Services Compensation Scheme in the event of the inability of a credit union to pay back deposits.[123] The cover excludes losses on deferred shares and subordinated loans.[124] Details of the Scheme, which is created by PRA rules made under s 213(1) of FSMA 2000 and art 2 of the Financial Services and Markets Act 2000 (Financial Services Compensation Scheme) Order 2013, SI 2013/598 are to be found in the Compensation part of the PRA Handbook (COMP).

13.12. ANTI-MONEY LAUNDERING (AML) RULES

Credit unions are subject to the Money Laundering Regulations 2007, SI 2007/2157.[125] In addition, they are subject to the general criminal offences concerning that activity in Part 7 of the Proceeds of Crime Act 2002.

The Joint Money Laundering Steering Group (JMLSG) has published specific guidance for credit unions which can be found at Part 4 of: http://www.jmlsg.org.uk/industry-guidance/article/guidance; but must be read with Part 1 of that Guidance which aptly summarises the obligations imposed on financial services organisations such as credit unions as follows:

- 'to apply Customer Due Diligence (CDD) measures (to identify/verify customers and to understand the nature and purpose of the proposed relationship);
- to maintain appropriate systems and controls for AML/CTF [Anti Money Laundering/Counter Terrorism Financing] purposes;
- to monitor customer transactions and activities;
- to report suspicious activity, both internally and, if appropriate, externally;
- to keep appropriate records, and train staff;
- to comply with the UK financial sanctions regime'.[126]

Specific regulatory guidance for credit unions includes the CREDS 8.3.5G(2) requirement that each credit union appoint someone to act in the capacity of money laundering reporting officer. In addition, CREDS 2.2.31G(2) requires any separate compliance function that a credit union establishes to deal with arrangements for the

[122] CUA 1979, s 16.
[123] COMP 5.3.1R(1).
[124] COMP 5.3.1R(2).
[125] SI 2007/2157, reg 3(1) and (2).
[126] JMLSG, Prevention of Money Laundering/ combating Terrorist Financing, 2011 Review Version Part 1 p 13.

detection prevention and reporting of money laundering and policy and procedures manuals should deal with the money laundering prevention function.[127]

13.13. POWERS OF THE FCA AND PRA

Sections 17 and 18 of CUA 1979 modify and strengthen the powers of the FCA under ss 105–107 of CCBSA 2014 to supervise and control credit unions.

Powers have been further strengthened over the years, by the application of the powers of the FCA and the PRA under FSMA 2000 and FSA 2012 to credit unions. The regulators can request a credit union board to apply to vary its permission or, if they resist this request, put in place procedures to vary the permission themselves. If a credit union's permission under Part 4A of the 2000 Act has been removed it may still exist as a society, but cannot function as a credit union since it no longer has permission to operate as a deposit-taker. A credit union that was insolvent would be declared in default by the Financial Services Compensation Scheme and procedures would be put in place to repay members.[128]

The most recent increase in powers is to be found in the Investigations Regulations 2014, which give the FCA powers in line with those of BIS under the Companies Act 2006 (see **Chapter 9**). In this chapter only the CUA 1979 powers are discussed.

The FCA or PRA have power by notice in writing to require a credit union or an officer or former officer of a credit union to produce to it any books, accounts, documents or other information relating to the business that it considers necessary to exercise its functions under the Act. Failure to comply with the notice is a criminal offence and the FCA or PRA can recover expenses.[129] These powers are over and above requirements of CREDS 8.2 that credit unions submit annual and quarterly returns that can be used in general information-gathering exercises or in pursuit of information about a particular situation or risk.

The FCA or PRA can appoint an inspector and or call a meeting of members if they are of the opinion that an investigation should be held into the affairs of the credit union for reasons connected to their role under CUA 1979 or CCBSA 2014.[130] These powers are separate from and additional to powers conferred by ss 106–107 of CCBSA 2014.

Section **13.14.2.** below deals with FCA and PRA powers to wind up a credit union.

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[127] CREDS 2.2.61G(8).
[128] Section **13.11.** above.
[129] CUA 1979, ss 17 and 17A.
[130] CUA 1979, s 18.

13.14. TRANSFORMATION AND DISSOLUTION OF CREDIT UNIONS

13.14.1. Transfers of engagements, amalgamations and conversions involving credit unions

The rules discussed in **Chapter 12** on the transfer of engagements and the conversion or amalgamation of societies apply to credit unions only with substantial modifications.

A credit union may only engage in transfers of engagements or amalgamations with another credit union.[131] A resolution for a transfer of engagements or amalgamation will not be registered if it would result in any violation of the CCBSA 2014 or CUA 1979 or would result in the creation of a credit union that did not meet the further requirements relating to locality. That decision is for the PRA in consultation with the FCA if the credit union is PRA authorised and for the FCA alone in other cases.[132]

A credit union can never convert itself into, amalgamate with, or transfer its engagements to, a company.[133]

If a company is to convert itself into a credit union, the requirements of s 23 of CUA 1979 (as amended by the Mutual Societies Orders 2001 and 2013) must be followed to ensure that the resulting credit union will comply with the CUA 1979, that any depositors have consented in writing to their deposits becoming credit union shares, and that the FCA is satisfied that CREDS requirements as to shareholding limits are met. The resulting credit union will have to meet the requirements for FSMA 2000 permission to operate as a deposit-taker. These requirements are in addition to those of ss 115–117 of CCBSA 2014.

13.14.2. Winding up, cancellation of registration, and dissolution of credit unions

Before ARA 2014, the only option for an insolvent credit union, like any other co-operative or community benefit society, was liquidation under the Insolvency Act 1986 as applied by s 123 of CCBSA 2014. As with other societies further options are now available including administration and company voluntary arrangements. **Chapter 12** deals with all of those procedures. At the time of writing the Bank Administration Procedure under Part 3 of the Banking Act 2009 did not apply to credit unions.

The rules in CCBSA 2014, discussed in **Chapter 12** dealing with the suspension or termination of a society's registration, apply to credit unions. However, they are applied with additional grounds for those steps. Section 20(1) of CUA applies ss 5–7 (cancellation of registration) and 8 (suspension of registration) of the 2014 Act to credit unions by including violation of the provisions of the 1979 Act and of the further requirements where common bonds relate to locality as grounds for these actions. It seems unlikely that these powers would be used when the regulators have direct powers over the operations of credit unions, as financial institutions.

[131] CUA 1979, ss 21(1) and (2).
[132] CUA 1979, s 21(3) and (3A) as altered by the 2011 LRO and the Mutual Societies Orders 2001 and 2013.
[133] CUA 1979, s 22.

In addition, the FCA may, within certain parameters and in consultation with the PRA, exercise the power to cancel the registration of a credit union under ss 5–7 of CCBSA 2014 if a credit union's permission has been cancelled or if it has received a warning notice under s 55Z of FSMA 2000. This procedure is detailed in s 20(1A)–(1E) of CUA 1979 as inserted by the Mutual Societies Order 2013.

Certain additional powers apply to the winding up of credit unions. The FCA or PRA can petition the court for the winding up of a credit union in consultation with each other. Again, voluntary or enforced variation of permissions would be a more likely path for a regulator in a situation where the cessation of a credit union's trading was seen as necessary.

The grounds for a winding-up petition by the regulators are:

(i) The credit union is unable to pay sums due and payable to its members or can only do so by defaulting on other obligations or accepting new subscriptions for shares. This appears to be directed at a present inability to pay rather than a prospective one but grounds (iv) or (v) may assist where future inability is likely. It is also probable that a violation of the legislation permitting action under ground (ii) will exist in such cases.

(ii) There has been a failure to comply with a provision of or direction made under CCBSA 2014 or CUA 1979.
The failure must have been 'in relation to that credit union'. Consequently, the failure cannot relate to another credit union or society but it need not be a failure by the credit union in question – it can be the failure of others so long as it relates to that credit union.

(iii) The further bonds relating to common bonds involving a connection with a locality are no longer met.

(iv) It appears to the regulators that the winding up of the credit union is in the public interest.
This ground might be used in situations in which the conduct of the business of the credit union has involved misrepresentations to members or potential members or other unethical or illegal practices that do not fall within conditions (i) to (iii) or only affect potential members who are not referred to in condition (v). The adverse effect of the society's operation on the wider financial system might also amount to a public interest ground but the limited size of most credit unions at present makes this an improbable threat.

(v) The winding up is just and equitable having regard to the interests of all the members of the credit union.
This wide ground for a petition seems to relate to members' interests and might include unfairness to certain groups of members arising from the decision-making process or decisions as to the application of profits which are not within grounds (i) to (iii).[134]

13.14.3. Surplus assets after solvent dissolution

Any surplus assets on the solvent dissolution of a credit union must be applied for charitable purposes if they are not transferred to another credit union.[135]

[134] CUA 1979, s 20(2) and (3) as amended by LRO 2011 and the Mutual Societies Orders 2001 and 2013.
[135] CUA 1979, s 4(1) and Sch 1, para 14.

APPENDIX

USEFUL CONTACTS

GOVERNMENT BODIES

Charity Commission
Charity Commission First Contact
PO Box 1227
Liverpool
L69 3UG
http://www.charitycommission.gov.uk/

Charity Commission for Northern Ireland
257 Lough Rd,
Lurgan,
Craigavon
BT66 6NQ
www.charitycommissionni.org.uk

Office of the Scottish Charity Regulator (OSCR)
2nd Floor
Quadrant House
9 Riverside Drive
Dundee
DD1 4NY
www.oscr.org.uk

International Labour Organisation (ILO) Co-operatives Unit
4 route des Morillons
CH-1211 Genève 22
Switzerland
http://www.ilo.org/coop

Financial Conduct Authority – Registrar of Co-operative and Community Benefit Societies
Mutual Societies Team
25 North Colonnade
Canary Wharf
London
E14 5HS
http://www.fca.org.uk/firms/firm-types/mutual-societies

HM Revenue & Customs – VAT, Gift Aid and other tax issues for charities or sports clubs
Charities Correspondence S0708
PO Box 205
Bootle
L69 9AZ
http://www.hmrc.gov.uk/charities/

Office for Civil Society – Government Department for charities, social enterprises and voluntary organisations
Cabinet Office
2nd Floor,
Admiralty Arch South Side,
The Mall,
London
SW1A 2WH
http://www.civilsociety.co.uk

GENERAL FEDERAL AND PROMOTIONAL BODIES

Co-operative Alternative Development Society
Unit 40A
NorthCity Business Centre
2 Duncairn Gardens
Belfast
BT15 2GG
www.coopalternatives.coop

Co-operative Development Scotland
Various sites in Scotland
www.cdscotland.co.uk
http://www.scottish-enterprise.com/microsites/co-operative-development-scotland.aspx

Co-operatives UK – UK Apex Association for Co-operatives
Holyoake House
Hanover Street
Manchester
M60 OAS
www.uk.coop

International Co-operative Alliance (ICA) – International Apex Body for co-operatives
Avenue Milcamps 105,
1030 Brussels,
Belgium
http://ica.coop/en

Wales Co-operative Centre – Co-operative Development in Wales
Y Borth
13 Beddau Way
Caerphilly
CF83 2AX
http://www.walescooperative.org/

SECTORAL BODIES

Education

Co-operative College – co-operative schools, courses, and education
Holyoake House
Hanover Street
Manchester
M60 0AS
http://www.co-op.ac.uk/

Employee Ownership

Baxendale Ownership – employee ownership supporting body
Ground floor,
43 Palace Street,
London S
W1E 5HL
http://www.baxendaleownership.co.uk/

Employee Ownership Association – promoting employee ownership
Brough Business Centre,
Skillings Lane,
Brough,
East Riding of Yorkshire
HU15 1EN
www.employeeownership.co.uk

Radical Routes – a radical Housing and Worker Co-op Mutual Aid Network
Radical Routes Enquiries
c/o Cornerstone Resource Centre
16 Sholebroke Avenue
Leeds
LS7 3HB
http://www.radicalroutes.org.uk/

Energy

Energy4All Limited – renewable energy
Unit 33, Trinity Enterprise Centre
Furness Business Park
Barrow-in-Furness
Cumbria
LA14 2PN
http://www.energy4all.co.uk

Sharenergy Co-operative Limited
The Pump House
Coton Hill
Shrewsbury
SY1 2DP
www.sharenergy.coop

Finance

Association of British Credit Unions Limited
Holyoake House
Hanover Street
Manchester
M60 0AS
www.abcul.org

Community Finance Development Association – social enterprises supporting communities
Unit 5, Angel Gate
320-326 City Road
London
EC1V 2PT
www.cdfa.org.uk

Community Shares Unit – using society shares for community projects
Holyoake House
Hanover Street
Manchester
M60 OAS
http://communityshares.org.uk

Community Shares Scotland– using society shares for community projects in Scotland
Development Trusts Association Scotland
54 Manor Place
Edinburgh
EH3 7EH
http://communitysharesscotland.org.uk/

Scottish League of Credit Unions (SLCU)
67 Longstone Road
Cranhill
Glasgow
G33 3JU
www.Scottishcu.org

UK Credit Unions Limited
Credit Union House
15 Greenfield Street
Haslingden
Rossendale
Lancs
BB4 5TG
http://www.ukcu.coop/

Food and Agriculture

Making Local Food Work – food enterprises and community supported agriculture
c/o The Plunkett Foundation
Units 2 & 3
The Quadrangle
Banbury Road
Woodstock
Oxfordshire
OX20 1LH
http://www.makinglocalfoodwork.co.uk/

National Society of Allotments and Leisure Gardeners Limited – allotment and leisure gardening societies
NSALG
O'Dell House
Hunters Road
Corby
Northants
NN17 1JE
http://www.nsalg.org.uk/

Plunkett Foundation – promotes community owned rural businesses eg village shops and pubs
The Quadrangle
Banbury Road
Woodstock
OX20 1LH
www.plunkett.co.uk

Plunkett Scotland
http://www.plunkett.co.uk/aboutus/PlunkettScotland.cfm

SAOS Ltd – Scottish Agricultural Co-operatives
Rural Centre
West Mains
Ingliston
Newbridge
EH28 8NZ
http://www.saos.coop

Welsh Agricultural Organisation Society Limited (WAOS Ltd) Agricultural Co-operation in Wales
PO Box 8
Gorseland
North Road
Aberystwyth
SY23 2WB
http://www.wfsagri.net

Wessex Community Assets – local food, community land trusts etc. in the West Country
Heatherton Park Studios
Bradford-on-Tone
Taunton
Somerset
TA4 1EU
http://www.wessexca.co.uk/

Housing

Confederation of Co-operative Housing
19 Devonshire Road
Liverpool
L8 3TX
http://www.cch.coop/

National Community Land Trust Network
70 Cowcross Street
London
EC1M 6EL
http://www.communitylandtrusts.org.uk

National Federation of Tenant Management Organisations
Burrows Street Resource Centre,
Burrowes Street,
Walsall
WS2 8NN
http://www.nftmo.com/

National Housing Federation – Housing Associations Trade Body
Lion Court
25 Procter Street
London
WC1V 6NY
http://www.housing.org.uk/

Radical Routes – a radical Housing and Worker Co-op Mutual Aid Network
Radical Routes Enquiries
c/o Cornerstone Resource Centre
16 Sholebroke Avenue
Leeds
LS7 3HB
http://www.radicalroutes.org.uk/

Scottish Federation of Housing Associations (SFHA)
Pegasus House
375 West George Street
Glasgow
G2 4LW
www.sfha.co.uk

SDS – Housing Co-operatives
The Co-operative Development Society Limited (trading as CDS Co-operatives)
3 Marshalsea Road
London
SE1 1EP
http://www.cds.coop

Sport and Leisure

Rugby Football Union – uses societies for rugby clubs
Rugby House
Rugby Road
Twickenham
Middlesex
TW1 1DZ
www.rfu.com

Supporters Direct – football supporters' trusts for fans to influence or control football clubs
3rd floor, Victoria House
Bloomsbury Square
London
WC1B 4SE
www.supporters-direct.org

Working Men's Club & Institute Union Limited (CIU) – social clubs
253-254 Upper Street
London
N1 1RY
http://www.wmciu.org.uk/

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CO-OPERATIVES UK

Handbook of Co-operative and Community Benefit Society Law

2nd Edition

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This long awaited second edition of Ian Snaith's *Handbook of Co-operative and Community Benefit Society Law* (formerly called the *Handbook of Industrial and Provident Society Law*) has been completely updated by a team of specialist contributors. It provides an authoritative and essential resource for anyone working with or studying co-operatives and community benefit societies.

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- recent changes to the limits for share capital holdings in societies
- the new insolvency regime for societies introduced in 2014
- the increased investigation powers of the society's regulator
- new rules on electronic communications.

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