THE TREND LINES OF *COOPERATIVE SHARE CAPITAL REGIME* IN THE NEW PORTUGUESE COOPERATIVE CODE

Deolinda Meira

Polytechnic of Porto/ISCAP/CECEJ/SGECOL

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- **Objective**: a brief analysis of the trends lines of cooperative share capital regime in the new Portuguese Cooperative Code.

- The entry into force of the Law No 119/2005, 31st august 2015, which approved the new *Portuguese Cooperative Code* (PCC), reveals trends in seemingly opposite directions, regarding the evolution of the cooperative share capital regime.

  - Reduction of the minimum amount of share capital;
  - Extension of limits of the right to reimbursement, in order to ensure that the cooperative share capital has a minimum of stability;
  - Opening cooperative share capital to outside investors.

Reduction of the minimum amount of share capital

- The requirement of a minimum share capital is mandatory (art. 81.2 *PCC*).
  - Hence there is an obligation to specify the share capital in the statutes.

- Impossibility to organize a cooperative without share capital.

- The ICA cooperative principle of economic participation by members does not require share capital in order to incorporate a cooperative. This cooperative principle uses the term 'capital' as a synonym for 'assets', stressing the indivisible assets of the cooperative.

- Reduction of the value of the minimum share capital.
  - Reduce context costs for the establishment of cooperatives.
  - Promote cooperative entrepreneurship.
  - Instrumental nature of share capital in cooperatives.

- In the Portuguese legal system, the legislator reduced, in 2015, the minimum share capital for 1 500 EUR (Article 81.2 *PCC)*.

Minimum contributions to capital

- The minimum share capital operates as a limit on the variability of share capital and on the reduction of the cooperative's assets, thus representing a minimum guarantee for the interests of creditors.

- The PCC established that, as a rule, minimum contributions to capital, to which each cooperator subscribes, are defined in the complementary legislation applicable to the various cooperative types of the cooperative sector or in the statutes. In any case, they can never be below the equivalent to three shares (Art. 83 *PCC*).

- Relevant omission: PCC does not set reduction of the share capital below any minimum prescribed may be cause for cooperative dissolution.

The variability of capital

- Under PCC, the variability of capital is an essential feature of cooperatives (Art. 81.1 *PCC*).
- *PCC* includes variability of share capital in the definition of a cooperative (Art. 2 *PCC*).

- Since cooperatives are governed by open and voluntary membership, capital variability facilitates the entry and exit of members.

- Recognizing the cooperators a real right to resign, consequence of the principle of voluntary and open membership (Art. 3 *PCC*), the result will be the repayment of their capital contribution.

- Article 89.1 *PCC* states that "*the cooperator that withdraws is entitled to a refund [...] in the amount of the member contribution to share capital, on the face value of shares*."

- The main consequence of this variability is the reduced financial quality of the share capital, particularly the economic and social security that the share capital represents for creditors, which can cause difficulties for cooperatives in raising external finance and, on occasion, can lead to undercapitalization.

- **Variability versus Stability**

PCC comprise measures intended to ensure that the cooperative share capital has a minimum of stability.

Examples:

- The possibility of deferred redemption for a period of time provided for in the statutes (Art. 89.1 *PCC*).
- The possibility to make deductions from the right to redemption (Art. 89.2 *PCC*).
- The application of deductions to the face value of the member's shares whenever losses are attributable to the cooperator member within the financial year in which the right to redemption originated (Art. 89.2 *PCC*).
- Statutory minimum periods of membership and rules fixing notice periods needed for a withdrawal (Art. 24.1 *PCC*).
- The possibility that the statutes may provide that, when in a financial year the amount of shares to repay exceeds a certain percentage of the amount of share capital established in the statutes, redemption will be subject to a resolution of the Board of Directors. The suspension of reimbursement, if any, must be reasoned and subject to ratification by the General Meeting (Art. 89, Nos 3 and 4, *PCC*).

- Under no circumstances may these mechanisms suppress the right to withdraw, given the need to respect the cooperative principle of open membership (Art. 24.3 *PCC*).

Problem:

- In the Portuguese legal system, there is no specific and differentiated accounting treatment for cooperatives, so those are subject to the International Accounting Standards (IAS), namely the IAS 32, with the risk of share capital being qualified, for accounting purposes, as a debt and not as a part of cooperatives' equity.

- This impediment to suppress the right to withdraw and the consequent reimbursement right means the rejection of the solution adopted in Spanish law as to prevent the share capital classification as a liability, which welcomes the possibility, by statuary clause, to introduce a duality in cooperatives' share capital, which shall be represented by reimbursable contributions or contributions whose repayment may be refused unconditionally by the cooperatives' management board in case of resignation of cooperators.

An intermediate solution

- Under *PCC*, the cooperative has not the unconditional right to refuse redemption of members' shares.

- For *PCC*, it is clear that cooperative share capital is equity/risk capital (i.e. funds provided by members in exchange for membership).
- Contributions to capital are an obligation to be met by members (Art. 83 *PCC*). This is a necessary condition to become a member, even though it may not be enough, since the cooperator must take part in the activity of the cooperative [Art. 22.2.c) *PCC*].

- Understanding of Scholars and Portuguese Accounting Standards Commission (CNC): Although the fact that cooperative share capital has many characteristics of debt capital, being equity/risk capital, it is the property of the cooperative and not a sum borrowed from members.

The opening of cooperative share capital to outside investors

- In addition to cooperative reference members —cooperators— the *PCC* includes the possibility of statutes admitting investor members [Art. 16.1.g) *PCC*].

- These investor members shall not participate in the cooperative transactions, limiting themselves to contribute financially to the cooperative.

- These investor members may provide the cooperative to obtain sources of finance on better terms than those offered by the market, if the resources brought by the cooperator members are not sufficient.

The opening of cooperative share capital to outside investors

- In the name of preserving the *principle of democratic member control* and the *principle of autonomy and independence*, the legislator has subjected this new figure to tight mandatory limits.

- The admission of investor members is subject to statutory provision [Articles 16.1.g); 20.1; and 41.1, *PCC*] and must be approved by the general meeting, being mandatorily proposed by the board of directors (Article 20.3 and 20.4, *PCC*).

- The statutes must identify the "*conditions and criteria*" on which depends the award of the plural vote to investor members (Article 41.5 *PCC*)

- However, there are restrictions that are mandatorily imposed: (i) no investor member can have more than 10% of the votes corresponding to the votes of cooperator members and (ii) the investor members may not, in total, have voting rights greater than 30% of the total votes of the cooperator members (Article 41.7 *PCC*).

- Investor members may join the board but cannot "*represent more than 25% of the number of effective elements that make up the body for which they are elected*" (Article 29.8 *PCC*).

- If the cooperative is managed by a sole Director (Articles 28.2; 45.2; and 62.2; *PCC*), he cannot, under any circumstances, be an investor member. The same is true when the supervisory body is composed of a single member [Article 51.1.a) *PCC*].