

BRARY COPY

Alagh Committee

Government of India
Department of Company Affairs
Ministry of Law, Justice & Company Affairs



सत्यमेव जयते

Report of the High Powered Committee
for Formation and Conversion of
Cooperative Business into Companies

New Delhi
March, 2000

**REPORT OF THE HIGH POWERED
COMMITTEE
FOR FORMATION AND CONVERSION OF
COOPERATIVE BUSINESS INTO
COMPANIES**

The Government of India in the Ministry of Law, Justice and Company Affairs (Department of Company Affairs), by its Order No. 11/12/99-CL-V. dated 1st November, 1999, constituted a High Powered Committee to (a) examine and make recommendations with regard to framing legislation which would enable incorporation of cooperatives as companies and conversion of existing cooperatives into companies; and (b) ensure that the proposed legislation accommodates the unique elements of cooperative businesses within a regulatory framework similar to that of a private limited company. A recommended draft of a Bill to Amend the Companies Act, 1956, which forms part of this Report, may be seen at Annex-I. The Order constituting the said Committee is at Annex-II.

The Composition of the Committee is as follows:

- | | | |
|----|---|----------------------|
| 1. | Dr. Y.K. Alagh, Economist | Chairman |
| 2. | Shri Bhagat Singh,
Addl. Secretary,
Department of Agriculture and Cooperation | Member |
| 3. | Dr. (Ms) Amrita Patel,
Chairman, NDDB | Member |
| 4. | Shri Vinay Kore,
Chairman,
Warana Rural Co-operative Complex | Member |
| 5. | Smt. Sudha Pillai,
Jt. Secretary,
Department of Rural Development | Member |
| 6. | Shri N.L. Vaidyanathan,
Senior Legal & Legislative Consultant | Member |
| 7. | Shri K.D. Singh,
Jt. Secretary & Legal Advisor,
Department of Legal Affairs | Member |
| 8. | Shri R.D. Joshi,
Jt. Secretary,
Department of Company Affairs | Member-
Secretary |

1.0 INTRODUCTION :

1.1 During the last decade, changes have taken place in the Indian economy, in the communication and transportation infrastructures, as well as in the methods of commerce, banking and international trade. Liberalisation of the economy is in the process of changing the terms of trade between rural and urban, labour and industry, finance and commerce. Advances in communication have resulted in information being available almost instantaneously. Modern technology is in many cases scale neutral. Biotechnology, the information revolution, and computerisation can all be used to raise the level of living of farmers and link them with regional, national and global demand. Institutions are needed to link the rural economy with these new opportunities, both on the side of inputs and demand opportunities.

1.2 New economic challenges and opportunities necessitate new institutional forms. This is particularly critical in order to ensure that rural producers are able to participate as equal partners in the national and international economy. The types of institutions that served us well during the decades after independence may still have important roles to play. At the same time, new institutions are required to effectively meet challenges and seize opportunities in ways that benefit, and do

not exploit, rural producers. In identifying appropriate institutions, several considerations are important.

1.3 First, it is fundamental to the interests of our rural producers and consumers that the nation promotes, advances and encourages the rational and organized marketing of rural produce; that everything possible is done to eliminate speculation and waste; that the distribution of rural products between producer and consumer be done as directly and efficiently as possible; and that the marketing of rural products is modernized, professionalized and stabilized.

1.4 Second, it must be recognized that rural agriculture and industry are individual, in contrast to the mass effort that characterizes other forms of production. It is in the public interest that rural producers bring their industry to the highest degree of efficiency and skill that characterizes other forms of enterprise. It is further in the interest of the country that the quality of rural life improves, preventing migration from farm to city and to ensure the agricultural self-sufficiency of the nation. The development of the economy therefore requires that rural producers are encouraged to market their products in a modern and professional manner, rather than continuing to rely on speculative and exploitative transactions.

1.5 Cooperative forms of organization are important to India's policy objectives. The Ninth Plan recognises this explicitly. The world over, cooperative methods are being emphasized in the transition to a more integrated economy. The General Assembly of the United Nations has recognized the broad significance of cooperative forms of enterprise in contributing to the solution of major economic and social problems. The UN has noted that user-owned business is becoming an indispensable factor in the economic and social development of all countries. The General Assembly has, by resolution, encouraged all Governments to review any legal or administrative constraints "with a view to eliminating those constraints that are not applied to other businesses and enterprises"

1.6 In other parts of the world, cooperatives and similar forms of user enterprise have evolved into major participants in their respective economies. In many such countries, these enterprises are registered and operate under the same laws as govern companies and other corporations, with the exception that their unique ownership features are recognized and expected. In Denmark, cooperatives operate under corporation law, with no specific modifications. In Switzerland, cooperatives are legally considered one form of business

organization along with corporations, sole proprietorships, general and limited partnerships, limited liability companies. Zimbabwe has a Co-operatives Company Act as part of its Companies Act. In Zimbabwe, the definition of "public company" is: "any company, including a cooperative company, which is not a private company...." In the United States, too, cooperatives are chartered under the company laws of their respective states, with special provisions that reflect their cooperative principles. Recent studies show that in land and water management as well as non-farm employment, such newer forms of organization are also developing in Asian countries.

1.7 In these and other companies, the recognition of user enterprise as a business organization and its equal treatment under the law, allows for a flexibility of organizational operations, including entering into national and international joint-ventures, that help to ensure that producers continue to benefit in a changing economic environment.

1.8 It is, therefore, recommended that the Government enact legislation to enable the registration and operation of producer companies, wholly-owned and self-regulated by users, managed by professionals in the users' interest, in a manner consistent with the principles of mutual assistance: voluntary

and open membership; democratic member control; member economic participation; autonomy and independence; education, training and information; cooperation with similar enterprise; and concern for the community.

2.0 The Committee's Work

2.1 In framing the Draft Legislation, the Committee had necessarily to provide for the formation of specially-structured Companies, integrating and blending cooperative principles with certain features of a limited company.....

2.1 The first meeting of the High Powered Committee was held on 21st December, 1999 at New Delhi under the Chairmanship of Dr. Y.K. Alagh. The broad features of the proposed Legislation and the its objectives were discussed. It was desired that the Report of the Committee, together with a recommended Draft Legislation, should be prepared. With this in view, a Sub-Committee was formed consisting of the following Members:-

1. Shri N.L. Vaidyanathan, Senior Legal & Legislative Consultant
2. Smt. Sudha Pillai, Jt.Secretary, Department of Rural Development

3. Shri K.D. Singh, Jt. Secretary & Legal Advisor,
Department of Legal Affairs
4. Shri R.D. Joshi, Jt. Secretary, Department of Company
Affairs
5. Shri Sukhdev Indoria, Director (Coop), Ministry of
Agriculture

2.3 The Sub-Committee held its first meeting on 28th December, 1999. The broad features of Legislation that would achieve the desired objectives were discussed in detail. It was decided that a Draft Bill, incorporating those features, should be prepared and taken up in the next meeting.

2.4 The Sub-Committee held its second meeting on 18th February, 2000. A draft of the Bill, was reviewed in detail to ensure that it incorporated the desired features. The same was approved by the Sub Committee to be forwarded to the High Powered Committee subject such changes as discussed during the deliberations. It was decided that the Draft Bill, so finalized, should be presented to the High Powered Committee at its meeting to be held on 6th March, 2000.

2.5 The High Powered Committee met on 6th March, 2000 at New Delhi and reviewed the Draft Legislation from

all angles. After being satisfied that the Draft Legislation would achieve the objectives in view, the Committee approved the same for forwarding it to the Hon'ble Minister for Law, Justice and Company Affairs.

2.6 The Bill, entitled "Companies (Amendment) Bill, 2000", hereto annexed, seeks to amend the Companies Act, (Act 1 of 1956), so as to insert an additional Part, "Part IXA", concerning the formation of Producer Companies and all matters relating thereto.

2.7.1 The rationale for the recommended Bill, along with a summary of the provisions, is given hereunder.

3.0 Producer Companies: An Alternative

3.1 Historical events in India have led cooperatives along a different path than that followed by cooperatives in many other parts of the world. Promoted initially as a response to a rural law and order problem, then evolving into a social service, post-Independence cooperatives have often become vehicles for government programmes, operating with substantial government funds and personnel. Government funding has often led to Government control, bureaucratisation and political interference.

3.2 Liberalisation and globalisation assume that all competitors are more or less equally endowed with resources, skills and opportunity. Our rural producers, however, are not equipped to compete as individuals. Undereducated or illiterate, resource poor and unskilled, they cannot participate on equal terms in a market economy. Nor can a market economy survive if it rests on a foundation of exploitation of rural producers. Professionally-managed cooperatives that operate efficiently in a competitive environment represent the only way in which our farmers can compete on equal terms.

3.3 However, many cooperatives today are anachronisms, plagued by interference and politicization and therefore unable and unfit to compete or serve their Members' interests. Some States have attempted to counter this malady by adopting progressive parallel legislation. This route will prospectively take too long to ensure that producer-controlled organizations have a viable and sustainable place in our market economy. Nor can it be expected that such reforms will occur nationwide. Other options, such as registration as societies or public trusts, are inherently unsuitable to commercial enterprises.

3.4 The Companies Act, offers a statutory and regulatory framework that allows for competition on an equal footing with other forms of enterprise. If the Companies Act is suitably adapted to serve producer-owned enterprises, their registration as companies will go a long way to advance the interests of producers. Provisions already exist for the formation of diverse types of Companies: private limited, public limited and trusteeship companies as well as *nidhis*. Further, it may be noted that in many parts of the world where cooperatives play a major economic role as successful, producer-owned businesses, they operate within the same legal framework as companies.

3.5 The Government of India has recognized that, in a market economy, rural producers are at a potential disadvantage given their generally limited assets, resources, education and access to advanced technology. In the present competitive scenario, if cooperative enterprises are to continue to serve rural producers, they require an alternative to the institutional forms presently available under Law. The best way of achieving the same, in our view, is to adopt the provisions contained in the draft Bill for the creation of specially-devised Companies called "Producer Companies". These Companies would blend many of the features of a

limited company with the principles and practices of mutual assistance, or cooperation.

3.6 It is therefore proposed that the Producers may form a Producer Company as aforesaid and carry on the business with objectives as are set out in the Draft Bill, provided the object of the Company extends to more than one State. Any existing cooperative enterprise having its objects not confined to one State may also exercise the option of voluntary conversion into a Producer company. The law does not envisage any element of compulsion whatsoever and it is presumed that even the conversion option will be exercised by an eligible cooperative only if it is found to be necessary or advantageous by its Members.

3.7 In formulating its recommendations, the Committee has devised a legislative approach that would:

- provide producer companies with equality of treatment with both private limited and public limited companies;
- retain the principles of mutual assistance that emphasize voluntary Membership, democratic decision-making, patronage rather than capital, distribution of surplus based on patronage, education of Members;
- enable rather than prescribe;

- encourage professionalisation and modern management,
- remain fundamentally consistent with the other provisions of the Companies Act;
- *inter alia* permit transformation of cooperatives whose objects extend beyond a State into Producer Companies.

4.0 Terminology

4.1 The new form of enterprise has been called a "Producer Company" to emphasize that it is fundamentally designed to serve producers of primary products, whether these be agricultural and related, or handicrafts and other artisan's goods.

4.2 The Producer Companies, in addition to being owned by producers, must operate consistently with the Principles of Mutual Assistance which are spelt out in the law as later set out herein.

4.3 Excepting those few instances where the unique nature of the Producer Company requires equally unique terminology, most terms, such as "objects", are in conformity with their usage in the Companies Act.

5.0 Objects of the Producer Company

5.1 For the purpose of the draft legislation, a Producers' Mutual-Assistance Company may be considered to be an enterprise that has for its object the economic and social betterment of its owners through self-help, mutual aid and voluntary association, and performs only such services as are primarily intended to benefit its owners.

5.2 The objects of a Producer Company may include:

1. Production, pooling, procurement, grading, marketing of primary produce;
2. Processing produce to add value;
3. Supply of inputs, machinery and equipment;
4. Education in relation to the other objects;
5. Technical and consulting services, training, research and development;
6. Activities related to production such as power and water;
7. Financial support and credit facilities to Members, and other activities that are ancillary or incidental.

6.0 Primary Produce

6.1 Primary produce is defined as produce arising from agriculture, including animal husbandry; from horticulture;

floriculture; pisciculture; viticulture, forestry, forest products, re-vegetation, bee raising and farming plantation products, as well as the produce of those engaged in handloom, handicraft and other cottage industry or artisan's products. It includes those products, including the by-products thereof, which result from adding value to any primary produce.

7.0 Principles of Mutual Assistance

7.1 The Producer Company must operate in consonance with the Principles of Mutual Assistance which include:

- Voluntary Membership;
- Democratic governance;
- No privilege to Capital;
- Equitable distribution of surplus;
- Education of Members, leaders, employees and the general public;
- Cooperation with similar organisations.

7.2 In order to ensure that the Principles of Mutual Assistance are given due importance, it is explicitly provided that, in the interpretation of the provisions relating to Producer Companies, a construction that promotes the

Principles of Mutual Assistance is to be preferred to the one that would not promote the Principles.

8.0 Formation

8.1 Ten or more individuals may form a Producer Company and get it registered. In the case of Producer Institutions however, two or more would suffice.

9.0 Transformation

9.1 In addition to providing for registration of new Producer Companies, the recommended Bill would enable transformation of existing producer organizations, such as cooperatives, into Producer Companies, provided that:

- Their objects are not confined to a single State
- Their general body adopts a resolution in favour of transformation with at least a two-thirds majority; and
- They otherwise satisfy the conditions for registration of a Producer Company.

The representative of Department of Agriculture noted that this will allow those cooperatives registered under State Cooperatives Act as are having activities beyond the state to get converted into Producer Companies without any further approval.

10.0 Prescriptive Provisions

10.1 The proposed Law seeks to enable rather than prescribe. Prescriptive provisions are limited to:

- The categories of provisions that must be included in the Memorandum of Association and Articles of Association of a Producer Company;
- The minimum and maximum numbers of Board Directors;
- The qualifications for election, and continuation, as a Director;
- The formula for the allocation to general reserves;
- The conditions and procedures for dissolution the Company;
- Some minor stipulations and limitations.

11.0 Member equals User

11.1 A Member has been defined as follows:

‘Member’, in relation to a Producer Company, means a person or group of persons (whether incorporated or not) qualified as stipulated in the Articles and admitted under it to Membership therein, and who retains the qualifications necessary for continuance as such, and ‘active Member’

means a Member whose extent and period of patronage of the Company is such as to satisfy the conditions required of him by the Articles to be considered as an active Member.”

The Law, therefore, permits termination of Membership, disqualification from election and/or from other privileges, for those who fail to meet the minimum patronage that may be specified in the Articles of Association.

12.0 Governance

12.1 The Law defines the roles of –

- (a) Members, acting through their General Body;
- (b) The Board (which may only act collectively in meetings);
and
- (c) the Chief Executive.

12.2 The Board may act only in areas not reserved to the General Body and may not exercise executive functions. In general, the Board is responsible for formulating, supervising, and monitoring of the performance of the Producer Company in respect of the following matters :

1. Mission, Long-term Strategic Plans, Financial Plans, Mobilization of Resources;
2. Organizational Policy;

3. Selection of the CEO;
4. Relations with Members, Government, and the public at large;
5. Company performance;
6. Holding of Meetings and Conduct of Elections;

12.3 The Board may make recommendations in the case of those matters reserved for decision of the General Body,.

12.4 The Chief Executive is responsible for the direction of the day-to-day management of the business including operation of bank accounts, approving expenditures, signing documents, ensuring maintenance of books and records, convening meetings of Members and the Board, appointment, supervision and termination of employees. In addition, the Chief Executive should assist the Board in the formulation of plans and policies and advise on legal and regulatory matters.

12.5 The General Body alone may-

- (a) Approve the Budget and adopt the Annual Accounts of the Company;
- (b) Approve the quantum of withheld price;
- (c) Approve the patronage bonus;

- (d) Authorise the issue of bonus shares;
- (e) Appoint an auditor;
- (f) Declare a dividend and decide on the distribution of patronage;
- (g) Amend the Memorandum of Association and Articles.
- (h) Specify the conditions and limits of loans that may be given by the Board to any Director; and
- (i) Approve or act on any other matters that are specifically reserved in the Articles for decision by the Members.

12.6 The members of Board Directors are elected. The manner of election of the Directors, as well as voting on other matters, is left to be specified in the Articles.

12.7 The sole restriction regarding voting is that votes may not be based on share holding. Consistent with the Principles of Mutual Assistance and those of similar types of organizations, the Articles of any Producer Company may provide for voting based on:

- (a) In a case where the membership consists solely of individual members, the voting rights shall be based on a single vote for every Member; irrespective of his shareholding or patronage of the Company; and

- (b) In a case where the membership is composed only of Producer institutions, the voting rights may be computed on the basis of the participation in the business dealings of the Company by the respective institutions in the previous year, save that for the first year of its registration, the voting rights shall be determined on the basis of the shareholding;
- (c) In a case where the membership is composed of individuals as well as Producer institutions, the voting rights shall be computed on the basis of a single vote for every Member.

12.8 The Articles, in addition to specifying the method of voting, will also indicate:

- (1) The number of Directors (subject to an upper limit of fifteen) and the number of Expert Directors (if any) to be included and the roles they are permitted to fulfil. (This is subject to the provision that Expert Directors may not vote in the election of the Chairman, but may serve in that position if elected by the Board).
- (2) The length of terms of Directors (subject to a minimum of one and maximum of five years), and

- (3) Whether Directors will be elected simultaneously or by rotation.

13.0 Finances

13.1 The finances of a Producer Company may be drawn from the following sources:

- Member equity
- Special user rights
- Borrowing
- Reserves

13.2 Only Members may purchase voting equity in the Company. Institutional Member share holding to be proportional to their patronage of the Company, to the extent practical. Member equity is not tradable but may be transferred, with Board approval, to another active Member who meets the conditions specified in the Articles.

14.0 Contribution to Deficit

14.1 Having regard to the fact that every Producer Company is a mutual assistance enterprise, it is provided that Members should contribute to the net deficit, where required,

in relation to any financial year, if the Articles of the Producer Company so provide.

15.0 Other Investments and Borrowing

15.1 Producer Companies may invest in the shares of other Producer Companies, as well as in joint-ventures, subsidiaries, etc., provided that the purpose is fundamentally consistent with the objects of the Company.

15.2 The Board may, consistent with the provisions made in the Articles and with approval of Members at any general meeting, borrow money to meet the capital needs of the Company.

16.0 Reserves

16.1 Only a General Reserve is required and provided for in the Law. Other reserves as are consistent with provisions in the Articles may be created with the approval of the General Body.

17.0 Audit

17.1 Producer companies may have a system of internal audit, which may be provided for in the Articles. Every Producer Company must have an external audit conducted by an auditor or auditors qualified to act as such under Sections 224 and 226 of the Companies Act.

17.2 The auditor will be required to make verifications and Statements concerning the economy, efficiency and effectiveness of operations as well as the standard Statements arising from the audit of a commercial firm.

18.0 Fiduciary Responsibility

18.1 Recognizing that responsibility in the absence of accountability is tantamount to license, the Law provides that, in cases where he acts dishonestly or without due care and diligence or take any action contrary to the law or the

provisions of the Articles of the Company concerned, the Directors, including the Chief Executive shall be individually and severally responsible for the consequences of their decisions.

19.0 Dissolution and Liquidation

19.1 Producer Companies may be dissolved by:

- The Members; or
- As provided in relation to companies under the Act.

19.2 In each case, the conditions and procedures are spelt out in the Law which includes the methods of meeting liabilities, distributing residual assets, etc.

20.0 Penalties

20.1 Penalties are prescribed for the failure to carry out specific functions such as conduct of elections, provision of information to Members or authorities, completion of the audit, etc. Each offence carries a maximum sentence as well as a maximum fine, with the latter normally linked to the turnover of the concerned company.

21.0 Resolution of Disputes

21.1 Disputes involving Members and past Members as well as those between the Company, and /or its Directors, and/ or office bearers, etc, are to be settled by Conciliation or Arbitration as provided for under the Arbitration and Conciliation Act, 1996 or by *Lok Adalats* constituted under the Legal Services Authorities Act 1987. A provision to that effect has been included.

22.0 Notifications

22.1 The Law would empower Government, by Notification, to:

- (1) Exempt Producer Companies or classes of Producer Companies from any specific provisions of the Companies Act, if required. However, the special provisions applicable to Producer Companies as included in the Part, are outside the purview of exemption provision.

(Note- There is precedent for this type of Notification in the Companies Act itself).

- (2) Remove difficulties with regard to implementation of the new provisions, but not in a manner inconsistent with the purpose thereof.
- (3) Remove difficulties that may arise in the transformation of any Multi-State Co-operative Society into a Producer Company.

22.2 The power to remove difficulties extends only to five years from the date of notification of the Act.


23.0 Recommendation

23.1 The Committee has evolved the Legislation, as reflected in the Draft Bill appended to this Report, after extensive research on the experience of producer organisations all over the country. It is the Committee's considered view that given its importance to the survival of producer organisations in a market economy, the Government of India should take up the matter of adoption of the Legislation as speedily as possible. The Legislation, as and when adopted will, in the Committee's view, provide rural producers with an effective alternate organisational form which will both encourage professionalisation and a modern corporate culture while retaining and supporting the principles of mutual assistance.

23.2 Before concluding, the Committee would like to express its appreciation and gratitude to all those who helped the Committee in various ways, ensuring that the task assigned was completed within the allotted time.

Y. K. Alagh
(Dr. Y.K. Alagh)
Chairman



(Dr. Amrita Patel)

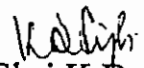

(Shri Vinay Kore)

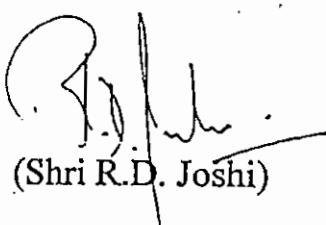

(Shri Bhagat Singh)

Adl Sec
7/1 Apr.


(Smt. Sudha Pillai)


(Shri N.L. Vaidyanathan)


(Shri K.D. Singh)


(Shri R.D. Joshi)