UNIFORM LIMITED COOPERATIVE ASSOCIATION ACT

drafted by the

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ON UNIFORM STATE LAWS

and by it

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NATIONAL CONFERENCE OF COMMISSIONERS
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UNIFORM LIMITED COOPERATIVE ASSOCIATION ACT

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UNIFORM LIMITED COOPERATIVE ASSOCIATION ACT

PREFATORY NOTE

Introduction to ULCAA

This Act (ULCAA) combines an unincorporated and flexible organizational structure with cooperative principles and values in order to obtain increased equity investment opportunity for capital intensive and start-up cooperative enterprises. It encourages equity investment by allowing, but not requiring, a limited cooperative association to have voting investor members in addition to patron members. Giving equity investors even limited voice in operations on an on-going basis is the biggest defining feature distinguishing this Act from other cooperative acts. Nonetheless, it is possible to view the distinction between debt and equity as one of degree rather than of kind. In effect this Act allows a limited cooperative association to substitute equity capital with limited, but real, governance rights for debt capital and lenders, through loan covenants, can control some activities of any kind of entity.

Another defining feature of this Act is that it is based in large part on unincorporated law and entities formed under it are intended to be unincorporated entities for state law purposes in the style of limited liability companies and limited partnerships. This feature may lead to rather sophisticated tax planning flexibility but is important, too, because cooperatives have historically functioned for specific purposes in a way analogous to, and sometimes in fact as, unincorporated associations. On the other hand, the names, but not necessarily the function, of the organic documents of a limited cooperative association are borrowed from corporate law based "traditional" cooperative statutes.

Limited cooperative associations are an alternative to other cooperative and unincorporated structures already available under state law. The Act is a free-standing act separate and apart from current cooperative acts and, therefore, is not a statutory replacement of other law. It is simply another statutory option under which to form an entity.

At the time of the promulgation of this Act, it is possible to qualify as a "cooperative" for some federal purposes without being organized as a cooperative under state law. That is, other forms of business organizations may be used for cooperative purposes. This Act, however, provides an efficient default template that encourages planners to utilize tested cooperative principles that reflect traditional cooperative values at a deeper level than provided in those other organizational structures. ULCAA may be correctly perceived as protecting cooperative principles within state law in ways not possible under more general organizational statutes.

The Act draws from existing statutes in Minnesota, Tennessee, Iowa, and Wisconsin, and, to a lesser extent, Wyoming which contemplate unincorporated cooperative entities and which encourage a greater use of outside equity furnished by "investors". These laws began with Wyoming in 2001 and continued from Minnesota in 2003 through Nebraska in 2007. ULCAA seeks to provide a template for uniformity and further evolution in this area of law. In some ways, this Act is more protective of patron members than most of the existing statutes. Even

before the enactment of these enabling laws, however, combinations of entities were being used to address equity capital concerns in cooperatives. *See, e.g.*, Michael L. Cooke, Constantine Iliopoulis, *Beginning to Inform the Theory of the Cooperative Firm: Emergence of the New Generation Cooperative* 1999 FINN. J. BUS. ECON. 525 (Issue 4).

At the time of the promulgation of this Act, combination entities continue to be used to pair cooperatives with other entities in partnerships and joint ventures. Typically the "other entity" provides financing and the joint venture agreement provides for the allocation of profits and losses between the venturers and for the payment of fees for the provision of necessary inputs such as management services. The use of these multiple entity structures builds on the practical experience of "New Generation" cooperatives. The "New Generation" cooperative model differs from the historical cooperative model because it requires substantial up-front investment by patron members, connects equity investment with the right and obligation to deliver specified quantities of product to the cooperative, and allows patron members to transfer their equity in the cooperative by private sale to another person eligible to become a patron member.

The broad definition of "person" (Section 102(24)), the manner in which a person becomes a member (Section 502), and the flexibility provided by broadly allowing the purpose of a limited cooperative association to encompass activities that may (or may not) be for-profit (Section 105), continue a trend in unincorporated entity law. It is possible for ULCAA limited cooperative associations, therefore, to serve as joint venture conduits between and among for-profit entities, not-for-profit entities, and governmental divisions, if the organic law (and tax law) of those other entities allows them to do so; and, if the other law makes such ventures practicable. This use is consistent with several traditional cooperative values because cooperatives are self-help organizations that in some states are, or may be, formed under not-for-profit statues. Moreover, the federal income taxation of specific types of cooperatives is based on exempt organization concepts (though it is unlikely a limited cooperative association can comply with that scheme of taxation as currently formulated). If a limited cooperative association is able to navigate regulatory and tax complexity, the limited cooperative association might be an alternative entity for organizations in the growing social sector.

There are two final introductory matters concerning nomenclature and citation in the following comments to ULCAA. Throughout the comments it is necessary or helpful to contrast limited cooperative associations from cooperative organizations formed under other law. A convention adopted for purposes of the comments is that "cooperative organizations formed under other law" are termed "traditional cooperatives". Reference and citation to frequently cited uniform or model acts are as follows: Revised Uniform Limited Liability Company Act is referenced as RULLCA (2006); Uniform Limited Partnership Act is referenced as ULPA (2001); Revised Uniform Partnership Act is referenced as RUPA (1997); Revised Uniform Limited Partnership Act with 1985 Amendments is referenced as RULPA (1976/1985); Model Entity Transaction Act is referenced as META; Revised Model Business Corporation Act (Model Business Corporation Act) is referenced as RMBCA.

Cooperative Principles

Cooperatives are unique organizations. Israel Packel emphasized the unique nature of the cooperative through four editions of his book on cooperatives from 1940 to 1970. He criticized attempts to interpret cooperatives solely by comparative classification as either "corporations" or "partnerships" by stating:

> Instead of a direct approach as to whether a particular rule, in the light of the reason for the rule, should be applied to cooperatives, courts in the past tended to create the preliminary hurdle of determining whether cooperatives are to be treated as corporations, partnerships, or other joint ventures. [He later discussed *Moore v. Hillsdale County Tel. Co.*, 137 N.W. 241 (Mich. 1912) (categorizing an unincorporated telephone cooperative as a joint venture).]
>
> The uselessness of such an analysis becomes even more apparent when it leads to a statement that cooperatives "are somewhat of a hybrid, partaking both of the nature of a corporation and a partnership" [*citing Philadelphia School Dist. v. Frankford Grocery Co.*, 103 A.2d 738 (Penn. 1954)].

ISRAEL PACKEL, THE ORGANIZATION AND OPERATION OF COOPERATIVES p. 5-6 (4th ed. 1970); *contra*, David Barton, *What is a Cooperative, in* COOPERATIVES IN AGRICULTURE, p. 1 (David Cobia, ed., 1989).

Even so, entity comparisons can be helpful for *understanding* the limited cooperative association. The basic features of limited cooperative associations formed under this Act (ULCAA) are flexible within bounds and largely based in contract consistent with other cooperative and unincorporated entity law. The organic rules, however, consistent with traditional cooperatives and corporations, are articles and bylaws though the articles are styled articles of organization, a term used in many limited liability company statutes. Member governance rights under the default rules share some aspects similar to those of limited partners in limited partnerships. For example, members do not have agency authority on behalf of the association. The governance structure is centralized with a board of directors like traditional cooperative statutes and, as a necessary result, the Act contains machinery necessary to support representational central authority.

Transferability of members' interests and entity duration are similar to traditional cooperative and limited liability companies. Members' liability is limited like both corporate and unincorporated limited liability entities. Allocation and distribution provisions are *sui generis* to this Act but are consistent with broad unincorporated concepts because they contemplate equity capital accounts in the names of the members.

Mechanical operation aside, the Act reflects cooperative principles except to the extent necessary to accommodate investor members for those limited cooperative associations choosing to have investor members. It is worth repeating that this Act does not require a limited cooperative association to have investor members. The Act results in an entity that is designed to function in close proximity to the way traditional cooperatives function in the absence of investor members.

Cooperative principles have historical roots that can be traced to the pre-revolutionary period in Pennsylvania where Benjamin Franklin helped form "what is considered the first formal cooperative business in the United States" in 1752. It was a mutual fire insurance company. Gene Ingalsbe & Frank Groves, *Historical Development, in* COOPERATIVES IN AGRICULTURE, 106 at 110-11 (David Cobia, ed., 1989).

The Rochdale Society of Equitable Pioneers, Ltd., however, is recognized as having "singular impact"on the cooperative movement. *Id.* at 109. It was a consumer cooperative formed in Rochdale, England, in 1844. The "Rochdale Principles" grew out of the experience of the Rochdale Society and probably "evolved from 'rules of conduct and points of organization'" published by the Society in 1860. The number of "Rochdale Principles" varies depending on source probably "because the rules enumerated by the Rochdale Society continued to evolve from its founding... up to its publication in 1860 and thereafter." DAVID BARTON, PRINCIPLES IN COOPERATIVES IN AGRICULTURES p. 22 (1989).

The number of stated enumerated principles varies between three and fourteen. In 1995, for example, the International Co-operative Alliance (ICA) listed the following seven cooperative principles: (1) voluntary and open membership; (2) democratic member control; (3) member economic participation; (4) autonomy and independence; (5) education, training and information for members; (6) cooperation among cooperatives; and, (7) concern for community. The 1995 list varies from ICA's list promulgated in 1966. The 1995 list deleted "business at cost" and "limited return on capital" but added numbers (3), (4) and (7) as enumerated above. *See* BARTON, *supra*, at pp. 31-2. Packel used the term "characteristics" rather than principles and suggested: "No single characteristic is necessarily all-controlling." Packel, *supra*, at p. 5.

A frequently quoted passage from a *dissent* written by Justice Brandeis (and joined by Justice Holmes) concerning whether a stock cooperative was the same as a non-stock cooperative for purposes of an Oklahoma regulatory statute stated:

> That no one plan of organization is to be labeled as truly co-operative to the exclusion of others was recognized by Congress in connection with co-operative banks and building and loan associations [citation omitted]. With the expansion of agricultural co-operatives it has been recognized repeatedly.

Frost v. Corporation Comm. (Oklahoma), 278 U.S. 515 at 546 (1929) (Brandeis, J., dissenting).

Justice Brandeis further stated:

> And experts in the Department of Agriculture, charged with disseminating information to farmers and Legislatures, have warned against any crystallization of the co-operative plan, so as to exclude any type of co-operation.

Id.

The interpretation of cooperative principles has evolved under other law, too. For example, the Internal Revenue Service changed its interpretation of whether operating on a cooperative basis required more than 50 percent of the cooperative's business be done with members on a patronage basis to qualify for tax treatment afforded one specific kind of cooperative. Rev. Rul. 93-21, 1993-1 C.B. 188 (stating that the 50 percent threshold is not necessary).

Cooperative principles undergird and animate many of ULCAA's provisions. As a result, understanding the Act at a fundamental level is aided by an overview of cooperative values and principles.

One of the fulcrums in this Act regarding cooperative values is Section 104 ("Nature of Limited Cooperative Association"). It addresses the values of member economic participation, autonomy, and independence. Autonomy, however, must be placed within the practical context of long-term debt, equity, and the use of combination entities. Voluntary membership remains voluntary in the sense that this Act requires the "consent" of both the person seeking to become a member and the association. *See* Section 113(a). Open membership has been compromised under existing law establishing entities similar to limited cooperative associations and remains so in ULCAA to allow (but not require) the formation of "closed" cooperatives. Closed cooperative structure assists patron members to share the increased value of the entity they helped build and provides member liquidity.

Section 1004 ("Allocations of Profits and Losses") expressly provides for the values of member economic participation; education, training and information, and; cooperation among cooperatives. One of the key balancing points of the Act concerns "democratic member control." Sections 405, 511(a) through 514, 804, and 816(a) (as well as the other voting provisions on fundamental changes) all concern the patron member control principle.

"Concern for community" is directly addressed by Section 820 which varies the law generally applicable to corporate directors, for example, to allow the directors of a limited cooperative association to consider cooperative principles as well as a number of community constituencies in making decisions. *See also* Section 1004(a)(2).

In sum, the Act expressly considers important traditional cooperative values and provides reasoned departures from those values only where necessary for purposes of reducing the cost of capital to limited cooperative associations in furtherance of the other cooperative principles.

Selected Features of the Uniform Limited Cooperative Association Act (ULCAA)

The features and provisions discussed in this portion of the Prefatory Note are particularly important to understand and use the Act. They include:

- Structure and Interpretation of ULCAA
- Organic Rules
- Investor Members
- Voting Control
- Board of Directors: "Fiduciary" Duties
- Formation of a Limited Cooperative Association
- Financial Rights
- Allocations and Distributions
- Marketing Contracts
- Interrelationship with Other Law

Structure and Interpretation of ULCAA

The structure of ULCAA follows, in a general way, the structure of RULLCA (2006), ULPA (2001), and RUPA (1997). Wherever appropriate, similar captions to those acts are used.

Sections 107 ("Governing Law"), 108 ("Supplemental Principles of Law") and 113 ("Effect of Organic Rules") relate to the application and interpretation of the Act. The first two sections are common with other uniform acts.

Section 113 underpins the contractual unincorporated nature of ULCAA. In the first instance the fluidness (or ambiguity) caused by the strong influence of contract law on the organic rules may seem troublesome. This fluidness, however, is generally consistent with member based entities and is fundamental to unincorporated entities. Indeed, whatever ambiguity exists concerning the boundary of the interpretation of the organic rules and contract in ULCAA should provide no more practical consternation than does the definition of "operating agreement" in RULLCA (2006) which states, in relevant part, that "operating agreement":

> means the agreement, whether or not referred to as an operating agreement and whether oral, in a record, implied, or in any combination thereof, of all the members of a limited liability company. . . .

RULLCA (2006) § (13).

By way of overview Section 113(a) provides that the organic rules govern relationships internal to the association. The balance of Section 113 performs two functions. The first function is that it indirectly establishes the interpretive primacy of the organic rules both within

Section 113(a) and other sections elsewhere in the Act that restrict, limit, qualify, or emphasize that primacy. Subsections (b) and (c) identify sections which limit the flexibility of the organic rules. Subsection (b) identifies provisions by section number that may be modified only in the articles of organization. Subsection (c), like subsection (b), identifies provisions by section number in which limitations exist; but, which may be modified in either the articles of organization or bylaws within those limitations. Thus, subsections (b) and (c) provide the necessary background rule for those sections that expressly limit the broad flexibility recognized in subsection (a). In addition to providing this negative definition to subsection (a), subsections (b) through (d) provide practical guidance for those drafting organic rules similar to the way provisions in RULLCA (2006), RULPA (2001), RUPA (1997) and RMBCA provide the same guidance.

On the other hand, many provisions that would clearly be interpreted as "flexible" under the application of the general rule of Section 113(a) contain an express statement that the organic rules may "otherwise provide." When used in this manner the quoted phrase is for emphasis and for the convenience of those using the Act, for example, opinion givers. The use of the phrase should not be interpreted as a negative implication about the flexibility of provisions that govern the internal affairs of the association but which do not contain the phrase. Nonetheless, like other organizational acts, this Act contains administrative provisions. For example, Section 111 ("Name") deals with the name of a limited cooperative association. Also, similar to other acts, these administrative provisions are mandatory even though they do not expressly so state.

Finally, as an introductory matter of interpretation, ULCAA does not contain restrictions concerning the effect of the organic rules on third parties as contained in some unincorporated laws; nor does it expressly state that the organic rules may be directly applicable to third parties as stated in others. There are two reasons for this treatment of the matter by this Act. First, at some level, expressly stating that the organic rules may not affect nonsignatory third parties seems to state the obvious. Second, and at the opposite interpretive extreme, cooperatives are somewhat unique among entities because their customers (patrons) are also typically their owners (patron members). Thus, whether the member is (or is not) a third party for a particular purpose will depend on unique facts and the organic rules themselves. This is not imprecision. It is recognition of the importance of context.

Moreover, some users of the cooperative may be "non-member patrons" (in the vernacular of the industry) and some items of the contract with "non-member patrons" may, in somewhat unusual circumstances, be addressed in the organic rules. These patrons may, under contract, share in "profits" or "savings." As a result of these unique relationships concerning "contracts" among and between the constituencies requires careful case-by-case scrutiny of what is meant by "third parties" for particular purposes. Such determinations, particularly at this early developmental stage of limited cooperative association law, are ill-suited to be addressed by statutory mandate.

Organic Rules

The organic rules of a limited cooperative association are its articles of organization and bylaws. They are modified versions of similar governing schemes in corporate law but in some ways are similar to the governing records and schemes found in a few early limited liability company statutes. *See, e.g.*, TEX. CIV. CODE ANN. § 2.09 (1992) (articles of organization and regulations).

The articles of organization are the highest authority of organic rules and may be amended only with a super-majority vote of the members. *See* Section 405 ("Approval of Amendment"). They are filed publicly. The bylaws, as a matter of default, may be amended only by a majority vote of the members but the power to amend most bylaw provisions may be delegated to the board of directors by the articles of organization. *Id.* The exceptions to the delegation of authority to the board for purposes of amending the bylaws include five fundamental matters (amending equity structure; transferability of a member's interest; allocation of profits and losses; quorum and voting rights; and, under certain circumstances, admission of new members). *Id.* Those five matters require super majority member vote whether located in the articles of organization or the bylaws.

Certain items must be contained in the articles of organization, some may be in the articles or bylaws. There is no penalty or adverse consequence under the Act if a limited cooperative association does not adopt bylaws even though the Act could be interpreted as requiring bylaws. *See* Comment to Section 304 ("Bylaws").

Investor Members

The introduction of voting investor members requires ULCAA to expressly guard cooperative principles and values which focus on user-owners (patron members) and their cooperative entity while at the same time balancing control and financial return in such a way as to encourage equity investment by investor members. Article 5 ("Members") contains the primary balancing point concerning voting rights and, relatedly, Article 8 ("Directors and Officers") requires that the majority of the board be elected by patron members. Article 10 ("Contributions, Allocations, and Distributions") contains the primary balancing point concerning capital, profits, and losses.

While the provisions of Articles 5 and 10 are flexible, they contain protections for both patron member and investor members. The general voting provisions favor patron members through a two-tiered voting structure but the organic rules can provide for significant influence, and possible blocking power, to investor members. Article 10 provides protections for patron members with respect to allocation of the association's profits and losses by establishing a baseline for patron members that is to be met in making allocations. There remains, however, great flexibility in structuring the financial arrangements among the patron members and the investor members by defining "profits"and through commercial arrangements among the members.

Voting Control

Control by members is a gravaman of cooperative theory and regulation. Cooperative principles require control by patron members. This Act allows for investor members. As a result it contains provisions that balance the need for patron member control with the enhanced ability of the association to obtain equity from investor members. The most basic provision for patron member control in limited cooperative associations with investor members requires that a majority of the voting power be held by patron members. *See* Section 514.

Voting control is addressed in three places in the Act: (1) election of the board of directors; (2) amendment of the organic rules; and, (3) fundamental changes such as mergers and conversions.

A strong measure of control is vested in patron members by the provisions addressing election and composition of the board of directors. The Act requires that a specified number of directors be patron members relative to the size of the board. For example, if the board has nine or more members at least one-third of the members must be patron members. Further, and at least as important as the number of patron members on the board, a majority of the board of directors must be *elected* by patron members. *See* Section 804. Patron member "control" provided by the election of a majority of directors is leveraged by the default rule that directors may be removed without cause. *See* Section 807. ULCAA, however, allows more flexibility than in other law for the election of independent directors whose use is becoming more popular in traditional cooperatives. In summary, the director election provisions assure patron members have a significant place at the board table and "control" over the composition of the board while at the same time providing investor members the minimum electoral voice believed necessary as a matter of policy to encourage their equity investment.

Amendment of the articles of organization, voting on proposed fundamental changes, and the amendment of bylaws are consistent with patron member control. As compared to amendment of the articles, however, the percentage of the vote is lowered in the case of bylaw amendments except for specified provisions. *See* "Organic Rules" in this Prefatory Note. The mandatory minimum vote required for fundamental changes and amendment of the articles of organization is two-thirds vote. *See, e.g.,* Section 405.

In associations with investor members the Act requires the vote for fundamental changes meet two tests:

(1) A majority of patron member voting power present must vote for the matter; *and*

(2) the total vote must meet either the two-thirds or majority default requirements, as appropriate.

See Comment to Section 405.

Patron member voting under ULCAA is not "block voting" as is provided by existing statutes similar to ULCAA. The difference is that under ULCAA a majority of the patron vote

does not control the entire patron member voting power. Therefore, the Act changes the voting dynamic between patron members and investor members as compared to similar laws but still requires that a majority of patron members have, in effect, a veto power. The Act allows the association to provide similar "veto power" to investor members which is similar to the power frequently demanded by lenders in loan covenants and by venture capitalists for their equity investments. *See* Section 514(3). The requirement that patrons have at least a majority of the voting power also differs from most, but not all, of the existing statutes on which this Act is based which allow for lower quantums of voting power for patron members (as low as 15 percent). As a result the Act can be seen as both more flexible and more protective of "control" by patron members than most (but again not all) of the similar statutes existing as of the promulgation of ULCAA.

The Act specifically addresses patron member district voting, voting by classes, proxy voting, quorum requirements, and other matters related to voting as is common in traditional cooperative statutes.

Board of Directors: "Fiduciary" Duty

The application of corporate based concepts such as the business judgment rule is controversial within unincorporated entities. *See* Elizabeth S. Miller and Thomas E. Rutledge, *The Duty of Finest Loyalty and Reasonable Decisions: The Business Judgment Rule in Unincorporated Business Organizations?* 30 DEL. J. CORP. L. 343 (2005). Even so, RULLCA (2006) Section 409 references the business judgment rule in the context of limited liability companies. There is no necessity for this Act to fuel or even enter this policy debate because the limited cooperative association, though intended to be an unincorporated association, also draws upon the long tradition and customary law applicable to cooperatives which for the past five decades has borrowed duties and standards from business and not-for-profit corporation law to identify the appropriate duties and measuring standards for its non-agent directors. These sources provide the context and flexibility necessary for judicial review in the broad range of entities that may be formed as limited cooperative associations under this Act.

States have had the opportunity to develop specific statutory policy regarding traditional cooperatives in the context of elected centralized management. This Act adopts those legislative formulations, as uniquely interpreted by the courts of individual states, as the appropriate starting place for the determination and continued evolution of the duties, responsibilities, and standards of directors of limited cooperative associations. As a result, ULCAA incorporates the preexisting law of the adopting state by reference in Sections 818 ("Standards of Conduct and Liability"), 819 ("Conflict of Interest") and 901 ("Indemnification"). The standards of conduct of officers, on the other hand, are left to agency law as a matter of affirmative policy, not of omission.

This Act, however, contains an important modification concerning the matters that may be appropriately considered by the board of directors. Unless the articles of organization otherwise provide, directors may consider other constituencies, the community, and cooperative principles and values, without breaching their duties. *See* Section 820 ("Other Considerations of

Directors"). It is only a default rule, but this modification is intended to reflect the traditional notion that cooperatives serve interests beyond narrowly defined constituencies. It provides a touch stone to the concern for public good as historically reflected by special treatment afforded cooperatives under some regulatory statutes and, more generally, helps explain the influence of not-for-profit law on traditional cooperatives.

Finally and as a more general matter, incorporation of material provisions by reference, while somewhat novel, is consistent with a nascent general trend to attempt to standardize like features of entity statutes for improved efficiency and predictability. *E.g.*, Model Entity Transactions Act, Model Registered Agent Act.

Formation of a Limited Cooperative Association

The formation of a limited cooperative association is more formal than some other unincorporated associations though it shares with other statutes the requirement of a public filing. The required filing under this Act is the articles of organization. *See* Section 302 ("Formation of Limited Cooperative Association; Articles of Organization").

The centralized management structure of a limited cooperative association includes a board of directors. The Act, therefore, has provisions dealing with the initial board as well as other provisions generally found in statutes governing traditional cooperatives.

ULCAA contemplates an unincorporated entity and unincorporated entities are governed principally by contract. This creates a theoretical issue about whether the entity can exist without members. *See* Comment to Section 301 ("Organization"). Mitigation of this important theoretical concern, which goes to the fundamental nature of an organization, is in contrast to practical filing considerations which sometimes necessitate filing before members are identified or known. The compromise solution is to allow filing but to require the association to have members before it commences business. *See* Section 501 ("Directors and Officers"). While mitigating the theoretical concern, these provisions may create practical formation issues that need to be carefully attended by advisors.

With one exception an association must have at least two members and the provisions concerning what happens when an association has but one member are functionally similar to the provisions found in ULPA (2001). The exception to the two member requirement is where another cooperative is the sole member. The exception is typical of traditional cooperative law.

One or more "organizers" may form the association and those organizers need not be members. *See* Article 3 ("Formation and Initial Articles of Organization of Limited Cooperative Association").

Financial Rights

A member's interest in a limited cooperative association consists of three clearly delineated rights: (1) governance rights; (2) financial rights; and, (3) the right or obligation, if

any, to do business with the association. *See* Section 601. Of the three rights only financial rights are transferable as a matter of default under the Act. Financial rights serve the same function as "transferable interests" under other unincorporated law. *See, e.g.,* ULPA (2001) Art. 7. As a result of this functional equivalency, ULCAA addresses the same issues concerning financial rights as other unincorporated law addresses under the rubric of "transferable interests." *See, e.g.,* Section 605 ("Charging Orders for Judgment Creditor of Member or Transferee").

ULCAA, unlike unincorporated acts since the original UPA, delineates and identifies non-transferable rights. The identification is a practical necessity because patron members in a cooperative also use the cooperative. That is, cooperative organizations *contract* with their patron members for the purchase or sale of goods or services and this contract may be the primary reason a patron member becomes a member. Under other unincorporated law such contracts are analyzed either as third party contracts or, conceivable as subsumed under the concept of "transferable interest." This Act must address these contracts apart from financial rights because of the central role they play in cooperatives.

Allocations and Distributions

The general trend among statutes governing unincorporated entities is to address distributions but to allow allocation of profits and losses to follow the agreement between the owners subject to the law of taxation and generally accepted accounting principles. State statutes relating to the formation and operation of traditional cooperatives have taken a minimalist approach to this matter focusing on the identity of those owning equity capital and by limiting return and voting rights for "non-patron" owners consistent with federal regulatory law. Illustratively, some traditional state cooperative statutes simply require cooperatives to operate in accordance with a "cooperative plan" without much further statutory definition or delineation.

ULCAA takes a different approach to allocations than either unincorporated law or traditional state cooperative statutes. It contains a more transparent fixed concept of the types of entities that can be reasonably called a kind of a cooperative by providing a framework that governs allocations *for state law purposes*. Thus, the Act addresses what it means to be a limited cooperative association. This finer treatment is necessary because ULCAA provides for investor members who are not limited to the users of the services provided by the association. One of two leverage points for this distributed definition of a limited cooperative association appears in the allocation provisions of profits and losses among members and, uniquely, members and the association as an entity. The other leverage point is a series of provisions surrounding member voting. *See* Prefatory Note ("Investor Members", "Voting Control").

Provisions addressing allocations and distributions appear in Sections 1004 ("Allocations of Profits and Losses"), 1005 ("Distributions") and 1006 ("Redemption and Repurchases"). Two provisions are central to both allocations and the definitional function of allocations. The first provision is Section 1004(b). It states the default rule that all profits and losses must be allocated to patron members (the "users" of the limited cooperative association). This formulation of the default rule is intended to shift the burden of negotiation to prospective investor members.

The second central and defining provision concerning allocation is the mandatory rule that patron members be allocated at least 50 percent of the profits and losses. *See* Section 1004(c). The definition of profits to be allocated provided by Section 1004 is flexible. It contemplates structures and arrangements currently possible using multi-entity combinations but enables the structure to exist in a single entity. Distributions under the Act, on the other hand, have few restrictions consistent with the flexibility necessary for equity redemption plans common in traditional cooperatives. *See* Section 1005 ("Distributions").

Section 1006 ("Redemption or Repurchase") may be of special interest to those familiar with the role that redemption of equity plays in traditional cooperative business models. Although stated in slightly different terms than those typically used in the context of traditional cooperatives, Section 1006 attempts to coordinate unincorporated entity distributions with equity redemption under the cooperative model.

The allocation and distribution provisions in ULCAA are purely a matter of state law, a point that is difficult to overemphasize. Financial reporting requirements, regulatory law, and tax law apply independently from the state law requirements of the Act. Benefits under other law may (or may not) be available to limited cooperative associations formed pursuant to ULCAA.

Marketing Contracts

A key feature of some types of traditional cooperatives is the right or obligation of a member to sell product to or through the cooperative. *See* Prefatory Note ("Financial Rights"). Special statutory provisions applicable to "marketing contracts" are usually contained in the state statute under which these types of traditional cooperatives are formed. The provisions frequently apply only to agricultural marketing cooperatives.

In practice, the terms of the marketing contract are sometimes distributed in several "places" possibly including the organic rules or separate agreements denominated "membership agreement." *See* Preliminary Comment to Article 7.

This Act, too, addresses marketing contracts. *See* Article 7 ("Marketing Contracts"). The ULCAA provisions are not limited in application to agricultural commodities but are limited to contracts where customers "sell, or deliver for sale or marketing on the person's behalf . . . products, commodities or goods" to the limited cooperative association. *See* Section 701(1). The Article addresses breach, remedies for breach, and anticipatory repudiation of the marketing contract. An important aspect of these provisions is they may apply to non-member third persons. It is a matter of contract, context, and interpretation as to whether contractual terms contained in the organic rules will bind or apply to third persons. *See* Preliminary Comment to Article 7.

Although the marketing contract provisions contained in this Act address the same issues as addressed in traditional cooperative statutes they are not as protective of the limited cooperative association as older statutes, in part, because of the refinement of that other law over the decades.

The mere existence of provisions relating to marketing contracts in ULCAA and in the law of traditional cooperatives underscores the self-help and mutual benefit aspects of cooperatives. That is, in some contexts, one member's breach of the marketing contract will cause the cooperative's downstream contract with purchasers to be breached for failure to deliver the required quantity or quality of the commodity. This, in turn, effects the price each member receives under its contract and sounds in mutually dependent relationships stereotypical of unincorporated entities even extending to general partnerships.

Interrelationship with Other Law

Several sections of this Act expressly deal with the interrelation of this Act with other law. First, and as necessary background, ULCAA is a free standing act and its terms neither repeal nor modify existing state cooperative statutes nor entities formed under them. Neither does the Act change any regulatory or tax law. As a matter of general legal principle, regulatory law is simply outside the scope and jurisdiction of this Act just as it is outside the scope of other statutes addressing the formation and operation of a specific entity. *See generally,* Section 108. This common legal understanding is made explicit by Section 109 ("Requirements of Other Laws") to avoid unintended interpretations because limited cooperative associations are a relatively new and unfamiliar entity.

Four other sections, however, directly address the relationship between ULCAA and specific provisions of other law because those provisions are included, at least in some states, within traditional cooperative statutes. These four sections (or portions of sections) are bracketed in the text of the Act meaning an adopting jurisdiction needs to be aware of the law governing traditional cooperatives in that jurisdiction.

One of these sections, Section 111(c), provides that the required use of the word "cooperative" within the context of "limited cooperative association" does not violate a specific law restricting the use of the word "cooperative" found in the traditional cooperative statutes of many states. This provision, like the rest of the provisions discussed here, should be adopted only by jurisdictions whose other law contains such a restriction. Another section that addresses the relationship of entities formed under this Act with other law involves exemptions to state restraint of trade and antitrust law for "cooperatives". *See* Section 110 ("Relation of Trade and Antitrust Laws").

A third section addressing a specific interrelationship issue is Section 1009 ("Relation to State Securities Law"). Section 1009 addresses the application of exemptions from state securities law and regulation for traditional cooperatives to the limited cooperative association. The fourth section concerns the law of a few states that allows cooperatives an alternative to the more generally applicable distribution of unclaimed property statutes. *See* Section 1010 ("Alternative Distributions of Unclaimed Property, Distributions, Redemptions, or Payments").

A final section expressly addresses other law, but it is different in kind and approach from the sections previously discussed. It provides detail about the coordination between

security interests in members' interests under ULCAA and the Uniform Commercial Code. *See* Section 604 ("Security Interest and Setoff").

UNIFORM LIMITED COOPERATIVE ASSOCIATION ACT

[ARTICLE] 1

GENERAL PROVISIONS

SECTION 101. SHORT TITLE . This [act] may be cited as the Uniform Limited Cooperative Association Act.

Comment

The title of this Act indicates a limited cooperative association is a type of cooperative different from cooperatives modeled on a corporate form, is an unincorporated association, and has aspects of limited partnerships and other unincorporated limited liability entities combined with features of cooperative organizations thought by many to be the "traditional" cooperative.

SECTION 102. DEFINITIONS . In this [act]:

(1) "Articles of organization" means the articles of organization of a limited cooperative association required by Section 302. The term includes the articles as amended or restated.

(2) "Board of directors" means the board of directors of a limited cooperative association.

(3) "Bylaws" means the bylaws of a limited cooperative association. The term includes the bylaws as amended or restated.

(4) "Certificate of authority" means a certificate issued by the [Secretary of State] for a foreign cooperative to transact business in this state.

(5) "Contribution," except as used in Section 1008(c), means a benefit that a person provides to a limited cooperative association to become or remain a member or in the person's capacity as a member.

(6) “Cooperative” means a limited cooperative association or an entity organized under any cooperative law of any jurisdiction.

(7) “Designated office” means the office that a limited cooperative association or a foreign cooperative is required to designate and maintain under Section 117(a)(1).

(8) “Director” means a director of a limited cooperative association.

(9) “Distribution,” except as used in Section 1007(e), means a transfer of money or other property from a limited cooperative association to a member because of the member’s financial rights or to a transferee of a member’s financial rights.

(10) “Entity” means a person other than an individual.

(11) “Financial rights” means the right to participate in allocations and distributions as provided in [Articles] 10 and 12 but does not include rights or obligations under a marketing contract governed by [Article] 7.

(12) “Foreign cooperative” means an entity organized in a jurisdiction other than this state under a law similar to this [act].

(13) “Governance rights” means the right to participate in governance of a limited cooperative association.

(14) “Investor member” means a member that has made a contribution to a limited cooperative association and

(A) is not required by the organic rules to conduct patronage with the association in the member’s capacity as an investor member in order to receive the member’s interest; or

(B) is not permitted by the organic rules to conduct patronage with the association in the member’s capacity as an investor member in order to receive the member’s interest.

(15) "Limited cooperative association" means an association organized under this [act].

(16) "Member" means a person that is admitted as a patron member or investor member, or both, in a limited cooperative association. The term does not include a person that has dissociated as a member.

(17) "Member's interest" means the interest of a patron member or investor member under Section 601.

(18) "Members meeting" means an annual members meeting or special meeting of members.

(19) "Organic law" means the statute providing for the creation of an entity or principally governing its internal affairs.

(20) "Organic rules" means the articles of organization and bylaws of a limited cooperative association.

(21) "Organizer" means an individual who signs the initial articles of organization.

(22) "Patron member" means a member that has made a contribution to a limited cooperative association and:

(A) is required by the organic rules to conduct patronage with the association in the member's capacity as a patron member in order to receive the member's interest; or

(B) is permitted by the organic rules to conduct patronage with the association in the member's capacity as a patron member in order to receive the member's interest.

(23) "Patronage" means business transactions between a limited cooperative association and a person which entitle the person to receive financial rights based on the value or quantity of business done between the association and the person.

(24) “Person” means an individual, corporation, business trust, cooperative, estate, trust, partnership, limited partnership, limited liability company, limited cooperative association, joint venture, association, public corporation, government or governmental subdivision, agency, or instrumentality, or any other legal or commercial entity.

(25) “Principal office” means the principal executive office of a limited cooperative association or foreign cooperative, whether or not in this state.

(26) “Record”, used as a noun, means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form.

(27) “Required information” means the information a limited cooperative association is required to maintain under Section 114.

(28) “Sign” means, with present intent to authenticate or adopt a record:

(A) to execute or adopt a tangible symbol; or

(B) to attach to or logically associate with the record an electronic symbol, sound, or process.

(29) “State” means a state of the United States, the District of Columbia, Puerto Rico, the United States Virgin Islands, or any territory or insular possession subject to the jurisdiction of the United States.

(30) “Transfer” includes an assignment, conveyance, deed, bill of sale, lease, mortgage, security interest, encumbrance, gift, and transfer by operation of law.

(31) “Voting group” means any combination of one or more voting members in one or more districts or classes that under the organic rules or this [act] are entitled to vote and can be counted together collectively on a matter at a members meeting.

(32) "Voting member" means a member that, under the organic law or organic rules, has a right to vote on matters subject to vote by members under the organic law or organic rules.

(33) "Voting power" means the total current power of members to vote on a particular matter for which a vote may or is to be taken.

Comment

This Section contains definitions for terms used throughout the Act. Section 1601 contains definitions specific to provisions of [Article] 16 limited to conversions and mergers.

Paragraph (1) [Articles of Organization] – This Act purposely uses the term "articles of organization" instead of "certificate of organization" or "articles of incorporation." The articles of organization may state substantive rules that together with the bylaws, govern the association and its members. For example, throughout this Act there are references to "unless the organic rules otherwise provide." Persons forming an association under this Act may find it advisable in some circumstances to place provisions varying the default rules under the Act in articles of organization. Therefore, the articles of organization filed under this Act may be more detailed in practice than a certificate of organization of a limited liability company filed under RULLCA (2006). Items required to be placed in the articles are listed in Section 302. In addition, other sections of this Act require items to be included in the articles of organization to be effective. *See* Section 113(b). Because an association under this Act is not an incorporated entity, it would be inappropriate to call the "articles" articles of incorporation. Articles of organization are included in the definition of "organic rules." *See also* Prefatory Note ("Organic Rules").

Paragraph (3) [Bylaws] – This definition must be read in conjunction with Section 304 of the Act and the various provisions permitting default rules to be varied by the organic rules. The definition is very broad when examined in light of Section 304(b) that permits the bylaws to contain any provision for managing and regulating the affairs of the association, unless prohibited by the Act or the articles of organization.

Section 304(a) states bylaws must be in a record.

Courts examining the relationship between a traditional cooperative and its members have found the relationship to be contractual with bylaws of the cooperative, and in some cases, other records being part of the contract. *See* Comment to Section 601. "Bylaws" has been used in this Act instead of operating agreement as used by limited liability companies or partnership agreement as used by partnerships to reflect the custom and practice in traditional cooperatives. Under this Act, bylaws may have a look and feel similar to corporate bylaws or may have a look and feel similar to a limited liability company operating agreement or a partnership agreement.

Paragraph (5) [Contribution] – This definition helps to distinguish capital contributions from other benefits which a member or other person provides to a limited cooperative association in a different capacity under Section 115. For example, if an individual provides services to the association in exchange for a membership in the association, the value of the services are a capital contribution. If the association hires the individual as an employee, the value of the services rendered to the association as an employee are not contributions.

The term is not used as the defined term in Section 1008(c). The term "contribution" plays an important role in the sections of this Act relating to financial rights and governance rights.

Paragraph (6) [Cooperative] – In this Act the term "cooperative" includes limited cooperative associations and all other types of cooperatives organized under any other cooperative law whether or not formed in this state. It includes entities formed under organic laws commonly considered cooperative laws. It does not include entities formed under other organic laws but operating on a cooperative basis as permitted, for example, under Subchapter T of the Internal Revenue Code.

Paragraph (7) [Designated office] – A limited cooperative association organized under this Act or a foreign cooperative must designate an office in this state under Section 117(a)(1). The designated office is the place where the association's agent for service of process is located and where service of process may be made. "Designated office" has replaced the historic corporate term "registered office."

Paragraph (9) [Distribution] – The term includes a transfer of money or other property by a limited cooperative association to a member or transferee in the form of a payment or other transfer of profits previously allocated to the member, dividends, cash portions of patronage dividends or refunds, repurchase redemption of retained allocated amounts not previously distributed, or any other form of payment or transfer with respect to the member's or transferee's financial rights. A distribution is different from an allocation. An allocation is a bookkeeping and accounting concept under this Act. "Allocation" may have important implications under income tax law. The term "distribution" does not typically include money or other property paid to a member for goods or services.

The term does not include amounts payable to a member by a limited cooperative association under commercial, contractual or other arrangements that are not within the association/member relationship even if these arrangements are made available only to members.

> **EXAMPLE:** Wages paid to a worker in a worker owned limited cooperative association are not distributions.
>
> **EXAMPLE:** A farmer sells oranges to an association for a fixed price. Payment of the price by the association is not a distribution.

EXAMPLE: A farmer sells oranges to an association for a price determined by the association's proceeds from resale, less its expenses. Payment of the price by the association is not a distribution.

Paragraph (11) [Financial rights] – "Financial rights" include rights to participate in the financial results of the operations of a limited cooperative association. For example, the term includes the right to be allocated profits and losses, to receive a proportionate share of distributions made to members, to receive dividends if dividends are a method used to distribute funds, to receive patronage allocations and dividends, to receive rebates, to have retained patronage allocations and per unit retains credited to the member's capital account, to receive an allocated share of losses, to receive payments for redemptions of retained patronage allocations or per unit retains, to receive a return of capital however described, to receive distributions upon dissolution and winding-up, as well as to receive any other allocations or distributions from the association that are a result of membership in the association.

Financial rights are separate and distinct from governance rights and other rights of a member, if any, to contract or otherwise transact business with a limited cooperative association. For example, in an agricultural limited cooperative association, membership may be required for an agricultural producer to be entitled to deliver his or her production to the association for processing. In an association where workers are the patron members, membership in the association may be required to be an employee of the association. Neither of these constitutes financial or governance rights but would be an integral part of the membership in the association.

Paragraph (12) [Foreign Cooperative] – A "foreign cooperative" is limited to entities formed under statutes similar to this Act. *See, e.g.,* Minnesota, MINN. STAT. ANNOT. §§ 305B.001 *et. seq.* (2006); Wyoming, WYO. STAT. ANNOT. §§ 17-10-201 *et. seq.* (2005).

A "foreign cooperative" includes an entity organized outside the United States if it is organized under a statute similar to this Act.

Paragraph (13) [Governance Rights] – "Governance rights" include, but are not limited to, the right of a member to vote on matters affecting a limited cooperative association to the extent the Act or the organic rules provide voting power to the member, the right to receive notices of members meetings and the right to participate in members meetings. "Governance rights" also include the right to petition the association or the board of directors and may be a required qualification, director or member of a committee of an association to the extent.

Paragraph (14) [Investor Member] – An "investor member" is a member who contributes capital to a limited cooperative association, may be provided governance rights, and is not required to conduct business with the association. The existence of investor members and patron members in a single entity is unusual, but not entirely novel, in traditional cooperatives whose organic law generally allows for preferred stockholders without governance rights. Allowing investor members to possess governance rights is an identifying feature of this Act.

Paragraph (16) [Member] – "Member" means both patron members and investor members. The definition recognizes a person can hold interests in a limited cooperative association either as a patron member or as an investor member. If a person holds both types of membership interests, each interest is governed by the provisions of the Act and the organic rules related to the particular type of membership. *See* Section 116.

A person may transact business with an association without being a member if the association's organic rules or operating methods permit it. The organic rules may provide that the non-member may have financial rights in the association (*e.g.*, rights to allocations of net profits) but not governance rights.

Paragraph (18) [Members Meeting] – This Act does not address record dates for voting at a members meeting (or for other matters, except to the extent an accounting date is used for determining allocations of profits and losses). The Act does not prohibit the organic rules, nor if the organic rules are silent, does it prohibit the board of directors from establishing a record date for determining voting members for purposes of a vote under the boards general authority.

Paragraph (20) [Organic Rules] – The definition of "organic rules" is confined to articles of organization and bylaws of a limited cooperative association. An association may have other contractual relationships providing benefits and obligations between the association and a member through a membership agreement, marketing contract, or other contractual relationship. Contracts of this type may have a material effect on the relationship of a member to the association but they are not included in the statutory term for purposes of this Act unless unique factual context otherwise requires. The board of directors may adopt policies and procedures that are not within the definition of organic rules. *See* Comment to Section 601.

Paragraph (22) [Patron Member] – A "patron member" is a member who is entitled or required to conduct patronage with a limited cooperative association, has governance rights, and may be required to pay a fee or make an investment to become a patron member. The fees or investments do not transform the patron member to an investor member or imply a dual capacity; that status is governed by the organic rules under this Act. Generally, an association must have two patron members to begin business. *See* Section 501.

Paragraph (23) [Patronage] – "Patronage" is a term of art adopted for this Act from traditional cooperative principles and concepts. "Patronage" may be conducted with a limited cooperative association by non-members as well as members if permitted by the association's organic rules.

Paragraph (25) [Principal Office] – A limited cooperative association's principal office may be the same or different than it's designated office.

Paragraph (27) [Required Information] – Information required to be maintained under Section 114 is significant in relation to the ability for members to access information from a limited cooperative association under Section 505.

Paragraph (30) [Transfer] – The reference to "transfer by operation of law" is significant in connection with Section 603 (Transferability of Member Interest). That Section severely restricts a transferee's rights (absent consent of the members or provisions in the organic rules), and this definition makes those restrictions applicable, for example, to transfers ordered by a family court as part of a divorce proceeding and transfers resulting from the death of a member. The restrictions also apply to transfers in the context of a member's bankruptcy, except to the extent that bankruptcy law supersedes the Act. Section 603(a), however, references certain limitations on transfer restrictions under the Uniform Commercial Code.

This Act does not define "transferee" but uses it in its ordinary context of a person who receives a transfer. Where used, "transferee" is used in place of "assignee."

Paragraph (31) [Voting Group] – Sections 511 and 517 of the Act permit patron members to be divided into geographic districts and for patron members and investor members to be divided into classes. If the members in a district or class have voting rights under the organic rules, the members in a district or class, or a combination of them, are a voting group whose voting procedures may be governed by the organic rules pursuant to Section 517. Similarly situated members are required to vote as a voting group where their rights are potentially affected adversely by the vote. *E.g.*, Sections 404 and 1608(d).

Paragraph (32) [Voting Member] – The Act requires that every patron member be entitled to vote. The organic rules could create classes of investor members that do not have voting rights.

Paragraph (33) [Voting Power] – "Voting Power" encompasses all votes that may be cast by members as provided by this Act or the organic rules on a particular matter.

SECTION 103. LIMITED COOPERATIVE ASSOCIATION SUBJECT TO AMENDMENT OR REPEAL OF [ACT] . A limited cooperative association governed by this [act] is subject to any amendment or repeal of this [act].

Comment

Source: RUPA § 107 (1997) which was adapted from RMBCA § 1.02 and RULPA (1976/1985).

Even though this Act governs an unincorporated entity, the limited cooperative association is of recent origin and has not yet benefitted from judicial construction.

As explained in the Official Comment to RMBCA Section 1.02, the genesis of these provisions is *Trustees of Dartmouth College v. Woodward*, 17 U.S. (4 Wheat) 518 (1819), which held that the United States Constitution prohibits the application of newly enacted statutes to existing corporations, while suggesting the efficacy of a reservation of power provision. The

purpose of the Section is to avoid any possible argument that a legal entity or its members have a vested right in any specific statutory provision and to ensure that the adopting jurisdiction may in the future modify its enabling statute as it deems appropriate and require existing entities to comply with the statutes as modified.

This Section has significance in the context of cooperative organizations where historically the organic rules have been construed to be part of contractual relationships among the cooperative organization and its members. Therefore this Section is included in this Act to avoid confusion.

An amendment or repeal of this Act would not affect a cause of action that had accrued prior to the amendment or repeal. This does not mean that a member of an association has a vested interest in the Act or the organic rules as they existed prior to the amendment or repeal. A cause of action could not be affected by an amendment or repeal if all the elements of the cause of action existed prior to the amendment or repeal. The amendment or repeal of this Act will not itself create a cause of action.

SECTION 104. NATURE OF LIMITED COOPERATIVE ASSOCIATION .

(a) A limited cooperative association organized under this [act] is an autonomous, unincorporated association of persons united to meet their mutual interests through a jointly owned enterprise primarily controlled by those persons, which permits combining:

(1) ownership, financing, and receipt of benefits by the members for whose interests the association is formed; and

(2) separate investments in the association by members who may receive returns on their investments and a share of control.

(b) The fact that a limited cooperative association does not have one or more of the characteristics described in subsection (a) does not alone prevent the association from being formed under and governed by this [act] nor does it alone provide a basis for an action against the association.

Comment

Section 104 is descriptive of an entity that is organized in conformity with this Act and, as such, there are no consequences if the limited cooperative association fails to conform to the

description in this Section. Cooperative values and principles are distributed throughout the Act, though some are varied as a result of permitting investor members with limited governance rights.

This Section introduces cooperative values and principles in this Act. The values and principles reflected elsewhere in the Act are in some cases mandatory and in others matters of default unless the association "opts-out".

Understanding the Act at a fundamental level is aided by an overview of cooperative values and principles. They have been stated in different ways, *see* Prefatory Note, and different kinds of cooperatives reflect them in various combinations and diverse ways.

As a matter of general consensus cooperative values and principles include voluntary and open membership; democratic member control; member economic participation; autonomy and independence; education, training and information; cooperation among cooperatives; and, concern for community.

Section 104 addresses the values of voluntary membership, member economic participation, and autonomy and independence. Voluntary membership is reflected by the term "persons united" in this Section and relationships that are "consensual" in Section 113(a). Open membership has been compromised under this Act and similar existing law in order to allow (but not require) the formation of "closed" cooperatives. Closed cooperative structure is necessary where an association desires for patron members to share fully in any increased value of their equity and to provide member liquidity.

A limited cooperative association is a self-help organization controlled by its members and is a separate entity from its members under Section 105. This principle of autonomy must, however, be placed within the practical context of long-term debt, equity, and contractual relationships both in this Act and in traditional cooperatives.

Section 1004 ("Allocations of Profits and Losses") expressly provides for the values of member economic participation; education, training and information; and cooperation among cooperatives. One of the key balancing points of the Act concerns "democratic member control." Sections 405, 511 through 514, 804, and 816(a) (as well as the other voting provisions on fundamental changes) all relate to this balance.

"Concern for community" is directly addressed in Section 820 which varies the law generally applicable to, for example, corporate directors, to allow the directors of a limited cooperative to consider a number of community constituencies in making decisions.

Another frequently articulated cooperative principle is "operation at cost." This principle is frequently recognized through allocations of profits and losses among members in a traditional cooperative in a manner similar to allocations in partnerships. Section 1004 reflects this approach. "Operation at cost" can also be addressed through pricing of goods and services received from or provided to members in ways that financially benefit the members. This, in

turn, will affect profits and losses available for allocation to members. This approach is taken in this Act.

In sum, this Act expressly considers important traditional cooperative values and provides reasoned departures from those values only where necessary for purposes of this Act. Its intention is to encourage the use of entities recognizing cooperative principles by providing greater options for obtaining equity financing, yet is flexible enough to form a limited cooperative association which operates like a traditional cooperative.

SECTION 105. PURPOSE AND DURATION OF LIMITED COOPERATIVE ASSOCIATION .

(a) A limited cooperative association is an entity distinct from its members.

(b) A limited cooperative association may be organized for any lawful purpose, whether or not for profit [except designated prohibited purposes].

(c) Unless the articles of organization state a term for a limited cooperative association's existence, the association has perpetual duration.

Legislative Note: *This Act does not preclude a limited cooperative association organized under this Act from pursuing any lawful purpose. If an adopting jurisdiction desires to prevent an association under this Act from being used for a particular purpose, this can be accomplished as follows. First, an exception for the particular purpose can be specified in subsection (b). Second, if there is another statute in the adopting jurisdiction that governs the particular purpose and that statute by its own terms does not already apply, the other statute could be amended to ensure that no entity organized under this Act may pursue the purpose identified in the other statute or that any entity organized under this Act will comply with the other statute. Third, Section 109 may identify a particular purpose or statute with which this Act should be coordinated; as is done in optional Section 109(c).*

Comment

Subsection (a) – This Section, together with Section 104, identifies the "separate entity" concept of a limited cooperative association. *See* Comment to Section 104.

Subsection (b) – The phrase "any lawful purpose, whether or not for profit" means a limited cooperative association need not be formed or operated with a profit motive. Existing law in some states provides traditional cooperatives may be formed under not-for-profit cooperative statutes which reflect the cooperative value of operating at cost.

Like RULLCA (2006) Section 104(b) this Act does not use the term "business" in connection with the purpose of the entity. The expansive approach to purpose in this Act also comports with ULLCA (1996) and with ULPA (2001). *See* ULLCA (1996) § 112(a) (captioned with reference to "Nature of Business" and permitting "any lawful purpose, subject to any law of this State governing or regulating business") and § 101(3) (defining "Business" as including "every trade, occupation, profession, and other lawful purpose, whether or not carried on for profit"); ULPA (2001) § 104(b) (permitting a limited partnership to be organized for any "lawful" purpose). *Compare* UPA (1997) § 6 (defining a general partnership as organized for profit), RUPA § 101(6) (same), and RULPA (1976/1985) § 106 (delineating the "Nature of [a limited partnership's] Business" by linking back to "any business that a partnership without limited partners may carry on").

The subsection does not prevent a limited cooperative association from being organized to carry on charitable activities, but this Act does not include any protective provisions pertaining to charitable purposes. Those protections must be (and typically are) found in other law, although sometimes that "other law" appears within a state's non-profit corporation statute. *See, e.g.,* MINN. STAT. ANNOT. § 317A.811 (2006) (providing restrictions on charitable organizations that seek to "dissolve, merge, or consolidate, or to transfer all or substantially all of their assets" but imposing those restrictions only on "corporations" which are elsewhere defined as corporations incorporated under the non-profit corporation act). Of course, tax law significantly effects charities and contains strict parameters beyond the scope of this Act.

Section 109 emphasizes that protective and other regulatory provisions outside this Act remain applicable to limited cooperative associations. Those laws and regulations are not supplanted by this Act or the organic rules of an association organized under this Act. *See* Section 109.

Subsection (c) – In this context, the word "perpetual" states the default rule consistent with statutes governing other entities. As in many current limited liability company statutes, this Act provides several methods that could be used to override perpetuity: a term specified in the articles of organization and occurrences specified in Sections 1202, 1203, 1205, and 1211. In this Act, "perpetuity" means that the Act does not require a definite term and creates no nexus between the dissociation of a member and the dissolution of the association beyond, in most cases, the requirement that a limited cooperative association have two members. *See* Section 501. (The dissociation of an association's last remaining member does threaten dissolution under the compulsory provisions of Section 1202(3).)

SECTION 106. POWERS . A limited cooperative association may sue and be sued in its own name and do all things necessary or convenient to carry on its activities. An association may maintain an action against a member for harm caused to the association by the member's violation of a duty to the association or of the organic law or organic rules.

Comment

Following RULLCA (2006) Section 105, and ULPA (2001) Section 105, this Act omits as unnecessary any detailed list of specific powers. *Compare* ULLCA § 12 (containing a detailed list).

The capacity to sue and be sued is mentioned specifically. It cannot be varied by the organic rules. The Section affirms the right of a limited cooperative association to maintain an action against a member in the circumstances described.

The omission of any reference to non-members in connection with a limited cooperative association maintaining an action against a member does not imply that an association may not sue non-members or restrict the association from engaging in business or other transactions with non-members. It is intended to broaden the rights of the association rather than narrow them.

SECTION 107. GOVERNING LAW . The law of this state governs:

(1) the internal affairs of a limited cooperative association; and

(2) the liability of a member as member and a director as director for the debts, obligations, or other liabilities of a limited cooperative association.

Comment

Source: RULLCA (2006) § 106.

This Section may not be varied by the organic rules. This Act is part of the law of this state. *See generally*, Section 113(a) (addressing the flexibility of this Act).

Paragraph (1) – The laws of this state, including this Act, govern the interpretation and enforcement of the organic rules and matters relating to relations among members as members and relations between the limited cooperative association and the members as members regardless of where the members are located. *Compare* RESTATEMENT (SECOND) OF CONFLICT OF LAWS §302, Comment A (defining "internal affairs" with reference to a corporation as "the relations inter se of the corporation, its shareholders, directors, officers or agents"). Like any other legal concept, "internal affairs" in paragraph (1) may be indeterminate in some circumstances.

In some types of cooperatives marketing contracts are an integral part of an association's business. Article 7 ("Marketing Contracts") of this Act, like most traditional marketing cooperative statutes, allows all or part of a marketing contract to be included in the organic rules. The placement of the terms of the marketing contract in the organic rules or in a separate agreement is not necessarily determinative of whether those terms are part of the internal affairs of the association. *See* Comments to Section 601 and Section 701.

Paragraph (2) – This paragraph relates to Section 504 (the liability shield for members) and Section 802 (the liability shield of directors) but does not necessarily encompass a claim for which a member or director may be liable to a third party for (i) having purported to bind a limited cooperative association to the third party; or (ii) having committed a tort against the third party while acting on the association's behalf or in the course of its business. That liability is not by status (*i.e.*, not as a member) but rather results from behavior or conduct, which is governed by agency or other law.

SECTION 108. SUPPLEMENTAL PRINCIPLES OF LAW . Unless displaced by particular provisions of this [act], the principles of law and equity supplement this [act].

Comment

Source: RULLCA (2006) § 107.

SECTION 109. REQUIREMENTS OF OTHER LAWS .

(a) This [act] does not alter or amend any law that governs the licensing and regulation of an individual or entity in carrying on a specific business or profession even if that law permits the business or profession to be conducted by a limited cooperative association, a foreign cooperative, or its members.

(b) A limited cooperative association may not conduct an activity that, under law of this state other than this [act], may be conducted only by an entity that meets specific requirements for the internal affairs of that entity unless the organic rules of the association conform to those requirements.

[(c) If an activity of a limited cooperative association is within the scope of [reference to the Uniform Common Interest Ownership Act or to the Model Real Estate Cooperative Act], the requirements of [reference to the Uniform Common Interest Ownership Act or to the Model Real Estate Cooperative Act] apply, even if there is a conflicting provision in this [act].]

Legislative Note*: If an adopting jurisdiction has enacted the Uniform Common Interest Ownership Act or the Model Real Estate Cooperative Act, the adopting jurisdiction should add subsection (c).*

The phrase "limited cooperative associations" should be added by amendment to other statutes outside this Act that contain lists of entities and other law should be conformed as appropriate.

Comment

Source: Greatly expanded but conceptually similar to ULLCA (1996) § 112(a).

Section 109 may appear to be surplusage because it restates the application of known legal interpretive principles outside this Act. Nonetheless it attempts to make clear that this Act is limited to its terms; that it does not supersede other law, either directly or by implication, including regulatory law; and that a limited cooperative association organized under this Act is not exempt from separately qualifying as a "cooperative" under other law. Thus, it serves a similar purpose for domestic associations as does Section 1401(c) for foreign cooperatives which provides that a "certificate of authority does not authorize the cooperative to exercise any power not given a limited cooperative association in this state". *See* RULLCA (2006) § 801(c). RUPA (1997) § 1101(c). To an extent, this is related to the policy that the use of the term "limited" is included in the name of the association to distinguish it from cooperatives formed under other law.

The following examples illustrate the application of this Section.

> **EXAMPLE**: Ten construction workers desire to form a worker's cooperative as a limited cooperative association. Organizing as a limited cooperative association will not excuse the limited cooperative from any contractor bonding requirements in other law. Further, the limited cooperative association will be required to comply with applicable wage and hour law.
>
> **EXAMPLE**: Same scenario as in previous example except the jurisdiction in which the workers desire to form a limited cooperative association has a specific workers' cooperative statute that expressly states all workers cooperatives must be organized under the workers cooperative statute. Workers cannot lawfully organize a workers cooperative under this Act in that jurisdiction.
>
> **EXAMPLE**: A group of consumers desires to form a limited cooperative association to conduct business as a natural foods cooperative. The association must comply with the health regulations applicable to grocery businesses as well as laws relating to distribution of natural foods.

> **EXAMPLE**: A real estate developer desires to organize as a limited cooperative association to develop property as a "housing cooperative." The state has a housing cooperative law that applies to all "residential common interest communities." In turn the statute defines "residential common interest community." If the planned project organized as a limited cooperative association meets the definition of the "residential common interest community," all the provisions of that law apply to the developer, the project, and the limited cooperative association. If the law contains disclosure requirements the association must make the required disclosures.

The number and types of regulatory laws are too numerous to list in the text of this Act and any exclusive list of laws or activities raises the risk of inadvertent omission. For example, the application for, the qualification of, and the licensing and examination of the following business professions would appear in a comprehensive statutory list: legal, medical, dental, optometry, engineers, architects, surveyors, public accountancy, opticians, psychologists, veterinary medicine, speech pathologists, audiologists, financial institutions, contractors, fumigators, pest control operators, real estate brokers and sales persons, electricians, plumbers, real estate appraisers, photographers, pharmacists, physical therapy, podiatry, barbering, nursing, social workers, embalmers and funeral directors, motor vehicle dealers, boxing contests, cable television, and degree granting institutions.

The list would include other general trade regulation and trade practice law such as trademark and trade names, trade secrets, franchise investment, business opportunity, consumer law, public accommodations, and many others.

Subsection (a) – This subsection is a general statement that the requirements of licensing and regulatory law apply to the conduct of activity by or through a limited cooperative association organized under it without attempting to provide a comprehensive list of specific professions, trades, or businesses.

> **EXAMPLE**: Two real estate brokers desire to form a limited cooperative association for the sale of residential real estate on a commission basis. Nothing in this Act would preclude them from organizing a limited cooperative association. Nonetheless, the form of the organization in which they conduct that activity is still subject to the law regulating the sale of residential real estate on a commission basis. Therefore if those laws do not permit the limited cooperative association as a permissible form in which to conduct business, the real estate brokers may not organize as an association to conduct their business. Moreover, organizing as a limited cooperative association, even if allowed for this purpose, will not exempt it from the application of other applicable regulation or law such as disclosure requirements or standards for the maintenance of trust funds or escrow accounts.

Subsection (b) – Some other laws contain requirements for the internal affairs of any organization used to conduct a specific activity or to perform a specific function. This subsection is a general statement that those requirements apply to a limited cooperative association conducting those activities or performing those functions.

> **EXAMPLE**: Same facts as in the previous example. The state housing cooperative law is silent concerning the type of entity permitted to be a "homeowners association." The statute does require that all members of the homeowners association must be able to vote in particular matters by a proxy and that only homeowners may be members of the association. Under these facts the homeowners association could be formed as a limited cooperative association but it would be necessary that the organic rules provide for voting by a proxy and the membership restrictions required by the housing cooperative law.

Subsection (c) – This subsection recognizes that the state's housing cooperative law contains a comprehensive and integrated regulatory scheme that extends to a substantial number of aspects of a housing cooperative. As a result, it might be argued that limited cooperative associations should not be able to be formed for that purpose. Exclusions described in terms of broad activities or purposes, however, are likely to be difficult to interpret and apply and run the risk of being either over or under exclusive. Expressly referencing a specific act mitigates these difficulties while clearly emphasizing the desired regulatory result which would probably otherwise apply because of subsections (a) and (b). This is consistent with the policy of permitting limited cooperative associations to be available for a broad range of endeavors.

[**SECTION 110. RELATION TO RESTRAINT OF TRADE AND ANTITRUST LAWS .** To the extent a limited cooperative association or activities conducted by the association in this state meet the material requirements for other cooperatives entitled to an exemption from or immunity under any provision of [the restraint of trade or antitrust laws of this state], the association and its activities are entitled to the exemption or immunity. This section does not create any new exemption or immunity for an association or affect any exemption or immunity provided to a cooperative organized under any other [law].]

Legislative Note*: Some states' existing general cooperative or marketing cooperative statutes contain an exemption from state restraint of trade and antitrust laws. In the context of a marketing cooperative such an exemption is historical and may be helpful because cooperatives are united groups of producers that could be interpreted to be fixing prices.*

This Section is bracketed because some states as a matter of policy do not include an exception in their other cooperative statutes and, presumably, would not include them in this Act. Moreover because this Act, unlike other cooperative statutes, allows for investor members, it can be distinguished from cooperatives organized under other laws. It is appropriate, therefore, that adopting jurisdictions consider if their existing policy should be applied to limited cooperative associations.

Comment

Many state cooperative statutes, most particularly marketing cooperative statutes, contain special exemptions from state antitrust and restraint of trade laws. There is variety in the formulation of such exemptions even in marketing cooperative statutes and the variation reflects policy distinctions between states. This Section reflects the settled policy of this state by reference to existing law.

SECTION 111. NAME .

[(a) Use of the term "cooperative" or its abbreviation under this [act] is not a violation of the provisions restricting the use of the term under [insert cross-reference to law of this state].]

[(a)][(b)] The name of a limited cooperative association must contain the words "limited cooperative association" or "limited cooperative" or the abbreviation "L.C.A." or "LCA". "Limited" may be abbreviated as "Ltd.". "Cooperative" may be abbreviated as "Co-op" or "Coop". "Association" may be abbreviated as "Assoc." or "Assn.". [[A limited cooperative association or a member may enforce the restrictions on the use of the term "cooperative" under this [act].] [or] [A limited cooperative association or a member may enforce the restrictions on the use of the term "cooperative" [insert cross-reference to other laws of this state].]]

[(b)][(c)] Except as otherwise provided in subsection (d), a limited cooperative association may use only a name that is available. A name is available if it is distinguishable in the records of the [Secretary of State] from:

(1) the name of any entity organized or authorized to transact business in this state;

(2) a name reserved under Section 112; and

(3) an alternative name approved for a foreign cooperative authorized to transact business in this state.

[(c)][(d)] A limited cooperative association may apply to the [Secretary of State] for authorization to use a name that is not available. The [Secretary of State] shall authorize use of the name if:

(1) the person with ownership rights to use the name consents in a record to the use and applies in a form satisfactory to the [Secretary of State] to change the name used or reserved to a name that is distinguishable upon the records of the [Secretary of State] from the name applied for; or

(2) the applicant delivers to the [Secretary of State] a certified copy of the final judgment of a court establishing the applicant's right to use the name in this state.

***Legislative Note**: The bracketed language in Sections 111(a) and 111(b) is optional. If the adopting jurisdiction has existing limitations in other law on the use of the term "cooperative," this Section should be adopted to further the policy of the jurisdiction and to avoid violation of the other law by limited cooperative associations. Section 111(b) requires "cooperative" or an abbreviation thereof in a limited cooperative association's name.*

Many cooperative statutes include name protection provisions unique among organizational laws. If the adopting jurisdiction has a prohibition of the use of the word "cooperative" or a permitted abbreviation by any entity other than a cooperative organized under a statute providing for the formation of cooperative entities, this Act will not violate that statute if this Section is adopted with a reference to that statute in subsection (a). Moreover, if this Section is adopted with a reference to the other statute in subsection (b), restrictions on the use of the word "cooperative" or a permitted abbreviation under that statute may be enforced by a limited cooperative association or a member of an association organized under this Act. Alternatively, the adopting jurisdiction could amend the other statute to permit an association organized under this Act to use the word "cooperative" or a permitted abbreviation without violating that statute and to enforce the restrictions on the use of the word or abbreviations under that statute.

If the adopting jurisdiction does not have a statute prohibiting the use of the word "cooperative" or a permitted abbreviation by any entity that is not organized as a cooperative, the adopting jurisdiction may wish to consider providing a prohibition and remedies in this Section.

Comment

This Section does not supercede or preempt fictitious or assumed name statutes. A foreign cooperative must comply with those statutes in the adopting jurisdiction. *See* Sections 112 and 1405.

Subsection (b) – The name of a limited cooperative association must contain the prescribed words or abbreviations in order to differentiate an association organized under this Act from traditional cooperatives or other entities organized under other statutes.

Traditional cooperative statutes recognize the unique nature of cooperative organizations and frequently protect cooperatives from the appropriation of the term "cooperative" by entities other than cooperatives. They typically provide authority for both the cooperative and a member to enforce the prohibition against use of the term "cooperative" by an entity that is not a cooperative. This subsection is designed to extend that protection to a limited cooperative association as well as to coordinate the protection of the term "cooperative" with those other statutes.

A person doing business with a cooperative may impute cooperative values and principles to an organization using that term in its name. Restricting the use of "cooperative" may help avoid misleading the public.

SECTION 112. RESERVATION OF NAME .

(a) A person may reserve the exclusive use of the name of a limited cooperative association, including a fictitious name for a foreign cooperative whose name is not available under Section 111, by delivering an application to the [Secretary of State] for filing. The application must set forth the name and address of the applicant and the name proposed to be reserved. If the [Secretary of State] finds that the name applied for is available under Section 111, the [Secretary of State] shall reserve the name for the applicant's exclusive use for a nonrenewable period of 120 days.

(b) A person that has reserved a name for a limited cooperative association may transfer the reservation to another person by delivering to the [Secretary of State] a signed notice of the transfer which states the name, street address, and, if different, the mailing address of the transferee. If the person is an organizer of the association and the name of the association is the same as the reserved name, the delivery of articles of organization for filing [by the Secretary of State] is a transfer by the person to the association.

Comment

The Act does not provide for renewal of a reserved name. It does not prevent a person from subsequently filing reservations for the same name for successive 120 day periods.

SECTION 113. EFFECT OF ORGANIC RULES .

(a) The relations between a limited cooperative association and its members are consensual. Unless required, limited, or prohibited by this [act], the organic rules may provide for any matter concerning the relations among the members of the association and between the members and the association, the activities of the association, and the conduct of its activities.

(b) The matters referred to in paragraphs (1) through [(9)] [(11)] may be varied only in the articles of organization. The articles may:

(1) state a term of existence for the association under Section 105(c);

(2) limit or eliminate the acceptance of new or additional members by the initial board of directors under Section 303(b);

(3) vary the limitations on the obligations and liability of members for association obligations under Section 504;

(4) require a notice of an annual members meeting to state a purpose of the meeting under Section 508(b);

(5) vary the board of directors meeting quorum under Section 815(a);

(6) vary the matters the board of directors may consider in making a decision under Section 820;

(7) specify causes of dissolution under Section 1202(1);

(8) delegate amendment of the bylaws to the board of directors pursuant to Section 405(f);

(9) provide for member approval of asset dispositions under Section 1501; [and]

[[(10)] subject to Section 820, provide for the elimination or limitation of liability of a director to the association or its members for money damages pursuant to Section 818;

[(11)] provide for permitting or making obligatory indemnification under Section 901(a); and]

[(10)] [(12)] provide for any matters that may be contained in the organic rules, including those under subsection (c).

(c) The matters referred to in paragraphs (1) through (25) may be varied only in the organic rules. The organic rules may:

(1) require more information to be maintained under Section 114 or provided to members under Section 505(k);

(2) provide restrictions on transactions between a member and an association under Section 115;

(3) provide for the percentage and manner of voting on amendments to the organic rules by district, class, or voting group under Section 404(a);

(4) provide for the percentage vote required to amend the bylaws concerning the admission of new members under Section 405(e)(5);

(5) provide for terms and conditions to become a member under Section 502;

(6) restrict the manner of conducting members meetings under Sections 506(c) and 507(e);

(7) designate the presiding officer of members meetings under Sections 506(e) and 507(g);

(8) require a statement of purposes in the annual meeting notice under Section 508(b);

(9) increase quorum requirements for members meetings under Section 510 and board of directors meetings under Section 815;

(10) allocate voting power among members, including patron members and investor members, and provide for the manner of member voting and action as permitted by Sections 511 through 517;

(11) authorize investor members and expand or restrict the transferability of members' interests to the extent provided in Sections 602 through 604;

(12) provide for enforcement of a marketing contract under Section 704(a);

(13) provide for qualification, election, terms, removal, filling vacancies, and member approval for compensation of directors in accordance with Sections 803 through 805, 807, 809, and 810;

(14) restrict the manner of conducting board meetings and taking action without a meeting under Sections 811 and 812;

(15) provide for frequency, location, notice and waivers of notice for board meetings under Sections 813 and 814;

(16) increase the percentage of votes necessary for board action under Section 816(b);

(17) provide for the creation of committees of the board of directors and matters related to the committees in accordance with Section 817;

(18) provide for officers and their appointment, designation, and authority under Section 822;

(19) provide for forms and values of contributions under Section 1002;

(20) provide for remedies for failure to make a contribution under Section 1003(b);

(21) provide for the allocation of profits and losses of the association, distributions, and the redemption or repurchase of distributed property other than money in accordance with Sections 1004 through 1007;

(22) specify when a member's dissociation is wrongful and the liability incurred by the dissociating member for damage to the association under Section 1101(b) and (c);

(23) provide the personal representative, or other legal representative of, a deceased member or a member adjudged incompetent with additional rights under Section 1103;

(24) increase the percentage of votes required for board of director approval of:

(A) a resolution to dissolve under Section 1205(a)(1);

(B) a proposed amendment to the organic rules under Section 402(a)(1);

(C) a plan of conversion under Section 1603(a);

(D) a plan of merger under Section 1607(a); and

(E) a proposed disposition of assets under Section 1503(1); and

(25) vary the percentage of votes required for members approval of:

(A) a resolution to dissolve under Section 1205;

(B) an amendment to the organic rules under Section 405;

(C) a plan of conversion under Section 1603;

(D) a plan of merger under Section 1608; and

(E) a disposition of assets under Section 1504.

(d) The organic rules must address members' contributions pursuant to Section 1001.

Legislative Note*: Bracketed subsections (a)(10) and (11) are illustrative. They apply only if the adopting jurisdiction selects both the state general business corporation act in Sections 818 and 901 and the act so selected provides for modification of those standards in the articles of incorporation. Thus, these provisions need to be conformed to the flexibility of choice provided by those sections.*

Comment

The Act contains default rules which may be varied by the organic rules. This Section identifies specific provisions in the Act that may be altered, eliminated, revised or otherwise modified by the organic rules. Subsection (b) identifies those provisions that may be modified only in the articles of organization. Subsection (c) identifies those provisions that may be modified in either the articles or the bylaws (the "organic rules"). The provisions identified in subsections (b) and (c) are substantive only to the extent they provide guidance on the interpretation of phrases like "unless otherwise provided in the organic rules." They serve the additional function of collecting references to provisions where variance from statutory default rules must be in the organic rules. Therefore, Section 113 does not perform the same function as Section 110 of RULLCA (2006). *But see* Prefatory Note ("Structure and Interpretation of ULCAA").

Subsection (a) – This Act generally follows the approach of other unincorporated entity statutes. If a particular matter is not prohibited or specifically mandated by the Act, a limited cooperative association may deal with the matter as part of its internal governance structure. If the Act does not address a subject with a specific requirement, permission, limitation or prohibition, a limited cooperative association is not limited in its approach or activities with respect to the subject.

Subsections (b) and (c) – In this Act, where the phrase "unless the organic rules otherwise provide" is used, that phrase signals freedom for the organic rules to vary the provision in which the phrase appears unless the provision itself contains a constraint on that freedom. In effect these provisions contain default rules. *See*, *e.g.*, Sections 504, 602 and 1005.

Other techniques are used to signal that sections are not mandatory. In some sections of the Act, there are specific prohibitions on how the Act may be varied or on how negation of a default result, such as a default delegation of authority to the board of directors, must be made. *See*, *e.g.*, Sections 812(a) and 1004(d). Other provisions in the Act use the phrase "may provide" to emphasize the flexibility of the Act and to provide further guidance with respect to a particular subject. The phrase does not necessarily grant additional authority beyond what is already available. By way of illustration, where "may provide" is used, the organic rules may state specific rules, instructions or results or may state a procedure by which the subject matter will be decided, such as delegating authority to the board of directors. *See*, *e.g.*, Sections 515(c) and (d) and 1004(a). For a more comprehensive discussion see the Prefatory Note ("Structure and Interpretation of ULCAA"; "Organic Rules").

Subsection (d) – This subsection is included to make it clear that contributions must be addressed in the organic rules. The subject matter of this subsection may represent a trap for the unwary. Though there are no negative legal consequences for not addressing contributions provided in this Act changes in contribution requirements require super-majority member vote.

SECTION 114. REQUIRED INFORMATION .

(a) Subject to subsection (b), a limited cooperative association shall maintain in a record available at its principal office:

(1) a list containing the name, last known street address and, if different, mailing address, and term of office of each director and officer;

(2) the initial articles of organization and all amendments to and restatements of the articles, together with a signed copy of any power of attorney under which any article, amendment, or restatement has been signed;

(3) the initial bylaws and all amendments to and restatements of the bylaws;

(4) all filed articles of merger and statements of conversion;

(5) all financial statements of the association for the six most recent years;

(6) the six most recent annual reports delivered by the association to the [Secretary of State];

(7) the minutes of members meetings for the six most recent years;

(8) evidence of all actions taken by members without a meeting for the six most recent years;

(9) a list containing:

(A) the name, in alphabetical order, and last known street address and, if different, mailing address of each patron member and each investor member; and

(B) if the association has districts or classes of members, information from which each current member in a district or class may be identified;

(10) the federal income tax returns, any state and local income tax returns, and any tax reports of the association for the six most recent years;

(11) accounting records maintained by the association in the ordinary course of its operations for the six most recent years;

(12) the minutes of directors meetings for the six most recent years;

(13) evidence of all actions taken by directors without a meeting for the six most recent years;

(14) the amount of money contributed and agreed to be contributed by each member;

(15) a description and statement of the agreed value of contributions other than money made and agreed to be made by each member;

(16) the times at which, or events on the happening of which, any additional contribution is to be made by each member;

(17) for each member, a description and statement of the member's interest or information from which the description and statement can be derived; and

(18) all communications concerning the association made in a record to all members, or to all members in a district or class, for the six most recent years.

(b) If a limited cooperative association has existed for less than the period for which records must be maintained under subsection (a), the period records must be kept is the period of the association's existence.

(c) The organic rules may require that more information be maintained.

Comment

This Section defines a minimum amount of information that must be maintained by a limited cooperative association. The listed items do not specify all records that may be advisable for an association to maintain for legal or business purposes. The Section does not prohibit an association from maintaining other records. The organic rules may identify other records to be maintained and specify the time period they must be maintained. The organic rules may also provide that records may be kept longer than the time specified in this Section.

Although the Section provides periods during which some of the listed items are to be maintained for purposes of this Act, this does not define the time frame for which the items should be maintained for other purposes, *e.g.*, records for purposes of taxation. As a practical matter, business practices may require that certain records such as minutes of directors and members meetings be maintained for longer periods. The period for maintenance of records is a matter for determination by the association except for the required minimum periods. The maintenance of records may also be governed by other law, for example, immigration compliance records and record retention for discovery under rules of civil procedure for pending or threatened litigation.

This Section coordinates with Section 505 ("Right of Member and Former Member to Information"). Section 505 that provides the rights of members and former members to access information required to be maintained under this Section. Conditions and limitations on a member's rights to information are also contained in Section 505.

A similar provision to this Section appears in ULPA (2001) Section 111 and RMBCA Section 16.01. It does not appear in RUPA or RULLCA (2006). RULLCA (2006) Section 410(a)(1) has a different format and a potentially broader application. *Compare* RUPA (1997) § 403. This Act does not draw a distinction between "kept" and "maintained". As in ULPA (2001) and RMBCA, this Act uses "maintained" for all purposes.

Subsection (a) – The requirement that a record of the required information be "available" at the "principal office" of the association does not mean the record must be maintained there at all times. It is sufficient if the record can be obtained and made available at the office and, therefore, includes records maintained electronically or in other forms that may or may not be instantaneously available.

Unlike ULPA (2001), this Act does not require the record to be maintained at a limited cooperative association's "designated office" because under this Act and similar statutes the association could have multiple designated offices if it operates in multiple jurisdictions. To impose a requirement that the records be maintained in each of those offices could be overly burdensome to the association.

The association's principal office under the Act is the principal executive office of the association or a foreign cooperative wherever located. Section 102(25).

The form of the record in which the information must be maintained is any form included in the definition of "record" in Section 102(26).

Subsection (a)(1) – "Officer" is not a defined term but means only individuals that have executive authority beyond the title of "officer".

Subsections (a)(2) and (3) – These requirements apply to superseded as well as current articles of organization and bylaws.

Subsections (a)(8) and (13) – These subsections do not require a limited cooperative association to make a record of consents given and votes taken although this may be required by Sections 516 and 812.

Subsection (a)(15) – The information required by this provision is essential for determining the rights and interests of a member generally and is especially important where a member is both a patron member and an investor member. It is also necessary because the information is referenced in Section 505(f) permitting a member to access the member's own information with respect to a limited cooperative association. This information may be particularly important where a member with dual capacity dissociates in one capacity but not the other.

Subsection (a) (18) – The emphasis in this subsection is on "all members." The subsection does not require communications to an individual member; only communications

directed to all members of a limited cooperative association or to all members in a district or class must be maintained.

Subsection (c) – This subsection is a good example of the operation of Section 113(c) because requiring greater information would be the rule even without this subsection. *See* Comment to Section 113 (“Subsections (b) and (c)”).

SECTION 115. BUSINESS TRANSACTIONS OF MEMBER WITH LIMITED COOPERATIVE ASSOCIATION . Subject to Sections 818 and 819 and except as otherwise provided in the organic rules or a specific contract relating to a transaction, a member may lend money to and transact other business with a limited cooperative association in the same manner as a person that is not a member.

Comment

Source: Derived from ULPA (2001) § 112.

SECTION 116. DUAL CAPACITY . A person may have a patron member’s interest and an investor member’s interest. When such person acts as a patron member, the person is subject to this [act] and the organic rules governing patron members. When such person acts as an investor member, the person is subject to this [act] and the organic rules governing investor members.

Comment

Source: ULPA (2001) § 113.

One person can be both a patron member and an investor member concurrently. Membership is governed by the provisions of the Act and the organic rules for each type of membership, respectively. *See* Comment to Section 102(16).

SECTION 117. DESIGNATED OFFICE AND AGENT FOR SERVICE OF PROCESS .

(a) A limited cooperative association, or a foreign cooperative that has a certificate of authority under Section 1404, shall designate and continuously maintain in this state:

(1) an office, as its designated office, which need not be a place of the association's or foreign cooperative's activity in this state; and

(2) an agent for service of process at the designated office.

(b) An agent for service of process of a limited cooperative association or foreign cooperative must be an individual who is a resident of this state or an entity that is authorized to do business in this state.

Comment

The Act uses the more current term "designated office" rather than "registered office" for the office to be maintained in this state. It is simply where the agent for service of process of a limited cooperative association is located.

Section 205 imposes liability on persons filing known inaccurate information that causes harm to those relying on the information.

SECTION 118. CHANGE OF DESIGNATED OFFICE OR AGENT FOR SERVICE OF PROCESS .

(a) Except as otherwise provided in Section 207(e), to change its designated office, its agent for service of process, or the street address or, if different, mailing address of its principal office, a limited cooperative association must deliver to the [Secretary of State] for filing a statement of change containing:

(1) the name of the limited cooperative association;

(2) the street address and, if different, mailing address of its designated office;

(3) if the designated office is to be changed, the street address and, if different, mailing address of the new designated office;

(4) the name of its agent for service of process; and

(5) if the agent for service of process is to be changed, the name of the new agent.

(b) Except as otherwise provided in Section 207(e), to change its agent for service of process, the address of its designated office, or the street address or, if different, mailing address of its principal office, a foreign cooperative shall deliver to the [Secretary of State] for filing a statement of change containing:

(1) the name of the foreign cooperative;

(2) the name, street address and, if different, mailing address of its designated office;

(3) if the current agent for service of process or an address of the designated office is to be changed, the new information;

(4) the street address and, if different, mailing address of its principal office; and

(5) if the street address or, if different, the mailing address of its principal office is to be changed, the street address and, if different, the mailing address of the new principal office.

(c) Except as otherwise provided in Section 204, a statement of change is effective when filed by the [Secretary of State].

Comment

Source: Derived from RULLCA (2006) § 114.

Changes in the address of a designated office or the name of the agent for service of process may also be made in an annual report under Section 207(e).

For liability for filing inaccurate information see Section 205.

SECTION 119. RESIGNATION OF AGENT FOR SERVICE OF PROCESS .

(a) To resign as an agent for service of process of a limited cooperative association or foreign cooperative, the agent must deliver to the [Secretary of State] for filing a statement of resignation containing the name of the agent and the name of the association or foreign cooperative.

(b) After receiving a statement of resignation under subsection (a), the [Secretary of State] shall file it and mail or otherwise provide or deliver a copy to the limited cooperative association or foreign cooperative at its principal office.

(c) An agency for service of process of a limited cooperative association or foreign cooperative terminates on the earlier of:

(1) the 31st day after the [Secretary of State] files a statement of resignation under subsection (b); or

(2) when a record designating a new agent for service of process is delivered to the [Secretary of State] for filing on behalf of the association or foreign cooperative and becomes effective.

Comment

Source: Derived from RULLCA (2006) § 115 and ULPA (2001) § 116.

An agent for service of process (registered agent) of a limited cooperative association may resign by following the procedure provided in this Section. Section 205 may provide for damages when any record relating to the resignation is inaccurate and a person suffers a loss because of the inaccuracy.

SECTION 120. SERVICE OF PROCESS .

(a) An agent for service of process appointed by a limited cooperative association or foreign cooperative is an agent of the association or foreign cooperative for service of process,

notice, or a demand required or permitted by law to be served upon the association or foreign cooperative.

(b) If a limited cooperative association or foreign cooperative does not appoint or maintain an agent for service of process in this state or the agent for service of process cannot with reasonable diligence be found at the address of the designated office on file with the [Secretary of State], the [Secretary of State] is an agent of the association or foreign cooperative upon which process, notice, or a demand may be served.

(c) Service of process, notice, or a demand on the [Secretary of State] as agent of a limited cooperative association or foreign cooperative may be made by delivering to the [Secretary of State] two copies of the process, notice, or demand. The [Secretary of State] shall forward one copy by registered or certified mail, return receipt requested, to the association or foreign cooperative at its principal office.

(d) Service is effected under subsection (c) on the earliest of:

(1) the date the limited cooperative association or foreign cooperative receives the process, notice, or demand;

(2) the date shown on the return receipt, if signed on behalf of the association or foreign cooperative; or

(3) five days after the process, notice, or demand is deposited by the [Secretary of State] for delivery by the United States Postal Service, if postage prepaid to the address of the principal office on file with the [Secretary of State].

(e) The [Secretary of State] shall keep a record of each process, notice, and demand served pursuant to this section and record the time of, and the action taken regarding, the service.

(f) This section does not affect the right to serve process, notice, or a demand in any other manner provided by law.

Comment

Source: RULLCA (2006) § 116 and ULPA (2001) § 117, which is based on ULLCA (1996) § 111.

[ARTICLE] 2

FILING AND ANNUAL REPORTS

SECTION 201. SIGNING OF RECORDS DELIVERED FOR FILING TO [SECRETARY OF STATE] .

(a) A record delivered to the [Secretary of State] for filing pursuant to this [act] must be signed as follows:

(1) The initial articles of organization must be signed by at least one organizer.

(2) A statement of cancellation under Section 302(d) must be signed by at least one organizer.

(3) Except as otherwise provided in paragraph (4), a record signed on behalf of an existing limited cooperative association must be signed by an officer.

(4) A record filed on behalf of a dissolved association must be signed by a person winding up activities under Section 1206 or a person appointed under Section 1206 to wind up those activities.

(5) Any other record must be signed by the person on whose behalf the record is delivered to the [Secretary of State].

(b) Any record to be signed under this [act] may be signed by an authorized agent.

Legislative Note: *This Act contemplates signatures on all records delivered to the office where records regarding entities are filed in a jurisdiction adopting this Act. Signatures may be electronic. See Section 102(28). In those jurisdictions that do not require signatures, the sections of the Act that require a signature should be revised to relate to the person causing the record to be delivered for filing. This Act assumes other law in the adopting jurisdiction addresses false filings with the appropriate filing officer.*

Comment

Source: Based on RULLCA (2006) § 203.

This Act does not provide that a person signing a record or delivering it for filing does so under penalties of perjury leaving that matter to other law of the state. For that approach, *see* RULLCA (2006) § 207(c). A person who knew information in a record was inaccurate and signed the record, or caused another person to sign it on the person's behalf, may be liable for damages to any person who suffers a loss by relying on the inaccurate record. *See* Section 205.

Subsection (b) – This subsection does not require that the agent's authority be memorialized in a writing or other record.

SECTION 202. SIGNING AND FILING OF RECORDS PURSUANT TO JUDICIAL ORDER .

(a) If a person required by this [act] to sign or deliver a record to the [Secretary of State] for filing does not do so, the [appropriate court], upon petition of an aggrieved person, may order:

(1) the person to sign the record and deliver it to the [Secretary of State] for filing; or

(2) delivery of the unsigned record to the [Secretary of State] for filing.

(b) An aggrieved person under subsection (a), other than the limited cooperative association or foreign cooperative to which the record pertains, shall make the association or foreign cooperative a party to the action brought to obtain the order.

(c) An unsigned record filed pursuant to this section is effective.

Comment

Source: Based on RULLCA (2006) § 204 and ULPA (2001) § 205, which are based on RULPA (1976/1985) § 205, which was the source of ULLCA (1996) § 120.

SECTION 203. DELIVERY TO AND FILING OF RECORDS BY [SECRETARY OF STATE]; EFFECTIVE TIME AND DATE .

(a) A record authorized or required by this [act] to be delivered to the [Secretary of State] for filing must be captioned to describe the record's purpose, be in a medium and format permitted by the [Secretary of State], and be delivered to the [Secretary of State]. If the filing fees have been paid, and unless the [Secretary of State] determines that the record does not comply with the filing requirements of this [act], the [Secretary of State] shall file the record [and send a copy of the filed record and a receipt for the fees to the person on whose behalf the record was filed].

(b) The [Secretary of State], upon request and payment of the required fee, shall furnish a certified copy of any record filed by the [Secretary of State] under this [act] to the person making the request.

(c) Except as otherwise provided in Sections 118 and 204, a record delivered to the [Secretary of State] for filing under this [act] may specify an effective time and a delayed effective date that may include an effective time on that date. Except as otherwise provided in Sections 118 and 204, a record filed by the [Secretary of State] under this [act] is effective:

(1) if the record does not specify an effective time and does not specify a delayed effective date, on the date and at the time the record is filed as evidenced by the [Secretary of State's] [endorsement] of the date and time on the record;

(2) if the record specifies an effective time but not a delayed effective date, on the date the record is filed at the time specified in the record;

(3) if the record specifies a delayed effective date but not an effective time, at 12:01 a.m. on the earlier of:

(A) the specified date; or

(B) the 90th day after the record is filed; or

(4) if the record specifies an effective time and a delayed effective date, at the specified time on the earlier of:

(A) the specified date; or

(B) the 90th day after the record is filed.

Comment

Source: Based on RULLCA (2006) § 205 and ULPA (2001) § 206, which was based on ULLCCA (1996) § 206.

This Act uses the concept of "filing" to refer to the official act of the Secretary of State, which is typically preceded by a person "delivering" some record "to the Secretary of State for filing."

Subsections (c)(3)(B) and (c)(4)(B) – If a person delivers to the Secretary of State for filing a record that contains a delayed effective date that is longer than allowed, the Secretary of State: (i) will not reject the record; and (ii) is neither required nor authorized to inform the person that this Act will truncate the period of delay specified in the record.

SECTION 204. CORRECTING FILED RECORD .

(a) A limited cooperative association or foreign cooperative may deliver to the [Secretary of State] for filing a statement of correction to correct a record previously delivered by the association or foreign cooperative to the [Secretary of State] and filed by the [Secretary of State] if, at the time of filing, the record contained inaccurate information or was defectively signed.

(b) A statement of correction may not state a delayed effective date and must:

(1) describe the record to be corrected, including its filing date, or have attached a copy of the record as filed;

(2) specify the inaccurate information and the reason it is inaccurate or the manner in which the signing was defective; and

(3) correct the inaccurate information or defective signature.

(c) When filed by the [Secretary of State], a statement of correction is effective:

(1) when filed as to persons relying on the inaccurate information or defective signature before its correction and adversely affected by the correction; and

(2) as to all other persons, retroactively as of the effective date and time of the record the statement corrects.

Comment

Source: Based on RULLCA (2006) § 206 and ULPA (2001) § 207, which was based on ULLCA (1996) § 207.

This Section does not require correction of a filed record that has become inaccurate because of the passage of time or a change in circumstances that renders information in the record as originally filed to become inaccurate after the original filing date. The Act requires different types of filings in those circumstances and filing a correction is not the appropriate filing.

SECTION 205. LIABILITY FOR INACCURATE INFORMATION IN FILED RECORD . If a record delivered to the [Secretary of State] for filing under this [act] and filed by the [Secretary of State] contains inaccurate information, a person that suffers a loss by reliance on the information may recover damages for the loss from a person that signed the record or caused another to sign it on the person's behalf and knew at the time the record was signed that the information was inaccurate.

Legislative Note: *In an adopting jurisdiction that does not require signatures on records delivered for filing, the jurisdiction may want to consider revising the Section to cause the liability to be applicable to the person or persons delivering the record for filing or causing the record to be filed.*

SECTION 206. CERTIFICATE OF GOOD STANDING OR AUTHORIZATION .

(a) The [Secretary of State], upon request and payment of the required fee, shall furnish any person that requests it a certificate of good standing for a limited cooperative association if the records filed in the office of the [Secretary of State] show that the [Secretary of State] has filed the association's articles of organization, that the association is in good standing, and that the [Secretary of State] has not filed a statement of termination.

(b) The [Secretary of State], upon request and payment of the required fee, shall furnish to any person that requests it a certificate of authority for a foreign cooperative if the records filed in the office of the [Secretary of State] show that the [Secretary of State] has filed the foreign cooperative's certificate of authority, has not revoked nor has reason to revoke the certificate of authority, and has not filed a notice of cancellation.

(c) Subject to any exceptions stated in the certificate, a certificate of good standing or authority issued by the [Secretary of State] establishes conclusively that the limited cooperative association or foreign cooperative is in good standing or is authorized to transact business in this state.

Comment

This Act differs from RULLCA (2006) and ULPA (2001) in using the term "certificate of good standing" instead of the more current term "certificate of existence." The Committee believed a "certificate of good standing" remains a commonly understood term. "Good Standing" implies many of the items further delineated by RULLCA (2006) Section 208 and ULPA (2001) Section 209. Section 206(b), dealing with certificates of authorization, also differs from RULLCA (2006) and ULPA (2001).

SECTION 207. ANNUAL REPORT FOR [SECRETARY OF STATE] .

(a) A limited cooperative association or foreign cooperative authorized to transact business in this state shall deliver to the [Secretary of State] for filing an annual report that states:

(1) the name of the association or foreign cooperative;

(2) the street address and, if different, mailing address of the association's or foreign cooperative's designated office and the name of its agent for service of process at the designated office;

(3) the street address and, if different, mailing address of the association's or foreign cooperative's principal office; and

(4) in the case of a foreign cooperative, the state or other jurisdiction under whose law the foreign cooperative is formed and any alternative name adopted under Section 1405.

(b) Information in an annual report must be current as of the date the report is delivered to the [Secretary of State].

(c) The first annual report must be delivered to the [Secretary of State] between [January 1 and April 1] of the year following the calendar year in which the limited cooperative association is formed or the foreign cooperative is authorized to transact business in this state. An annual report must be delivered to the [Secretary of State] between [January 1 and April 1] of each subsequent calendar year.

(d) If an annual report does not contain the information required by subsection (a), the [Secretary of State] shall promptly notify the reporting limited cooperative association or foreign cooperative and return the report for correction. If the report is corrected to contain the information required by subsection (a) and delivered to the [Secretary of State] not later than 30 days after the date of the notice from the [Secretary of State], it is timely delivered.

(e) If a filed annual report contains an address of the designated office, name of the agent for service of process, or address of the principal office which differs from the information shown in the records of the [Secretary of State] immediately before the filing, the differing information in the annual report is considered a statement of change.

(f) If a limited cooperative association fails to deliver an annual report under this section, the [Secretary of State] may proceed under Section 1211 to dissolve the association administratively.

(g) If a foreign cooperative fails to deliver an annual report under this section, the [Secretary of State] may revoke the certificate of authority of the cooperative.

Legislative Note: *In adopting jurisdictions that require entities to file reports with the [Secretary of State] at times other than annually or at times different from those provided in this Section, this Section should be revised accordingly.*

Comment

Source: Derived from RULLCA (2006) § 209.

This Act does not have a provision providing for the effective date of notices. It leaves the determination of the effective date of notice here, and elsewhere, to other law. *See* Prefatory Note.

The information provided in a certificate of good standing or authorization is current only as of the date of the certificate.

SECTION 208. FILING FEES . The filing fee for records filed under this [article] by the [Secretary of State] is [insert appropriate fee or citation to fee provision under other state law].

Legislative Note: *A jurisdiction adopting this Act should consider establishing fees in this Section or cite to a fee structure statute concerning filing fees for records of limited partnerships or limited liability companies in the jurisdiction and provide a fee schedule for limited cooperative associations in the other statute.*

If the adopting jurisdiction has a statute providing a unified fee structure the bracketed language should be a cross-reference to the appropriate unified schedule.

[ARTICLE] 3

FORMATION AND INITIAL ARTICLES OF ORGANIZATION OF LIMITED COOPERATIVE ASSOCIATION

SECTION 301. ORGANIZERS. A limited cooperative association must be organized by one or more organizers.

Comment

The definition of "organizer" in Section 102(21) requires an organizer to be an individual.

This Act permits the organizing of limited cooperative associations without members at the time of organization. Section 501, however, requires the existence of at least two patron members before a limited cooperative association may begin business (unless the sole member is a cooperative). It may seem somewhat paradoxical that an unincorporated entity may exist, even if largely for filing convenience, without members. Some limited liability company statutes, however, provide for such "shelf" organizations. The member requirement for beginning business is an attempt to mitigate that theoretical issue. The member requirement, however, raises some common practice concerns such as providing an opinion on commencement of business. RULLCA (2006) Section 201 takes a different approach by permitting articles of organization to be filed without the limited liability company having members but not becoming effective until the company has at least one member.

Historically, cooperative statutes required multiple organizers who were to be members. Some statutes for specific types of cooperatives required permission by designated administrative agencies to form a cooperative. This Act requires neither.

SECTION 302. FORMATION OF LIMITED COOPERATIVE ASSOCIATION; ARTICLES OF ORGANIZATION .

(a) To form a limited cooperative association, an organizer of the association must deliver articles of organization to the [Secretary of State] for filing. The articles must state:

(1) the name of the association;

(2) the purposes for which the association is formed;

(3) the street address and, if different, mailing address of the association's initial designated office and the name of the association's initial agent for service of process at the designated office;

(4) the street address and, if different, mailing address of the initial principal office;

(5) the name and street address and, if different, mailing address of each organizer; and

(6) the term for which the association is to exist if other than perpetual.

(b) Subject to Section 113(a), articles of organization may contain any other provisions in addition to those required by subsection (a).

(c) A limited cooperative association is formed after articles of organization that substantially comply with subsection (a) are delivered to the [Secretary of State], are filed, and become effective under Section 203(c).

(d) If articles of organization filed by the [Secretary of State] state a delayed effective date, a limited cooperative association is not formed if, before the articles take effect, an organizer signs and delivers to the [Secretary of State] for filing a statement of cancellation.

Comment

A limited cooperative association is a unique unincorporated association. This Act borrows terminology and concepts from partnership, limited liability company, corporate and traditional cooperative laws but an association organized under this Act, despite some similarities, is none of those.

A limited cooperative association is both a creature of statute and contract like limited partnerships, limited liability companies, and some traditional cooperatives. Therefore, unlike in limited partnerships, for example, articles of organization have more significance in the internal governance of an association than does a certificate of limited partnership under limited partnership law.

This Section governs how a limited cooperative association comes into existence. An association is formed only if (i) articles of organization are prepared, signed and delivered to the specified public official for filing, (ii) the public official files the articles, (iii) the articles are in substantial compliance with this Section, and (iv) the articles become effective under Section 203(c). To commence business an association must have patron members. *See* Section 501.

Despite its foundational importance, the articles of organization of a limited cooperative association are not required to contain significant amounts of information. Under this Act bylaws must contain certain provisions that are fundamental to the organizational structure of a limited cooperative association if those matters are not contained in the articles or which override specific default rules hereunder. *See* Sections 113, 304(a) and 405(e). The bylaws of an association play a more powerful role than is typical in corporate law. Together the articles and bylaws are similar to the operating agreement of a limited liability company or the partnership agreement of a partnership. The relationship between the articles and bylaws of limited cooperative associations, therefore, places great weight on any planning decision to delegate authority to the board of directors to amend the bylaws.

The bylaws are, however, subject to the articles. *See* Section 304(a). Some matters must be addressed, if at all, in the articles to effectively vary the default rules of this Act. *See* Section 113(b).

Subsection (a)(1) – Section 111 contains name requirements. To be acceptable for filing, articles of organization must state a name for a limited cooperative association that complies with Section 111. *See* Comment to Section 111.

Subsection (a)(2) – For "the purposes for which the association is formed," the articles of organization may state "any lawful purpose." *See* Section 105(b); *see generally* Section 113(a).

SECTION 303. ORGANIZATION OF LIMITED COOPERATIVE ASSOCIATION .

(a) After a limited cooperative association is formed:

(1) if initial directors are named in the articles of organization, the initial directors shall hold an organizational meeting to adopt initial bylaws and carry on any other business necessary or proper to complete the organization of the association; or

(2) if initial directors are not named in the articles of organization, the organizers shall designate the initial directors and call a meeting of the initial directors to adopt initial

bylaws and carry on any other business necessary or proper to complete the organization of the association.

(b) Unless the articles of organization otherwise provide, the initial directors may cause the limited cooperative association to accept members, including those necessary for the association to begin business.

(c) Initial directors need not be members.

(d) An initial director serves until a successor is elected and qualified at a members meeting or the director is removed, resigns, is adjudged incompetent, or dies.

Comment

The articles of organization of a limited cooperative association are not required to list initial directors. This Section addresses how initial directors are designated if they are not named in the articles and the steps to be taken by the initial directors at a first meeting of the directors.

Subsection (a) – This subsection contemplates adoption of initial bylaws by the initial directors. There are circumstances, however, under which bylaws might not be required such as where all provisions required to be in the bylaws or articles of organization are in the articles of organization. *See* Section 304(a) and Comment to Section 304.

Subsection (b) – The articles of organization may name initial members. *See* Section 302(b). This subsection permits the initial board of directors to admit new members. If initial members are identified in the articles of organization, the initial board may admit additional members. If the articles of organization provide requirements for membership qualification, the initial board of directors' admission of members must comply with those requirements.

Subsection (c) – To facilitate the organizing process, the initial directors do not need to be members of the association. *See* Section 803.

SECTION 304. BYLAWS .

(a) Bylaws must be in a record and, if not stated in the articles of organization, must include:

(1) a statement of the capital structure of the limited cooperative association, including:

(A) the classes or other types of members' interests and relative rights, preferences, and restrictions granted to or imposed upon each class or other type of member's interest; and

(B) the rights to share in profits or distributions of the association;

(2) a statement of the method for admission of members;

(3) a statement designating voting and other governance rights, including which members have voting power and any restriction on voting power;

(4) a statement that a member's interest is transferable if it is to be transferable and a statement of the conditions upon which it may be transferred;

(5) a statement concerning the manner in which profits and losses are allocated and distributions are made among patron members and, if investor members are authorized, the manner in which profits and losses are allocated and how distributions are made among investor members and between patron members and investor members;

(6) a statement concerning:

(A) whether persons that are not members but conduct business with the association may be permitted to share in allocations of profits and losses and receive distributions; and

(B) the manner in which profits and losses are allocated and distributions are made with respect to those persons; and

(7) a statement of the number and terms of directors or the method by which the number and terms are determined.

(b) Subject to Section 113(c) and the articles of organization, bylaws may contain any other provision for managing and regulating the affairs of the association.

(c) In addition to amendments permitted under [Article] 4, the initial board of directors may amend the bylaws by a majority vote of the directors at any time before the admission of members.

Comment

The initial directors adopt the original bylaws. Section 303.

The Act does not provide a penalty and does not work a dissolution of a limited cooperative association or prevent it from being duly organized solely because it fails to adopt bylaws. Without bylaws much of the relationship between the limited cooperative association and its members will be covered by the Act's default rules. The Act does not, however, provide default rules for all the fundamental governing provisions listed in this Section.

This Act provides default rules for many items that can be covered in bylaws and permits the bylaws to vary many of those default rules. This Act does not address or provide for all matters that are permitted in an association's bylaws. *See* Section 113(c) and Section 304(b). Best practices might dictate that bylaws contain comprehensive provisions for the governance and financial structure of the association.

Bylaws have played a particularly central role in traditional cooperatives. Traditional cooperative statutes sometimes place power in the members to determine specific matters in the bylaws, such as the allocations of the profits or savings of the association. In practice bylaws have been a source for the cooperative principle of democratic control by members. *See* Comment to Section 104. Membership qualification and eligibility frequently appear in the bylaws. In the agricultural marketing cooperative, even the marketing contract sometimes appears in the bylaws. Under this Act, members are specifically required to address and vote on various matters unless the bylaws, or the articles of organization, otherwise provide.

Bylaws of traditional cooperatives have generally been considered to be part of the contract between the cooperatives and its members. *See* Section 102(3).

Subsection (a) – This subsection states the minimum requirements for bylaws of a limited cooperative association if those required provisions are not contained in the articles of organization. It draws upon the statutory requirements for bylaws of traditional cooperatives. In

addition, it contains matters within the scope of limited liability company operating agreements and limited partnership agreements. *See* RULLCA (2006) § 110 and ULPA (2001) § 110. The primary focus of the required provisions is on governance and financial rights.

Oral bylaws are not permitted by this Act, however, not all policies or procedures adopted by the board of directors pursuant to Section 801(b) need be contained in the bylaws. *Compare* Section 304(b) *with* Section 801(b).

Subsection (a)(1) – This subsection, together with Section 1001, requires the organic rules to set forth the financial rights and obligations between the members and the limited cooperative association. The items contained in subsection (a)(1)(A) broadly include both financial benefits and burdens. Therefore, for example, provisions for additional capital contribution requirements must be made in the organic rules under Section 1001.

[ARTICLE] 4

AMENDMENT OF ORGANIC RULES OF LIMITED COOPERATIVE ASSOCIATION

SECTION 401. AUTHORITY TO AMEND ORGANIC RULES .

(a) A limited cooperative association may amend its organic rules under this [article] for any lawful purpose. In addition, the initial board of directors may amend the bylaws of an association under Section 304.

(b) Unless the organic rules otherwise provide, a member does not have a vested property right resulting from any provision in the organic rules, including a provision relating to the management, control, capital structure, distribution, entitlement, purpose, or duration of the limited cooperative association.

Comment

This Section is important because it introduces the manner and method of amending the organic rules and provides background concerning the unique relationship and distinction between the articles of organization and bylaws of a limited cooperative association. *See* Sections 113 and 405(e). It is important because it contains a clear statement of authority to amend the organic rules.

All entities, whether they are incorporated or unincorporated, contain provisions for amending their internal governing rules. In many unincorporated entities, the default rule is unanimous consent. Under corporate statutes, a percentage vote which is less than unanimous is permitted. Corporate law has, and some original limited liability company law had, two levels of internal rules, such as articles of incorporation and bylaws. The articles are the highest authority within the organization and are a public filing. Under this Act, most items may be contained in the articles or the bylaws. If certain items are contained in the bylaws, they are subject to a different vote for amendment than other provisions in the bylaws. *See* Comment to Section 405.

Unlike some corporate law, under this Act, the default rule for all bylaw amendments includes member voting. These provisions are consistent with the nature of the limited cooperative association and underscore its unique management structure with centralized management, but democratic control. The organic rules may provide for greater voting percentages than the default rules, including unanimity. The Act provides mechanisms in this Article and elsewhere which balance and protect the interests of patron members and investor members when investor members are introduced into the association. *See, e.g.*, Sections 405

(“Approval of Amendment”), 1004 (“Allocations of Profits and Losses”), and 1203 (“Judicial Dissolution”).

Subsection (a) – This subsection provides authority for amending the organic rules of a limited cooperative association. An amendment to either the articles or bylaws can add, change or delete provisions.

Subsection (b) – Without this subsection, it is possible that all amendments would require unanimity based on contract principles because the contractual nature of an association might give rise to vested property rights. *See* Prefatory Note. The subject of this Section also appears in corporate law for slightly different historical reasons. Much of the common law for traditional cooperatives has arisen under a corporate structure and, therefore, may be helpful here. This subsection does not directly address contracts between an association and its members or between members that are independent from the organic rules. This subsection does not address contracts between an association and its members or between members that are independent from the organic rules.

SECTION 402. NOTICE AND ACTION ON AMENDMENT OF ORGANIC RULES .

(a) Except as provided in Sections 401(a) and 405(f), the organic rules of a limited cooperative association may be amended only at a members meeting. An amendment may be proposed by either:

(1) a majority of the board of directors, or a greater percentage if required by the organic rules; or

(2) one or more petitions signed by at least 10 percent of the patron members or at least 10 percent of the investor members.

(b) The board of directors shall call a members meeting to consider an amendment proposed pursuant to subsection (a). The meeting must be held not later than 90 days following the proposal of the amendment by the board or receipt of a petition. The board must mail or otherwise transmit or deliver in a record to each member:

(1) the proposed amendment, or a summary of the proposed amendment and a statement of the manner in which a copy of the amendment in a record may be reasonably obtained by a member;

(2) a recommendation that the members approve the amendment, or if the board determines that because of conflict of interest or other special circumstances it should not make a favorable recommendation, the basis for that determination;

(3) a statement of any condition of the board's submission of the amendment to the members; and

(4) notice of the meeting at which the proposed amendment will be considered, which must be given in the same manner as notice for a special meeting of members.

Comment

This Section is mandatory and establishes the two ways that an amendment to the organic rules may be proposed. There are two exceptions to the rules provided in this Section with respect to amendment of the bylaws. They are: (1) amendments by the initial directors permitted by Sections 401(a) and 305; and (2) that the articles may delegate authority to the board to adopt and amend most bylaws under Section 405(f).

An amendment to either the articles of organization or the bylaws may be proposed either by the board of directors or by petitions from members. This Section provides how a meeting of members will be called and notice of the meeting is to be given for voting on the amendment.

This same procedure is utilized not only for amendments but also for other fundamental changes such as mergers.

SECTION 403. METHOD OF VOTING ON AMENDMENT OF ORGANIC RULES .

(a) A substantive change to a proposed amendment of the organic rules may not be made at the members meeting at which a vote on the amendment occurs.

(b) A nonsubstantive change to a proposed amendment of the organic rules may be made at the members meeting at which the vote on the amendment occurs and need not be separately voted upon by the board of directors.

(c) A vote to adopt a nonsubstantive change to a proposed amendment to the organic rules must be by the same percentage of votes required to pass a proposed amendment.

Comment

No substantive amendment to a proposed amendment to the organic rules may be made at a meeting of members where the proposed amendment is considered. What constitutes a "substantive" amendment is left to the particular facts and circumstances related to the proposed amendment. A nonsubstantive change certainly includes matters of spelling and punctuation that do not affect the meaning of the proposed amendment. Substantive amendments include changes that modify the meaning or effect of the proposed amendment.

SECTION 404. VOTING BY DISTRICT, CLASS, OR VOTING GROUP.

(a) This Section applies if the organic rules provide for voting by district or class, or if there is one or more identifiable voting groups that a proposed amendment to the organic rules would affect differently from other members with respect to matters identified in Section 405(e)(1) through (5). Approval of the amendment requires the same percentage of votes of the members of that district, class, or voting group required in Sections 405 and 514.

(b) If a proposed amendment to the organic rules would affect members in two or more districts or classes entitled to vote separately under subsection (a) in the same or a substantially similar way, the districts or classes affected must vote as a single voting group unless the organic rules otherwise provide for separate voting.

Comment

Section 405 provides the fundamental voting structure for the members in a limited cooperative association. This structure is repeated throughout the Act although the percentage votes are different in various areas. The rules of that Section apply whether there are only patron members of an association or a combination of patron members and investor members voting

together as the entire membership. This Section 404 provides an alternative voting structure if the organic rules provide for members to be divided into districts or classes as authorized in Section 517. Where the members are to vote on the amendments to the organic rules by district or class, the rules of Section 405 apply in determining whether a proposed amendment is passed in each district or class.

The same alternative structure applies to other identifiable voting groups that would be affected differently from other members with respect to the items listed in Section 405(e)(1) through (5). "Voting group" is a defined term. *See* Section 102(31). The concept of voting group is protective. It gives a group of similarly situated members who share a specific burden under a fundamental change a right to vote separately in order to protect their interests. Voting groups are not provided in the organic rules. Rather only districts and classes are provided for in the organic rules. Voting groups for purposes of voting on a proposed amendment to the organic rules would be determined based upon the scope of the amendment and the members it would affect.

This Act does not attempt to provide a comprehensive default system for the use of districts or classes. The use of districts or classes provides a great deal of flexibility to the Act and permits the drafting of blocking power in a district or class under Section 405 ("Approval of Amendment"). It leaves the crafting of rules governing the use of districts or classes to the organic rules.

Limited cooperative associations should carefully craft provisions about districts and classes if they decide to establish them in their organic rules.

Subsection (b) – This subsection is a default rule for a limited cooperative association that has districts or classes, but does not address whether the votes in the classes or districts will be counted separately or together. The default rule reflects the overall cooperative principle of democratic control within the entire membership of a cooperative. The default rule provides that members in districts or classes that would be affected in a substantially similar way by a proposed amendment are counted together (and not separately by district or class) unless the organic rules otherwise provide.

SECTION 405. APPROVAL OF AMENDMENT .

(a) Subject to Section 404 and subsections (c) and (d), an amendment to the articles of organization must be approved by:

(1) at least two-thirds of the voting power of members present at a members meeting called under Section 402; and

(2) if the limited cooperative association has investor members, at least a majority of the votes cast by patron members, unless the organic rules require a greater percentage vote by patron members.

(b) Subject to Section 404 and subsections (c), (d), (e) and (f), an amendment to the bylaws must be approved by:

(1) at least a majority vote of the voting power of all members present at a members meeting called under Section 402, unless the organic rules require a greater percentage; and

(2) if a limited cooperative association has investor members, a majority of the votes cast by patron members, unless the organic rules require a larger affirmative vote by patron members.

(c) The organic rules may require that the percentage of votes under subsection (a)(1) or (b)(1) be:

(1) a different percentage that is not less than a majority of members voting at the meeting;

(2) measured against the voting power of all members; or

(3) a combination of paragraphs(1) and (2).

(d) Consent in a record by a member must be delivered to a limited cooperative association before delivery of an amendment to the articles of organization or restated articles of organization for filing pursuant to Section 407, if as a result of the amendment the member will have:

(1) personal liability for an obligation of the association; or

(2) an obligation or liability for an additional contribution.

(e) The vote required to amend bylaws must satisfy the requirements of subsection (a) if the proposed amendment modifies:

(1) the equity capital structure of the limited cooperative association, including the rights of the association's members to share in profits or distributions, or the relative rights, preferences, and restrictions granted to or imposed upon one or more districts, classes, or voting groups of similarly situated members;

(2) the transferability of a member's interest;

(3) the manner or method of allocation of profits or losses among members;

(4) the quorum for a meeting and the rights of voting and governance; or

(5) unless otherwise provided in the organic rules, the terms for admission of new members.

(f) Except for the matters described in subsection (e), the articles of organization may delegate amendment of all or a part of the bylaws to the board of directors without requiring member approval.

(g) If the articles of organization delegate amendment of bylaws to the board of directors, the board shall provide a description of any amendment of the bylaws made by the board to the members in a record not later than 30 days after the amendment, but the description may be provided at the next annual members meeting if the meeting is held within the 30-day period.

Comment

Voting structure is one of the key balancing points between patron members and investor members necessary to fulfill the purposes of the Act. The voting structure in this Section is also contained in correlative voting provisions concerning dissolution (Section 1205), conversion and

merger (Sections 1603 and 1608), and disposition of assets (Section 1604). Another important balancing provision is Section 514(1) that requires the majority of voting power be held by patron members.

Existing traditional cooperative statutes provide a rather remarkable range of voting options. For example, within limitations, there can be voting or nonvoting preferred shareholders who are not necessarily required to be members. Nonetheless, this act permits investor members and because of the existence of investor members the Act provides a rather detailed allocation of voting power between investor members and patron members.

The articles of organization may be amended under subsection (a); and, generally, the bylaws may be amended under subsection (b). Specified items under subsection (e) may appear in either the articles or bylaws. Those items may be amended only in the same manner as the amendment of the articles. Amendments affecting a member's liability require the consent of that member under subsection (d). As a general matter, the articles may provide that the bylaws can be amended by the board of directors. *But see* subsection (e).

Subsection (a) – The default vote to amend the articles of organization is two-thirds of the voting power present at the meeting.

In a limited cooperative association which permits investor members, however, the subsection requires a bifurcated approach to better protect the decisional power of patron members relative to investor members. First, it requires a two-thirds vote of all members present (patron members and investor members). Second, the votes of patron members are counted. A simple majority of patron members present and voting is required to adopt the amendment.

This bifurcated voting procedure assures patron members substantial decisional authority. Indeed requiring a majority of the patron members to vote for an amendment gives the patron members absolute blocking power on amendments.

> **EXAMPLE**: Assume a limited cooperative association under which 34 votes are in patron members and 33 votes are in investor members and all members are present and voting. The total vote required to pass the amendment is two-thirds of the voting power of members present. Thus, the first voting prong requires at least 45 (two-thirds) votes of the total cast to be for the amendment. The second prong requires at least a majority of the 34 patron members votes to be for the amendment. Thus, at least 18 of the patron member votes must be cast for the amendment. If only 17 patron members voted for the amendment it would fail under the second prong even if all of the investor members voted for the amendment.

The bifurcated voting structure also provides investor members significant voting influence. The two-thirds majority under subsection (a)(1) would not be reached in the Example

even if all the patron member votes were cast for the amendment unless a sufficient number of investor members vote to achieve the required two-thirds. In addition, using the flexibility afforded under Section 404, blocking power could be provided to investor members by establishing strict class voting for them in the organic rules. The same could be done for patron members.

Subsection (c) – The vote required to amend the organic rules may be varied by the organic rules but only within the parameters of this subsection.

Subsection (d) – If a member will have personal liability as a result of an amendment, the member must consent to the amendment.

Subsection (e) – The five matters listed in subsection (e) require the same vote as necessary to amend the articles of organization whether or not the matters are contained in the articles or the bylaws.

Subsection (g) – If bylaw amendments are delegated to the board of directors, a description of an amendment adopted by the board must be provided to the members in accordance with this subsection. *See* Subsection (f).

SECTION 406. RESTATED ARTICLES OF ORGANIZATION . A limited cooperative association, by the affirmative vote of a majority of the board of directors taken at a meeting for which the purpose is stated in the notice of the meeting, may adopt restated articles of organization that contain the original articles as previously amended. Restated articles may contain amendments if the restated articles are adopted in the same manner and with the same vote as required for amendments to the articles under Section 405(a). Upon filing, restated articles supersede the existing articles and all amendments.

Comment

This Section permits the board of directors to restate the articles of organization. A restatement of the articles is helpful after several amendments have been made over time. The board of directors, however, is not permitted to adopt any amendments to the articles when it restates them. If the restatement is to include amendments to the articles, the amendments must be adopted in the manner provided in this Article. If a restatement includes amendments, the entire restated articles may be adopted pursuant to this Act, but care should be exercised to comply with the notice requirements for amendments. *See* Section 402. Filing of restated articles is governed by Section 407.

SECTION 407. AMENDMENT OR RESTATEMENT OF ARTICLES OF ORGANIZATION; FILING .

(a) To amend its articles of organization, a limited cooperative association must deliver to the [Secretary of State] for filing an amendment of the articles, or restated articles of organization or articles of conversion or merger pursuant to [Article] 16, which contain one or more amendments of the articles of organization, stating:

(1) the name of the association;

(2) the date of filing of the association's initial articles; and

(3) the changes the amendment makes to the articles as most recently amended or restated.

(b) Before the beginning of the initial meeting of the board of directors, an organizer who knows that information in the filed articles of organization was inaccurate when the articles were filed or has become inaccurate due to changed circumstances shall promptly:

(1) cause the articles to be amended; or

(2) if appropriate, deliver an amendment to the [Secretary of State] for filing pursuant to Section 203.

(c) If restated articles of organization are adopted, the restated articles may be delivered to the [Secretary of State] for filing in the same manner as an amendment.

(d) Upon filing, an amendment of the articles of organization or other record containing an amendment of the articles which has been properly adopted by the members is effective as provided in Section 203(c).

Comment

If a restatement of the articles of organization contains amendments, it must be filed. If a restatement does not contain amendments, this Section permits it to be filed. Amendments to the articles may also be included in articles of conversion or merger that are filed.

[ARTICLE] 5

MEMBERS

SECTION 501. MEMBERS . To begin business, a limited cooperative association must have at least [two] patron members unless the sole member is a cooperative.

Legislative Note*: The "two" in brackets means an adopting jurisdiction may increase the number of required patron members required for a limited cooperative association to begin business. It does not mean the number should be reduced unless the association is to be a wholly-owned subsidiary of a cooperative.*

Comment

One person may organize a limited cooperative association under Section 301 but this Section adds an additional requirement that the association have at least two *patron* members to begin business unless the sole member is a cooperative. More than one member is required consistent with the general meaning of "cooperation." The requirement of multiple members to begin business is, thus, somewhat analogous to partnership law that requires two members to form a partnership. In this regard compare of RUPA (1997) Section 202(a) to Section 301 of this Act. *See* Comment to Section 301. The reason a cooperative is allowed to be a sole member is because its "organic" law will provide the necessary "cooperation" among members.

A limited cooperative association has some flexibility in determining its number of members. A membership interest could be held in cotenancies such as tenancy in common or may be community property in community property jurisdictions. The organic rules may provide that co-owners will be treated as one person or will be treated individually as separate persons subject to the law governing those relationships. The organic rules may also address other ownership arrangements. For example, the organic rules of traditional agricultural marketing cooperatives sometimes contain provisions concerning cooperative memberships in the context of landlord-tenant relationships for agricultural land.

SECTION 502. BECOMING A MEMBER . A person becomes a member:

(1) as provided in the organic rules;

(2) as the result of a merger or conversion under [Article] 16; or

(3) with the consent of all the members.

Comment

This Section combines concepts from traditional cooperatives, limited liability companies and partnerships in determining how persons become members. Traditional cooperatives usually

provide for the qualifications and the process for admitting members in their bylaws. Limited liability companies and partnerships usually provide for these matters in their operating agreements or partnership agreements, respectively, and frequently require member consent for admission as a member or partner in the entity.

Section 603 of the Act addresses transfers of membership interests, the limitations on transfers, and whether a transferee may become a member as a result of transfer.

Initial members may be (a) named in the articles of organization, (b) admitted by the board of directors pursuant to Section 303(b), or (c) admitted in a manner provided in the organic rules. Once initial members are admitted, additional members may be admitted pursuant to the organic rules or by unanimous consent of the members. The unanimous consent of all members is an exception to changing membership requirements through a change of the organic rules. *See* Section 405(e)(5) (with respect to the terms for admission of members in the bylaws).

The method for admitting new members is a mandatory provision for the organic rules under Section 304(a)(2) because admission of members is a central feature of a limited cooperative association. The provision deserves care in drafting. Nonetheless, Section 502(3) provides a “fail safe” mechanism if a membership provision is not contained in the organic rules.

Paragraph (2) - Subsection (2) recognizes that memberships may be continued or new memberships may be created in a merger or conversion.

SECTION 503. NO POWER AS MEMBER TO BIND ASSOCIATION . A member, solely by reason of being a member, may not act for or bind the limited cooperative association.

Comment

Source: Derived from ULPA (2001) § 302 and RULLCA (2006) § 301(a).

This Section confirms a member is not an agent for a limited cooperative association simply by being a member. This is similar to a limited partner in a limited partnership, shareholder in a corporation, and members under traditional cooperative law. It serves the same function as similar statements in limited liability company laws. One of its purposes is to reject any implication of “statutory apparent authority” in members by reason of their membership. The Section does not prohibit an association from specifically appointing a member to act as an agent of the association, for example, by an act of the board of directors, with power to bind the association under the law of agency as otherwise applicable.

SECTION 504. NO LIABILITY AS MEMBER FOR ASSOCIATION'S OBLIGATIONS . Unless the articles of organization otherwise provide, a debt, obligation, or other liability of a limited cooperative association is solely that of the association and is not the debt, obligation, or liability of a member solely by reason of being a member.

Comment

Source: Based on ULPA (2001) § 303.

This Section shields members from debts, obligations, and liabilities of a limited cooperative association unless the articles of organization provide otherwise. The shield may not be removed in bylaws. This Section does not apply to claims seeking to hold a member directly liable on account of the member's own conduct.

> **EXAMPLE:** A member personally guarantees a debt of a limited cooperative association. This Section does not govern the member's liability as a guarantor.

> **EXAMPLE:** A member purports to bind a limited cooperative association while lacking any agency law power to do so. The association is not bound, but the member is liable for having breached the "warranty of authority" (an agency law doctrine). This Section does not apply. The liability is not *for* an obligation of the association, but rather is the member's direct liability resulting because the association is *not* indebted, obligated or otherwise liable. *See* RESTATEMENT (THIRD) OF AGENCY § 6.10 (2006).

This Section does not eliminate a member's liability for required contributions to capital of a limited cooperative association under the organic rules or contribution agreements. Sections 1001 through 1003. It does not eliminate a member's liability for improper distributions. Section 1008. Liability for those obligations pertains to a person's status as a member but is not for an obligation of the association.

This Section has no application to directors whose liability is addressed in Sections 802 and 818 through 820.

This Act does not address the equitable doctrine of "piercing the veil" which is well-established, and which courts regularly apply to limited liability companies. *See* Comment to RULLCA (2006) § 304(b). Because certain formalities are required in the operation of a limited cooperative association organized under this Act, corporate law regarding "piercing the corporate veil" (including the factor of "disregard of corporate formalities") could properly be applied to

associations organized under this Act under some circumstances even though they are unincorporated associations. Of course, disregard of formalities is but one factor of the multifactor analysis applied in cases of equitable piercing. Finally, some provision of regulatory law outside this Act may impose liability on members and this Section does not affect the operation of those regulations.

SECTION 505. RIGHT OF MEMBER AND FORMER MEMBER TO INFORMATION .

(a) Not later than 10 business days after receipt of a demand made in a record, a limited cooperative association shall permit a member to obtain, inspect, and copy in the association's principal office required information listed in Section 114(a)(1) through (8) during regular business hours. A member need not have any particular purpose for seeking the information. The association is not required to provide the same information listed in Section 114(a)(2) through (8) to the same member more than once during a six-month period.

(b) On demand made in a record received by the limited cooperative association, a member may obtain, inspect, and copy in the association's principal office required information listed in Section 114(a)(9), (10), (12), (13), (16) and (18) during regular business hours, if:

(1) the member seeks the information in good faith and for a proper purpose reasonably related to the member's interest;

(2) the demand includes a description with reasonable particularity of the information sought and the purpose for seeking the information;

(3) the information sought is directly connected to the member's purpose; and

(4) the demand is reasonable.

(c) Not later than 10 business days after receipt of a demand pursuant to subsection (b), a limited cooperative association shall provide, in a record, the following information to the member that made the demand:

(1) if the association agrees to provide the demanded information:

(A) what information the association will provide in response to the demand; and

(B) a reasonable time and place at which the association will provide the information; or

(2) if the association declines to provide some or all of the demanded information, the association's reasons for declining.

(d) A person dissociated as a member may obtain, inspect, and copy information available to a member under subsection (a) or (b) by delivering a demand in a record to the limited cooperative association in the same manner and subject to the same conditions applicable to a member under subsection (b) if:

(1) the information pertains to the period during which the person was a member in the association; and

(2) the person seeks the information in good faith.

(e) A limited cooperative association shall respond to a demand made pursuant to subsection (d) in the manner provided in subsection (c).

(f) Not later than 10 business days after receipt by a limited cooperative association of a demand made by a member in a record, but not more often than once in a six-month period, the

association shall deliver to the member a record stating the information with respect to the member required by Section 114(a)(17).

(g) A limited cooperative association may impose reasonable restrictions, including nondisclosure restrictions, on the use of information obtained under this section. In a dispute concerning the reasonableness of a restriction under this subsection, the association has the burden of proving reasonableness.

(h) A limited cooperative association may charge a person that makes a demand under this section reasonable costs of copying, limited to the costs of labor and material.

(i) A person that may obtain information under this section may obtain the information through an attorney or other agent. A restriction imposed on the person under subsection (g) or by the organic rules applies to the attorney or other agent.

(j) The rights stated in this section do not extend to a person as transferee.

(k) The organic rules may require a limited cooperative association to provide more information than required by this section and may establish conditions and procedures for providing the information.

Comment

Source: Derived from ULPA (2001) § 304.

This Section provides to members of a limited cooperative association rights of inspection of records of the association that must be maintained by it under Section 114, but the Section does not require an association to maintain any records that are not specifically required to be maintained under Section 114. These rights may not be reduced by the organic rules although subsection (h) does permit an association to impose reasonable restrictions on the use of information obtained by a member under this Section.

Cooperative associations present a conundrum with respect to information about the association. Cooperatives are owned and controlled by their members. Members need information for that purpose. Most cooperatives are, however, representative democracies governed by a board of directors or similar body elected by the members. This may reduce the

need for information on the part of members and permit a cooperative to withhold confidential information from the members. The "particular purpose" provision of subsection (b) allows an evaluation of the need for the information demanded by the member making the demand to be measured against the needs of the association. If there is a change in information obtained by a member under this Section, the changed information is new information for purposes of this Section. The Section anticipates that both a member and the limited cooperative association will act in good faith with respect to the rights and obligations of each under this Section.

There is a burden on a member seeking records if the member is not located in the jurisdiction in which the association's principal office is located and is, therefore, required to travel. This burden is reduced by the member being entitled to engage an attorney or agent in the jurisdiction where the principal office is located in order to access the records under Section 505(i). Nothing in the Act prevents the association from making records available at locations in addition to the principal office or electronically.

Records listed in subsections 114(a)(11), (14) and (15) regarding accounting records and contributions are not covered by the inspection rights of this subsection because of concerns over confidentiality and privacy.

Subsection (a) – The subsection permits a member to request, inspect and copy records specified in Section 114(a)(1) through (8) that are records that should be generally available and relate to the organization, general financial condition and membership actions of the association. No particular purpose is required for the inspection and copying.

Subsection (b) – The subsection permits a member to request, inspect and copy records specified in Section 114(a)(9), (10), (12), (13), (16) and (18) that may be records more likely to contain confidential information or information that may be more difficult to understand or harder for an association to produce than the records referenced in subsection (a). To obtain access to these records a member must act in good faith and state a "proper purpose" for seeking the records that must be directly connected to the member's purpose. "Proper purpose" is a well recognized term. This subsection closely follows corporate provisions. *See* RMBCA § 16.02.

The six month time period in subsection (a) and "proper purpose" under subsection (b) serve an analogous function to the phrase, "except to the extent the demand or information demanded is unreasonable or otherwise improper under the circumstances" in RULLCA (2006) Section 410(a)(2)(B).

Subsection (c) – If a limited cooperative association refuses to produce information demanded by a member, it must state why it has refused the request.

Subsection (d) – A person dissociated as a member may obtain any of the information referenced in subsections (a) or (b) but in either case must follow the procedures for a member seeking to obtain information under subsection (b). The right to inspect and copy records under this Section does not extend to a transferee of a member who has not been admitted as a member

in the limited cooperative association. If a member dies or is adjudged incompetent Section 1103 applies.

Subsection (f) – A member may obtain information regarding the member's own interest in the limited cooperative association but the member may not obtain information about any other member except the names and addresses of other members under subsection (b).

Subsection (h) – The subsection permits a limited cooperative association to include nondisclosure restrictions on the use of information obtained by a member under the Section. Some of the information to which a member may have access under this Section could contain confidential information of the association. The association has the right to reasonably restrict the uses to which the information may be put by the member. The restriction could be in contractual form and a violation of the contract could result in damages or a right to injunctive relief in favor of the association.

SECTION 506. ANNUAL MEETING OF MEMBERS .

(a) Members shall meet annually at a time provided in the organic rules or set by the board of directors not inconsistent with the organic rules.

(b) An annual members meeting may be held inside or outside this state at the place stated in the organic rules or selected by the board of directors not inconsistent with the organic rules.

(c) Unless the organic rules otherwise provide, members may attend or conduct an annual members meeting through any means of communication if all members attending the meeting can communicate with each other during the meeting.

(d) The board of directors shall report, or cause to be reported, at the association's annual members meeting the association's business and financial condition as of the close of the most recent fiscal year.

(e) Unless the organic rules otherwise provide, the board of directors shall designate the presiding officer of the association's annual members meeting.

(f) Failure to hold an annual members meeting does not affect the validity of any action by the limited cooperative association.

Comment

Section 506(a) requires every limited cooperative association to hold an annual meeting of members each year. Rather than having an annual meeting, the members may take action by written consent under Section 516. Unlike corporate statutes, this Section does not specifically require an election of directors to the board of directors at the annual meeting, but this is implied from subsection 805(a) that provides a director's term expires at the annual meeting following the director's election or appointment unless the organic rules otherwise provide. The purpose of an annual meeting is not limited and provides an appropriate forum for a member to raise any relevant question about the association's operations unless inconsistent with notices of annual meetings where fundamental changes such as amendments to organic rules and mergers are to be considered. *See* Sections 402, 508(b), and 1607.

If an annual meeting is not held, directors' terms are extended under Section 805(c) until a successor is elected or appointed and qualified.

The requirement of Section 506(a) that an annual meeting be held is phrased in mandatory terms to ensure that every member entitled to participate in the meeting has an opportunity to do so. There is no specific provision in this Act that governs the procedure for applying to a court for intercession if an annual meeting is not held but under appropriate circumstances a direct or derivative action could be brought for this purpose. Section 506(f) provides that failure to hold the annual meeting does not affect the validity of any action taken by the association.

The organic rules or the board of directors may fix the time and place for annual meetings. This gives the limited cooperative association the flexibility to meet at various times and various places depending on convenience and circumstances. Where authority is granted to the board to fix the time and place of the annual meeting, the authority must be exercised in good faith. *See Schnell v. Chris-Craft Industries, Inc.*, 285 A.2d 437 (Del. 1971) (relating to corporations). Failure to have annual meetings may also be evidence of oppression for purposes of Section 1203(2)(B).

The default rule in subsection (c) provides great flexibility by allowing conduct of meetings and member attendance through means of modern communication while protecting the deliberative function of the meeting. The use of the words "attend" and "conduct" encompass the ability to vote and, therefore, voting under subsection (c) is not "voting by other means" for purposes of Section 515(d).

SECTION 507. SPECIAL MEETING OF MEMBERS .

(a) A special meeting of members may be called only:

(1) as provided in the organic rules;

(2) by a majority vote of the board of directors on a proposal stating the purpose of the meeting;

(3) by demand in a record signed by members holding at least 20 percent of the voting power of the persons in any district or class entitled to vote on the matter that is the purpose of the meeting stated in the demand; or

(4) by demand in a record signed by members holding at least 10 percent of the total voting power of all the persons entitled to vote on the matter that is the purpose of the meeting stated in the demand.

(b) A demand under subsection (a)(3) or (4) must be submitted to the officer of the limited cooperative association charged with keeping its records.

(c) Any voting member may withdraw its demand under subsection (a)(3) or (4) before receipt by the limited cooperative association of demands sufficient to require a special meeting of members.

(d) A special meeting of members may be held inside or outside this state at the place stated in the organic rules or selected by the board of directors not inconsistent with the organic rules.

(e) Unless the organic rules otherwise provide, members may attend or conduct a special meeting of members through the use of any means of communication if all members attending the meeting can communicate with each other during the meeting.

(f) Only business within the purpose or purposes stated in the notice of a special meeting of members may be conducted at the meeting.

(g) Unless the organic rules otherwise provide, the presiding officer of a special meeting of members shall be designated by the board of directors.

Comment

This Section provides the means for calling and holding special members meetings of the limited cooperative association. Any meeting of members other than an annual meeting is a special meeting. The primary difference between an annual meeting and a special meeting under this Act is that any issue relevant to the association may be discussed at an annual meeting subject only to special notice requirements for certain matters under this Act, for example, voting on amendments to the organic rules, mergers, sales of assets. Only issues provided in the call and notice of a special meeting may be discussed at a special meeting. If an annual meeting is not held, members could demand that a special meeting be held to consider specific items that would ordinarily be considered at an annual meeting.

Democratic control by members is a cooperative principle. Inherent in this principle is the members' right to voice opinions and the board of director's ability to receive advice and direction from members at a deliberative meeting. Therefore this Section provides several ways by which a special meeting may be called and the organic rules may provide other ways to call special meetings or state circumstances under which special meetings are required.

Members may suggest a place for a special meeting, but the ultimate authority for determining the place is the organic rules or the board of directors under Subsection (d). The Act does not specifically state who sets the time and date of a special meeting. Generally the board of directors acting for the limited cooperative association would set the time and date under its management authority in Section 701 and the notice provisions of Section 508(a).

If demands stating different purposes for a special meeting are received by a limited cooperative association, the board of directors has reasonable discretion to combine or otherwise coordinate the demands into one meeting.

SECTION 508. NOTICE OF MEMBERS MEETING .

(a) A limited cooperative association shall notify each member of the time, date, and place of a members meeting [at least 15 and not more than 60] days before the meeting.

(b) Unless the articles of organization otherwise provide, notice of an annual members meeting need not include any purpose of the meeting.

(c) Notice of a special meeting of members must include each purpose of the meeting as contained in the demand under Section 507(a)(3) or (4) or as voted upon by the board of directors under Section 507(a)(2).

(d) Notice of a members meeting must be given in a record unless oral notice is reasonable under the circumstances.

Comment

This Act requires that notice of meetings be given to all members of a limited cooperative association whether they are entitled to vote at the meeting or not. This seems more consistent with cooperative principles than corporate statutes under which, generally, only shareholders who are entitled to vote at a meeting are entitled to notice. *See* RMBCA § 7.05(a).

This Act does not contain a provision that relieves a limited cooperative association from giving notice to a member if mailings to the member have been returned as undeliverable over a period of time as is found in RMBCA § 16.06 and a number of state corporate statutes.

Subsection (d) – The subsection permits oral instead of written notice if oral notice of a members meeting is "reasonable under the circumstances." This recognizes there may be situations when oral notice is appropriate, but it is likely this would be an exception rather than a rule. Reliance on oral notice, however, may create evidentiary issues if a dispute concerning notice arises. If membership would be small enough that oral notice might be appropriate, the members might consider taking action by consent under Section 516.

SECTION 509. WAIVER OF MEMBERS MEETING NOTICE .

(a) A member may waive notice of a members meeting before, during, or after the meeting.

(b) A member's participation in a members meeting is a waiver of notice of that meeting unless the member objects to the meeting at the beginning of the meeting or promptly upon the

member's arrival at the meeting and does not thereafter vote for or assent to action taken at the meeting.

Comment

Patron members are entitled to vote under Section 511. The organic rules may provide for voting or nonvoting investor members under Section 513. Section 508 requires notice of members meetings be given to all members, including members who are not entitled to vote at the meeting, including an investor member not entitled to vote at the meeting.

Subsection (b) – This Act requires objections to be made at the beginning of the meeting or promptly after the member's arrival at the meeting if the member does not wish attendance at the meeting to constitute waiver of notice of a meeting.

SECTION 510. QUORUM OF MEMBERS . Unless the organic rules otherwise require a greater number of members or percentage of the voting power, the voting member or members present at a members meeting constitute a quorum.

Comment

This Section states a default rule. Absent a provision in the organic rules to the contrary, one person with a voting interest in a limited cooperative association who is in attendance at a duly called meeting would constitute a quorum for the meeting, the meeting could proceed, and actions taken at the meeting could be valid if the votes meet the voting requirements in, *e.g.* Section 405.

With the interaction of Sections 509 and 510, a member who attends a meeting for the sole purpose of objecting to the meeting would nevertheless be present for purposes of a quorum under Section 510. Section 509 relates solely to a waiver of notice, not to presence at a meeting, for purposes of a quorum.

SECTION 511. VOTING BY PATRON MEMBERS . Except as provided by Section 512(a), each patron member has one vote. The organic rules may allocate voting power among patron members as provided in Section 512(a).

Comment

In following cooperative principles of ownership by patrons and democratic control cooperative statutes have, historically, limited voting power of any one member to one vote. The "one member, one vote" principle, for example, is a requirement in a number of federal statutes

in order for an entity to be a cooperative for the purposes of the federal statute or to be operating on a "cooperative basis." Many of those federal statutes, however, provide an additional or alternative requirement based on the cooperative principle of a limited return on investment by capping the percentage return that may be paid on member investments in their cooperative. *See, e.g.*, 12 U.S.C.A. § 1141(j)(a) (definition of "cooperative association" for Agricultural Marketing Act), 12 U.S.C.A. § 3015(a) (definition of "eligible cooperative" for National Consumer Cooperative Bank), 15 U.S.C.A. § 521 (definition of fishing association). In recent years, revisions to some traditional state cooperative statutes have permitted percentage voting by members although in some cases with a limitation. For example, the Colorado Cooperative Act permits voting by patronage or patronage equity in the cooperative, but all members must have at least one vote and no member may have more than two and one-half percent of the total votes of the members of the cooperative. COL. REV. STAT. § 7-56-305(3) (2006). The Ohio Cooperative Law and the Oregon Cooperative Corporation Act permit voting based on patronage. OHIO REV. CODE § 1729.17 (2004); OR. REV. STAT. § 62.265 (2003).

Section 513 governs voting by investor members.

SECTION 512. DETERMINATION OF VOTING POWER OF PATRON MEMBER.

(a) The organic rules may allocate voting power among patron members on the basis of one or a combination of the following:

(1) one member, one vote;

(2) use or patronage;

(3) equity; or

(4) if a patron member is a cooperative, the number of its patron members.

(b) The organic rules may provide for the allocation of patron member voting power by districts or class, or any combination thereof.

Comment

If the strict "one member, one vote" principle in subsection (a)(1) is not followed, the Act permits the use of three other methods: a member's use or patronage of the limited cooperative association, a member's equity in the association, or if the member of the association is itself a cooperative by the number of patron members in the member cooperative. The association may combine two, three, or all four methods in establishing the voting power among patron members but no patron member may be deprived of a vote. *See* Section 511.

Subsection (a) – This Act permits the organic rules to provide for more than one vote per member in a limited cooperative association; but, in the absence of other provisions in the organic rules, defaults to one member one vote. Section 512(a) provides the means through which the organic rules may allocate voting power among the patron members.

Subsection (a)(2) – Use of patronage of the limited cooperative association can be measured in a variety of ways. For example, it can be based on a dollar volume of business conducted by a patron member with the association.

> **EXAMPLE:** A member sells and delivers wheat to the association. The member is paid $60,000 for the wheat sold and delivered. Over a one year period, the association paid $2,000,000 for all the wheat it purchased from all of its members. The association's organic rules base voting power on patronage measured by the purchase price paid to each member for wheat purchased from each member during the year. The member that was paid $60,000 would be entitled to 3% of the voting power of all of the voting members in the association.
>
> If the association in this example had ten members, and each had only one vote, each member would have 10% of the voting power. If voting in this example is based on patronage percentages, the fact that the member did not have ten percent of the voting power does not violate Section 511 because the member is entitled to vote the member's percentage of total member patronage as determined under the organic rules of the association. CAVEAT: *There is a potential drafting trap for planners who do not provide for circumstances where a patron member for some reason does not conduct patronage during the relevant patronage measuring period*.

If voting is allocated based on patronage, each patron member conducting patronage with the association will be eligible to vote, even though the percentage weight of that vote may be a smaller percentage proportion than represented by one vote. A complicating feature in this Act is that in no event, consistent with traditional cooperative principles, may any patron member be deprived of voting under Section 511. Thus, for example, a patron member, so long as it is a member, must be allocated some vote even though it did not conduct patronage during the relevant measuring period.

It would then be possible for the organic rules to provide each patron member with one vote and then allocate an additional number of votes fixed in the organic rules based solely on proportional patronage conducted with the association. The number of votes fixed in the organic rules could be less than, equal to, or far greater than the number of votes allocated based on membership alone.

Other types of patronage measurement include the quantity of business a member conducts with the association measured in units, weight or other methods of measuring quantities such as hours worked in a worker owned association.

Subsection (a)(3) – The organic rules could base voting on a percentage of equity in the limited cooperative association or on each dollar of equity in the association. The equity could be paid in capital or retained allocations in the capital accounts of the members that have not been distributed, or a combination of both.

> **EXAMPLE:** A member has $1,000 of paid in capital in an association that has a total of $20,000 in paid in capital from all voting members. In addition, the member has $15,000 of retained allocations in the member's capital account that have not been distributed. All of the members together have $100,000 of retained allocations in their capital accounts collectively.
>
> The organic rules of the association could provide that voting power will be based on paid in capital. The member would have 1/20, or 5%, of the total voting power in the association.
>
> The organic rules could provide that voting power will be based on retained allocations. The member would have 15/100, or 15%, of the total voting power.
>
> The organic rules could provide that voting power will be based on total equity in the association, a combination of paid in capital and retained allocations. The member would have a total of $16,000 in equity ($1,000 of paid in capital plus $15,000 of retained allocations). Total equities of the association as a whole would be $120,000 ($20,000 of paid in equity plus $100,000 of retained allocations). The member would have 16/120, or 13.3%, of the total voting power.

CAVEAT: *Voting based on equity may cause unintended consequences for other regulation and governmental programs.*

Subsection (a)(4) – The paragraph does not refer to a limited cooperative association itself but rather to a cooperative that is a patron member of the association. In that case, the organic rules could provide that in counting the total voting power in the association the number of members of the cooperative member could be counted among the voting members.

> **EXAMPLE:** An association has 20 individual members and a cooperative entity as a member that itself has 15 members. The organic rules could provide for adding all the individual members

of the association and the 20 members of the cooperative together for a total of 35 votes of which 15 would be cast by the cooperative member.

Paragraph (4) is not the exclusive way that votes may be allocated to a cooperative that is a member but is in addition to the other alternatives.

Subsection (b) – Cooperatives that have drawn members from large geographic areas have frequently divided the members into geographic districts for purposes of the election of directors or voting generally on matters affecting the cooperative. Because the voting power in traditional cooperatives has usually, although not exclusively, been confined to one class of voting membership or stock, there has been little need for classifying members by class of membership or stock for voting purposes.

This Act permits more complex membership structures than are usually seen in traditional cooperatives. This subsection authorizes the association to divide patron members into districts, classes of membership, or combinations of districts and classes.

SECTION 513. VOTING BY INVESTOR MEMBERS. If the organic rules provide for investor members, each investor member has one vote, unless the organic rules otherwise provide. The organic rules may provide for the allocation of investor member voting power by class, classes, or any combination of classes.

Comment

This Act does not require a limited cooperative association to have investor members.

If there are to be investor members the organic rules must provide for them. If they do not do so, all of the members must be patron members by default. *See* Section 502(a). If the organic rules provide for investor members, they may provide for any means of allocating voting power among them including the use of classes and combinations of classes. If the organic rules do not provide another means of allocating voting power, each investor member will have one vote following the cooperative "one person, one vote" principle. *See* Comment to Section 411. However, unlike patron member voting under Section 411, this Section permits the organic rules to provide for nonvoting investor members. The distinction is articulated in the Act by using the phrase "[u]nless the organic rules provide for a larger number" in Section 411(a) and the phrase "unless the organic otherwise provide" without any modifier in this Section. No matter of the quantum of votes a member votes, the voting provisions of an association must meet the requirements of Section 514.

SECTION 514. VOTING REQUIREMENTS FOR MEMBERS. If a limited cooperative association has both patron and investor members, the following rules apply:

(1) the total voting power of all patron members may not be less than a majority of the entire voting power entitled to vote.

(2) action on any matter is approved only upon the affirmative vote of at least a majority of:

(A) all members voting at the meeting unless more than a majority is required by [Articles] 4, 12, 15 through 16 or the organic rules; and

(B) votes cast by patron members unless the organic rules require a larger affirmative vote by patron members.

(3) The organic rules may provide for the percentage of the affirmative votes that must be cast by investor members to approve the matter.

Comment

This Act seeks to balance financial and governance rights between patron members and investor members where a limited cooperative association has both types of members. In doing so, this Act does not follow the similar statutes in Minnesota, Wisconsin, Tennessee and Iowa that were catalysts in the development of this Act. This Act establishes a floor for patron member voting power below which the organic rules may not go. The organic rules may provide for greater voting power for patron members than required in this Section.

Paragraph (1) – At least a majority of the voting power in an association must be in the patron members if the association has both patron and investor members.

Paragraph (2) – If there are investor members this Section mandates two tests must be met for members to take action: (1) a majority of all members voting must be in the affirmative; and, (2) a majority of patron members voting must be in the affirmative. The two test approach is used for voting by members throughout the Act. The organic rules may require a larger affirmative vote for all members voting or may increase the affirmative vote required by patron members. By mandating patron member votes to be counted separately, this Act gives the patron members blocking power in all votes but does not necessarily give them the ability to dictate affirmative action.

Voluntary dissolution, amendments to the organic rules, conversions, mergers and certain dispositions of assets have special minimum voting requirements under Sections 405, 1205, 1504, 1603, and 1608.

> **EXAMPLE:** An association has 30 members of which 20 are patron members and 10 are investor members all of whom attend and vote at a meeting of members. The bylaws provide for voting on a "one member, one vote" basis. The association has a majority of the total voting power in patron members. On a particular proposition, 12 of the patron members vote "yes" and eight vote "no." Four investor members vote "yes" and six vote "no." A majority of all members (16 of 30) voted "yes" and a majority of the patron members (12 of 20) voted "yes." The proposition passes.
>
> **EXAMPLE:** In the preceding example, eight of the patron members vote "yes"and 12 vote "no." All of the investor members vote "yes." Clearly a majority of all the members (18 of 30) voted "yes" but the proposition does not pass because a majority of the patron members did not vote "yes."
>
> **EXAMPLE:** In the first example, 18 patron members vote "yes" and two vote "no." All of the investor members vote "no." The proposition passes because a majority of the members (18 of 30) voted "yes" and a majority of the patron members (18 of 20) voted "yes" even though the proposition received no votes from the investor members. *But see* Comment to paragraph (3).

Paragraph (3) – In addition to the requirement for separately counting patron member votes, the organic rules may provide for a percentage of affirmative votes of the investor members necessary for a matter to be approved. That percentage does not necessarily need to be a majority and, unlike patron member voting percentage under paragraph (2), may be below a majority. A separate affirmative vote by investor members as permitted by this paragraph may result in giving investor members blocking power. This paragraph is for emphasis because it would be allowed under the general flexibility of the Act if the Act were silent. *See* Section 113.

SECTION 515. MANNER OF VOTING .

(a) Unless the organic rules otherwise provide, voting by a proxy at a members meeting is prohibited. This subsection does not prohibit delegate voting based on district or class.

(b) If voting by a proxy is permitted, a patron member may appoint only another patron member as a proxy and, if investor members are permitted, an investor member may appoint only another investor member as a proxy.

(c) The organic rules may provide for the manner of and provisions governing the appointment of a proxy.

(d) The organic rules may provide for voting on any question by ballot delivered by mail or voting by other means on questions that are subject to vote by members.

Comment

Subsection (a) – Many traditional cooperatives have not permitted voting by a proxy at membership meetings because of a belief that voting by a proxy is inconsistent with cooperative principles. In other cooperatives, such as housing cooperatives, proxies are viewed as an essential protection of members' democratic control. This Act permits the organic rules to provide for voting by a proxy. If the organic rules do not expressly permit voting by a proxy, voting by a proxy is not permitted.

The word "proxy" is often used ambiguously, sometimes referring to the grant of authority to vote, sometimes to the document granting the proxy, and sometimes to the person to whom the authority is granted. This Act uses the term "proxy" to mean the person to whom authority to vote is granted.

The appointment of a proxy is, at base, the appointment of an agent and is governed by agency law and principles except that subsection (c) permits the organic rules to provide the manner of and provisions governing appointment of a proxy. The organic rules are entitled to provide how an appointment is to be made and proven, the duration of an appointment, whether an appointment may be irrevocable, and any other matter relating to a proxy that is not prohibited by this Act.

Subsection (b) – If voting by a proxy is permitted, patron members may only authorize other patron members; and, investor members may only authorize other investor members to be their proxy. If a member is both a patron member and an investor member, the member must authorize only another patron member to vote for the member as a patron member, and the member may only authorize other investor members to vote for the member as an investor member. This could be accomplished by appointing another member that is both a patron member and investor member.

Subsection (d) – The subsection gives broad power for the organic rules to provide for membership voting to be conducted in ways other than by being in attendance at a meeting or by

authorizing a vote to be cast by a proxy. The power can be extended to all or less than all matters brought before the members at a meeting. The power can be utilized to prohibit other means of voting. Secret ballots could be required. Voting by mail could be authorized.

For purposes of subsection (d), attendance and voting pursuant to Sections 506(c) and 507(e) are not "voting by other means" because the member is present. *See* Comments to Sections 506(c) and 507(e).

An association may desire to study whether it is wise or a best practice to authorize both voting by mail or other means and by a proxy at the same time. If voting by mail or other means is permitted, votes may be cast without the benefit of discussion provided by attendance at a meeting. Although a member authorizing a proxy to vote for the member would not have that benefit, at least the proxy could have that advantage if the proxy had discretion in how to vote. On the other hand, if mail or other means are not permitted, less than a representative vote may be obtained.

SECTION 516. ACTION WITHOUT A MEETING .

(a) Unless the organic rules require that action be taken only at a members meeting, any action that may be taken by the members may be taken without a meeting if each member entitled to vote on the action consents in a record to the action.

(b) Consent under subsection (a) may be withdrawn by a member in a record at any time before the limited cooperative association receives a consent from each member entitled to vote.

(c) Consent to any action may specify the effective date or time of the action.

Comment

Almost half of the state business corporation statutes allow for less than unanimous consent in writing for action by shareholders and the consents are generally effective if signed and delivered by the number of shareholders necessary to pass a matter if it were voted on at a meeting. Unincorporated law rarely, if ever, requires meetings but does contemplate written consents. *See* RULLCA (2006) § 407(d). This Act retains the historical and more prevalent requirement that written consent to action without a meeting must be unanimous. The unanimity requirement provides that each member has the ability to force a meeting for purposes of voting and discussion of the matter to be voted upon. This is consistent with the deliberative function of meetings and cooperative principles.

SECTION 517. DISTRICTS AND DELEGATES; CLASSES OF MEMBERS.

(a) The organic rules may provide for the formation of geographic districts of patron members and:

(1) for the conduct of patron member meetings by districts and the election of directors at the meetings; or

(2) that districts may elect district delegates to represent and vote for the district at members meetings.

(b) A delegate elected under subsection (a)(2) has one vote unless voting power is otherwise allocated by the organic rules.

(c) The organic rules may provide for the establishment of classes of members, for the preferences, rights, and limitations of the classes, and:

(1) for the conduct of members meetings by classes and the election of directors at the meetings; or

(2) that classes may elect class delegates to represent and vote for the class in members meetings.

(d) A delegate elected under subsection (c)(2) has one vote unless voting power is otherwise allocated by the organic rules.

Comment

This Section is the specific authorization for a limited cooperative association to divide patron members into geographic districts and all members into classes. It must do so, if at all, in its organic rules. The preferences, rights, and limitations applicable to any class authorized may be provided in the organic rules not inconsistent with this Act. The organic rules may provide for members to hold meetings by district or class, the election of directors from districts or classes, and the authority of members in districts or classes to elect delegates to annual or special membership meetings. Delegates to membership meetings have only one vote unless the organic rules provide for different allocation of voting from districts pursuant to Section 512(a) or different aggregate or representative voting under Sections 511 through 513.

Section 404 addresses voting by district, class or other voting groups with respect to proposed amendments to the organic rules.

Subsections (a) and (b) – The geographic locations of patron members in a limited cooperative association may cause them to reflect different perspectives with respect to the association. For this reason, many traditional cooperatives, especially in agriculture, have permitted the division of members into geographic districts within which the members can address localized concerns, have representatives or delegates represent those interests in association wide meetings, and otherwise benefit from more localized structures within larger organizations. These subsections permit the organic rules to provide for formation of geographic districts of patron members, the conduct of district meetings, the election of directors from districts, and provides a default rule for voting by a delegate elected by a district to represent the district in a full membership meeting. The subsections do not provide details for the structure or operation of a district leaving that to the organic rules and, under its general management authority, the board of directors.

Investor members may not be divided into districts under this Act because the geographic location of investor members is unlikely to affect their perspectives with respect to the association in the same way or with the significance that geographic location could affect the relationships between patron members and the association.

Subsections (c) and (d) – The concept of "class" is a familiar one in the context of business corporation law where shares with identical or different preferences, limitations and rights including voting, may be issued. *See, e.g.,* RMBCA § 6.01. Although the term "class" is used less frequently in unincorporated law the agreement that governs the relationship between the members frequently provides great variation in preferences, limitations, and rights among and between members. This Act expressly authorizes that the organic rules may provide classes of membership. An example of the use of a class would be to have two classes of investor members each of which elects one member of the board of directors. Of course, any such structure would also need to comply with Section 804.

Similar to other provisions, the authorization emphasizes the flexibility inherent in the Act and contemplates that the board of directors could be delegated the authority of establishing classes by the organic rules in a way that would emulate a "series" of shares in corporate law.

[ARTICLE] 6

MEMBER'S INTEREST IN LIMITED COOPERATIVE ASSOCIATION

SECTION 601. MEMBER'S INTEREST . A member's interest:

(1) is personal property;

(2) consists of:

(A) governance rights;

(B) financial rights; and

(C) the right or obligation, if any, to do business with the limited cooperative association; and

(3) may be in certificated or uncertificated form.

Comment

This Act has its genesis in cooperative principles and laws. Its structure combines elements of cooperative law, limited liability company law, and aspects of general and limited partnerships and corporate laws. The entity that may be formed under this Act is intended to be an unincorporated entity for state law purposes. With the flexibility of organizational structure and rights and obligations within an unincorporated entity structure, the relationships between the limited cooperative association and its members (and to some extent among the members themselves) have strong contractual underpinnings. This is consistent with cooperative common law where the courts have found the relationships between a cooperative and its members to be based on contract. In those cases, the articles of incorporation and bylaws of a cooperative, and sometimes additional contracts, are components of a contract even when the cooperative is organized under a corporate form of cooperative statute. The determination of the terms of the contract are made on a case by case basis and the cases are well-known. *See, e.g.*, *State ex rel. Boldt v. St. Cloud Milk Producers' Association*, 200 Minn. 1, 273 N.W. 603 (Minn. 1937); *Tennessee Cotton Growers' Association v. Hanson*, 2 Tenn. App. 118 (1926); *Boyle v. Pasco Growers' Ass'n, Inc.*, 170 Wash. 516 17 P.2d (1932); *New England Trust Co. V. Abbott*, 162 Mass. 148, 38 N.E. 432 (1894).

The contractual interpretive gloss is a unique feature of cooperatives. This Act envisions its interpretation will be consistent with general cooperative law and reflect approaches similar to other unincorporated law.

Nonetheless, this Act provides for the fundamental governance rights and financial rights within a limited cooperative association and between the association and its members as well as the governance and financial relationships among all the members. The Act permits the organic rules of an association to vary, with certain limitations (for example, Section 514 that requires certain voting power for patron members), many of the rules provided by the Act as default rules so that the governance and financial relationships within the association can be designed to fit the objectives and needs of the association and its members. *See* Section 113.

Paragraph (1) – Like RULLCA (2006) and ULPA (2001), a member's interest in a limited cooperative association is personal property. Section 603(a) deals with transferability and the results of transfers or attempted transfers, either voluntary or involuntary.

Paragraph (2) – The paragraph delineates in summary form the three basic rights of a member's interest in a limited cooperative association. Detailed provisions with respect to governance rights and financial rights are contained in other parts of the Act.

Paragraph (2)(C) – One reason for the existence of cooperatives is for patron members to engage in business with the cooperative as a form of self-help. This subparagraph expressly recognizes the right or obligation of a member to engage in business with the cooperative as a component of the member's interest in the association. The right or obligation is typically evidenced by a marketing or use contract, a membership agreement, or a combination of the two. In addition, portions of those contracts or agreements are sometimes contained in the organic rules. Marketing or similar contracts are usually interpreted the same way as third party contracts. The placement of provisions that would otherwise be interpreted as a third party contract in either a membership agreement or the organic rules may affect whether those provisions are interpreted solely as a matter of third party contract. Such a determination will depend on all the facts and circumstances of the particular scenario.

A membership agreement should not be confused with a control agreement (for example, the typical shareholders' agreement in business corporation planning).

This Act does not provide details of the rights or obligations of a member to do business with the limited cooperative association leaving maximum flexibility for development of them to the organic rules and separate contract. For example in an agricultural limited cooperative association, membership may be required for an agricultural producer to be entitled to deliver production to the association for processing. In an association where workers are the patron members, membership in the association may be required to be an employee of the association. Typically, but again depending on the facts and circumstances, neither of these requirements would constitute financial or governance rights but, nonetheless, would be an integral part of the membership in the association.

Some traditional cooperatives provide in their organic rules and operating policies that simply engaging in business with the cooperative constitutes an application for membership in the cooperative or automatically constitutes a person as a member of the cooperative. For example, rural telephone cooperatives almost always provide that a request for service also

constitutes an application for membership and, in some cases, require a person to be a member to obtain telephone service. This Act does not prohibit this type of provision in the organic rules.

Traditional cooperatives may engage in business with persons who are not members of the cooperative unless prohibited by the organic rules. Traditionally cooperatives have referred to those persons as "non-member patrons." This Act does not prevent a limited cooperative association from engaging in business or other activities with non-members. These arrangements are not addressed in this Act. They are governed by general contract law. If an association engages in business or other activities with non-members, the organic rules may authorize the non-members to share in profit of the association but this would be done through a contract. Nothing in this Act prohibits an association from engaging in business with "non-member patrons." The organic rules of an association could address "non-member patrons" as well.

Paragraph (3) – A limited cooperative association formed under this Act is not required to issue membership certificates, but it may do so. If it does so, it is required to note restrictions on transfer of membership interests on the certificate under Section 603(d)(2).

SECTION 602. PATRON AND INVESTOR MEMBERS' INTERESTS .

(a) Unless the organic rules establish investor members' interests, a member's interest is a patron member's interest.

(b) Unless the organic rules otherwise provide, if a limited cooperative association has investor members, while a person is a member of the association, the person:

(1) if admitted as a patron member, remains a patron member;

(2) if admitted as an investor member, remains an investor member; and

(3) if admitted as a patron member and investor member remains a patron and investor member if not dissociated in one of the capacities.

Comment

Subsection (a) – A limited cooperative association may have both patron members and investor members. Investor members are not permitted unless the organic rules provide for them.

Subsection (b) – If a limited cooperative association has investor members, persons who become a member as either a patron member or as an investor member will remain that type of member so long as the person remains a member of the association. A person may hold

memberships in both capacities. *See* Section 116. The organic rules could provide that a patron member is converted to an investor member upon the occurrence of specified events, such as ceasing to qualify as a patron member under the organic rules. If a person holds memberships in both capacities, the member could dissociate in one capacity but not in the other or, subject to the Act and the organic rules of the association, could transfer one type of membership interest but not the other.

SECTION 603. TRANSFERABILITY OF MEMBER'S INTEREST .

(a) The provisions of this [act] relating to the transferability of a member's interest are subject to [reference to Uniform Commercial Code].

(b) Unless the organic rules otherwise provide, a member's interest other than financial rights is not transferable.

(c) Unless a transfer is restricted or prohibited by the organic rules, a member may transfer its financial rights in the limited cooperative association.

(d) The terms of any restriction on transferability of financial rights must be:

(1) set forth in the organic rules and the member records of the association; and

(2) conspicuously noted on any certificates evidencing a member's interest.

(e) A transferee of a member's financial rights, to the extent the rights are transferred, has the right to share in the allocation of profits or losses and to receive the distributions to the member transferring the interest to the same extent as the transferring member.

(f) A transferee of a member's financial rights does not become a member upon transfer of the rights unless the transferee is admitted as a member by the limited cooperative association.

(g) A limited cooperative association need not give effect to a transfer under this section until the association has notice of the transfer.

(h) A transfer of a member's financial rights in violation of a restriction on transfer contained in the organic rules is ineffective as to a person having notice of the restriction at the time of transfer.

Comment

Generally – Unincorporated entity law restricts transferability of interests because of the personal and contractual nature of the entities. Members choose to form unincorporated entities in reliance on their knowledge of, and comfort with, the persons with whom they will be associated. The governing law generally distinguishes between the governance (or management) rights of members and their financial rights. *See, e.g.,* RULLCA (2006) § 501 (transferable interest is personal property); § 502(a)(3)(A) (transfer does not entitle transferee to participate in management or conduct of company's activities); § 502(a)(3)(B) (transferee has right to receive distributions to which transferor would otherwise be entitled).

This Act draws the same basic distinction. Thus, subsections (b) and (c) provide the default rule that only financial rights may be transferred, and subsection (f) states that a transferee of financial rights does not thereby become a member. Subsection (e) provides that a transferee of financial rights receives only the right to share in the allocation of profits and losses and the right to receive the distributions to which the transferring member would otherwise have been entitled. A member who transfers financial rights retains governance rights. *See* Comment to Section 102(13).

Governance rights are a statutory component of a member's interest, which is itself defined in Section 601(1) as personal property. The differentiation between financial rights and governance rights under this Act, and the exclusion of management rights from transferable interests under other unincorporated entity acts, rests in part on the fact that governance rights are as close to contracts for unique personal services as they are to purely commercial transactions or even the servicing and maintenance agreements attendant to the purchase of other property. This is especially true in a small, closely held entity.

Subject to Uniform Commercial Code – Unlike some entity statutes, such as RULLCA (2006), this Act specifies all of the rights and obligations that are components of a member's interest and addresses assignments of governance rights as well as financial rights. RULLCA provides rules governing assignments of "transferable interests," which are the equivalent of "financial rights" under this Act, but does not have a term equivalent to "governance rights" under this Act and does not deal with their assignment.

In transactions subject to Article 9 of the Uniform Commercial Code ("UCC"), Sections 9-406 and 9-408 must be consulted to determine the effectiveness of the provisions of this Act limiting transferability. Assuming the interest being transferred is not a "security" or "financial asset" as defined in UCC Article 8, it will be a "general intangible" (UCC Section 9-102(a)(42)) for purposes of Article 9 and the limited cooperative association will be an "account debtor"

(UCC Section 9-102(a)(3)). If the account debtor's principal obligation is a monetary obligation, it will be a "payment intangible" (UCC Section 9-102(a)(61)), a subset of general intangibles. Thus, a member's financial rights constitute both a general intangible and a payment intangible, while the full set of rights that constitute a member's interest are a general intangible but not a payment intangible.

UCC Article 9 applies to an assignment of any general intangible as collateral for an obligation, but it does not apply to the sale of a general intangible unless it is a payment intangible. If a general intangible that is not a payment intangible (a member's interest) is assigned as collateral for an obligation, or if a payment intangible (a member's financial rights) is sold, UCC Section 9-408 must be consulted. Under UCC Section 9-408(c), a legal rule restricting alienation, such as that set forth in Section 503(b) of this Act, "is ineffective to the extent that [it]: (1) would impair the creation, attachment, or perfection of a security interest; or (2) provides that the assignment or transfer or the creation, attachment, or perfection of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination, or remedy. . . ." The same result would obtain under UCC Section 9-408(a) if the restriction on assignment or provision making an assignment an event of default constituted a term in an agreement between an account debtor and a debtor (a limited cooperative association and its member).

These provisions are not as far-reaching as they may at first appear. While a member may create a security interest in the rights at issue and will not be in default for doing so, the security interest in favor of the lender or buyer will not be enforceable if the statutory or agreement-based transfer restriction is effective under law other than the UCC. Of course, the provisions of this Act permitting restrictions on transfer constitute such a law. UCC Section 9-408(d) provides *inter alia* that, if the transfer restriction is effective under other law, the security interest created by the debtor is not enforceable against the account debtor, does not impose a duty on the account debtor, does not require the account debtor to recognize the security interest or deal in any manner with the secured party, does not entitle the secured party to use or reassign the rights, and does not entitle the secured party to trade secrets or confidential information. In other words, the secured party may have a perfected security interest in the rights but, other than pursuing proceeds if such are generated or attempting to use the security interest to enhance the value of its secured claim in bankruptcy, the secured party is powerless to enforce its security interest unless the limited cooperative association agrees to waive some or all of its rights.

If a payment intangible is assigned as collateral for an obligation, UCC Section 9-406(d) rather than UCC Section 9-408(a) applies to contractual restraints on alienation, and UCC Section 9-408(c), discussed above, applies to legal restrictions. UCC Section 9-406(d) overrides terms in an agreement between an account debtor and a debtor restricting assignment or making it an event of default. Unlike UCC Section 9-408(a), the override extends to the "creation, attachment, perfection, *or enforcement* of a security interest [emphasis supplied]." Although the secured party has enforcement rights, those rights are limited as a practical matter to collection of sums due from the account debtor under UCC Section 9-607 and do not extend to enforcement by a foreclosure sale under UCC Section 9-610 or the acceptance of collateral in whole or partial satisfaction of the secured obligations under UCC Section 9-620. Such a sale or acceptance

would be governed by UCC Section 9-408. *See* UCC Sections 9-406(e) and 9-408(b). Thus, when financial rights are used as collateral for a loan, the only risk to the limited cooperative association is that it will be required to direct payments that otherwise would have gone to the member to a secured party instead.

Because members other than the member attempting to create a security interest are not account debtors, a contract among all the members would not be an agreement between an account debtor and a debtor. Thus, the restrictions on agreement-based anti-alienation provisions discussed above would not be applicable.

This Section has no application to agreement-based rights and obligations between a limited cooperative association and members under contracts that exist outside a member's financial or governance rights in an association and the right or obligation of a member to do business with the association. *See* Comment to Section 601 and Preliminary Comment to Article 7.

Subsection (b) – If there are restrictions on transfers of interests in a limited cooperative association, except for financial rights, the interests are not transferable unless permitted by the organic rules, the association's membership records, and on certificates of interest if the association issues certificates. An association does not need to issue certificates. *See* Section 601(3).

Subsection (c) – To be effective, a restriction or prohibition on the transfer of financial rights in a limited cooperative association must be set forth in the organic rules. The default rule that financial rights are transferable is based on laws governing other unincorporated entities, where such rights are considered to be personal property that is not subject to transfer restrictions except to the extent a restriction is set forth in the entity's organic document. *See* CARTER G. BISHOP AND DANIEL S. KLEINBERGER, LIMITED LIABILITY COMPANIES: TAX AND BUSINESS LAW, ¶ 8.06[2] (discussing the "pick your partner" principle in the contexts of partnerships and limited liability companies); *Cf.* LARRY E. RIBSTEIN AND ROBERT R. KEATINGE, RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES (2d ed.) § 7:8, p. 7-15 (2007).

Subsection (e) – If a transferee is entitled under the Act and the organic rules to receive transfer of financial rights from a member of a limited cooperative association, the transferee is entitled to share in allocations of profit and loss and distributions of the association. This does not mean a transferee would have a greater right than the transferor. If it is a requirement that a patron member transact patronage with an association to participate in allocations of profit and loss, a transferee of financial rights from that member would not be permitted to receive a share of allocations of profit and loss if the member did not transact patronage with the association during the period for which the allocations are determined.

Subsection (f) – A transferee of the financial rights of a member of a limited cooperative association does not automatically become a member of the association because of the transfer. For a transferee to become a member (with all the rights of a member including governance rights) requires an act of the association to admit the transferee as a member of the association.

A mere transfer of financial rights does not alone dissociate the transferor member. *See* Section 1101. Therefore, under the default rules, the transferor retains all other rights including the right to vote as a member. If the transferor is dissociated pursuant to Section 1101, the voting rights associated with the membership vanish. The organic rules could vary this result, however, by admitting the transferee as a member. If the organic rules admit the transferee, they should address the case of a transfer to a transferee who is an existing member; especially if the association uses the one member - one vote manner of voting.

Subsection (g) – This subsection recognizes an administrative necessity by relieving a limited cooperative association of any obligation with respect to a transfer of a membership interest in the association, or any portion of an interest, if the association has no knowledge or notice of the transfer or attempted transfer. As in other parts of the Act, what constitutes effective "notice" in this Section is left to other law. Provisions dealing with "notice" could also be written in the organic rules.

Subsection (h) – A transfer of all or a portion of a member's interest in violation of a restriction on transfer is not effective against a person who had knowledge of the restriction. Conversely, if a transferee had no notice of the restriction, the transfer is effective.

SECTION 604. SECURITY INTEREST AND SET-OFF.

(a) A member or transferee may create an enforceable security interest in its financial rights in a limited cooperative association.

(b) Unless the organic rules otherwise provide, a member may not create an enforceable security interest in the member's governance rights in a limited cooperative association.

(c) The organic rules may provide that a limited cooperative association has a security interest in the financial rights of a member to secure payment of any indebtedness or other obligation of the member to the association. A security interest provided for in the organic rules is enforceable under, and governed by, [reference to Article 9 of the Uniform Commercial Code].

(d) Unless the organic rules otherwise provide, a member may not compel the limited cooperative association to offset financial rights against any indebtedness or obligation owed to the association.

Comment

This Section succinctly addresses recurring security interest issues that arise concerning members' interest and that are common to both cooperative and unincorporated entities. Under subsections (a) and (b) a member may create an enforceable security interest in its financial rights but, unless the organic rules provide otherwise, may not create an enforceable security interest in governance rights. The word "enforceable" is significant here and ties into the relationship between the provisions of this Act relating to transferability and those of UCC Sections 9-406 and 9-408. This relationship is discussed in the Comment to Section 603 ("Subject to Uniform Commercial Code").

Subsection (c) – This subsection permits the organic rules of a limited cooperative association to create an enforceable UCC Article 9 security interest in the financial rights of a member to secure the indebtedness or the performance of obligations of a member to the association with the organic rules themselves constituting the security agreement. In other words, the organic rules will have the same legal effect as a UCC Article 9 security agreement authenticated by the debtor (member) and describing the collateral as the member's financial rights. If the organic rules provide for such a security interest, issues of perfection, priority, and the manner of enforcement are governed by the relevant provisions of the UCC.

The creation of the security interest in the organic rules is consistent with the mutual self-help purpose of a cooperative which recognizes all members are inter-reliant. That is, a default by one member of an obligation to the cooperative can affect all members.

The usefulness of the ability of a cooperative to protect itself, and thus all of its members, in the event of a failure of one member to meet its obligations to the cooperative can arise in many contexts. If members in a supply cooperative fail to pay for goods received from the cooperative, the failure damages all other members by reducing the receipts of the cooperative used to cover its expenses in providing services to its members. Some agricultural cooperatives pay for commodities received by them through "net proceeds contracts" where the purchase price is determined by the total amounts received for the commodities by the cooperative less the cooperative's expenses during a marketing period. Many of these cooperatives make advances towards the purchase price during the marketing period. If at the end of the marketing period, it is discovered the cooperative has overpaid its members, the security interest (although unperfected) can assist the cooperative in recovering the overpayments for the equitable treatment and benefit of all the members. This subsection constitutes a balancing of the interests of the member and creditors of the member, on one hand, and the association and its other members and creditors on the other. It reflects one of the unique features of cooperatives: those who own them are both their primary customers and sources of capital. This feature is present in limited cooperative associations even though it is arguably diluted by the possible existence of non-patron investor members.

Subsection (d) – Under the default rule of this subsection, no member of a limited cooperative association may require the association to offset amounts due to the member from

the association against amounts due to the association from the member. An association may, however, offset against amounts due a member in accordance with other law.

SECTION 605. CHARGING ORDERS FOR JUDGMENT CREDITOR OF MEMBER OR TRANSFEREE .

(a) On application by a judgment creditor of a member or transferee, a court may enter a charging order against the financial rights of the judgment debtor for the unsatisfied amount of the judgment. A charging order issued under this subsection constitutes a lien on the judgment debtor's financial rights and requires the limited cooperative association to pay over to the creditor or receiver, to the extent necessary to satisfy the judgment, any distribution that would otherwise be paid to the judgment debtor.

(b) To the extent necessary to effectuate the collection of distributions pursuant to a charging order under subsection (a), the court may:

(1) appoint a receiver of the share of the distributions due or to become due to the judgment debtor under the judgment debtor's financial rights, with the power to make all inquiries the judgment debtor might have made; and

(2) make all other orders that the circumstances of the case may require to give effect to the charging order.

(c) Upon a showing that distributions under a charging order will not pay the judgment debt within a reasonable time, the court may foreclose the lien and order the sale of the financial rights. The purchaser at the foreclosure sale obtains only the financial rights that are subject to the charging order, does not thereby become a member, and is subject to Section 603.

(d) At any time before a sale pursuant to a foreclosure, a member or transferee whose financial rights are subject to a charging order under subsection (a) may extinguish the charging

order by satisfying the judgment and filing a certified copy of the satisfaction with the court that issued the charging order.

(e) At any time before sale pursuant to a foreclosure, the limited cooperative association or one or more members whose financial rights are not subject to the charging order may pay to the judgment creditor the full amount due under the judgment and succeed to the rights of the judgment creditor, including the charging order. Unless the organic rules otherwise provide, the association may act under this subsection only with the consent of all members whose financial rights are not subject to the charging order.

(f) This [act] does not deprive any member or transferee of the benefit of any exemption laws applicable to the member's or transferee's financial rights.

(g) This section provides the exclusive remedy by which a judgment creditor of a member or transferee may satisfy the judgment from the member's or transferee's financial rights.

Comment

Source: RULLCA (2006) § 505.

Charging order provisions appear in various forms in UPA, ULPA, RULPA (1976/1985), ULLCA, ULPA (2001), and RULLCA (2006). RULLCA (2006) § 505 built on those previous acts, while: (i) modernizing the language; (ii) making explicit certain points that had been at best implicit; and (iii) seeking to delineate more precisely the types of extraordinary circumstances that would have to exist before a court enforcing a charging order would be justified in interfering with a limited liability company's management or activities. Much of this comment is closely derived from the comments to RULLCA (2006) § 505.

This Section balances the needs of a judgment creditor of a member or transferee with the needs of the limited cooperative association and its members. The Section achieves that balance by allowing the judgment creditor to collect on the judgment from distributions with respect to financial rights of the judgment debtor in the association while prohibiting interference in the management and activities of the association by the judgment creditor or a court. If the organic rules permit the entire interest of a member in an association to be transferred, this Section only permits a charging order to reach the member's or transferee's financial rights. It does not

permit a charging order to reach governance rights in the association prior to foreclosure under those circumstances. *See* Comment to RULLCA (2006) § 505.

Under this Section, the judgment creditor of a member or transferee is entitled to a charging order against the relevant financial rights. While the order is in effect, it entitles the judgment creditor to whatever distributions would otherwise be due to the member or transferee whose interest is subject to the order. However, the judgment creditor has no voice in determining the timing or amount of those distributions. The charging order does not entitle the judgment creditor to accelerate any distributions or to otherwise interfere with the management and activities of the limited cooperative association.

"Distributions" may be made in a variety of ways under Section 1005 including the distribution of property. The charging order would apply to those distributions, but this would not compel the association to accelerate the time at which the property would be distributed or converted to money by the association in its ordinary course of operations.

This Section may not be varied by the organic rules.

Subsection (a) – The phrase "judgment debtor" encompasses both members and transferees. As a matter of civil procedure and due process, an application for a charging order must be served both on the limited cooperative association and the member or transferee whose financial rights are to be charged. *See* Comment to RULLCA (2006) § 505.

Subsection (b) – Paragraph (2) refers to "other orders" rather than "additional orders". Therefore, given appropriate circumstances, a court may invoke either paragraph (1) or (2), or both.

Subsection (b)(1) – The receiver contemplated here is not a receiver for the limited cooperative association, but rather a receiver for the distributions. The principal advantage provided by this paragraph is a probable expanded right to information. However, that right goes no further than "the extent necessary to effectuate the collections of distributions pursuant to a charging order". *See* Comment to RULLCA (2006) § 505.

Subsection (b)(2) – This paragraph must be understood in the context of the balance described in the general comment to this Section. In particular, the court's power to make orders "that the circumstances of the case may require" is limited to "giv[ing] effect to the charging order."

> **EXAMPLE:** A judgment creditor with a charging order believes that the limited cooperative association should invest less of its surplus in operations, leaving more funds for distributions. The creditor moves the court for an order directing the association to restrict re-investment. Subsection (b)(2) does not authorize the court to grant the motion.

> **EXAMPLE:** A judgment creditor with a judgment for $10,000 against a member obtains a charging order against the member's financial rights. Having been properly served with the order, the limited cooperative association nonetheless fails to comply and makes a $3,000 distribution to the member. The court has the power to order the association to pay $3,000 to the judgment creditor to "give effect to the charging order."

Under subsection (b)(2), the court also has the power to decide whether a particular payment is a distribution, because that decision determines whether the payment is part of the financial rights subject to the charging order. To the extent a payment is not a distribution, it may not be part of the financial rights and, if not, would not be subject to subsection (g).

Issues have arisen in the income tax area, as well as in some non-tax areas, with respect to whether monies distributed by business corporations or allocated and distributed by S corporations as dividends to stockholders employed by the corporations are really compensation or whether amounts treated by a corporation as compensation for services rendered by a stockholder are really disguised dividends. Whether a charging order applies to amounts constituting reasonable compensation for present or past services or reasonable payments made in the ordinary course of business under a bona fide retirement program or other benefits program or for other purposes for which compensation is ordinarily due, is a question of importance to this Section. The same issues could arise with limited cooperative associations. A court may be required to examine the true nature and purpose of monies or other property transferred to a member who is an employee of a limited cooperative association. Even in the context of other entities, however, case law is scant, but there is authority holding that compensation is a distribution. *PB Real Estate, Inc. v. Dem II Properties*, 719 A.2d 73, 75 (Conn. Appl Ct. 1998) (rejecting the defendants' claim that the payments at issue were merely compensation for their services to their law firm, which was organized as a limited liability company, noting that the defendants' characterization was at odds with the firm's business records and tax returns and holding that the payments received were distributions subject to the charging order). *See* Comment to RULLCA (2006) § 505.

As in RULLCA, this Act has no specific rules for determining the fate or effect of a charging order when the limited cooperative association undergoes a merger or conversion under Article 16.

Subsection (c) – The phrase "that distributions under the charging order will not pay the judgment debt within a reasonable period of time" comes from case law. *See, e.g., Nigri v. Lotz*, 453 S.E.2d 780, 783 (Ga. Ct. App. 1995).

Enforcement of a charging order is by a foreclosure sale of the interest to which the charging order applies. *See* subsection (g).

Subsection (e) – The Comment to subsection (e) of RULLCA § 503 states: "This Act [RULLCA] jettisons the confusing concept of redemption [of the judgment under charging order

provisions] and substitutes an approach that more closely parallels the modern, real-world possibility of the LLC or its members buying the underlying judgment (and thereby dispensing with any interference the judgment creditor might seek to inflict on the LLC)." This subsection follows RULLCA's approach. The change in nomenclature is particularly helpful in the context of this Act because in traditional cooperatives equity accounts are frequently "redeemed." Redemptions provide funds to members and maintain ownership of the cooperative by active members. The definition of "distribution" in Subsection 102(9) is broad enough to include payments in redemption of a membership interest in a limited cooperative association under Section 1006 making those payments a part of a member's financial rights. A charging order could reach distributions to redeem the interest. The procedure provided in RULLCA and followed in this Act is appropriate for limited cooperative associations.

At the same time, when possible, buying the judgment remains superior to the mechanism provided by this subsection, because this subsection requires full satisfaction of the underlying judgment, while the limited cooperative association or the other members might be able to buy the judgment for less than face value. On the other hand, this subsection operates without need for the judgment creditor's consent, so it remains a valuable protection in the event a judgment creditor seeks to do mischief to the association.

A unanimous vote of members is required for an association to pay a member's judgment creditor under this subsection unless otherwise provided in the organic rules.

Subsection (g) – This subsection does not override Article 9 of the Uniform Commercial Code ("UCC"), which may provide different remedies for a secured creditor acting in that capacity. A secured creditor with a judgment might decide to proceed under UCC Article 9 alone, under this Section alone, or under both UCC Article 9 and this Section. In the last-mentioned circumstance, the constraints of this Section would apply to the charging order but not to the UCC Article 9 remedies. The effect of Section 604 with respect to the creation of security interests in membership interests in a limited cooperative association needs to be considered in connection with UCC Article 9 security interests and related remedies if a creditor seeks a security interest in a membership interest in an association in which the creditor's debtor is a member.

See Comments to Sections 603 and 604.

[ARTICLE] 7

MARKETING CONTRACTS

Preliminary Comment

Agricultural cooperatives that market or process members' agricultural commodities have benefitted from special statutory marketing contract provisions that are unique to agricultural cooperatives under many traditional cooperative statutes. These statutes authorize the cooperative to enter into agricultural marketing contracts that specifically authorize sums for, or methods to establish, liquidated damages for a breach of the contract by a member selling and delivering or consigning commodities to the cooperative. In the early 1900s absent these statutory authorizations, marketing contracts were held to be void as against public policy. The damages provided in the contracts were treated as unenforceable penalties. *E.g.*, *Burns v. Wray Farmers' Grain Co.*, 65 Colo. 425, 176 P. 487 (1918) (agreement void); *Rifle Potato Growers' Coop. Ass'n v. Smith*, 78 Colo. 171, 240 P. 937 (1925) (agreement upheld and is not invalid because it permits injunctive relief or specific performance); *Mountain States Beet Growers' Mkt. Ass'n v. Monroe*, 84 Colo. 300, 269 P. 886 (1928) (discuss history of marketing contracts). Section 704 contains but a vestige of these statutory provisions addressing the enforcement of remedies that may be in the contract.

The Act broadens the application of marketing contracts from solely for agricultural commodities to the sale of products processed from any type of product, commodity, or goods furnished by a member; and, to commodities, products, and goods of any kind that are marketed through the association. Oregon, for example, has provided for a similar breadth in its traditional cooperative statute. OR. REV. STAT. § 62.355 (2003).

This Article has no application to contracts for the purchase of any item by a limited cooperative association for its members in the role of a purchasing entity for the members or to contracts between an association and its members under which members of the association market their services to others. Likewise, it does not have any application to any other type of contractual relationship between the association and a member other than a marketing contract. It neither authorizes nor prevents the enforcement of remedies, including liquidated damages and injunctive relief, under other types of contracts. Those contracts are governed under the general law of contracts and other law.

"Goods" is used in the definitional sense of the Uniform Commercial Code but is supplemented by "products" and "commodities" to emphasize the breadth of authorization for an association's use of marketing contracts governed by this Article.

Marketing contract provisions are sometimes distributed across a number of agreements or documents and do not necessarily appear within the four corners of a single instrument. *See* Comment to Section 601(2)(C); *cf.* JAMES R. BAARDA, STATE INCORPORATION STATUTES FOR FARMER COOPERATIVES, AGRICULTURAL COOPERATIVES SERVICE, UNITED STATES DEPARTMENT OF AGRICULTURE, Info. Rep. 30, § 14.04.12, p. 102 (1982). Provisions are sometimes placed in

the organic rules, even though this can create difficulties if the provisions require amendment. Provisions are also sometimes placed in separate membership agreements.

Whether rights and obligations under a marketing contract are subject to assignment may be addressed in the organic rules or the terms of the contract itself as supplemented by the law of contracts. In the absence of express provisions concerning assignment in the organic rules or the contract itself, general contract law will govern. The contract or the provisions governing membership, wherever located, frequently require a person to be a member of a cooperative as a prerequisite to entering into a marketing contract. Such provisions may affect the assignability of a marketing contract.

If a limited cooperative association is not prevented by its organic rules from engaging in business with persons who are not members, frequently called "non-member patrons," the association may enter into marketing contracts with the non-member patrons. *See* Comment to Section 601(2)(C). Those contracts are authorized by Section 701(1) of the Act and could contain provisions authorized by this Article including the remedies provided in Section 704. If, however, provisions of the marketing contract are contained in the organic rules and those provisions are amended by an amendment to the organic rules, the amendments to the organic rules might not be binding on a non-member patron in the absence of the non-member patron's specific consent.

The provisions of this Act regarding marketing contracts do not affect the application of statutes, such as the Packers and Stockyards Act, 7 U.S.C.A. Section 181 *et seq.*, that provide protections for payments to agricultural producers who deliver their livestock or commodities to a buyer or processor.

This Article has no effect on contracts, other than marketing contracts.

SECTION 701. AUTHORITY . In this [article], "marketing contract" means a contract between a limited cooperative association and another person, that need not be a patron member:

(1) requiring the other person to sell, or deliver for sale or marketing on the person's behalf, a specified part of the person's products, commodities, or goods exclusively to or through the association or any facilities furnished by the association; or

(2) authorizing the association to act for the person in any manner with respect to the products, commodities, or goods.

Comment

Paragraph (1) – A marketing contract may cover a portion or all of a member's products, commodities, or goods. It need not be a total output contract to be subject to this Article.

Paragraph (2) – This paragraph permits a limited cooperative association to be a buyer, a sales agent, a consignee, or act in any other capacity in connection with marketing products, commodities, or goods under a marketing contract.

SECTION 702. MARKETING CONTRACTS .

(a) If a marketing contract provides for the sale of products, commodities, or goods to a limited cooperative association, the sale transfers title to the association upon delivery or at any other specific time expressly provided by the contract.

(b) A marketing contract may:

(1) authorize a limited cooperative association to create an enforceable security interest in the products, commodities, or goods delivered; and

(2) allow the association to sell the products, commodities, or goods delivered and pay the sales price on a pooled or other basis after deducting selling costs, processing costs, overhead, expenses, and other charges.

(c) Some or all of the provisions of a marketing contract between a patron member and a limited cooperative association may be contained in the organic rules.

Comment

Subsection (a) – This subsection addresses the question of when title passes to products, commodities, or goods delivered and sold to a limited cooperative association under a marketing contract. The question often has no clear answer under other law if the contract does not provide one. This subsection provides the date of delivery as a default rule but recognizes the contract may provide a different time.

Subsection (b)(1) – This subsection recognizes that it may be necessary for business reasons for a limited cooperative association to borrow money to carry on its operations, including for purposes of making payments to its member patron suppliers, before it has sold the products, commodities, or goods delivered to it under the contract. A marketing contract may permit the association to grant a security interest in the products, commodities, or goods

delivered to it even if title has not passed to the association. Perfection, priority and other matters related to the security interest are governed by other law such as Article 9 of the Uniform Commercial Code.

Subsection (b)(2) – This subsection permits a marketing contract to provide one of a variety of ways to determine the price or amount to be paid for products, commodities, or goods delivered to the association. It expressly includes pooling of products, commodities, or goods from all or several producers for marketing, sale, and payment based on the results of marketing the entire pool. The Act does not provide default rules. The marketing contract must provide those terms.

SECTION 703. DURATION OF MARKETING CONTRACT . The initial duration of a marketing contract may not exceed 10 years, but the contract may be self-renewing for additional periods not exceeding five years each. Unless the contract provides for another manner or time for termination, either party may terminate the contract by giving notice in a record at least 90 days before the end of the current term.

Comment

This Section limits the primary term of a marketing contract to a maximum of 10 years which is in accord with similar provisions concerning marketing contracts in traditional cooperative statutes.

SECTION 704. REMEDIES FOR BREACH OF CONTRACT .

(a) Damages to be paid to a limited cooperative association for breach or anticipatory repudiation of a marketing contract may be liquidated, but only at an amount or under a formula that is reasonable in light of the actual or anticipated harm caused by the breach or repudiation. A provision that so provides is not a penalty.

(b) Upon a breach of a marketing contract, whether by anticipatory repudiation or otherwise, a limited cooperative association may seek:

(1) an injunction to prevent further breach; and

(2) specific performance.

(c) The remedies in this section are in addition to any other remedies available to an association under law other than this [act].

Comment

Subsections (a) and (b) – Many traditional cooperative statutes addressing marketing contracts in agriculture have detailed provisions regarding the enforcement and remedies. This Section identifies three primary remedies which a marketing contract may provide and authorizes their enforcement as provided in the contract. The remedies are expressed somewhat differently in this Act as compared to their expression in many traditional cooperative statutes that include similar provisions.

[ARTICLE] 8

DIRECTORS AND OFFICERS

Preliminary Comment

This Act draws its substance from limited liability company and partnership concepts and limited cooperative associations formed under it are unincorporated entities under state law. *See* Section 104. Traditional cooperatives, however, use a board of director management structure similar to corporate law (whether for-profit or not-for-profit). Therefore, this Article dealing with boards of directors draws primarily from traditional cooperative and for-profit corporation statutes. This Act requires an elected board of directors for general governance of a limited cooperative association. Though not statutorily required by limited liability company law, some LLCs choose to organize their internal management to provide for a board management structure. Members have a more participatory role in cooperatives than in typical business corporations and any analogy to corporate management, therefore, is by its nature somewhat limited. Nonetheless, some of the meeting and notice provisions borrow heavily from corporate law because that content is where those provisions have the longest history and experience. This Article does not generally contain the level of detail that is present in business corporation law leaving many of the details to be developed by the parties in the organic rules in a manner similar to other unincorporated or alternative entities like limited liability companies.

A substantial number of the provisions of this Article, as in other Articles, may be modified by the organic rules, but in the absence of modification, the Article provides sufficient default rules that a board of directors can be elected and function.

SECTION 801. BOARD OF DIRECTORS .

(a) A limited cooperative association must have a board of directors of at least three individuals, unless the association has fewer than three members. If the association has fewer than three members, the number of directors may not be fewer than the number of members.

(b) The affairs of a limited cooperative association must be managed by, or under the direction of, the board of directors. The board may adopt policies and procedures that do not conflict with the organic rules or this [act].

(c) An individual is not an agent for a limited cooperative association solely by being a director.

Comment

Subsection (a) – This subsection is similar to Section 62.280(2) of the Oregon Cooperative Corporation Act. The subsection does not limit the number of directors to the number of members where there are fewer than three members but it does require there be at least the number of directors equal to the number of members in that case. The flexibility to deviate below three directors when there are fewer than three members allows an industry practice of having wholly-owned cooperative subsidiaries of a cooperative. It seems *unnecessary* as a matter of law to require three directors if there are only one or two members. Section 803(c)(1) permits an association to have one director who is a non-member if so provided in the organic rules if there is at least one director that is a member. Subsection 801(a) provides the members great, but not unfettered, flexibility in organizing their board governance structure.

Subsection (b) – This Act follows statutes for most entities which have a governing body or other individuals authorized by statute or the entity's organic rules to manage or provide for the direction of the entity. This is consistent with a representative democracy approach followed in most traditional cooperative statutes and by most cooperatives. The general management authority of the board of directors is mandatory.

Subsection (c) – Simply being a director does not make the director an agent nor does it confer agency authority on a person to act on behalf of a limited cooperative association. The association could delegate agency authority to a director in the same manner as it delegates agency authority to other persons. This subsection contrasts the agency of directors in this Act with managers in many limited liability company statutes who are cloaked with statutory agency authority.

SECTION 802. NO LIABILITY AS DIRECTOR FOR LIMITED COOPERATIVE ASSOCIATION'S OBLIGATIONS . A debt, obligation, or other liability of a limited cooperative association is solely that of the association and is not a debt, obligation, or liability of a director solely by reason of being a director. An individual is not personally liable, directly or indirectly, for an obligation of an association solely by reason of being a director.

Comment

Source: Derived from ULPA (2001) § 303.

This Section is "new" to the law of cooperatives as a codified statement and is arguably necessary because limited cooperative associations are unincorporated entities and distinguishes directors under this Act with general partners of limited partnerships to whom they may be compared. It does not change the result under existing traditional cooperative law. The liability

shield for directors is not different in-kind from the shield for members under Section 504. *See* Comment to Section 504. It does not shield the director from liability on account of the director's own conduct, for improper distributions under Section 1008(a), or for a breach of the duties under Section 718 or 819.

SECTION 803. QUALIFICATIONS OF DIRECTORS .

(a) Unless the organic rules otherwise provide, and subject to subsection (c), each director of a limited cooperative association must be an individual who is a member of the association or an individual who is designated by a member that is not an individual for purposes of qualifying and serving as a director. Initial directors need not be members.

(b) Unless the organic rules otherwise provide, a director may be an officer or employee of the limited cooperative association.

(c) If the organic rules provide for nonmember directors, the number of nonmember directors may not exceed:

(1) one, if there are two through four directors;

(2) two, if there are five through eight directors; or

(3) one-third of the total number of directors if there are at least nine directors.

(d) The organic rules may provide qualifications for directors in addition to those in this Section.

Comment

This Section follows traditional cooperative approaches for the qualifications of directors in that, generally the directors must be individuals and must be a member of the limited cooperative association or a designee of a member that is not an individual even though a limited number of non-members may be directors. This Section is also analogous to older unincorporated law which could be interpreted to require "management" to be vested only in members (owners).

The director qualification requirements of this Act limiting the number of nonmember directors, as in cooperatives generally, may conflict with the concept of an "independent board." The conflict may be important in specific regulatory contexts. *See* Comment to subsection (c).

This Section needs to be coordinated with Section 804 in practical application.

Subsection (b) – An officer or employee of the association may be a director, but would be required to be a member, a designee of a member that is not an individual, or a non-member director if non-member directors are authorized by the organic rules within the limitations of subsection (c), and meet any other qualifications for eligibility to be a director established in the organic rules under subsection (d).

Subsection (c) – In keeping with traditional cooperative governance structures which require directors to be members, the directors must be predominantly members or designees of members who are not individuals. This is a traditional cooperative policy that is different from corporate policy and against the general thrust of federal securities laws for publicly traded corporations. Traditional cooperative policy requires the governance of the cooperative to be in the hands of the members who are its owners and users and who provide the primary financial support of the cooperative. This Act follows that policy but provides some flexibility in recognition of the possibility of having investor members in a limited cooperative association and in recognition of the potential usefulness of having a limited number of nonmember directors to provide outside advice and counsel in the affairs of the association.

Subsection (d) – Consistent with Section 113, the organic rules may provide additional qualifications for eligibility to be a director. Those qualifications may not conflict with the requirements of this Section.

SECTION 804. ELECTION OF DIRECTORS AND COMPOSITION OF BOARD.

(a) Unless the organic rules require a greater number:

(1) the number of directors that must be patron members may not be fewer than:

(A) one, if there are two or three directors;

(B) two, if there are four or five directors;

(C) three, if there are six through eight directors; or

(D) one-third of the directors if there are at least nine directors; and

(2) a majority of the board of directors must be elected exclusively by patron members.

(b) Unless the organic rules otherwise provide, if a limited cooperative association has investor members, the directors who are not elected exclusively by patron members are elected by the investor members.

(c) Subject to subsection (a), the organic rules may provide for the election of all or a specified number of directors by one or more districts or classes of members.

(d) Subject to subsection (a), the organic rules may provide for the nomination or election of directors by districts or classes, directly or by district delegates.

(e) If a class of members consists of a single member, the organic rules may provide for the member to appoint a director or directors.

(f) Unless the organic rules otherwise provide, cumulative voting for directors is prohibited.

(g) Except as otherwise provided by the organic rules, subsection (e), or Sections 303, 516, 517, and 809, member directors must be elected at an annual members meeting.

Comment

This Section reflects one of the major policy decisions in the Act concerning the cooperative principle of "user control" and the flexibility for an equity structure that includes "non-user" investor members. It resolves the matter by bifurcating the issue as follows: (1) director qualification requirements assuring a significant percentage of the board will be composed of patron members; and (2) requiring a majority of the board will be elected by patron members.

> **EXAMPLE**: Assume a limited cooperative association has 20 members (14 patron members, six investor members), six directors, and one vote for each member. Under the default rules, (1) two of the directors (one-third of the total number) must be patron members by whomever elected, and (2) only the patron members elect four (a majority) of the directors. The investor members may elect the other two directors.

The Act's resolution of composition assures patron members have significant "control" over choosing board members. The extent of patron member "control," however, hinges on the

terms of the organic rules and the interplay between the qualification, nomination and election provisions in them. This Act does not address the nomination process. The protection of patron member control by the default and mandatory rules, however, is neither perfect nor designed to be complete and does not guarantee that patron members will always be able to dictate results.

Subsection (a)(1) – This subsection provides for the minimum number of directors who must be patron members. The organic rules may require that there be a greater number of directors who are patron members.

Subsection (a)(2) – In addition to the requirements of subsection (a)(1), the majority of the directors must be elected by the patron members, whether the directors are patron members, investor members, designees of members who are not individuals, or nonmembers. *See* Section 803.

Subsection (b) – Although a majority of the directors must be elected by patron members, this subsection permits a limited cooperative association through its organic rules to have great flexibility in the manner of electing the remaining directors.

Subsection (c) – Subject to the requirements of subsection (a) regarding the number of directors who must be patron members, the organic rules may provide for some or all of the directors of a limited cooperative association to be elected by districts or classes of members that may be established pursuant to Section 517. An association could have some directors elected by districts or classes and some elected at large. In the context of this Act, the term "classes" of members is broader than the distinction between patron members and investor members. Election by classes, in particular, can significantly vary the results of elections when compared to the results under the default rules.

Subsection (d) – If provided by the organic rules, directors may be nominated or elected directly by members in districts or classes without a vote of the entire membership or the districts or classes may elect delegates to nominate or vote for directors at the annual meeting of a cooperative association without nominations from, or votes by, the entire membership. Of course, under the general flexibility of this Act the organic rules may provide for other methods of nomination.

Subsection (e) – If a class of members consists of only one member, for example where there is only one investor member, the single member of the class may appoint a director rather than requiring the director to stand for election if such an appointment process is provided by the organic rules.

Subsection (f) – Cumulative voting for directors is not permitted in most traditional cooperatives. This subsection permits the organic rules to provide for cumulative voting. Corporate statues typically no longer define "cumulative voting." This subsection follows that approach. Best practices would provide a definition in the organic rules if cumulative voting is to be permitted. The organic rules should fully cover how cumulative voting is intended to apply because of its complexity where classes or districts may exist.

Subsection (g) – This subsection provides a default rule that directors are elected at an annual meeting of the members. It may be varied by the organic rules within parameters. Other exceptions to this default rule reference other provisions of the Act that apply in the context of specific circumstances. They are the appointment or naming of the initial board of directors (Section 303), by action taken without a meeting (Section 516) and filling a vacancy on the board (Section 809). The other exceptions to the default rule stated in this subsection occur when the organic rules (1) provide for districts and classes (Section 517) including single member classes (subsection (e)), or (2) provide for nonmember directors (Section 803(c)). The method or manner of selecting directors under the last two exceptions are left to the organic rules because the exceptions themselves are creatures of the organic rules.

SECTION 805. TERM OF DIRECTOR .

(a) Unless the organic rules otherwise provide, and subject to subsections (c) and (d) and Section 303(c), the term of a director expires at the annual members meeting following the director's election or appointment. The term of a director may not exceed three years.

(b) Unless the organic rules otherwise provide, a director may be reelected.

(c) Except as otherwise provided in subsection (d), a director continues to serve until a successor director is elected or appointed and qualifies or the director is removed, resigns, is adjudged incompetent, or dies.

(d) Unless the organic rules otherwise provide, a director does not serve the remainder of the director's term if the director ceases to qualify to be a director.

Comment

This Section coordinates with Section 809 relating to filling a vacancy on the board of directors of a limited cooperative association.

Subsection (a) – This subsection provides for one year terms for directors but the organic rules may provide for longer terms not to exceed three years. Exceptions to the term are provided for initial directors whose terms are governed by Section 303(c), for holdover directors under subsection (c), and for directors who cease to qualify to be a director under subsection (d).

Requiring reelection at least every three years is conceptually important because this Act, like cooperatives generally, contemplates meaningful participation by members coupled with

centralized management control by the board of directors. This is true in any event, but especially if the board may amend the bylaws.

Nothing in this Act prohibits staggered terms for directors and it expressly provides that the organic rules may establish terms longer than one year which are necessary for staggered terms. *See* Section 113(a).

Subsection (b) – This subsection permits directors to serve unlimited numbers of terms but the organic rules could obviously provide term limitations for directors. *See* Section 113.

Subsection (c) – This subsection provides for "holdover" directors so that director positions do not automatically become vacant at the expiration of their terms. Rather, the same directors continue in office until successors qualify for office. This allows the board of directors to act continuously and without interruption even if an election is not held or the members are deadlocked and unable to elect directors. *See generally* Section 1203 ("Judicial Dissolution").

SECTION 806. RESIGNATION OF DIRECTOR . A director may resign at any time by giving notice in a record to the limited cooperative association. Unless the notice states a later effective date, a resignation is effective when the notice is received by the association.

Comment

The resignation of a director is effective when a notice in a record is received by a limited cooperative association unless the notice provides a later effective date. If the notice provides a later effective date, since the person giving the notice is still a member of the board, the person may participate in all decisions until the specified date. The participation of the resigning director in the decision of the successor may be particularly important where political balances within the board may be affected by the resignation. Relatedly, Section 809 places limitations on the persons who may be appointed as replacements with respect to classes who elected the resigning director.

SECTION 807. REMOVAL OF DIRECTOR . Unless the organic rules otherwise provide, the following rules apply:

(1) Members may remove a director with or without cause.

(2) A member or members holding at least 10 percent of the total voting power entitled to be voted in the election of a director may demand removal of the director by one or more

signed petitions submitted to the officer of the limited cooperative association charged with keeping its records.

(3) Upon receipt of a petition for removal of a director, an officer of the association or the board of directors shall:

(A) call a special meeting of members to be held not later than 90 days after receipt of the petition by the association; and

(B) mail or otherwise transmit or deliver in a record to the members entitled to vote on the removal, and to the director to be removed, notice of the meeting which complies with Section 508.

(4) A director is removed if the votes in favor of removal are equal to or greater than the votes required to elect the director.

Comment

All provisions of this Section may be varied by the organic rules providing maximum latitude for a limited cooperative association to fashion the standard, manner and procedure for removal of directors. This Act does not provide for removal of a director by the board of directors but this could be provided in the organic rules. It does expressly provide for removal of a director by judicial proceedings. The board may suspend a director, however, under Section 808. In the absence of variation of the Act's provisions by the organic rules, this Section provides the rules regarding the removal of directors.

Paragraph (1) – This Section reflects the policy that the members are the owners of a limited cooperative association and should be entitled to change the directors if they desire to do so. It is consistent with the notion of member control. This differs from corporate common law that a director may only be removed "for cause"such as fraud, criminal conduct, gross abuse of office or similar conduct.

Paragraph (2) – The process of removing a director by the members is commenced by a demand made in a signed record (essentially a petition process) by members holding 10 percent of the *total* voting power of the membership group who could vote on the election of the director. The record must be delivered to the officer of the limited cooperative association who is charged with keeping its records.

The organic rules may provide that a director may only be removed for cause. "Cause" can be defined in the organic rules.

Paragraph (3) – Once the signed record of the demand is received by the limited cooperative association, an officer or the board of directors must call a special members meeting that is to be held within 90 days and provide proper notice to the members of the meeting stating that the removal will be considered at the meeting.

Paragraph (4) – The vote on the removal of a director by the members must be the same as the vote that would be necessary to have elected the director. This means, consistently with subsection (2): a director elected solely by patron members can be removed only by patron members; a director elected solely by investor members can be removed only by investor members; directors elected by a district or class can be removed only by members of that district or class. If cumulative voting is permitted by the organic rules, cumulative voting would be applicable in a removal vote. *See* Comment to RMBCA § 8.08 (describing how cumulative voting operates in connection with a vote on removal).

SECTION 808. SUSPENSION OF DIRECTOR BY BOARD.

(a) A board of directors may suspend a director if, considering the director's course of conduct and the inadequacy of other available remedies, immediate suspension is necessary for the best interests of the association and the director is engaging, or has engaged, in:

(1) fraudulent conduct with respect to the association or its members;

(2) gross abuse of the position of director;

(3) intentional or reckless infliction of harm on the association; or

(4) any other behavior, act, or omission as provided by the organic rules.

(b) A suspension under subsection (a) is effective for 30 days unless the board of directors calls and gives notice of a special meeting of members for removal of the director before the end of the 30-day period in which case the suspension is effective until adjournment of the meeting or the director is removed.

Comment

Although the board of directors may not remove a director, it may suspend a director for 30 days for cause as defined in subsection (a). Within the 30 day period the board may call and give notice of a special meeting of members to consider removing the suspended director in the same manner as if the board received a demand for removal from members under Section 807.

In that case, the suspension continues until the removal is determined at the members meeting. If members do not vote to remove the director, the director continues in office.

SECTION 809. VACANCY ON BOARD .

(a) Unless the organic rules otherwise provide, a vacancy on the board of directors must be filled:

(1) within a reasonable time by majority vote of the remaining directors until the next annual members meeting or a special meeting of members called to fill the vacancy; and

(2) for the unexpired term by members at the next annual members meeting or a special meeting of members called to fill the vacancy.

(b) Unless the organic rules otherwise provide, if a vacating director was elected or appointed by a class of members or a district:

(1) the new director must be of that class or district; and

(2) the selection of the director for the unexpired term must be conducted in the same manner as would the selection for that position without a vacancy.

(c) If a member appointed a vacating director, the organic rules may provide for that member to appoint a director to fill the vacancy.

Comment

Subsection (a) – This subsection provides that the remaining directors (without regard to quorum requirements) are to fill a vacancy on the board within a reasonable time. The replacement director is to serve until the next annual members meeting or until a special meeting is called by the remaining directors to fill the vacancy. If the term of the director whose position is vacant would have extended beyond the next annual meeting of members, the members are to vote on a person to fill the vacancy until the end of the term. The special members meeting could be the same meeting at which members were asked to vote on the removal of a director if the appropriate notice was given.

Subsection (b) – This subsection provides that if a voting group of members is entitled to elect a director, only that voting group is entitled to fill a vacant office which was held by a

director elected by that voting group. This section is part of the consistent treatment of directors elected by a voting group of members. *See* Section 804(c).

Subsection (c) – This subsection permits the organic rules to provide that a member, who alone constitutes a class of members entitled to appoint a director under Section 804(e), may appoint a director to replace a director previously appointed by the member if that director's position becomes vacant. Unless the organic rules provide for this, the vacancy would be filled in the same manner as other vacancies under subsections (a) and (b).

SECTION 810. REMUNERATION OF DIRECTORS . Unless the organic rules otherwise provide, the board of directors may set the remuneration of directors and of nondirector committee members appointed under Section 817(a).

Comment

Although the Act permits the organic rules to provide other means for establishing the compensation of directors, the default rule is for the board of directors to fix the remuneration of directors and nondirector committee members appointed by the board pursuant to subsection 817(a).

SECTION 811. MEETINGS .

(a) A board of directors shall meet at least annually and may hold meetings inside or outside this state.

(b) Unless the organic rules otherwise provide, a board of directors may permit directors to attend or conduct board meetings through the use of any means of communication, if all directors attending the meeting can communicate with each other during the meeting.

Comment

This Section provides maximum flexibility for directors meetings requiring only that the directors meet at least once a year.

In the traditions of many types of cooperatives, non-director members of the cooperative are permitted to observe board meetings. These traditions may have emerged from the member governance concepts in cooperatives especially those in the non-profit sector or where cooperatives operate within a regulatory sphere which makes them quasi-public entities. The Act does not address this matter. Best practices may suggest this matter be addressed in the organic rules. This Act implicitly allows the board to close its meetings. In some areas, such as

employment law, legal requirements and best business practices may make it advisable or necessary to close meetings of the directors.

SECTION 812. ACTION WITHOUT MEETING .

(a) Unless prohibited by the organic rules, any action that may be taken by a board of directors may be taken without a meeting if each director consents in a record to the action.

(b) Consent under subsection (a) may be withdrawn by a director in a record at any time before the limited cooperative association receives consent from all directors.

(c) A record of consent for any action under subsection (a) may specify the effective date or time of the action.

Comment

Formal board meetings are not the most efficient manner in which to take board action. Often board action is not controversial but needs to be memorialized in a record of unanimous consent. For example, where a limited cooperative association is a wholly-owned subsidiary of another cooperative entity and there is only one director of the association, a record of action by the sole director is an efficient and practical way to make a record of the action. Consent may be given in one or more records as defined in Section 102, which includes the use of electronic media.

A director who believes discussion or further consideration is necessary or helpful may force a meeting by withholding consent.

SECTION 813. MEETINGS AND NOTICE .

(a) Unless the organic rules otherwise provide, a board of directors may establish a time, date, and place for regular board meetings, and notice of the time, date, place, or purpose of those meetings is not required.

(b) Unless the organic rules otherwise provide, notice of the time, date, and place of a special meeting of a board of directors must be given to all directors at least three days before the

meeting, the notice must contain a statement of the purpose of the meeting, and the meeting is limited to the matters contained in the statement.

Comment

Regular meetings of the board of directors may be held at designated times without further notice of time, date, place or purpose. Special meetings require three days' notice and must state the time, date, place and purpose. At special meetings, only the matters specified in the notice may be subject to action at the meeting. The latter differs from typical provisions in business corporation law. This Act does not require the notice of a special meeting to be in writing.

Best practices might suggest that at least some reminder of a regular meeting and a proposed agenda be given to directors prior to the meeting. This Act does not require a notice because (a) any additional requirements may subvert certainty of action taken at regular meetings, and (b) it conforms to the purpose of this Act to provide a flexible entity to meet the unique needs of different groups that may organize under the Act.

The organic rules may provide for different requirements regarding notices of meetings.

SECTION 814. WAIVER OF NOTICE OF MEETING .

(a) Unless the organic rules otherwise provide, a director may waive any required notice of a meeting of the board of directors in a record before, during, or after the meeting.

(b) Unless the organic rules otherwise provide, a director's participation in a meeting is a waiver of notice of that meeting unless:

(1) the director objects to the meeting at the beginning of the meeting or promptly upon the director's arrival at the meeting and does not thereafter vote in favor of or otherwise assent to the action taken at the meeting; or

(2) the director promptly objects upon the introduction of any matter for which notice under Section 813 has not been given and does not thereafter vote in favor of or otherwise assent to the action taken on the matter.

Comment

Subsection (a) – This subsection follows modern corporate practice in viewing notice as a technical requirement with waivers being favored at the level of the board of directors. Generally, subsection (a) applies where a director desires to waive notice so that action taken will be valid.

Subsection (b) – This subsection addresses the effect of a director's attendance at a meeting as related to waiver of notice. The subsection governs circumstances clearly distinguishable from voluntary waivers under subsection (a). Absent modification by the organic rules, this subsection requires a director to object to the holding of a meeting for lack of notice at the beginning of the meeting or upon the director's arrival. If there is no objection to the notice of a meeting, but a matter is presented at a meeting that was not included in the notice, a director may object at the time the matter is presented.

A director who stays during a meeting to which the director has objected is not presumed to have waived notice of the meeting unless the director votes for or assents to action taken at the meeting in which case the director would be considered to have waived objection to the meeting for lack of notice.

SECTION 815. QUORUM .

(a) Unless the articles of organization provide for a greater number, a majority of the total number of directors specified by the organic rules constitutes a quorum for a meeting of the directors.

(b) If a quorum of the board of directors is present at the beginning of a meeting, any action taken by the directors present is valid even if withdrawal of directors originally present results in the number of directors being fewer than the number required for a quorum.

(c) A director present at a meeting but objecting to notice under Section 814(b)(1) or (2) does not count toward a quorum.

Comment

Subsection (a) – The default rule under this Act, which may be varied by the organic rules, requires the number of directors to be fixed either in the organic rules or by a resolution of the board within parameters established by the organic rules. Thus, this subsection establishes a quorum as a majority of the fixed number of directors. If a higher number is to be required for a quorum, it must be provided in the articles of organization and not in the bylaws.

Subsection (b) – This subsection permits a meeting to continue once a quorum is established even if a sufficient number of directors leave the meeting to reduce the number in attendance to less than a quorum. This means no director may block the board from acting simply by leaving the meeting.

Subsection (c) – For purposes of establishing a quorum, a director who is present but only to object to the meeting because of lack of notice is not counted in determining the presence of a quorum.

SECTION 816. VOTING .

(a) Each director shall have one vote for purposes of decisions made by the board of directors.

(b) Unless the organic rules otherwise provide, the affirmative vote of a majority of directors present at a meeting is required for action by the board of directors.

Comment

A limited cooperative association may not provide for any director to have more, or less, than one vote in connection with action by the board of directors. A majority of directors present may take action as a board, but the organic rules may establish a different voting standard, including unanimity, on some or all matters that come before the board.

SECTION 817. COMMITTEES .

(a) Unless the organic rules otherwise provide, a board of directors may create one or more committees and appoint one or more individuals to serve on a committee.

(b) Unless the organic rules otherwise provide, an individual appointed to serve on a committee of a limited cooperative association need not be a director or member.

(c) An individual who is not a director and is serving on a committee has the same rights, duties, and obligations as a director serving on the committee.

(d) Unless the organic rules otherwise provide each committee of a limited cooperative association may exercise the powers delegated to it by the board of directors, but a committee may not:

(1) approve allocations or distributions except according to a formula or method prescribed by the board of directors;

(2) approve or propose to members action requiring approval of members; or

(3) fill vacancies on the board of directors or any of its committees.

Comment

Many types of committees have become common in organizations, *e.g.*, executive committees, audit committees, litigation committees, legislative committees, membership committees. Those committees, however, are subject to the oversight responsibility of the board.

This Section provides substantial flexibility in the board of directors to establish committees. The flexibility may be expanded or contracted by the organic rules. The Act does not provide for creation of committees to which the board may delegate its power by any means other than by board action or in the organic rules.

Subsection (a) – Under this subsection a committee can consist of only one individual. This can facilitate rapid decision making when circumstances require it.

Subsections (b) and (c) – The directors may appoint persons who are not directors or members of the limited cooperative association to a committee, but if persons are appointed who are not directors, they have all the rights, duties, and obligations of a director appointed to serve on a committee. This is broader than, for example, RMBCA Section 8.25 which authorizes the board of directors of a corporation to create committees that consist only of board members. This Act provides for the board to have greater flexibility in the creation of committees to which the board may delegate its power. It does not limit other ways in which a committee may be created and its members designated. *But see* Comment to Section 901 (indemnification and insurance considerations). In any event, however, the board has oversight responsibility. Those willing to serve on such committees need to be aware of their statutory obligations. Consulting arrangements, may in many circumstances, be an alternative to the official delegation of board authority.

Subsection (d) – The board of directors can delegate substantial powers to a committee but may not do so with respect to the three subjects listed in paragraphs (1), (2) or (3). The organic rules may prohibit the delegation of other subjects to a committee established by the board. *See* Comments to subsections (b) and (c) and Section 818.

SECTION 818. STANDARDS OF CONDUCT AND LIABILITY. Except as otherwise provided in Section 820:

(1) the discharge of the duties of a director or member of a committee of the board of directors is governed by the law applicable to directors of entities organized under [reference to this state's cooperative corporation act or the general business corporation act]; and

(2) the liability of a director or member of a committee of the board of directors is governed by the law applicable to directors of entities organized under [insert reference to this state's cooperative corporation act or to the general business corporation act].

Legislative Note*: Adopting jurisdictions should choose only one of the bracketed alternative statutes to govern what has traditionally been called the "fiduciary duties" of directors. While the listed laws are generally similar in most jurisdictions, they do not contain the same formulation either between the laws in a given jurisdiction or between laws governing even the same type of entity among various jurisdictions. Thus the choice of the bracketed law, including any power to modify the law as referenced in optional Sections 113(b)(10) and (11), has policy implications for limited cooperative associations organized under this Act.*

Adopting jurisdictions should carefully coordinate the choices under this Section and Sections 819 and 901.

Comment

The approach taken to Sections 818 and 819 recognizes that (1) states take fundamentally different approaches to the duties of managers or governors within unincorporated organizations of the same kind; (2) there is variety among the states in their approach to duties within corporate statutes; and (3) there is variety among the states in their approach in cooperative laws. The existing cooperative statutes appear to most closely follow corporate duty formulations.

This Act establishes an unincorporated cooperative. Although an unincorporated entity, the board of directors of a limited cooperative association under this Act functions more analogously to a corporate board than to the typical managers in a manager-managed limited liability company or general partners in a limited partnership. Nonetheless, the duties in almost all entities use the same labels of care and loyalty. Indeed, managers of limited liability companies under RULLCA (2006) Section 409 even share the concept of the "business judgment rule" standard more commonly associated with corporate law. Thus adopting corporate standards in this Act, while unusual for unincorporated entities (but not cooperatives), is unusual only to a matter of degree even apart from the distinctive features of the standards.

If a statute to which reference is made in this Act permits the equivalent of its organic rules to vary the standards of conduct and liability of directors, drafters of the organic rules of a limited cooperative association should take care to provide for the levels of conduct and potential liability to be imposed on directors consistent with those statutory provisions. *See* Legislative Note to this Section.

SECTION 819. CONFLICT OF INTEREST.

(a) The law applicable to conflicts of interest between a director of an entity organized under [reference to this state's cooperative corporation act or the general business corporation act] governs conflicts of interest between a limited cooperative association and a director or member of a committee of the board of directors.

(b) A director does not have a conflict of interest under this [act] or the organic rules solely because the director's conduct relating to the duties of the director may further the director's own interest.

Legislative Note*: See the Legislative Note to Section 818.*

Comment

See Comment to Section 818.

Subsection (b) – This subsection recognizes that the members of a cooperative entity, including a limited cooperative association, both own and patronize the cooperative and that directors are commonly required to be members of the cooperative. Thus there will be technical conflicts of interest even where a director properly performs a director's functions because the director may receive contractual benefits shared by other members. This subsection makes it clear that a director will not be held to have a conflict of interest simply by performing the required duties of a director even if the director is benefitted as a member.

SECTION 820. OTHER CONSIDERATIONS OF DIRECTORS. Unless the articles of organization otherwise provide, in considering the best interests of a limited cooperative association, a director of the association in discharging the duties of director, in conjunction with

considering the long and short term interest of the association and its patron members, may consider:

(1) the interest of employees, customers, and suppliers of the association;

(2) the interest of the community in which the association operates; and

(3) other cooperative principles and values that may be applied in the context of the decision.

Comment

In keeping with traditional cooperative values and principles, *e.g.*, community interests, interests of persons related to the cooperative, and other appropriate cooperative principles such as education regarding cooperative organizations, this Section clearly permits the board of directors of a limited cooperative association to consider matters which may be improper for consideration in connection with other entities. The additional factors identified in this Section modify the statutes referenced in Sections 818 and 819 in application. Such application will be highly contextual.

SECTION 821. RIGHT OF DIRECTOR OR COMMITTEE MEMBER TO INFORMATION. A director or a member of a committee appointed under Section 817 may obtain, inspect, and copy all information regarding the state of activities and financial condition of the limited cooperative association and other information regarding the activities of the association if the information is reasonably related to the performance of the director's duties as director or the committee member's duties as a member of the committee. Information obtained in accordance with this section may not be used in any manner that would violate any duty of or to the association.

Comment

This Section gives a director or a member of a committee created and appointed by the board of directors a right to access to all information regarding a limited cooperative association that is necessary for the individual to perform the functions of a director or a member of a committee. A director's or committee member's use of the information is, however, limited to

its use in performing the functions for which the information was obtained and not in any way that would violate the individual's duty to the association or any duty of the association to others.

SECTION 822. APPOINTMENT AND AUTHORITY OF OFFICERS.

(a) A limited cooperative association has the officers:

(1) provided in the organic rules; or

(2) established by the board of directors in a manner not inconsistent with the organic rules.

(b) The organic rules may designate or, if the rules do not designate, the board of directors shall designate, one of the association's officers for preparing all records required by Section 114 and for the authentication of records.

(c) Unless the organic rules otherwise provide, the board of directors shall appoint the officers of the limited cooperative association.

(d) Officers of a limited cooperative association shall perform the duties the organic rules prescribe or as authorized by the board of directors not in a manner inconsistent with the organic rules.

(e) The election or appointment of an officer of a limited cooperative association does not of itself create a contract between the association and the officer.

(f) Unless the organic rules otherwise provide, an individual may simultaneously hold more than one office in a limited cooperative association.

Comment

This Section provides substantial flexibility for a limited cooperative association to structure its internal affairs with respect to officers. Only an officer to prepare and maintain records required by Section 114 and to authenticate records is required. Practically, most limited cooperative associations will need additional officers. The offices may be established through the organic rules or by the board of directors in a manner not inconsistent with the organic rules. The duties, authority and obligations of officers are to be provided in the organic rules and by the

board of directors in accordance with the organic rules. If the organic rules are silent the board has broad authority. The Act contemplates the board will appoint officers but this can be modified by the organic rules.

SECTION 823. RESIGNATION AND REMOVAL OF OFFICERS.

(a) The board of directors may remove an officer at any time with or without cause.

(b) An officer of a limited cooperative association may resign at any time by giving notice in a record to the association. Unless the notice specifies a later time, the resignation is effective when the notice is given.

Comment

If an officer is removed or resigns, this in and of itself will have no effect on contractual rights of an officer under an employment or other contract with the association which will govern the rights and obligations of the officer and the association following the removal or resignation. *See* Section 822(e).

This Act contains no provision directly addressing the standard of conduct of officers. This is, at the least, not unusual in the world of general cooperative statutes. This Act leaves much of the law governing officers to contract and agency principles.

There is a distinction between the power to remove an officer and the right to do so. This Section is intended to give complete discretion to the board of directors to remove officers (the power). The exercise of that power, however, may lead to a damage claim by the officer if, for example, the officer has a separate employment contract. The exercise of the power could also violate other law (*e.g.*, Title VII of the Civil Rights Act).

Subsection (a) – Authority for removal of an officer resides in the board of directors under its general management authority and is necessary in order to match board liability with board authority. *See* Section 801(b). Removal need not be for cause.

Subsection (b) – Subsection (b) follows current corporate law permitting an officer to resign immediately or through a resignation that becomes effective at a later date. Notice of the resignation must be given to the limited cooperative association. This subsection does not require any action by the association with respect to a resignation.

[ARTICLE] 9

INDEMNIFICATION

Legislative Note*: See the Legislative Note to Section 818. Adopting jurisdictions should coordinate the selection of the bracketed references with the selections made in conjunction with Sections 818 and 819. As with standards of conduct and liability and conflicts of interest, the matter of indemnification of directors and officers of an entity can be among the most complex and important in a statute governing an entity. Because most, if not all, adopting jurisdictions will have addressed this issue in statutes relating to corporations or in other cooperative statutes, an adopting jurisdiction should consistently reference one of the bracketed statutes to provide a workable and comprehensive policy with respect to indemnification and the right of a limited cooperative association to provide insurance.*

SECTION 901. INDEMNIFICATION.

(a) Indemnification of an individual who has incurred liability or is a party, or is threatened to be made a party, to litigation because of the performance of a duty to, or activity on behalf of, a limited cooperative association is governed by [reference to this state's cooperative corporation act or this state's general business corporation act].

(b) A limited cooperative association may purchase and maintain insurance on behalf of any individual against liability asserted against or incurred by the individual to the same extent and subject to the same conditions as provided by [reference to this state's cooperative corporation act or this state's general business corporation act].

Comment

This Section takes the same approach to indemnification and related insurance as Sections 818 and 819 take to "Standards of Conduct and Liability" and "Conflict of Interest." The identity of the individuals referred to in this Section is limited to those identified in the referenced statutes as being entitled to indemnification or the benefit of insurance under those statutes.

The referenced statutes govern the ability and the extent of that ability to expand or limit indemnification for specified actions and standards for indemnification and the provision of insurance by a limited cooperative association. If the referenced statute requires such matters to be addressed in the articles or bylaws those requirements apply to an association under this Act.

The association should consider the scope of sections referenced in this Section and Sections 818 and 819 in anticipation of appointing non-directors to committees under Section 817.

[ARTICLE] 10

CONTRIBUTIONS, ALLOCATIONS, AND DISTRIBUTIONS

Preliminary Comment

The development and management of the capital structure and handling of profits and losses in a cooperative entity help to define the uniqueness of the cooperative. There are strong similarities in these areas, however, between cooperatives and other types of entities. This Article contains the provisions relating to contributions (Sections 1001 through 1003), allocations (Section 1004), distributions (Sections 1005, 1007 and 1008) and redemptions of capital (Section 1006).

The contribution and distribution provisions in this Article address issues that are dealt with in ways similar across many entities but with recognition of cooperative principles peculiarly applicable to limited cooperative associations organized under this Act. While redemptions are treated in this Act as a kind of distribution in a manner similar, for example, to state partnership law, this Article reflects the slightly different business role and function of redemption plays under traditional cooperative law where it functions rather like a nonguaranteed buy-out for dissociating members.

The manner in which profits and losses are allocated among members is a defining element of a cooperative. Allocations are central to this Act and limited cooperative associations organized under it. For this reason, Section 1004 is a pivotal provision. The addition of investor members to limited cooperative associations made possible by this Act requires a more detailed definition of what it means to be a "cooperative" than is necessary under other kinds of cooperative statutes and this Article, particularly Section 1004, serves that definitional and regulatory purpose. Thus Section 1004 contains more detail than is frequently found in the statutes under which other types of entities are organized. Emphatically, however, this Article governs allocations for state law purposes only. Financial reporting and income taxation are clearly beyond the scope of this Act.

This Article reflects cooperative principles related to "operation at cost" and ownership of profits based on the use of the cooperative by its members. *See* Comment to Section 1004. Partnership based accounting mechanisms provide an appropriate and efficient means to achieve a cooperative result and are the basis of that Section.

SECTION 1001. MEMBERS' CONTRIBUTIONS. The organic rules must establish the amount, manner, or method of determining any contribution requirements for members or must authorize the board of directors to establish the amount, manner, or other method of determining any contribution requirements for members.

***Legislative Note**: The type of property that is permitted to be contributed to organizations and entities is sometimes, though increasingly rarely, a subject contained in state constitutions. Adopting jurisdictions should review their constitutions for the existence of inconsistent provisions and revise this Section to be consistent therewith.*

Comment

This Section requires the organic rules to contain provisions governing contribution requirements for new members and additional capital contributions from existing members. *See also* Section 502. It allows the organic rules to provide for a structure like that of limited partnerships where "capital call" provisions are often part of the partnership agreement but which may, by terms of the provision, be subject to rather broad authority in the general partner.

An amendment of the organic rules pursuant to Section 405 is necessary to require existing members to contribute additional capital if the organic rules are silent regarding additional contributions by members. Under that Section consent in a record by each member that the amendment proposes to require to make additional contributions is necessary. *See* Section 405(d)(2). The consent requirement, therefore, is consistent with the merger and conversion provisions in this Act and roughly consistent with unanimity requirements for partnerships.

The limited cooperative association also has information requirements concerning contributions. *See* Section 114(a)(14).

It is certainly permissible, given the flexibility of the Act, for the organic rules to provide for pre-emptive rights for existing members or to fashion other anti-dilution provisions but no such matters are addressed by the Act. Further, tailored redemption and buy-sell agreements are appropriately addressed in planning under the Act. *See* Section 1006.

SECTION 1002. CONTRIBUTION AND VALUATION.

(a) Unless the organic rules otherwise provide, the contributions of a member to a limited cooperative association may consist of tangible or intangible property or other benefit to the association, including money, labor or other services performed or to be performed, promissory notes, other agreements to contribute money or property, and contracts to be performed.

(b) The receipt and acceptance of contributions and the valuation of contributions must be reflected in a limited cooperative association's records.

(c) Unless the organic rules otherwise provide, the board of directors shall determine the value of a member's contributions received or to be received and the determination by the board of directors of valuation is conclusive for purposes of determining whether the member's contribution obligation has been met.

Legislative Note*: The type of property that is permitted to be contributed to organizations and entities is sometimes, though increasingly rarely, the subject of state constitutions. Adopting jurisdictions should review their constitutions for the existence of inconsistent provisions and revise this Section accordingly.*

Comment

Subsection (a) – This subsection is derived from RULLCA (2006) Section 402 and provides wide latitude for the form of contribution.

Subsection (c) – The board of directors, subject to modification by the organic rules, has the authority and obligation to determine the value of a member's contribution and reflects the central role performed by the board of directors under traditional cooperative statutes. Valuation of different forms of contributions raises the specter of unfairness or abuse if, for example, services are valued optimistically. A modicum of protection from such abuse is provided by director standards of conduct and liability under Section 818 and by provisions related to conflicts of interest under Section 819. As a result this Act's approach differs from ULPA (2001) Section 502(c) and RULLCA (2006) Section 403 in that it does not give creditors an express direct right to enforce the contribution obligation of a member. Any such rights, by design, are left to the common law.

SECTION 1003. CONTRIBUTION AGREEMENTS.

(a) Except as otherwise provided in the agreement, the following rules apply to an agreement made by a person before formation of a limited cooperative association to make a contribution to the association:

(1) The agreement is irrevocable for six months after the agreement is signed by the person unless all parties to the agreement consent to the revocation.

(2) If a person does not make a required contribution:

(A) the person is obligated, at the option of the association, once formed, to contribute money equal to the value of that part of the contribution that has not been made, and the obligation may be enforced as a debt to the association; or

(B) the association, once formed, may rescind the agreement if the debt remains unpaid more than 20 days after the association demands payment from the person, and upon rescission the person has no further rights or obligations with respect to the association.

(b) Unless the organic rules or an agreement to make a contribution to a limited cooperative association otherwise provide, if a person does not make a required contribution to an association, the person or the person's estate is obligated, at the option of the association, to contribute money equal to the value of the part of the contribution which has not been made.

Comment

Pre-formation agreements to contribute to a limited cooperative association are addressed in subsection (a). It states default terms variable by the terms of the agreement itself.

Post-formation agreements are addressed in subsection (b) and are subject to the terms of the agreement and the applicable provisions of the organic rules. *See also* Section 1001.

Section 114(a)(14) and (15) require the association to maintain a record of the amount of money or value of contributions other than money agreed to be contributed by each member.

SECTION 1004. ALLOCATIONS OF PROFITS AND LOSSES.

(a) The organic rules may provide for allocating profits of a limited cooperative association among members, among persons that are not members but conduct business with the association, to an unallocated account, or to any combination thereof. Unless the organic rules otherwise provide, losses of the association must be allocated in the same proportion as profits.

(b) Unless the organic rules otherwise provide, all profits and losses of a limited cooperative association must be allocated to patron members.

(c) If a limited cooperative association has investor members, the organic rules may not reduce the allocation to patron members to less than 50 percent of profits. For purposes of this subsection, the following rules apply:

(1) amounts paid or due on contracts for the delivery to the association by patron members of products, goods, or services are not considered amounts allocated to patron members.

(2) amounts paid, due, or allocated to investor members as a stated fixed return on equity are not considered amounts allocated to investor members.

(d) Unless prohibited by the organic rules, in determining the profits for allocation under subsections (a), (b), and (c), the board of directors may first deduct and set aside a part of the profits to create or accumulate:

(1) an unallocated capital reserve; and

(2) reasonable unallocated reserves for specific purposes, including expansion and replacement of capital assets; education, training, cooperative development; creation and distribution of information concerning principles of cooperation; and community responsibility.

(e) Subject to subsections (b) and (f) and the organic rules, the board of directors shall allocate the amount remaining after any deduction or setting aside of profits for unallocated reserves under subsection (d):

(1) to patron members in the ratio of each member's patronage to the total patronage of all patron members during the period for which allocations are to be made; and

(2) to investor members, if any, in the ratio of each investor member's contributions to the total contributions of all investor members.

(f) For purposes of allocation of profits and losses or specific items of profits or losses of a limited cooperative association to members, the organic rules may establish allocation units or methods based on separate classes of members or, for patron members, on class, function, division, district, department, allocation units, pooling arrangements, members' contributions, or other equitable methods.

Comment

The first part of this Comment explains the importance of Section 1004 and places it within the context of the Act and cooperative law. It identifies the policy behind the Section. The second part of the Comment briefly explains the mechanical operation of the Section and then discusses each subsection.

Generally - Allocation of profits and losses is typically not a matter of detailed statutory treatment in general unincorporated or general corporate statutes. The modern trend of organizational law is to expressly govern distributions but not detail the manner or method of the internal allocation of profits and losses between and among the owners. *But see* RUPA (1997) Section 401(a) (requiring capital accounts for each partner). Rather, allocations are left to organic rule, for example, the operating agreement in limited liability companies. Moreover, accounting conventions for financial accounting or reporting, and state and federal income tax law for purposes of taxation will, in any event, apply largely independent of any state law allocation provisions. For example unallocated reserves will raise federal income taxation for unincorporated entities but are contemplated by the law of taxation in the context of cooperatives.

For general business entities there seems to be little purpose for intervention in allocations by a state organizational statute. Indeed, general business corporation law has abandoned much of the corporate legal capital machinery required by older corporate statutes. One of the primary purposes of that machinery was creditor protection. A leading treatise observed, concerning changes in that machinery, "It is conceivable, even, that the proposed changes may lead some persons for the first time to examine the degree of protection afforded to creditors by the present legal capital system and discover that it is a Swiss Cheese made up mainly of holes . . .." BAYLESS MANNING AND JAMES J. HANKS, LEGAL CAPITAL, 194 (3rd ed. 1990).

It is for good reason, therefore, that there is a trend away from including statutory provisions concerning allocations of profit and loss. Nonetheless, regulatory law sometimes uses balance sheet accounting for regulatory purposes, for example, in the regulation of financial institutions. There are, however, good reasons for including such provisions in cooperative law. *See generally* Comment to Article 10.

One reason "allocations" are important in cooperative law is as an analogue to regulatory law. Allocation of profit and loss to members is a key component to determine whether an entity is operating in accordance with a "cooperative plan" which is a term used in some traditional cooperative statutes or on a "cooperative basis" which is a term of art for defining "cooperative" for some purposes of federal income taxation. This Act takes the approach that the mere use of terms of art from other substantive bodies of law is too ambiguous for purposes of defining a limited cooperative association for state law purposes. And that such importation represents a trap to the unwary, and would inhibit the use of this Act that contemplates voting investor members.

A second reason, related to the first, is both historical and a matter of cooperative principles. One of the fundamental principles of cooperative organizations is that they operate "at cost." This is a different concept from operating "for profit" or "not for profit." This principle has caused much confusion for persons dealing with cooperatives, including regulators, who seek to compartmentalize cooperatives as either "for profit" or "not for profit" entities. Cooperatives are unique in having a principle that, in operation, results in a cooperative having "no profit" and "no loss" at the end of an annual accounting period. Business methods have been developed to reach the "at cost" result while at the same time providing necessary capital to the cooperative.

Profits are usually allocated among members (and in some cooperatives among non-member patrons) through some method that returns annual profits to the members on the books of the cooperative, in cash payments, or a combination of both. Traditional midwestern agricultural cooperatives have usually used patronage dividends (called by various names such as "patronage allocations" and "allocations of net margins") as the means to allocate net profits at the end of an accounting year among the members. This approach is similar to the allocation of profits among partners in a partnership or among members in a limited liability company. It is derived in a cooperative, however, from a different philosophical basis.

Another method utilized by certain marketing cooperatives is a "per unit retain" under which the cooperative withholds a portion of the purchase price to be paid to a member for goods or commodities marketed by or through the cooperative as a capital contribution to the cooperative.

Traditional cooperatives may permit assessments of members if there is a loss at the end of an annual accounting period. Among other techniques, losses may also be charged against reserves or surplus accounts or be carried over to be offset against future profits. The method of allocation of losses is usually the same as allocations of profits. This is reflected in Section 1004, notably Section 1004(a).

Although more detailed with respect to allocations than statutes governing other entities, this Act does not address any *particular allocation* method to be used by an association. Section 1004 does not prohibit any method to be authorized in the organic rules. While based on partnership accounting, Section 1004 overlays partnership accounting with allocation methods based on patronage for patron members developed in traditional cooperatives. *See* Section

1004(e)(1). The organic rules can authorize methods of allocation and, further, can designate the Board of Directors to apply the methods. *See also* Section 817(d)(1).

Investor members are not patron members. *But see* Section 116 ("Dual Capacity"). The organic rules may provide methods unburdened by patronage considerations for allocating net profits and losses among investor members.

A third reason this Act provides rather detailed allocation provisions is because "profit" is a key concept in Section 1004(c) which tests and constrains the division of profits between patrons and investor members under this Act. Here Section 1004 operates in a regulatory manner.

Section 1004 – Section 1004 addresses the allocation of profit and loss among members of a limited cooperative association. As an important policy matter, it establishes that patron members must be allocated at least 50 percent of the profit of the association as determined under customary accounting procedures and as augmented, amplified, and defined by this Section.

Section 1004 is a part of state organizational law governing limited cooperative associations. Accounting standards, tax law, and exceptions and qualifications found in other state and federal laws and regulations independently apply to associations governed by this Act. These other laws and regulations may require careful drafting of organic rules to take advantage of, or comply with, those laws. This Section has no application to distributions. Distributions are governed by Sections 1005 through 1008.

The distinct concepts of "profit" and "allocation" animate the operation of this Section. Simply stated, Section 1004 provides a framework that in application results in a number of dollars representing profit (or loss) of the association being allocated to the members of the limited cooperative association to provide some assurance that patron members receive "their share" of profit.

The basic mechanical operation of the Section is:

- take the profit of the association (subsection (a)), as determined in accordance with the accounting method of the association, and deduct amounts placed in reserves (subsection (d));
- apportion it between groups entitled to receive an allocation of profit and loss (subsections (a), (b) and (c)); and
- allocate the apportioned amounts within the groups' members (subsections (e) and (f)).

Subsection (a) – The organic rules may provide that profit and loss be allocated only among members (patron members and investor members), and others who utilize the cooperative but are not members, to an unallocated account (such as a reserve), or in some combination of the foregoing.

Losses are to be allocated in the same manner as profits unless the organic rules establish a different means for allocating losses.

Some traditional cooperatives permit the cooperative to engage in business with non-members and permit those non-members (sometimes called "participating patrons" or "non-member patrons") to share in allocations of profit and loss. Allocations to non-members who do business with the association create complexities and may affect matters outside this Act such as financial reporting and taxation.

Subsection (b) – The general default rule under Section 1004 is that profit and loss are to be allocated among patron members. Therefore if there are investor members to whom profit is to be allocated, the organic rules must provide for making those allocations.

Subsection (c) – While Section 1004 provides significant flexibility in how allocations of profit are to be determined, this subsection places parameters on those allocations. It is central to the Act. Patron members must be allocated at least 50 percent of profit that is allocated in accordance with this Section. A larger percentage, but not a lower one, could be provided by the organic rules.

The provisions in this subsection are mandatory and may not be varied by the organic rules for purposes of measuring the minimum 50 percent allocation to patron members. The determination of the percentage required to be allocated to patron members is a difficult policy decision *for an association*. On one hand, the percentage goes to the heart of what it means to be a cooperative in which the patron members are to share in any profit of the entity resulting from their use and the "investment" of their allocated retained earnings. On the other hand, one of the purposes of the Act is to encourage greater equity capital formation by allowing investor members to receive a return on their capital investments in the association. To that end, the Act seeks to provide enough flexibility to allow financial participation by investor members while protecting the economic interests of patron members.

Subsections (c)(1) and (2) modify "profits" for purposes of applying the 50 percent minimum standard to be allocated to patrons. They contain mandatory rules regarding the treatment of amounts paid to patron members for products, goods or services delivered to a limited cooperative association for marketing; and, for specifically identified categories of amounts paid, due or allocated to investor members on the equity (capital) account established for them in the association. These amounts are not treated as allocations to the recipients *for purposes of determining whether the patron members have been allocated 50 percent* of profit (or a higher amount provided in the organic rules).

> **EXAMPLE**: A limited cooperative association has investor members and allocates 50 percent of the profits to them under its organic rules. It contracts to purchase 500 units of goods from its patron members for $10 for each unit. The association resells the goods for a total of $11,000. The only expense for the association

is the total price paid to its patron members. It has revenues of $11,000 (resale). Its expense is $5000 (500 units at $10 per unit). Therefore, its "profit" is $6,000. ($11,000 minus $5,000). Under its 50 percent allocation rule the patron members are allocated $3,000 profit and the investor members are allocated $3,000 profit. Under subsection (c)(1), the $5,000 paid as a purchase price to patron members for the goods is not counted as an allocation to the patron members *for purposes of the 50 percent test* because it is characterized at the association level as cost of goods sold (an expense).

EXAMPLE: Same facts as in the previous Example except the investor members receive a stated fixed return on their contributions (equity). The stated fixed return is 10 percent of the value of their contributions and their total contributions are $12,000. Therefore, they are paid $1,200 as a return on contributions. The profit from the above Example is $6,000 and remains $6,000 in this Example because a stated fixed return on equity contributions is not an expense under general accounting practices. As a result, as in the previous Example, the patron members would be allocated $3,000 profit (and also receive the price paid for their goods) and the investor members would be allocated $3,000 profit. Under subsection (c)(2), the $1,200 paid to investor members for the stated fixed return on contributions is not treated as an allocation to the investor members for purposes of the 50 percent test. Note that money allocated is not the same as money paid-out. While seemingly complex this difference is present and material in the drafting and planning of unincorporated "deals". That is, the source of the $1,200 paid to the investor members is "cash" not profit.

There is a relevant, but subtle, distinction between the *probable* accounting treatment of the two Examples. In the first Example, the purchase price for the goods paid to the patron members represents an expense in determining profit which is the starting point in applying the 50 percent test under subsection (c). In the second Example, the stated fixed return paid to investor members on their equity capital (contributions) is not an expense in determining profit under general accounting practices. Although the distinction is worth noting, it does not directly affect the mechanical operation of subsection (c).

In traditional cooperatives various ways exist to compensate members for products, goods or services. For example, cooperatives may pay a market or otherwise fixed price for the products, goods or services. There are, however, a variety of other arrangements under which products, goods or services may be sold through the cooperative. These other arrangements include several commonly used, but vastly different, methods for determining the amount to be paid to the patron member. Some of these methods are net proceeds contracts, agency contracts,

and marketing pool arrangements. In some of them a proportionate part of the total gross amount received by the cooperative from its sale of the products, goods and services after deducting the operating costs of the cooperative is paid to the member. Under these circumstances, the "price" for the products, goods and services marketed through the cooperative by the member is the amount received by the member. Any of these approaches may be provided by contract but the method used will greatly affect the allocation calculations under this Section.

> **EXAMPLE**: Same facts as in the first Example except the arrangement between the patron member and the association is different. It is a net proceeds contract under which the revenues from resale ($11,000) less the association's expenses are paid to the patron members as the price of the goods. Just as in the first example there are no expenses other than the purchase price of the goods. Therefore, the purchase price is $11,000 ($11,000 revenues minus $0 other association expenses). There is no profit to be allocated to the members.

Subsection (d) – In determining the amount of profit to be allocated, a limited cooperative association's board of directors may first set aside a portion of profit for reserves of the types specified in subsections (d)(1) and (2). The portion set aside under subsection (d) is subtracted from the association's profit to determine the "profit" to be allocated.

The phrase "unless the organic rules prohibit" is used to make clear that, if the organic rules are silent, the board of directors may set aside a portion of the profit for reserves in determining "profit" as the term is used in the rest of the Section. Over time it is conceivable that these reserves could be the source of funds to pay investor members a fixed stated return on their contributions.

Subsection (e) – Once the provisions of subsections (c) and (d) have been applied in determining profit or loss of a limited cooperative association, profit or loss is first apportioned between patron members as a categorical group and investor members as a categorical group as provided in the organic rules pursuant to subsection (b). Then the apportioned amounts are further allocated to the members in each group. The default method for patron member allocation is based on patronage (subsection (e)(1)). The default method for investor member allocation is based on contributions (subsection (e)(2)). Of course, the organic rules may change the default rules provided in this Section. *See also* subsections (a), (b), and (f).

Subsection (f) – Subsection (f) is intended to provide the association great latitude in the ways it may establish allocated profit and loss among patron members.

SECTION 1005. DISTRIBUTIONS.

(a) Unless the organic rules otherwise provide and subject to Section 1007, the board of directors may authorize, and the limited cooperative association may make, distributions to members.

(b) Unless the organic rules otherwise provide, distributions to members may be made in any form, including money, capital credits, allocated patronage equities, revolving fund certificates, and the limited cooperative association's own or other securities.

Comment

Subsection (a) – This subsection is consistent with unincorporated entity law in that members are not entitled to distributions. It is also consistent with cooperative and corporate law where dividends or other distributions are at the discretion of the board of directors. In the context of the law of other business organizations, distributions under this Section might be termed "interim distributions" to distinguish them from distributions under Section 1207 ("Distributions of Assets in Winding Up Limited Cooperative Associations").

"Interim" distributions to members are related to the allocation provisions in Section 1004 but not determined by them and the calculations and limitations in Section 1004 do not apply directly to distributions.

The reference to Section 1007 is because Section 1007 limits distributions under certain circumstances based on the financial position of the association.

Subsection (b) – Cooperative statutes typically contain this or a similar provision consistent with cooperative business practices. This subsection contains terms that are common in the context of cooperatives but which are not defined for purposes of the Act. They are used for purposes of illustrating the variety of forms of distributions and as a common point of reference between this Act and other cooperative statutes.

SECTION 1006. REDEMPTION OR REPURCHASE. Property distributed to a member by a limited cooperative association, other than money, may be redeemed or repurchased as provided in the organic rules but a redemption or repurchase may not be made without authorization by the board of directors. The board may withhold authorization for any

reason in its sole discretion. A redemption or repurchase is treated as a distribution for purposes of Section 1007.

Comment

This Section coordinates "redemption" as used practically in traditional cooperatives with the operation of unincorporated entities. This Section, together with Section 1005(b), addresses features that are ubiquitous in cooperative businesses. "Redemption" has a special role in cooperatives and is one way, if not the only way, members receive their share of accumulated capital when "retiring" or terminating their membership. In the business policy of some types of traditional marketing cooperatives "redemption" serves as a kind of functional equivalent to buy-out rights of a dissociated partner in general partnerships for a term. *See* RUPA (1997) § 701. The legal rules in the two situations are, however, markedly different and the similarity is in function only. A Department of Agriculture publication stated:

> Although equity accumulation is one of the biggest challenges facing cooperatives, each year many associations redeem part of their patronage-based capital. Equity redemption frequently focuses on the oldest allocations in the cooperative. Redeeming the oldest equities, particularly those of persons no longer patronizing the cooperative, implements the cooperative principle that financing should come from persons currently benefitting from the cooperative's services.

DONALD A. FREDERICK, INCOME TAX TREATMENT OF COOPERATIVES, DISTRIBUTIONS, RETAINS, REDEMPTIONS AND PATRONS' TAXATION, Info. Rep. 44, Part 3, p. 4 (2005).

This Act affords flexibility for planning different "buy-out" and "redemption" arrangements. One disadvantage of using traditional cooperatives is that members infrequently receive a portion of the increase of value of the entity due in part to their "investment" and use of the entity. This was one of the important financial reasons for the advent of "new generation" cooperatives which were frequently "closed-end." *See* Prefatory Note ("Introduction to ULCAA"). It is also an important reason for the flexibility afforded under this Act which allows the organic rules to provide for a plethora of plans and arrangements including the reflection of appreciated value.

Redemption or repurchase must be in the discretion of the board of directors because of its duty to manage the association. *See* Section 801(b). The necessity of this authority is illustrated, for example, in the application of Section 1007.

SECTION 1007. LIMITATIONS ON DISTRIBUTIONS.

(a) A limited cooperative association may not make a distribution if, after the distribution:

(1) the association would not be able to pay its debts as they become due in the ordinary course of the association's activities; or

(2) the association's assets would be less than the sum of its total liabilities.

(b) A limited cooperative association may base a determination that a distribution is not prohibited under subsection (a) on financial statements prepared on the basis of accounting practices and principles that are reasonable in the circumstances or on a fair valuation or other method that is reasonable in the circumstances.

(c) Except as otherwise provided in subsection (d), the effect of a distribution allowed under subsection (b) is measured:

(1) in the case of distribution by purchase, redemption, or other acquisition of financial rights in the limited cooperative association, as of the date money or other property is transferred or debt is incurred by the association; and

(2) in all other cases, as of the date:

(A) the distribution is authorized, if the payment occurs not later than 120 days after that date; or

(B) the payment is made, if payment occurs more than 120 days after the distribution is authorized.

(d) If indebtedness is issued as a distribution, each payment of principal or interest on the indebtedness is treated as a distribution, the effect of which is measured on the date the payment is made.

(e) For purposes of this section, "distribution" does not include reasonable amounts paid to a member in the ordinary course of business as payment or compensation for commodities, goods, past or present services, or reasonable payments made in the ordinary course of business under a bona fide retirement or other benefits program.

Comment

Source: RULLCA (2006) § 405, ULPA (2001) § 508, which was derived from ULLCA (1996) § 406, which was derived from RMBCA § 6.40.

Subsection (b) – This subsection seems to establish a standard of care for purposes of this Section that could be different than the standard in the statute referenced in Section 818.

Subsection (e) – This exception is directly derived from RULLCA (2006) Section 405(g). It emphasizes that protection from the operation of this Section extends to some contracts between members and the association. It applies only for purposes of this Section.

SECTION 1008. LIABILITY FOR IMPROPER DISTRIBUTIONS; LIMITATION OF ACTION.

(a) A director who consents to a distribution that violates Section 1007 is personally liable to the limited cooperative association for the amount of the distribution which exceeds the amount that could have been distributed without the violation if it is established that in consenting to the distribution the director failed to comply with Section 818 or 819.

(b) A member or transferee of financial rights which received a distribution knowing that the distribution was made in violation of Section 1007 is personally liable to the limited cooperative association to the extent the distribution exceeded the amount that could have been properly paid.

(c) A director against whom an action is commenced under subsection (a) may:

(1) implead in the action any other director who is liable under subsection (a) and compel contribution from the person; and

(2) implead in the action any person that is liable under subsection (b) and compel contribution from the person in the amount the person received as described in subsection (b).

(d) An action under this section is barred if it is commenced later than two years after the distribution.

Comment

Source: ULPA (2001) § 509, which was derived from ULLCA (1996) § 407. *See* RULLCA (2006) § 406; RMBCA § 8.33.

This Section is mandatory and may not be changed by the organic rules. This Comment closely tracks the comment to ULPA (2001) Section 509. In substance and effect this Section protects the interests of creditors of the limited cooperative association.

Subsection (a) – This subsection refers both to Section 1007 which includes in its subsection (c) a standard of ordinary care ("reasonable in the circumstances"), and to Section 818 and Section 819 (concerning standards of conduct and liability of directors). Section 818 adopts the standards of other law in this state by reference.

A limited cooperative association's failure to meet the standard of Section 1007(c) cannot by itself cause a director to be liable under Section 1008(a). *Both* of the following would have to occur before a failure to satisfy Section 1007(c) could occasion personal liability for a director under Section 1008(a):

(1) the association "base[s] a determination that a distribution is not prohibited . . . on financial statements prepared on the basis of accounting practices and principles that are [not] reasonable in the circumstances or on a valuation [that is not fair] or other method that is [not] reasonable in the circumstances"[Section 1007(c)].

and

(2) the director's decision to rely on the improper methodology in consenting to the distribution constitutes a breach of the standard imported into [this Act] by Section 818 or Section 819.

[SECTION 1009. RELATION TO STATE SECURITIES LAW. Patron members' interest in a limited cooperative association has the same exemption as provided for substantially similar interests in cooperatives under [reference to appropriate provision of this state's laws].]

Legislative Note*: Section 1009 is bracketed because it represents a unique policy decision that concerns both limited cooperative associations and state securities law. If the adopting jurisdiction has a securities exemption for general cooperatives located in cooperative statutes, it should determine whether the jurisdiction is best served by including limited cooperative associations within the existing exemption by referencing the statutory provision here. If the adopting jurisdiction's free standing securities law has a specific exemption or definitional exclusion for cooperatives this optional Section needs not be included but the adopting jurisdiction might consider whether limited cooperative associations should be treated similarly by that statutory provision.*

Comment

There is a great variation among the states concerning exemptions for cooperatives from state securities laws and this Act does not attempt to change the settled policy of any state. Section 1009 is further limited, however, to apply the law of this state to patron member interests because those interests are most similar to membership interests in traditional cooperatives. Securities exemptions may be particularly important where the limited cooperative association distributes interests which might be deemed to be securities in lieu of money on a regular basis. *See, e.g.*, Section 1005(b). Federal securities law will, obviously, apply independently of this Act and any securities law exemptions, if any, available under federal law must be obtained in accordance with that law.

[SECTION 1010. ALTERNATIVE DISTRIBUTION OF UNCLAIMED PROPERTY, DISTRIBUTIONS, REDEMPTIONS, OR PAYMENTS. A limited cooperative association may distribute unclaimed property, distributions, redemptions, or payments under [reference to the appropriate provision in the law governing cooperatives not formed under this [act] in this state].]

Legislative Note*: The general cooperative law of some, but not all states, contains a provision unique to cooperatives concerning the disposition of unclaimed property. Some of these provisions allow unclaimed property to revert to the cooperative if, after reasonable search, the member cannot be found; others may allow the cooperative to donate unclaimed property to a charity. See, e.g., OREGON REV. STAT. § 62.425 (2003). In states having such a provision the legislature should consider as a matter of policy whether the same provision should be applicable to limited cooperative associations. This is the appropriate place in this Act for*

referencing the provision contained in other law of the adopting jurisdiction and thereby incorporating it by reference. If the referenced statute in a given state requires the cooperative's articles or bylaws to authorize the use of the statutory provision, the authorization requirement should be added in the appropriate subsection of Section 113.

Comment

This Section is intended to provide an exception to this state's general unclaimed property statute.

The probable reasons that some state traditional cooperative statutes contain unique provisions concerning unclaimed property is two-fold. First, many cooperatives have revolving membership and, in the regular course of business, have occasional small sales that are patronage; for example, a consumer food cooperative. In these cases it can be reasonably anticipated that there will be numerous accounts with small balances that will not be claimed. Second, cooperative principles and values emphasize community and operation on a cost basis. While operation at cost is not synonymous with either not-for-profit or charity, it may be appropriate to distinguish cooperatives from general for-profit entities for purposes of treatment of unclaimed property.

[ARTICLE] 11

DISSOCIATION

SECTION 1101. MEMBER'S DISSOCIATION .

(a) A person has the power to dissociate as a member at any time, rightfully or wrongfully, by express will.

(b) Unless the organic rules otherwise provide, a member's dissociation from a limited cooperative association is wrongful only if the dissociation:

(1) breaches an express provision of the organic rules; or

(2) occurs before the termination of the limited cooperative association and:

(A) the person is expelled as a member under subsection (d)(3) or (4); or

(B) in the case of a person that is not an individual, trust other than a business trust, or estate, the person is expelled or otherwise dissociated as a member because it dissolved or terminated in bad faith.

(c) Unless the organic rules otherwise provide, a person that wrongfully dissociates as a member is liable to the limited cooperative association for damages caused by the dissociation. The liability is in addition to any other debt, obligation, or liability of the person to the association.

(d) A member is dissociated from the limited cooperative association as a member when:

(1) the association receives notice in a record of the member's express will to dissociate as a member, or if the member specifies in the notice an effective date later than the date the association received notice, on that later date;

(2) an event stated in the organic rules as causing the member's dissociation as a member occurs;

(3) the member is expelled as a member under the organic rules;

(4) the member is expelled as a member by the board of directors because:

(A) it is unlawful to carry on the association's activities with the member as a member;

(B) there has been a transfer of all the member's financial rights in the association, other than:

(i) a creation or perfection of a security interest; or

(ii) a charging order in effect under Section 605 which has not been foreclosed;

(C) the member is a limited liability company, association, or partnership, which has been dissolved, and its business is being wound up; or

(D) the member is a corporation or cooperative and:

(i) the member filed a certificate of dissolution or the equivalent, or the jurisdiction of formation revoked the association's charter or right to conduct business;

(ii) the association sends a notice to the member that it will be expelled as a member for a reason described in clause (i); and

(iii) not later than 90 days after the notice was sent under clause (ii), the member did not revoke its certificate of dissolution or the equivalent, or the jurisdiction of formation did not reinstate the association's charter or right to conduct business; or

(E) the member is an individual and is adjudged incompetent;

(5) in the case of a member who is an individual, the individual dies;

(6) in the case of a member that is a trust or is acting as a member by virtue of being a trustee of a trust, all the trust's financial rights in the association are distributed;

(7) in the case of a member that is an estate, the estate's entire financial interest in the association is distributed;

(8) in the case of a member that is not an individual, partnership, limited liability company, cooperative, corporation, trust, or estate, the member is terminated; or

(9) the association's participation in a merger if, under the plan of merger as approved under [Article] 16, the member ceases to be a member.

Comment

Source: Derived from RULLCA (2006) § 601; ULPA (2001) §§ 601 and 603, RUPA § 601.

This Act follows current unincorporated law terminology in using "dissociation" as the term used to mean a person ceasing to be affiliated with an organization as a member or partner.

This Section, together with Sections 1102 and 1103, addresses a member's dissociation from a limited cooperative association. Many provisions of these subsections may be varied by the organic rules. Drafters of organic rules should consider the different dynamics in associations with many members versus those with a small number of members and recognize those differences in the organic rules. For example, associations with few members may need to be designed with more restrictions on dissociation than would be appropriate for associations with many members. This Act does not provide different rules for associations with a large number of members versus associations with a small number but the organic rules could be drafted to be appropriate under the circumstances. This is consistent with RULLCA (2006) and ULPA (2001) where dissociation of members or partners is treated generally without regard to the numbers of members in the entity. Consideration should also be given to the dichotomy between patron members and investor members where investor members are authorized.

After a person has been dissociated as a member, the rights of the person as a member cease, but debts, obligations, or liabilities of the person to the association that arose prior to the dissociation continue and are enforceable as debts, obligations, or liabilities of the person to the association without regard to membership status. *See* Section 1102. A person who is both a patron member and an investor member could be dissociated in one capacity but not the other. *See* Section 116.

As in other provisions of this Act, what constitutes proper notice in connection with a dissociation is governed by other law.

Subsection (a) – This subsection recognizes the power of a person to dissociate as a member of a limited cooperative association. The "power" to dissociate is different from the "right" to dissociate. While a member may have the power to dissociate from an association, the dissociation may be "wrongful" as a violation of the organic rules because, for example, a specific prohibition on the right to dissociate, or for other reasons described in subsection (b). A prohibition against dissociation in the organic rules cannot stop a member from dissociating from the association (the power to dissociate) but, on the other hand, the dissociation could be a clear violation of the rules (there being no right to dissociate).

The organic rules may not eliminate the power to dissociate.

Subsection (b) – This subsection provides a limited number of situations when a dissociation is wrongful. The situations could be expanded or contracted by the organic rules.

Subsection (c) – This confirms that a wrongful dissociation may result in the dissociating member being liable to the limited cooperative association if the dissociation causes harm to the association. The amount of damages would need to be proven. These damages are in addition to any other obligation the member owes to the association.

Subsection (d) – This subsection details the various means through which different types of members are dissociated from a limited cooperative association, whether voluntarily or involuntarily.

Subsection (d)(4) – None of the events described in paragraphs (A) through (E) of this subsection cause a dissociation of a member without action of the board of directors to expel the member. Stated another way, these events do not cause an automatic dissociation of the member.

Subsection (d)(4)(C) – "Partnership" in this provision includes a general partnership, a limited partnership, a limited liability partnership, and any other type of partnership.

Subsection (d)(4)(E) – A member who has been adjudged incompetent may be dissociated by the board of directors. This could be addressed in the organic rules. Section 1103 provides for the representative of an expelled incompetent member to have certain rights which are less than the rights of the personal representative settling the estate of a deceased member. Being adjudged incompetent, however, does not automatically dissociate the member. If the member is not expelled they would continue to have the rights of a member.

Subsection (d)(5) – An individual is dissociated upon death under this provision. The decedent's estate has the powers conferred by Section 1103. An estate that is carrying on business could become a member by admission.

> **EXAMPLE**: An individual farmer who was not a member of the limited cooperative association dies. The decedent's estate anticipates farming for three years before the estate closes. The estate could become a member of the association pursuant to the organic rules of the association for admission of member.

Subsection (d)(9) – A plan of merger under Article 16 could provide for dissociation of members in a limited cooperative association.

SECTION 1102. EFFECT OF DISSOCIATION AS MEMBER.

(a) Upon a member's dissociation:

(1) subject to Section 1103, the person has no further rights as a member; and

(2) subject to Section 1103 and [Article] 16, any financial rights owned by the person in the person's capacity as a member immediately before dissociation are owned by the person as a transferee.

(b) A person's dissociation as a member does not of itself discharge the person from any debt, obligation, or liability to the limited cooperative association which the person incurred under the organic rules, by contract, or by other means while a member.

Comment

Source: ULPA (2001) § 602, RUPA (1997) § 603(b).

Subsection (a) – In general, when a person dissociates as a member, the person's rights as a member disappear and, subject to Section 116 ("Dual Capacity"), the person's status degrades to that of a mere transferee of financial rights. However, Section 1103, provides some special rights when dissociation is caused by an individual's death or a member has been adjudged incompetent and expelled by the board of directors of the limited cooperative association.

SECTION 1103. POWER OF ESTATE OF MEMBER. Unless the organic rules provide for greater rights, if a member is dissociated because of death, dies or is expelled by reason of being adjudged incompetent, the member's personal representative or other legal

representative may exercise the rights of a transferee of the member's financial rights and, for purposes of settling the estate of a deceased member, may exercise the informational rights of a current member to obtain information under Section 505.

Comment

Source: Derived from ULPA (2001) § 704.

Section 603 limits the rights of transferees of a member's financial rights. In particular, a transferee or holder of financial rights has no voting rights, rights to serve as a director, rights to participate in future allocations of profits or losses, and, except following dissociation, no information rights. *See* Comment to Section 1101(d)(4)(E).

[ARTICLE] 12

DISSOLUTION

SECTION 1201. DISSOLUTION AND WINDING UP. A limited cooperative association is dissolved only as provided in [this article] and upon dissolution winds up in accordance with [this article].

Comment

There are only three basic ways in which a limited cooperative association is dissolved: non-judicially, judicially and administratively. In subsequent sections the Act identifies these ways in detail and provides how each of the three ways is applied.

After dissolution, no matter how the dissolution occurred, Sections 1206 through 1210 govern the winding up process including the handling of claims and final distributions. In that regard, Section 1010, an optional provision, may provide an alternative to the general unclaimed property statute of this State.

Sections 1213 and 1214 provide for voluntary filings that may prove helpful to the limited cooperative association under certain circumstances.

SECTION 1202. NONJUDICIAL DISSOLUTION. Except as otherwise provided in Sections 1203 and 1211, a limited cooperative association is dissolved and its activities must be wound up:

(1) upon the occurrence of an event or at a time specified in the articles of organization;

(2) upon the action of the association's organizers, board of directors, or members under Section 1204 or 1205; or

(3) 90 days after the dissociation of a member, which results in the association having one patron member and no other members, unless the association:

(A) has a sole member that is a cooperative; or

(B) not later than the end of the 90-day period, admits at least one member in accordance with the organic rules and has at least two members, at least one of which is a patron member.

Comment

Source: Based on ULPA (2001) § 801.

The exception for Sections 1203 relating to judicial dissolution and 1211 relating to administrative dissolution is to make it clear those sections provide the only other ways that a limited cooperative association may be dissolved. *See* Section 1201.

Paragraph (1) – The articles of organization may, but are not required to, state events or times when a limited cooperative association is dissolved. To be effective, the provision must be in the articles of organization (not in the bylaws). For example, the articles could provide for dissolution to be required if the association has only five remaining members. This does not contradict the provision in paragraph (3) because it would provide a higher standard. The articles could also provide for a term of years for the association consistent with subsection 301(a)(6). That subsection requires the term be stated in the articles if the association is not to have perpetual existence.

Paragraph (3) – This paragraph and Section 501 (requiring at least two members for a limited cooperative association to commence business) together state a requirement that there be at least two members except where an association is wholly-owned by a cooperative.

SECTION 1203. JUDICIAL DISSOLUTION. The [appropriate court] may dissolve a limited cooperative association or order any action that under the circumstances is appropriate and equitable:

(1) in a proceeding initiated by the [Attorney General], if:

(A) the association obtained its articles of organization through fraud; or

(B) the association has continued to exceed or abuse the authority conferred upon it by law; or

(2) in a proceeding initiated by a member, if:

(A) the directors are deadlocked in the management of the association's affairs, the members are unable to break the deadlock, and irreparable injury to the association is occurring or is threatened because of the deadlock;

(B) the directors or those in control of the association have acted, are acting, or will act in a manner that is illegal, oppressive, or fraudulent;

(C) the members are deadlocked in voting power and have failed to elect successors to directors whose terms have expired for two consecutive periods during which annual members meetings were held or were to be held; or

(D) the assets of the association are being misapplied or wasted.

Comment

Source: Derived from RMBCA § 14.30.

Section 1203 permits a court to fashion remedies other than dissolution if an application to dissolve is made to the court. Illustratively, a court could refuse to dissolve a limited cooperative association and instead appoint provisional directors or force a buy-out of membership interests. This follows what appears to be a trend in both statutory and case law of corporations. The language expressly providing for such remedies is "or order any action that under the circumstances is appropriate and equitable." This provision is not subject to change by the organic rules and in that regard differs from RULLCA. *See* Comment to RULLCA (2006) § 701(b).

Neither a creditor of a limited cooperative association nor a transferee may initiate an action to dissolve a limited cooperative association. In the case of a creditor with a claim or judgment against the association, the creditor's remedies are left to other law, such as bankruptcy or fraudulent transfer law. Flatly, a transferee may not seek dissolution. This is consistent with other unincorporated entity law.

Paragraph (1) – A proceeding may be initiated by the attorney general to dissolve a limited cooperative association only if its articles of organization were obtained through fraud or the association continues to exceed or abuse its legal authority. "Continued" in this context implies that the behavior is temporal in nature and has not ceased. It is somewhat similar to "acting" as used in paragraph (2)(B).

A policy reason for the attorney general having authority to bring an action to dissolve the limited cooperative association is rooted in the history of cooperatives as a unique type of

entity formed for the mutual benefit of its members and in recognition that some cooperatives receive special statutory treatment under particular laws. Traditional cooperative laws typically contain a similar provision.

Paragraph (2) – A member may seek dissolution of a limited cooperative association if the member can demonstrate one of the four conditions stated as grounds for a court to dissolve the association. The burden of proof is on the member who initiates the proceeding.

Paragraphs (2)(B) and (2)(D) – The language in these paragraphs have an effect similar to ULPA (2001) Section 802. The ULPA (2001) section, however, is much shorter and more restrictive authorizing judicial dissolution only "if it is not reasonably practicable to carry on the activities of the limited partnership in conformity with the partnership agreement." The language is much closer to that commonly found in corporate law and it invites the courts to apply the "oppression" doctrine from closely-held corporation law to limited cooperative associations as they have begun to do in the context of limited liability companies. These subsections permit inquiry into the management and operations of a limited cooperative association within the stated parameters of the litigation if dissolution is sought by a member.

SECTION 1204. VOLUNTARY DISSOLUTION BEFORE COMMENCEMENT OF ACTIVITY . A majority of the organizers or initial directors of a limited cooperative association that has not yet begun business activity or the conduct of its affairs may dissolve the association.

Comment

This Section reflects the practical reality that the organizers or initial directors need to be able to dissolve a limited cooperative association before it begins business. Corporate law recognizes that both organizers and the initial board of directors owe duties to the entity.

SECTION 1205. VOLUNTARY DISSOLUTION BY THE BOARD AND MEMBERS.

(a) Except as otherwise provided in Section 1204, for a limited cooperative association to voluntarily dissolve:

(1) a resolution to dissolve must be approved by a majority vote of the board of directors unless a greater percentage is required by the organic rules;

(2) the board of directors must call a members meeting to consider the resolution, to be held not later than 90 days after adoption of the resolution; and

(3) the board of directors must mail or otherwise transmit or deliver to each member in a record that complies with Section 508:

(A) the resolution required by paragraph (1);

(B) a recommendation that the members vote in favor of the resolution or, if the board determines that because of conflict of interest or other special circumstances it should not make a favorable recommendation, the basis of that determination; and

(C) notice of the members meeting, which must be given in the same manner as notice of a special meeting of members.

(b) Subject to subsection (c), a resolution to dissolve must be approved by:

(1) at least two-thirds of the voting power of members present at a members meeting called under subsection (a)(2); and

(2) if the limited cooperative association has investor members, at least a majority of the votes cast by patron members, unless the organic rules require a greater percentage.

(c) The organic rules may require that the percentage of votes under subsection (b)(1) is:

(1) a different percentage that is not less than a majority of members voting at the meeting; or

(2) measured against the voting power of all members; or

(3) a combination of paragraphs (1) and (2).

Comment

Subsections (a) and (b) – These subsections follow the notice, action, and voting procedures in other parts of the Act for amendments to the organic rules, conversion, merger, and disposition of assets. *See* Comments to Sections 402 and 405.

Subsection (c) – The articles of organization or the bylaws may provide for a voting percentage to approve dissolution that ranges from a majority of the voting power of the members present at a meeting of the members to unanimity of all members. If there are investor members, at least one-half of the votes cast by patron members must be affirmative unless the organic rules require a larger percentage. *See* Comment to Section 405.

SECTION 1206. WINDING UP.

(a) A limited cooperative association continues after dissolution only for purposes of winding up its activities.

(b) In winding up a limited cooperative association's activities, the board of directors shall cause the association to:

(1) discharge its liabilities, settle and close its activities, and marshal and distribute its assets;

(2) preserve the association or its property as a going concern for no more than a reasonable time;

(3) prosecute and defend actions and proceedings;

(4) transfer association property; and

(5) perform other necessary acts.

(c) After dissolution and upon application of a limited cooperative association, a member, or a holder of financial rights, the [appropriate court] may order judicial supervision of the winding up of the association, including the appointment of a person to wind up the association's activities, if:

(1) after a reasonable time, the association has not wound up its activities; or

(2) the applicant establishes other good cause.

(d) If a person is appointed pursuant to subsection (c) to wind up the activities of a limited cooperative association, the association shall promptly deliver to the [Secretary of State] for filing an amendment to the articles of organization to reflect the appointment.

Comment

Source: Based on ULPA (2001) § 803, RUPA (1997) §§ 802 and 803.

Sections 1206 through 1210 govern the process of winding-up including the handling of claims and final distributions no matter how the dissolution occurred. *See also* Section 1010 ("Alternative Distribution of Unclaimed Property, Distributions, Redemptions or Payments").

Sections 1214 and 1215 permit a limited cooperative association to deliver for filing a statement of dissolution and a statement of termination. For the effect of filing the statements see Comment to Section 1214. The purpose of the filings is to provide public notice relevant to the post-dissolution activities of the association.

Subsection (a) – Dissolution changes the scope of activities in which a limited cooperative association may engage. Following dissolution, the association may only engage in activities consistent with winding up its affairs.

Subsection (b) – The subsection places the primary obligations in the winding up process on the board of directors consistent with its general management authority under this Act. Despite the limitation on the scope of business of a limited cooperative association following dissolution, this subsection provides broad authority in the board of directors to undertake activities in connection with winding up the affairs of the association. The subsection is expansive to enable the board of directors to conduct the winding up process. The board has authority to designate agents and others to conduct winding up activities. Whether the agent has the authority to bind the association in any given transaction during the winding-up process is a matter of agency law.

The board of directors is given broad authority to take necessary action to wind-up its affairs under subsection (b)(6). For example, if any of the limited cooperative's assets are insubstantial in value and cannot be readily converted to cash, those assets may be abandoned or donated to a charitable organization without violating the obligations of the person conducting the winding up of the association.

Subsection (c) – If the board of directors of a limited cooperative association fails to carry out its obligations under subsection (b), either the association, a member or a holder of financial rights (a transferee) may apply to a court for supervision of the winding up process. This subsection is a safety net for members and holders of financial rights if winding up is unreasonably delayed or other good cause for judicial supervision can be shown.

Subsection (d) – This subsection requires an amendment to the articles of organization to be delivered to the Secretary of State for filing only when a person is appointed by a court to wind up the association's activities. This requirement is not applicable if the board of directors manages the winding up. *See* RULLCA (2006) § 702(d)(2).

SECTION 1207. DISTRIBUTION OF ASSETS IN WINDING UP LIMITED COOPERATIVE ASSOCIATION.

(a) In winding up a limited cooperative association's business, the association shall apply its assets to discharge its obligations to creditors, including members that are creditors. The association shall apply any remaining assets to pay in money the net amount distributable to members in accordance with their right to distributions under subsection (b).

(b) Unless the organic rules otherwise provide, in this subsection "financial interests" means the amounts recorded in the names of members in the records of a limited cooperative association at the time a distribution is made, including amounts paid to become a member, amounts allocated but not distributed to members, and amounts of distributions authorized but not yet paid to members. Unless the organic rules otherwise provide, each member is entitled to a distribution from the association of any remaining assets in the proportion of the member's financial interests to the total financial interests of the members after all other obligations are satisfied.

Comment

Source: RULLCA (2006) § 708.

Subsection (a) – This subsection follows a traditional approach to the distribution of assets in winding up an entity. It leaves priorities among creditors to other law, such as the Uniform Commercial Code and real property mortgage law.

Subsection (b) – This subsection provides for a distribution to all members of assets available for distribution to members after all other obligations of the limited cooperative association are satisfied. The distribution is based on a proportional comparison of the financial

interests of the members. "Financial interests" is a specially defined term for purposes of the subsection.

In some cooperatives, such as rural electric associations, other law or custom may provide for a "look back" period of a designated amount of time to determine members entitled to receive a distribution in the winding up process. This could be addressed in the organic rules. If members or holders of financial rights cannot be located, Section 1010 ("Alternative Distributions of Unclaimed Property, Distributions, Redemptions or Payments") of this Act and other law governing unclaimed property apply.

The organic rules may establish rules to determine the financial interests and manage the distributions under this Section but only as a matter of the internal relationship between and among the members and the entity. The existence of nonmember patrons that may have what appears to be equity accounts may raise difficult interpretive issues that turn on the unique facts under the circumstances.

SECTION 1208. KNOWN CLAIMS AGAINST DISSOLVED LIMITED COOPERATIVE ASSOCIATION.

(a) Subject to subsection (d), a dissolved limited cooperative association may dispose of the known claims against it by following the procedure in subsections (b) and (c).

(b) A dissolved limited cooperative association may notify its known claimants of the dissolution in a record. The notice must:

(1) specify that a claim be in a record;

(2) specify the information required to be included in the claim;

(3) provide an address to which the claim must be sent;

(4) state the deadline for receipt of the claim, which may not be less than 120 days after the date the notice is received by the claimant; and

(5) state that the claim will be barred if not received by the deadline.

(c) A claim against a dissolved limited cooperative association is barred if the requirements of subsection (b) are met, and:

(1) the association is not notified of the claimant's claim, in a record, by the deadline specified in the notice under subsection (b)(4);

(2) in the case of a claim that is timely received but rejected by the association, the claimant does not commence an action to enforce the claim against the association within 90 days after receipt of the notice of the rejection; or

(3) if a claim is timely received but is neither accepted nor rejected by the association within 120 days after the deadline for receipt of claims, the claimant does not commence an action to enforce the claim against the association:

(A) after the 120-day period; and

(B) within 90 days after the 120-day period.

(d) This section does not apply to a claim based on an event occurring after the date of dissolution or a liability that is contingent on that date.

Comment

Source: Derived from RULLCA (2006) § 703, ULPA (2001) § 806, which was based on ULLCA § 807, which in turn was based on RMBCA § 14.06.

This Section provides a means for a dissolved limited cooperative association to address known claims against it and to bar those claims if the claimant does not act in a timely manner or meet other requirements for making a claim to the association. The Section also provides the procedures to be followed by a claimant in seeking to enforce a claim against a dissolved association.

Subsection (c)(3) – This paragraph addresses what a claimant needs to do to enforce a claim against a dissolved limited cooperative association when the association does not act on a properly presented claim by the deadline for claims as stated in the notice given to claimants under subsection (b). The claimant must wait until 120 days after the deadline and then the claimant must commence an action in court to enforce the claim within 90 days following the 120-day period or the claim will be barred. The purpose of requiring the claimant to wait 120 days after the deadline is to give the association reasonable time to receive all claims and, once received, determine the validity and assess the priority of each claim. Other law ultimately governs the priority of the claims received by the association.

SECTION 1209. OTHER CLAIMS AGAINST DISSOLVED LIMITED COOPERATIVE ASSOCIATION.

(a) A dissolved limited cooperative association may publish notice of its dissolution and request persons having claims against the association to present them in accordance with the notice.

(b) A notice under subsection (a) must:

(1) be published at least once in a newspaper of general circulation in the [county] in which the dissolved limited cooperative association's principal office is located or, if the association does not have a principal office in this state, in the [county] in which the association's designated office is or was last located;

(2) describe the information required to be contained in a claim and provide an address to which the claim is to be sent; and

(3) state that a claim against the association is barred unless an action to enforce the claim is commenced not later than three years after publication of the notice.

(c) If a dissolved limited cooperative association publishes a notice in accordance with subsection (b), the claim of each of the following claimants is barred unless the claimant commences an action to enforce the claim not later than three years after the first publication date of the notice:

(1) a claimant that is entitled to but did not receive notice in a record under Section 1208; and

(2) a claimant whose claim is contingent or based on an event occurring after the effective date of dissolution.

(d) A claim not barred under this section may be enforced:

(1) against a dissolved limited cooperative association, to the extent of its undistributed assets; or

(2) if the association's assets have been distributed in connection with winding up the association's activities against a member or holder of financial rights to the extent of that person's proportionate share of the claim or the association's assets distributed to the person in connection with the winding up, whichever is less. The person's total liability for all claims under this paragraph shall not exceed the total amount of assets distributed to the person as part of the winding up of the association.

Comment

Source: RULLCA (2006) § 704, ULPA (2001) § 807, which was based on ULLCA § 808, which was based on RMBCA § 14.07.

This Section provides a means for a dissolved limited cooperative association to address unknown claims against it and to bar those specific types of claims. Those claims are barred three years after completion of publication by the association of a notice to submit claims if a claim is not presented to the association within that period.

Subsection (c) – This subsection identifies the specific types of claims which may be barred under this Section. They include known claimants who did not receive notice under Section 1108. They also include claimants with contingent claims and claimants whose claims are based on an event occurring after the date of dissolution.

Subsection (d)(2) – Liability under this paragraph would extend to anyone who has received distributions as a member or as a holder of financial rights (transferee, assignee) and under a charging order attaching to financial rights. This paragraph contains no "knowledge" element.

SECTION 1210. COURT PROCEEDING.

(a) Upon application by a dissolved limited cooperative association that has published a notice under Section 1209, the [appropriate court] in the [county] where the association's

principal office is located or, if the association does not have a principal office in this state where its designated office in this state is located, may determine the amount and form of security to be provided for payment of claims against the association that are contingent, have not been made known to the association, or are based on an event occurring after the effective date of dissolution but that, based on the facts known to the association, are reasonably anticipated to arise after the effective date of dissolution.

(b) Not later than 10 days after filing an application under subsection (a), a dissolved limited cooperative association shall give notice of the proceeding to each known claimant holding a contingent claim.

(c) The court may appoint a representative in a proceeding brought under this section to represent all claimants whose identities are unknown. The dissolved limited cooperative association shall pay reasonable fees and expenses of the representative, including all reasonable attorney's and expert witness fees.

(d) Provision by the dissolved limited cooperative association for security in the amount and the form ordered by the court satisfies the association's obligations with respect to claims that are contingent, have not been made known to the association, or are based on an event occurring after the effective date of dissolution, and the claims may not be enforced against a member that received a distribution.

Comment

This Section is similar to RMBCA Section 14.08. It provides a procedure under which a dissolved limited cooperative association that has followed the procedures under Section 1209 to seek judicial assistance for providing security for contingent and unknown claims and claims based on events occurring after dissolution. Its purpose is to provide greater certainty for distributions made in liquidation. If satisfactory security is provided, the association can confidently distribute the remaining assets. Subsection (d) provides protection to the recipients of the distributions from recovery by claimants of the association.

It is expected a court would use its discretion and deny the protections of Section 1210 to a dissolved association where it is determined that the association is dissolving for purposes of avoiding anticipated claims of future tort claimants. *See, e.g.*, Uniform Fraudulent Transfers Act.

SECTION 1211. ADMINISTRATIVE DISSOLUTION.

(a) The [Secretary of State] may dissolve a limited cooperative association administratively if the association does not:

(1) pay, not later than 60 days after the due date, any fee, tax, or penalty due to the [Secretary of State] under this [act] [or other law]; or

(2) deliver not later than 60 days after the due date its annual report to the [Secretary of State].

(b) If the [Secretary of State] determines that a ground exists for dissolving a limited cooperative association administratively, the [Secretary of State] shall file a record of the determination and serve the association with a copy of the record.

(c) If, not later than 60 days after service of a copy of the [Secretary of State's] determination under subsection (b), the association does not correct each ground for dissolution or demonstrate to the satisfaction of the [Secretary of State] that each uncorrected ground determined by the [Secretary of State] does not exist, the [Secretary of State] shall dissolve the association administratively by preparing and filing a declaration of dissolution which states the grounds for dissolution. The [Secretary of State] shall serve the association with a copy of the declaration.

(d) A limited cooperative association that has been dissolved administratively continues its existence only for purposes of winding up its activities.

(e) The administrative dissolution of a limited cooperative association does not terminate the authority of its agent for service of process.

Legislative Note: *In adopting jurisdictions that do not generally permit administrative dissolution of entities that do not pay required fees, taxes or penalties to governmental agencies other than the [Secretary of State], the words "or other law" in Section 1211(a)(1) should be deleted.*

Comment

Source: RULLCA (2006) § 705, ULPA (2001) § 809, which was based on ULLCA §§ 809 and 810.

Subsection (a)(2) – Under this provision, a limited cooperative association may deliver its annual report to the Secretary of State any time after the due date if administrative dissolution has not occurred. If a ground for administrative dissolution is failure to file the annual report, the filing of the annual report would be a correction of a ground for administrative dissolution under subsection (c). Other law may provide the Secretary of State authority to collect additional fees and penalties for the untimely filing of annual reports.

SECTION 1212. REINSTATEMENT FOLLOWING ADMINISTRATIVE DISSOLUTION .

(a) A limited cooperative association that has been dissolved administratively may apply to the [Secretary of State] for reinstatement not later than two years after the effective date of dissolution. The application must be delivered to the [Secretary of State] for filing and state:

(1) the name of the association and the effective date of its administrative dissolution;

(2) that the grounds for dissolution either did not exist or have been eliminated; and

(3) that the association's name satisfies the requirements of Section 111.

(b) If the [Secretary of State] determines that an application contains the information required by subsection (a) and that the information is correct, the [Secretary of State] shall:

(1) prepare a declaration of reinstatement;

(2) file the original of the declaration; and

(3) serve a copy of the declaration on the association.

(c) When reinstatement under this section becomes effective, it relates back to and takes effect as of the effective date of the administrative dissolution, and the limited cooperative association may resume or continue its activities as if the administrative dissolution had not occurred.

Comment

Source: RULLCA (2006) § 706, ULPA (2001) § 810, which was based on ULLCA § 811.

Subsection (a) – The two year reinstatement bar is short given current statutory trends but is consistent with older law and arguably encourages careful compliance with the requirements that, if not observed, may lend to administrative dissolution under Section 1211(a).

Subsection (c) – This subsection reinstates an administratively dissolved limited cooperative association effective on the date of the original administrative dissolution as if the dissolution had not occurred. It does not address the liability of the association to persons who relied on the dissolution before reinstatement.

SECTION 1213. DENIAL OF REINSTATEMENT; APPEAL.

[(a)] If the [Secretary of State] denies a limited cooperative association's application for reinstatement following administrative dissolution, the [Secretary of State] shall prepare and file a notice that explains the reason for denial and serve the association with a copy of the notice.

[(b) Not later than 30 days after service of a notice of denial of reinstatement by the [Secretary of State], a limited cooperative association may appeal the denial by petitioning the [appropriate court] to set aside the dissolution. The petition must be served on the [Secretary of State] and contain a copy of the [Secretary of State's] declaration of dissolution, the association's application for reinstatement, and the [Secretary of State's] notice of denial.

(c) The court may summarily order the [Secretary of State] to reinstate the dissolved cooperative association or may take other action the court considers appropriate.]

Legislative Note: *Some adopting jurisdictions may have provisions addressing the matters contained in subsections (b) and (c) either in an administrative procedures act or in a free standing statute governing this process across all entity types. Those jurisdictions should not adopt subsections (b) and (c) but should include limited cooperative associations within the other statutes. If an adopting jurisdiction adopts subsections (b) and (c), in subsection (b) it should specify the court with appropriate jurisdiction.*

Comment

Source: RULLCA (2006) § 707, ULPA (2001) § 811.

SECTION 1214. STATEMENT OF DISSOLUTION.

(a) A limited cooperative association that has dissolved or is about to dissolve may deliver to the [Secretary of State] for filing a statement of dissolution that states:

(1) the name of the association;

(2) the date the association dissolved or will dissolve; and

(3) any other information the association considers relevant.

(b) A person has notice of a limited cooperative association's dissolution on the later of:

(1) 90 days after a statement of dissolution is filed; or

(2) the effective date stated in the statement of dissolution.

Comment

This Section provides for the voluntary filing of a statement of dissolution with the Secretary of State. The effect of filing the statement is to give notice that a limited cooperative association has dissolved or will soon dissolve and is winding up. It provides constructive notice of dissolution under subsection (b). If a person is appointed by a court to wind up the activities of a dissolved association under subsection 1206(c), an amendment to the articles of organization reflecting the appointment must be filed with the Secretary of State under subsection 1206(d).

SECTION 1215. STATEMENT OF TERMINATION.

(a) A dissolved limited cooperative association that has completed winding up may deliver to the [Secretary of State] for filing a statement of termination that states:

(1) the name of the association;

(2) the date of filing of its initial articles of organization; and

(3) that the association is terminated.

(b) The filing of a statement of termination does not itself terminate the limited cooperative association.

Comment

This Section provides for the voluntary filing of a statement of termination with the Secretary of State. The effect of filing the statement is to give notice that a limited cooperative association has terminated its existence. As with the statement of dissolution under Section 1214, the effect of this notice is left to other law, including the law of agency.

Filing of a notice of termination does not eliminate the obligations of the association and those handling its winding up to complete the winding up of the association's affairs and distributing its assets as required by this act.

If a statement of dissolution or a statement of termination is not filed, and no further annual reports are filed with the Secretary of State, the Secretary of State will eventually administratively dissolve the limited cooperative association under Section 1211.

[[ARTICLE] 13

ACTION BY MEMBER

Legislative Note: *This entire [Article] is bracketed to indicate its adoption is optional depending on whether an adopting jurisdiction places the substantive law regarding derivative actions in its statutes relating to entities or in its civil procedure law including its rules of civil procedure. If an adopting jurisdiction places derivative actions in its entity statutes, this [Article] should be adopted. If the adopting jurisdiction places provisions concerning derivative actions in its civil procedure law, this [article] should not be adopted although the adopting jurisdiction could place a reference to that law as the text of this [Article]. If the adopting jurisdiction's laws regarding derivative actions specifically reference particular types of entities to which derivative actions are to be applicable, this [Act] should be referenced in those laws.*

SECTION 1301. DERIVATIVE ACTION. A member may maintain a derivative action to enforce a right of a limited cooperative association if:

(1) the member demands that the association bring an action to enforce the right; and

(2) any of the following occur:

(A) the association does not, within 90 days after the member makes the demand, agree to bring the action;

(B) the association notifies the member that it has rejected the demand;

(C) irreparable harm to the association would result by waiting 90 days after the member makes the demand; or

(D) the association agrees to bring an action demanded and fails to bring the action within a reasonable time.

Comment

This Section and Article apply only to derivative suits and this Section authorizes such actions. As a general matter, the Act borrows basic concepts from the law of other unincorporated organizations and is broadly similar to RULLCA (2006) Art. 10 and ULPA (2001) Art. 9. Some sections, including this Section, contain more specific and detailed procedural requirements than provided in other unincorporated entity statutes.

The board of directors is charged with managing a limited cooperative association and, therefore, has decisional authority concerning what legal actions to pursue, and how to pursue them, on behalf of the association. The derivative action gives the members judicial recourse for protecting the interests of the association if the board fails to do so.

This Act, unlike both RULLCA (2006) and ULPA (2001), does not contain a provision concerning "direct" actions. This omission is intentional and does not mean that a member may not bring a direct action. As the comments to those other acts state: "In ordinary contractual situations it is axiomatic that each party to a contract has standing to sue for breach of contract." *See* Comment to ULPA (2001) § 1001. This Act appropriately relies on common law to determine the line between derivative and direct actions. The number of members and other circumstances require the exercise of sound judicial discretion. Further, borrowing statutory language concerning direct actions from other law is not entirely appropriate because members in cooperative entities are frequently its only customers or suppliers which makes the direct-derivative distinction more difficult to divine in the abstract outside a given set of facts.

Neither does this Article expressly provide for legal machinery like "special litigation committees." The absence of a provision specially providing for a litigation committee does not mean that special litigation committees may not be used. *See* Sections 212 and 817. It does mean, however, that the appropriateness and the effect of the use of a special litigation committee will be judicially reviewed on a case-by-case basis.

Paragraph (1) – This subsection requires a demand to be made of the limited cooperative association by a member instituting a derivative action. This demand requirement avoids the time and expense of litigating whether a demand is necessary or futile. It also assures the board of directors has the opportunity to undertake corrective action and to control prosecution of the suit.

A written demand is not specified, but best practices require the demand be made in a manner by which its contents and delivery can be proven. The contents of the demand are not specified. It should contain sufficient information to demonstrate the person making the demand could initiate litigation under this Article and to apprise the limited cooperative association of the facts underlying the reason for the demand being made.

Paragraph (2) – The subsection lists four prerequisites for a derivative action. Subparagraph (D) provides a "reasonable" time standard will apply to a limited cooperative association that has agreed to bring an action and fails to do so. Obviously "reasonable" depends on particular facts and circumstances. Paragraph (2)(A) provides a 90-day period for the association to respond to a demand.

SECTION 1302. PROPER PLAINTIFF .

(a) A derivative action to enforce a right of a limited cooperative association may be maintained only by a person that:

(1) is a member or a dissociated member at the time the action is commenced and:

(A) was a member when the conduct giving rise to the action occurred; or

(B) whose status as a member devolved upon the person by operation of law or the organic rules from a person that was a member at the time of the conduct; and

(2) adequately represents the interests of the association.

(b) If the sole plaintiff in a derivative action dies while the action is pending, the court may permit another member who meets the requirements of subsection (a) to be substituted as plaintiff.

Comment

Subsection (a)(1) – The contemporaneous ownership requirement is simple and the easiest rule to apply.

Subsection (a)(2) – The member must "adequately represent the interests of the association." This is a different standard from the "shareholders similarly situated" standard under some corporate law which has been criticized by the courts. *See Nolen v. Shaw-Walker Company*, 449 F.2d 506, 508 n.4 (6th Cir. 1972).

Subsection (b) – If a plaintiff dies, the court may permit another member to be substituted for the deceased plaintiff, but that plaintiff must also meet the contemporaneous ownership requirement.

SECTION 1303. PLEADING . In a derivative action to enforce a right of a limited cooperative association, the complaint must state:

(1) the date and content of the plaintiff's demand under Section 1301(1) and the association's response;

(2) if 90 days have not expired since the demand, how irreparable harm to the association would result by waiting for the expiration of 90 days; and

(3) if the association agreed to bring an action demanded, that the action has not been brought within a reasonable time.

Comment

This Section reflects the policy of additional certainty by referencing the 90 day period provided in Section 1301(2). *See* Comment to Section 1301.

SECTION 1304. APPROVAL FOR DISCONTINUANCE OR SETTLEMENT. A derivative action to enforce a right of a limited cooperative association may not be discontinued or settled without the court's approval.

Comment

Discontinuance or settlement of a derivative action must be approved by the court. This acts as a prophylactic against strike suits where a member-plaintiff brings an action with the primary objective to obtain a private settlement.

The Section does not address whether a court must provide notice to any members who might be affected by discontinuance of a derivative suit or a settlement. The court has discretion to determine what information should be provided to others in its judicial administration of the suit.

SECTION 1305. PROCEEDS AND EXPENSES .

(a) Except as otherwise provided in subsection (b):

(1) any proceeds or other benefits of a derivative action to enforce a right of a limited cooperative association, whether by judgment, compromise, or settlement, belong to the association and not to the plaintiff; and

(2) if the plaintiff in the derivative action receives any proceeds, the plaintiff shall immediately remit them to the association.

(b) If a derivative action to enforce a right of a limited cooperative association is successful in whole or in part, the court may award the plaintiff reasonable expenses, including reasonable attorney's fees and costs, from the recovery of the association.

Comment

Source: RULLCA (2006) § 906; ULPA (2001) § 1005; RULPA (1976/1985) § 1004.]

[ARTICLE] 14

FOREIGN COOPERATIVES

SECTION 1401. GOVERNING LAW.

(a) The law of the state or other jurisdiction under which a foreign cooperative is organized governs relations among the members of the foreign cooperative and between the members and the foreign cooperative.

(b) A foreign cooperative may not be denied a certificate of authority because of any difference between the law of the jurisdiction under which the foreign cooperative is organized and the law of this state.

(c) A certificate of authority does not authorize a foreign cooperative to engage in any activity or exercise any power that a limited cooperative association may not engage in or exercise in this state.

Comment

Source: Derived from ULPA (2001) § 901.

The definition of a "foreign cooperative" in Section 102(12) identifies a foreign cooperative as an entity organized under a law "similar" to this Act. This contemplates a statute (in another jurisdiction) that provides for entities of the same general type as a limited cooperative association under this Act, but does not require the other statute to contain provisions that are the same as provisions in this Act.

Subsection (c) – This subsection is consistent with other organizational law and makes it clear that a foreign cooperative with a certificate of authority has no greater authority to conduct activities in this state than a limited cooperative association organized in this state. This subsection and Section 109 are to be applied in a consistent manner.

SECTION 1402. APPLICATION FOR CERTIFICATE OF AUTHORITY .

(a) A foreign cooperative may apply for a certificate of authority by delivering an application to the [Secretary of State] for filing. The application must state:

(1) the name of the foreign cooperative and, if the name does not comply with Section 111, an alternative name adopted pursuant to Section 1405;

(2) the name of the state or other jurisdiction under whose law the foreign cooperative is organized;

(3) the street address and, if different, mailing address of the principal office and, if the law of the jurisdiction under which the foreign cooperative is organized requires the foreign cooperative to maintain another office in that jurisdiction, the street address and, if different, mailing address of the required office;

(4) the street address and, if different, mailing address of the foreign cooperative's designated office in this state, and the name of the foreign cooperative's agent for service of process at the designated office; and

(5) the name, street address and, if different, mailing address of each of the foreign cooperative's current directors and officers.

(b) A foreign cooperative shall deliver with a completed application under subsection (a) a certificate of good standing [or existence] or a similar record signed by the [Secretary of State] or other official having custody of the foreign cooperative's publicly filed records in the state or other jurisdiction under whose law the foreign cooperative is organized.

Legislative Note: *This [Act] refers to a certificate of good standing rather than a certificate of existence. If an adopting jurisdiction generally uses the term "certificate of existence" that term should be substituted for "certificate of good standing" in subsection (b).*

Comment

Source: RULLCA (2006) § 802; ULPA (2001) § 902, which was based on ULLCA § 1002.

Subsection (a)(3) – The requirement for the address of the "other office" of the foreign cooperative in the jurisdiction of its organization, if one is required by the other jurisdiction, is to give the Secretary of State an additional initial address in the application process for purposes of

administrative convenience. The requirement may also provide some practical assistance to third parties conducting due diligence on other matters. Unlike other information in this Section, this address is not required to be updated elsewhere in the Act.

Subsection (a)(6) – The foreign cooperative's current directors and their addresses must be listed in an application for a certificate of authority.

SECTION 1403. ACTIVITIES NOT CONSTITUTING TRANSACTING BUSINESS .

(a) Activities of a foreign cooperative which do not constitute transacting business in this state under this [article] include:

(1) maintaining, defending, and settling an action or proceeding;

(2) holding meetings of the foreign cooperative's members or directors or carrying on any other activity concerning the foreign cooperative's internal affairs;

(3) maintaining accounts in financial institutions;

(4) maintaining offices or agencies for the transfer, exchange, and registration of the foreign cooperative's own securities or maintaining trustees or depositories with respect to those securities;

(5) selling through independent contractors;

(6) soliciting or obtaining orders, whether by mail or electronic means, through employees, agents, or otherwise, if the orders require acceptance outside this state before they become contracts;

(7) creating or acquiring indebtedness, mortgages, or security interests in real or personal property;

(8) securing or collecting debts or enforcing mortgages or other security interests in property securing the debts, and holding, protecting, and maintaining property so acquired;

(9) conducting an isolated transaction that is completed within 30 days and is not one in the course of similar transactions; and

(10) transacting business in interstate commerce.

(b) For purposes of this [article], the ownership in this state of income-producing real property or tangible personal property, other than property excluded under subsection (a), constitutes transacting business in this state.

(c) This section does not apply in determining the contacts or activities that may subject a foreign cooperative to service of process, taxation, or regulation under law of this state other than this [act].

Comment

Source: RULLCA (2006) § 803; ULPA (2001) § 903, which was based on ULLCA § 1003.

The interpretation of subsection (a) must be interpreted with subsection (b). For example, if a foreign cooperative maintains a physical presence in this state it would likely be transacting business under subsection (b) even if the only activities conducted are those identified in subsection (a).

Subsection (a)(10) – The better interpretation of this subsection is that "interstate commerce" means *exclusively* in interstate commerce. For example, a limited cooperative association that regularly transports product by truck from Wyoming to Minnesota using Interstate Highway 90 would not solely by that conduct, be transacting business in South Dakota.

SECTION 1404. ISSUANCE OF CERTIFICATE OF AUTHORITY . Unless the [Secretary of State] determines that an application for a certificate of authority does not comply with the filing requirements of this [act], the [Secretary of State], upon payment by the foreign cooperative of all filing fees, shall file the application, issue a certificate of authority, and send a copy of the filed certificate, together with a receipt for the fees, to the foreign cooperative or its representative.

Comment

Source: RULLCA (2006) § 804; ULPA (2001) § 904, which was based on ULLCA § 1004 and RULPA § 903.

A certificate of authority under this Section is different than a certificate of authorization furnished under Section 206(b). The certificate of authorization under Section 206(b) certifies that a foreign cooperative has obtained a certificate of authority under this Section.

SECTION 1405. NONCOMPLYING NAME OF FOREIGN COOPERATIVE .

(a) A foreign cooperative whose name does not comply with Section 111 may not obtain a certificate of authority until it adopts, for the purpose of transacting business in this state, an alternative name that complies with Section 111. A foreign cooperative that adopts an alternative name under this subsection and then obtains a certificate of authority with that name need not also comply with [reference this state's fictitious or assumed name statute]. After obtaining a certificate of authority with an alternative name, a foreign cooperative's business in this state must be transacted under that name unless the foreign cooperative is authorized under [reference this state's fictitious or assumed name statute] to transact business in this state under another name.

(b) If a foreign cooperative authorized to transact business in this state changes its name to one that does not comply with Section 111, it may not thereafter transact business in this state until it complies with subsection (a) and obtains an amended certificate of authority.

Comment

Source: RULLCA (2006) § 805; ULPA (2001) § 905, which was based on ULLCA § 1005.

SECTION 1406. REVOCATION OF CERTIFICATE OF AUTHORITY .

(a) A certificate of authority may be revoked by the [Secretary of State] in the manner provided in subsection (b) if the foreign cooperative does not:

(1) pay, not later than 60 days after the due date, any fee, tax, or penalty due to the [Secretary of State] under this [act] [or law of this state other than this [act]];

(2) deliver, not later than 60 days after the due date, its annual report;

(3) appoint and maintain an agent for service of process; or

(4) deliver for filing a statement of change not later than 30 days after a change has occurred in the name of the agent or the address of the foreign cooperative's designated office.

(b) To revoke a certificate of authority, the [Secretary of State] must file a notice of revocation and send a copy to the foreign cooperative's registered agent for service of process in this state or, if the foreign cooperative does not appoint and maintain an agent for service of process in this state, to the foreign cooperative's principal office. The notice must state:

(1) the revocation's effective date, which must be at least 60 days after the date the [Secretary of State] sends the copy; and

(2) the foreign cooperative's noncompliance that is the reason for the revocation.

(c) The authority of a foreign cooperative to transact business in this state ceases on the effective date of the notice of revocation unless before that date the foreign cooperative cures each failure to comply stated in the notice. If the foreign cooperative cures the failures, the [Secretary of State] shall so indicate on the filed notice.

Legislative Note: *In adopting jurisdictions that do not generally permit a certificate of authority to be revoked because entities do not pay required fees, taxes or penalties to governmental agencies other than the [Secretary of State], the words "or law of this state other than this [act]" in subsection (a) should be deleted. If an adopting jurisdiction provides for fees, taxes or penalties in another statute, reference to that statute should be made in subsection (a).*

Comment

Source: RULLCA (2006) § 806; ULPA (2001) § 906, which was based on ULLCA § 1006.

SECTION 1407. CANCELLATION OF CERTIFICATE OF AUTHORITY; EFFECT OF FAILURE TO HAVE CERTIFICATE .

(a) To cancel its certificate of authority, a foreign cooperative must deliver to the [Secretary of State] for filing a notice of cancellation. The certificate is canceled when the notice becomes effective under Section 203.

(b) A foreign cooperative transacting business in this state may not maintain an action or proceeding in this state unless it has a certificate of authority.

(c) The failure of a foreign cooperative to have a certificate of authority does not impair the validity of a contract or act of the foreign cooperative or prevent the foreign cooperative from defending an action or proceeding in this state.

(d) A member of a foreign cooperative is not liable for the obligations of the foreign cooperative solely by reason of the foreign cooperative's having transacted business in this state without a certificate of authority.

(e) If a foreign cooperative transacts business in this state without a certificate of authority or cancels its certificate, it appoints the [Secretary of State] as its agent for service of process for an action arising out of the transaction of business in this state.

Comment

Source: RULLCA (2006) §§ 807 and 808; ULPA (2001) § 907, which was based on RULPA § 907(d) and ULLCA § 1008.

SECTION 1408. ACTION BY [ATTORNEY GENERAL] . The [Attorney General] may maintain an action to restrain a foreign cooperative from transacting business in this state in violation of this [article].

Comment

Source: RULLCA (2006) § 809; ULPA (2001) § 908, which was based on RULPA § 908 and ULLCA § 1009.

[ARTICLE] 15

DISPOSITION OF ASSETS

SECTION 1501. DISPOSITION OF ASSETS NOT REQUIRING MEMBER APPROVAL. Unless the articles of organization otherwise provide, member approval under Section 1502 is not required for a limited cooperative association to:

(1) sell, lease, exchange, license, or otherwise dispose of all or any part of the assets of the association in the usual and regular course of business; or

(2) mortgage, pledge, dedicate to the repayment of indebtedness, or encumber in any way all or any part of the assets of the association whether or not in the usual and regular course of business.

Comment

This Section and Article do not have express counterparts in RULLCA (2006), ULPA (2001), or RUPA (1997), though in application those acts provide for similar heightened voting as matter of default in the context of a disposition of assets. For example, Section 401(j) of RUPA (1997) provides that a majority of partners may decide matters arising "in the ordinary course of business" while an "act outside the ordinary course of business . . . and an amendment to the partnership agreement may be undertaken only with the consent of all the partners." This Act similarly requires, unless the articles otherwise provide, the same voting standard and mechanism for dispositions of assets as for amending the articles of organization if the disposition is outside the usual and regular course of business. *See* Section 1502.

This Section allows a limited cooperative association the flexibility to deal with its assets as required by modern business practices. No member approval is required for asset dispositions if they occur in the usual and regular course of business.

> **EXAMPLE**: A limited cooperative association of artisans purchases wares from its artisan members. It is organized in such a way that the artisans' ship wares from their personal studios located in twenty different states to a temporary market location in a different city every three months. The association leases market space in each city for one week and sells substantially all of the inventory of wares shipped to that location. The only other assets the association has are a small leased home office, leased telecommunication equipment and two personal computers. The sale of all the association's inventory of wares is in the usual and regular course of business and this Article

does not require member approval for its disposition even though the sale of the inventory represents substantially all of the assets of the association.

SECTION 1502. MEMBER APPROVAL OF OTHER DISPOSITION OF ASSETS. A sale, lease, exchange, license, or other disposition of assets of a limited cooperative association, other than a disposition described in Section 1501, requires approval of the association's members under Sections 1503 and 1504 if the disposition leaves the association without significant continuing business activity.

Comment

The test in determining whether member approval is necessary for the disposition of assets is not alone a matter of the nominal value of the assets to be disposed or the relative percentage of the value of assets disposed to the value of the assets owned by the limited cooperative association. This Section, together with Section 1501, focuses the inquiry on whether the disposition is in the regular or usual course of business of the association and how the disposition effects the association's existence, purpose, and continued activity.

A primary reason for requiring member approval for the disposition of assets outside the usual and regular course of business is because such a sale may be used as a transactional substitute or a piece of a transactional substitute for a merger or conversion.

SECTION 1503. NOTICE AND ACTION ON DISPOSITION OF ASSETS. For a limited cooperative association to dispose of assets under Section 1502:

(1) a majority of the board of directors, or a greater percentage if required by the organic rules, must approve the proposed disposition; and

(2) the board of directors must call a members meeting to consider the proposed disposition, hold the meeting not later than 90 days after approval of the proposed disposition by the board, and mail or otherwise transmit or deliver in a record to each member:

(A) the terms of the proposed disposition;

(B) a recommendation that the members approve the disposition, or if the board determines that because of conflict of interest or other special circumstances it should not make a favorable recommendation, the basis for that determination;

(C) a statement of any condition of the board's submission of the proposed disposition to the members; and

(D) notice of the meeting at which the proposed disposition will be considered, which must be given in the same manner as notice of a special meeting of members.

SECTION 1504. DISPOSITION OF ASSETS.

(a) Subject to subsection (b), a disposition of assets under Section 1502 must be approved by:

(1) at least two-thirds of the voting power of members present at a members meeting called under Section 1503(2); and

(2) if the limited cooperative association has investor members, at least a majority of the votes cast by patron members, unless the organic rules require a greater percentage vote by patron members.

(b) The organic rules may require that the percentage of votes under subsection (a)(1) is:

(1) a different percentage that is not less than a majority of members voting at the meeting;

(2) measured against the voting power of all members; or

(3) a combination of paragraphs (1) and(2).

(c) Subject to any contractual obligations, after a disposition of assets is approved and at any time before the consummation of the disposition, a limited cooperative association may

approve an amendment to the contract for disposition or the resolution authorizing the disposition or approve abandonment of the disposition:

(1) as provided in the contract or the resolution; and

(2) except as prohibited by the resolution, with the same affirmative vote of the board of directors and of the members as was required to approve the disposition.

(d) The voting requirements for districts, classes, or voting groups under Section 404 apply to approval of a disposition of assets under this [article].

Comment

Action on the proposed disposition of assets is coordinated with voting on amendments to the articles of organization. *See* Section 405 and Comment to Section 405.

[ARTICLE] 16

CONVERSION AND MERGER

SECTION 1601. DEFINITIONS . In this [article]:

(1) "Constituent entity" means an entity that is a party to a merger.

(2) "Constituent limited cooperative association" means a limited cooperative association that is a party to a merger.

(3) "Converted entity" means the organization into which a converting entity converts pursuant to Sections 1602 through 1605.

(4) "Converting entity" means an entity that converts into another entity pursuant to Sections 1602 through 1605.

(5) "Converting limited cooperative association" means a converting entity that is a limited cooperative association.

(6) "Organizational documents" means articles of incorporation, bylaws, articles of organization, operating agreements, partnership agreements, or other documents serving a similar function in the creation and governance of an entity.

(7) "Personal liability" means personal liability for a debt, liability, or other obligation of an entity imposed, by operation of law or otherwise, on a person that co-owns or has an interest in the entity:

(A) by the entity's organic law solely because of the person co-owning or having an interest in the entity; or

(B) by the entity's organizational documents under a provision of the entity's organic law authorizing those documents to make one or more specified persons liable for all or

specified parts of the entity's debts, liabilities, and other obligations solely because the person co-owns or has an interest in the entity.

(8) "Surviving entity" means an entity into which one or more other entities are merged, whether the entity existed before the merger or is created by the merger.

Comment

Source: Derived from RULLCA (2006) § 1001, ULPA (2001) § 1101.

This Section and Article are closely derived from RULLCA (2006) and is generally designed to be consistent with the Model Entity Transaction Act. Modifications are made, however, because this Act does not provide for domestifications. Consistent with those acts, this Act does not provide for divisions.

As with many provisions in this Act, fundamental changes like mergers and conversions may have significant income and other tax implications. Some of these implications may be catastrophic to the association or its members.

SECTION 1602. CONVERSION.

(a) An entity that is not a limited cooperative association may convert to a limited cooperative association and a limited cooperative association may convert to an entity that is not a limited cooperative association pursuant to this section, Sections 1603 through 1605, and a plan of conversion, if:

(1) the other entity's organic law authorizes the conversion;

(2) the conversion is not prohibited by the law of the jurisdiction that enacted the other entity's organic law; and

(3) the other entity complies with its organic law in effecting the conversion.

(b) A plan of conversion must be in a record and must include:

(1) the name and form of the entity before conversion;

(2) the name and form of the entity after conversion;

(3) the terms and conditions of the conversion, including the manner and basis for converting interests in the converting entity into any combination of money, interests in the converted entity, and other consideration; and

(4) the organizational documents of the proposed converted entity.

Comment

Source: RULLCA (2006) § 1006, ULPA (2001) § 1102.

In a statutory conversion an existing entity changes its form and, in addition, may change the jurisdiction of its governing statute. It is important to understand two fundamental items concerning conversions under this Act. As a matter of operative rules, this Act only governs one side of the transaction. That is, it provides the law governing only those matters directly relating to limited cooperative associations organized in this state under this Act. For example, if a traditional cooperative desires to "convert" to a limited cooperative association governed by this Act, the statute under which the cooperative is formed must allow such a conversion. This operational aspect of the Act, however, reflects more than just the typical boundary of scope between acts governing different types of organizations. It also reflects policy at a deeper level because the limited cooperative association permits investor members which may change the dynamic as compared to existing cooperatives. For both scope and policy reasons, therefore, this Act does not attempt to change the law of other organizations by allowing or encouraging conversion, in the illustration, from a traditional cooperative form to a limited cooperative form. Effecting those kinds of policy decisions is beyond the scope of this Act. Conversions implicate the federal income tax and, depending on the particular parties to the conversion, could have significant tax consequences.

For the general operation of this Section see Comment to Section 1606 ("Merger").

SECTION 1603. ACTION ON PLAN OF CONVERSION BY CONVERTING LIMITED COOPERATIVE ASSOCIATION.

(a) For a limited cooperative association to convert to another entity, a plan of conversion must be approved by a majority of the board of directors, or a greater percentage if required by the organic rules, and the board of directors must call a members meeting to consider the plan of conversion, hold the meeting not later than 90 days after approval of the plan by the board, and mail or otherwise transmit or deliver in a record to each member:

(1) the plan, or a summary of the plan and a statement of the manner in which a copy of the plan in a record may be reasonably obtained by a member;

(2) a recommendation that the members approve the plan of conversion, or if the board determines that because of a conflict of interest or other circumstances it should not make a favorable recommendation, the basis for that determination;

(3) a statement of any condition of the board's submission of the plan of conversion to the members; and

(4) notice of the meeting at which the plan of conversion will be considered, which must be given in the same manner as notice of a special meeting of members.

(b) Subject to subsections (c) and (d), a plan of conversion must be approved by:

(1) at least two-thirds of the voting power of members present at a members meeting called under subsection (a); and

(2) if the limited cooperative association has investor members, at least a majority of the votes cast by patron members, unless the organic rules require a greater percentage vote by patron members.

(c) The organic rules may require that the percentage of votes under subsection (b)(1) is:

(1) a different percentage that is not less than a majority of members voting at the meeting;

(2) measured against the voting power of all members; or

(3) a combination of paragraphs (1) and (2).

(d) The vote required to approve a plan of conversion may not be less than the vote required for the members of the limited cooperative association to amend the articles of organization.

(e) Consent in a record to a plan of conversion by a member must be delivered to the limited cooperative association before delivery of articles of conversion for filing if as a result of the conversion the member will have:

(1) personal liability for an obligation of the association; or

(2) an obligation or liability for an additional contribution.

(f) Subject to subsection (e) and any contractual rights, after a conversion is approved and at any time before the effective date of the conversion, a converting limited cooperative association may amend a plan of conversion or abandon the planned conversion:

(1) as provided in the plan; and

(2) except as prohibited by the plan, by the same affirmative vote of the board of directors and of the members as was required to approve the plan.

(g) The voting requirements for districts, classes, or voting groups under Section 404 apply to approval of a conversion under this [article].

Comment

Action on the plan of conversion follows the procedure for proposing and voting on the amendment of the articles of organization under Article 4 and embodies similar policy concerns. *See* Section 405 and Comment to Section 405. The reason it does so is because conversions, like amendments to the articles of organizations, represent fundamental changes to the limited cooperative association. The sections need to be consistent because a conversion can, under some circumstances, effect the same result as an amendment and be used as a substitute therefore.

SECTION 1604. FILINGS REQUIRED FOR CONVERSION; EFFECTIVE DATE.

(a) After a plan of conversion is approved:

(1) a converting limited cooperative association shall deliver to the [Secretary of State] for filing articles of conversion, which must include:

(A) a statement that the limited cooperative association has been converted into another entity;

(B) the name and form of the converted entity and the jurisdiction of its governing statute;

(C) the date the conversion is effective under the governing statute of the converted entity;

(D) a statement that the conversion was approved as required by this [act];

(E) a statement that the conversion was approved as required by the governing statute of the converted entity; and

(F) if the converted entity is an entity organized in a jurisdiction other than this state and is not authorized to transact business in this state, the street address and, if different, mailing address of an office which the [Secretary of State] may use for purposes of Section 120; and

(2) if the converting entity is not a converting limited cooperative association, the converting entity shall deliver to the [Secretary of State] for filing articles of organization, which must include, in addition to the information required by Section 302:

(A) a statement that the association was converted from another entity;

(B) the name and form of the converting entity and the jurisdiction of its governing statute; and

(C) a statement that the conversion was approved in a manner that complied with the converting entity's governing statute.

(b) A conversion becomes effective:

(1) if the converted entity is a limited cooperative association, when the articles of conversion take effect pursuant to Section 203(c); or

(2) if the converted entity is not a limited cooperative association, as provided by the governing statute of the converted entity.

Comment

Source: RULLCA (2006) § 1008, ULPA (2001) § 1104.

SECTION 1605. EFFECT OF CONVERSION.

(a) An entity that has been converted pursuant to this [article] is for all purposes the same entity that existed before the conversion and is not a new entity but, after conversion, is organized under the organic law of the converted entity and is subject to that law and other law as it applies to the converted entity.

(b) When a conversion takes effect under this [Article]:

(1) all property owned by the converting entity remains vested in the converted entity;

(2) all debts, liabilities, and other obligations of the converting entity continue as obligations of the converted entity;

(3) an action or proceeding pending by or against the converting entity may be continued as if the conversion had not occurred;

(4) except as prohibited by other law, all the rights, privileges, immunities, powers, and purposes of the converting entity remain vested in the converted entity;

(5) except as otherwise provided in the plan of conversion, the terms and conditions of the plan of conversion take effect; and

(6) except as otherwise provided in the plan of conversion, the conversion does not dissolve a converting limited cooperative association for purposes of [Article] 12.

(c) A converted entity that is an entity organized under the laws of a jurisdiction other than this state consents to the jurisdiction of the courts of this state to enforce any obligation owed by the converting limited cooperative association if, before the conversion, the converting limited cooperative association was subject to suit in this state on the obligation. A converted entity that is an entity organized under the laws of a jurisdiction other than this state and not authorized to transact business in this state appoints the [Secretary of State] as its agent for service of process for purposes of enforcing an obligation under this subsection. Service on the [Secretary of State] under this subsection is made in the same manner and with the same consequences as under Section 120(c) and (d).

Comment

Source: RULLCA (2006) § 10091, ULPA (2001) § 1005. *See also* META (2007) § 406.

The primary distinction between a merger and a conversion is that a conversion involves a single entity. A conversion changes an entity's legal type, but does not create a new entity in spite of the change. This Section states the state organic law effect of a conversion. *See generally*, Comment 1 to META (2007) § 406.

SECTION 1606. MERGER .

(a) One or more limited cooperative associations may merge with one or more other entities pursuant to this [article] and a plan of merger if:

(1) the governing statute of each of the other entities authorizes the merger;

(2) the merger is not prohibited by the law of a jurisdiction that enacted any of those governing statutes; and

(3) each of the other entities complies with its governing statute in effecting the merger.

(b) A plan of merger must be in a record and must include:

(1) the name and form of each constituent entity;

(2) the name and form of the surviving entity and, if the surviving entity is to be created by the merger, a statement to that effect;

(3) the terms and conditions of the merger, including the manner and basis for converting the interests in each constituent entity into any combination of money, interests in the surviving entity, and other consideration;

(4) if the surviving entity is to be created by the merger, the surviving entity's organizational documents;

(5) if the surviving entity is not to be created by the merger, any amendments to be made by the merger to the surviving entity's organizational documents; and

(6) if a member of a constituent limited cooperative association will have personal liability with respect to a surviving entity, the identity of the member by descriptive class or other reasonable manner.

Comment

Source: RULLCA (2006) § 1002; ULPA (2001) § 1106.

This Section and the following sections in this Article only apply to a limited cooperative association that is a constituent entity in a merger. The members of an association that is a constituent entity have the rights and obligations provided elsewhere in this Act. A constituent entity that is not a limited cooperative association is governed by the law of its formation and its organizational documents. This is similar to conversions under this Act. For a discussion of practical and policy concerns see Comment to Section 1602. As a result, other law will determine whether a constituent entity that is not a limited cooperative association may merge with a limited cooperative association and, if so, the other law will establish the procedure to be followed by the other entity.

This Act is limited to state organic law. Obviously other law, such as state and federal tax law, may have a profound effect on the economic and financial consequences of any merger. Other law may also require notification or approval by a regulatory agency. *See* Section 109.

Subsection (b)(3) – A plan of merger, absent restrictions in the organic rules, may provide that some members will be "cashed-out" (paid money for their interests) while others will continue with the surviving entity as owners. Owners may receive different types of ownership under the plan. The Act, therefore, allows for great flexibility in merging limited cooperative associations themselves or merging them with other types of entities. Nonetheless, just as in the context of other entities, the terms are not without constraint and may violate obligations of the board of directors or contractual rights whether within the organic rules or outside those rules.

Subsection (b)(6) – This subsection is not expressly included in RULLCA (2006) or ULPA (2001) but appears in this Act as a reminder that Section 1608(d), like similar provisions in RULLCA (2006) and ULPA (2001), contains a mandatory consent requirement for members who have additional direct liability as a result of the merger.

SECTION 1607. NOTICE AND ACTION ON PLAN OF MERGER BY CONSTITUENT LIMITED COOPERATIVE ASSOCIATION.

(a) For a limited cooperative association to merge with another entity, a plan of merger must be approved by a majority vote of the board of directors or a greater percentage if required by the association's organic rules.

(b) The board of directors shall call a members meeting to consider a plan of merger approved by the board, hold the meeting not later than 90 days after approval of the plan by the board, and mail or otherwise transmit or deliver in a record to each member:

(1) the plan of merger, or a summary of the plan and a statement of the manner in which a copy of the plan in a record may be reasonably obtained by a member;

(2) a recommendation that the members approve the plan of merger, or if the board determines that because of conflict of interest or other special circumstances it should not make a favorable recommendation, the basis for that determination;

(3) a statement of any condition of the board's submission of the plan of merger to the members; and

(4) notice of the meeting at which the plan of merger will be considered, which must be given in the same manner as notice of a special meeting of members.

Comment

Sections 1607 and 1608 are parallel to Section 1604 which deals with the same topic in the context of conversions.

SECTION 1608. APPROVAL OR ABANDONMENT OF MERGER BY MEMBERS.

(a) Subject to subsections (b) and (c), a plan of merger must be approved by:

(1) at least two-thirds of the voting power of members present at a members meeting called under Section 1607(b); and

(2) if the limited cooperative association has investor members, at least a majority of the votes cast by patron members, unless the organic rules require a greater percentage vote by patron members.

(b) The organic rules may provide that the percentage of votes under subsection (a)(1) is:

(1) a different percentage that is not less than a majority of members voting at the meeting;

(2) measured against the voting power of all members; or

(3) a combination of paragraphs (1) and (2).

(c) The vote required to approve a plan of merger may not be less than the vote required for the members of the limited cooperative association to amend the articles of organization.

(d) Consent in a record to a plan of merger by a member must be delivered to the limited cooperative association before delivery of articles of merger for filing pursuant to Section 1609 if as a result of the merger the member will have:

(1) personal liability for an obligation of the association; or

(2) an obligation or liability for an additional contribution.

(e) Subject to subsection (d) and any contractual rights, after a merger is approved, and at any time before the effective date of the merger, a limited cooperative association that is a party to the merger may approve an amendment to the plan of merger or approve abandonment of the planned merger:

(1) as provided in the plan; and

(2) except as prohibited by the plan, with the same affirmative vote of the board of directors and of the members as was required to approve the plan.

(f) The voting requirements for districts, classes, or voting groups under Section 404 apply to approval of a merger under this [article].

Comment

Source: RULLCA (2006) § 1004; ULPA (2001) § 1108.

Subsection (d) – *See* Comment to Section 1606(b)(6).

SECTION 1609. FILINGS REQUIRED FOR MERGER; EFFECTIVE DATE.

(a) After each constituent entity has approved a merger, articles of merger must be signed on behalf of each constituent entity by an authorized representative.

(b) The articles of merger must include:

(1) the name and form of each constituent entity and the jurisdiction of its governing statute;

(2) the name and form of the surviving entity, the jurisdiction of its governing statute, and, if the surviving entity is created by the merger, a statement to that effect;

(3) the date the merger is effective under the governing statute of the surviving entity;

(4) if the surviving entity is to be created by the merger and:

(A) will be a limited cooperative association, the limited cooperative association's articles of organization; or

(B) will be an entity other than a limited cooperative association, the organizational document that creates the entity;

(5) if the surviving entity is not created by the merger, any amendments provided for in the plan of merger to the organizational document that created the entity;

(6) a statement as to each constituent entity that the merger was approved as required by the entity's governing statute;

(7) if the surviving entity is a foreign organization not authorized to transact business in this state, the street address and, if different, mailing address of an office which the [Secretary of State] may use for the purposes of Section 120; and

(8) any additional information required by the governing statute of any constituent entity.

(c) Each limited cooperative association that is a party to a merger shall deliver the articles of merger to the [Secretary of State] for filing.

(d) A merger becomes effective under this [article]:

(1) if the surviving entity is a limited cooperative association, upon the later of:

(A) compliance with subsection (c); or

(B) subject to Section 203(c), as specified in the articles of merger; or

(2) if the surviving entity is not a limited cooperative association, as provided by the governing statute of the surviving entity.

Comment

Source: RULLCA § 1004; ULPA (2001) § 1108.

Subsection (d) – The governing law of the surviving entity determines the effective date of the merger. *See also* subsection (b)(3).

SECTION 1610. EFFECT OF MERGER.

(a) When a merger becomes effective:

(1) the surviving entity continues or comes into existence;

(2) each constituent entity that merges into the surviving entity ceases to exist as a separate entity;

(3) all property owned by each constituent entity that ceases to exist vests in the surviving entity;

(4) all debts, liabilities, and other obligations of each constituent entity that ceases to exist continue as obligations of the surviving entity;

(5) an action or proceeding pending by or against any constituent entity that ceases to exist may be continued as if the merger had not occurred;

(6) except as prohibited by law other than this [act], all rights, privileges, immunities, powers, and purposes of each constituent entity that ceases to exist vest in the surviving entity;

(7) except as otherwise provided in the plan of merger, the terms and conditions of the plan take effect;

(8) except as otherwise provided in the plan of merger, if a merging limited cooperative association ceases to exist, the merger does not dissolve the association for purposes of [Article] 12;

(9) if the surviving entity is created by the merger and:

(A) is a limited cooperative association, the articles of organization become effective; or

(B) is an entity other than a limited cooperative association, the organizational document that creates the entity becomes effective; and

(10) if the surviving entity is not created by the merger, any amendments made by the articles of merger for the organizational documents of the surviving entity become effective.

(b) A surviving entity that is an entity organized under the laws of a jurisdiction other than this state consents to the jurisdiction of the courts of this state to enforce any obligation owed by the constituent entity if, before the merger, the constituent entity was subject to suit in this state on the obligation. A surviving entity that is an entity organized under the laws of a jurisdiction other than this state and not authorized to transact business in this state appoints the [Secretary of State] as its agent for service of process for purposes of enforcing an obligation under this subsection. Service on the [Secretary of State] under this subsection is made in the same manner and with the same consequences as in Section 120(c) and (d).

Comment

Source: RULLCA (2006) § 1005; ULPA (2001) § 1109.

This Section parallels Section 1605 ("Effect of Conversion").

SECTION 1611. CONSOLIDATION.

(a) Constituent entities that are limited cooperative associations or foreign cooperatives may agree to call a merger a consolidation under this [article].

(b) All provisions governing mergers or using the term merger in this [act] apply equally to mergers that the constituent entities choose to call consolidations under subsection (a).

Comment

The use of the term “consolidation” as a term of art is becoming rare in the law of business organizations. This act follows modern organizational law that recognizes consolidations are legally the same as mergers. The “consolidation” nomenclature, however, remains in some cooperative law and practice. This Section reflects that use.

SECTION 1612. [ARTICLE] NOT EXCLUSIVE . This [article] does not prohibit a limited cooperative association from being converted or merged under law other than this [act].

Comment

Source: RULLCA (2006) § 1015, ULPA (2001) § 1113.

[ARTICLE] 17

MISCELLANEOUS PROVISIONS

SECTION 1701. UNIFORMITY OF APPLICATION AND CONSTRUCTION. In applying and construing this uniform act, consideration must be given to the need to promote uniformity of the law with respect to its subject matter among states that enact it.

Comment

Source: RULLCA (2006) § 1101; ULPA (2001) § 1201.

SECTION 1702. RELATION TO ELECTRONIC SIGNATURES IN GLOBAL AND NATIONAL COMMERCE ACT. This [act] modifies, limits, or supersedes the federal Electronic Signatures in Global and National Commerce Act, 15 U.S.C. Section 7001 et seq., but does not modify, limit, or supersede Section 101(c) of that act, 15 U.S.C. Section 7001(c) or authorize electronic delivery of any of the notices described in Section 103(b) of that act, 15 U.S.C. Section 7003(b).

Comment

Source: RULLCA (2006) § 1102.

SECTION 1703. SAVINGS CLAUSE. This [act] does not affect an action or proceeding commenced, or right accrued, before [the effective date of this [act]].

Comment

Source: RULLCA (2006) § 1103.

SECTION 1704. EFFECTIVE DATE. This [act] takes effect [effective date].

***Legislative Note**: If the adopting jurisdiction has an existing act similar to this Act (as of August 2, 2007, there were six such states), it should consider adding a new section immediately after Section 1704 providing for a phasing in of this Act's application to existing limited cooperative associations and might consider repealing the existing statute. The Revised Uniform Limited Liability Company Act (2006) (which addresses this same issue because adopting jurisdictions of*

RULLCA have in place existing LLC statutes) provides an illustrative sample for phasing in application as follows:

APPLICATION TO EXISTING RELATIONSHIPS

> *(a) Before [all-inclusive date], this [act] governs only:*
>
> *(1) a limited liability company formed on or after [the effective date of this Act]; and*
>
> *(2) except as otherwise provided in subsection (c), a limited liability company formed before [the effective date of this act] which elects, in the manner provided in its operating agreement or by law for amending the operating agreement, to be subject to this [act].*
>
> *(b) Except as otherwise provided in subsection (c), on and after [all-inclusive date] this [act] governs all limited liability companies.*
>
> *(c) For the purposes applying this [act] to a limited liability company formed before [the effective date of this act]:*
>
> *(1) the company's articles of organization are deemed to be the company's certificate of organization; and*
>
> *(2) for the purposes of applying Section 102(1) and subject to Section 112(d), language in the company's articles of organization designating the company's management structure operates as if that language were in the operating agreement.*

The Legislative Note to RULLCA states, in relevant part:

> *It is recommended that the "all-inclusive" date should be at least one year after the date of enactment but no longer than two years.*
>
> *Each enacting jurisdiction should consider whether: (i) this Act makes material changes to the "default" (or "gap filler") rules of jurisdiction's predecessor statute; and (ii) if so, whether subsection (c) should carry forward any of those rules for pre-existing limited liability companies. In this assessment, the focus is on pre-existing limited liability companies that have left default rules in place, whether advisedly or not. The central question is whether, for such limited liability companies, expanding subsection (c) is necessary to prevent material changes to the members' "deal."*

> *For an example of this type of analysis in the context of another business entity act, see the Uniform Limited Partnership Act (2001), § 1206(c).*

Of course, the specific cross-references to RULLCA provisions in the sample language would not apply to this Act. They are included here for illustrative purposes only.

Comment

Source: ULPA (2001) § 1204.