

D R A F T
FOR DISCUSSION ONLY

UNIFORM COOPERATIVE ASSOCIATION ACT

NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS

For Committee on Style Meeting January 19-22, 2006

WITH PREFATORY AND REPORTER'S NOTES

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By
NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS

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UNIFORM COOPERATIVE ASSOCIATION ACT

PREFATORY NOTE

(1) Introduction and Process

The Committee is charged with drafting a Cooperative Association Act. *The Act is to be a free-standing act separate and apart from current cooperative acts and, therefore, is not a statutory replacement of other law but; rather, another statutory option for organizing cooperatives as a way to encourage economic development.*

It is important to remember that this act does not replace any existing state co-op laws and, therefore, fulfills a different niche in the cooperative economic ecosystem. Thus, some provisions will be different than the more corporate-like framework of existing traditional statutes. It is intended to provide a cooperative structure as an alternative to the LLC; and, in some ways, “investor participants” are similar to limited partners in a limited partnership. It seeks to provide an alternative which accounts cooperative principles to a *greater* extent, with *less* room for design abuse than can be engineered in a combination of entities. Nonetheless, though some features of the cooperative association are very similar to the features of other entities and descriptive analogies to other entities may be helpful, it is imperative to understand that the cooperative association is a unique entity with important distinctions from each of the other entities to which it is often compared.

The Committee’s scope was originally limited to “Agriculture and Agriculture Related” purposes. In effect, neither the Iowa nor Minnesota Acts are limited to agriculture.

An overarching question raised by this project, and discussed at the Drafting Committee meetings, is what it means to be a cooperative. Older traditional statutes have found meaning and form by finding the definition of a cooperative in other law or by stating that the cooperative must be operated pursuant to a “cooperative plan,” a term that is undefined and without fixed meaning even within the industry. As a practical matter, perhaps, the most important definition of “cooperative” appears under the guise of the definition of operating on a “cooperative basis” found in federal income tax law. A brief illustrative discussion of some of those definitions is contained in the next part of this preliminary note (“Cooperatives: Background Information”).

The definitions of these terms do a modicum of “evolvability” over time, at least on the margin (and concerning select issues). For example, the Service threw in the towel on the issue of whether operating on a cooperative basis required more than 50 percent of the cooperatives business be done with members on a patronage basis. (Rev. Rul. 93-21, 1993-1 C.B. 188, stating that the 50 percent threshold is not necessary). Further a frequently quoted passage from a *dissent* written by Justice Brandeis (and joined by Holmes) 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), 2788 U.S. 515 (1929) (Brandeis, J., dissenting, Westlaw p. 14).

Brandeis, as of 1929, also 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.

The genesis of the project was the enactment of the “Wyoming Processing Cooperative Law” in 2001 and the “Minnesota Cooperative Associations Act” in 2003. The Province of Saskatchewan enacted an Act for similar purposes that predated the Wyoming law. Tennessee and Iowa have enacted statutes based on the Minnesota Act. Wisconsin has introduced similar legislation the past two years but it has not been passed. Similar legislation was introduced in Vermont and Missouri but not passed.

(2) Cooperatives: General Background Information

Traditionally, cooperatives have been organized as corporations under State laws specifically enacted to authorize the creation of businesses operated on a cooperative basis. The statutes direct organizers to follow so-called cooperative principles of user-control, user-benefit, and user-ownership. Voting rights are only available to patron-users of the cooperative’s services and earnings are allocated to patrons on the basis of use, rather than on the basis of investment. Member-patrons are the primary source of equity, which is accumulated over time in the form of retained earnings allocated to equity accounts of the patrons on the basis of each patron’s pro rata share of business conducted each year with the cooperative. No market exists for this equity and it is usually only redeemable at face value by the cooperative at the discretion of the cooperative’s board of directors.

The new cooperative acts (Wyoming and Minnesota) on which this project is based are sometimes known as “New Generation Cooperative” (“NGC” acts) though that name has not gained a precise technical meaning and one of the primary reasons for this project is to attempt to gain a measure of uniformity between and among cooperative association acts as they are adopted by the states and to provide as well-drafted and considered an act as reasonably possible.

In fact, a new cooperative model gained some popularity, particularly in the Upper Midwest starting in the 1970’s. The features that distinguish *these* “New Generation”

cooperatives from traditional cooperatives include: (1) a new equity accumulation program based on substantial upfront investments by patron-members, (2) a tie-in between equity investment and the right and obligation to deliver a fixed quantity of product to the cooperative each year, and (3) a right of patron-members to transfer their equity to another person eligible to become a patron-member at whatever price is acceptable to both parties. While traditional cooperatives usually seek to maximize membership, New Generation cooperatives are “closed-end” with a limited number of members.

While New Generation cooperatives involve some significant departures from traditional cooperative structure, they have been organized under traditional cooperative statutes. Thus they have limited voting rights to patron-users and allocated earnings to users based on use.

The new cooperative acts on which this project is based are sometimes known as “LLC-Cooperative” laws though that name has not gained a precise technical meaning. They differ in several important ways from traditional cooperative laws. First, the entities created are unincorporated associations. Thus they have the option, under the Internal Revenue Service check-the-box regulations, to be taxed as partnerships rather than as cooperative associations. Second, up to 85 percent of the voting rights can be vested in non-patron investor members. And third, up to 85 percent of the earnings can be directed to non-patron investor members on the basis of investment. The stated purpose of those laws, as well as this project, is to provide a vehicle for economic development (especially, though by for exclusively in rural areas).

The new cooperative acts are more flexible than traditional cooperative acts and such flexibility moves away from fail-safe statutory drafting for purposes of qualifying as a “cooperative” under other federal and state law and regulation. The primary “other laws” are anti-trust law, taxation, securities law, and access to the Farm Credit System.

An example of how other laws relate to the law of cooperatives is the Capper-Volstead Act of 1922. Without the Capper-Volstead Act, the Sherman Act of 1890 would apply to make most farmer marketing contracts with cooperatives *per se* illegal restraints of trade because the contracts fix prices. That is, when farmers market products through cooperatives they agree on prices they will charge and may agree to sell *exclusively* to the cooperative. The Capper-Volstead Act provides limited, but important protection from the Sherman Act. In order for a cooperative to qualify for the protection: (1) only agricultural producers may be voting members; (2) the cooperative must be operated for the mutual benefit of members as producers; (3) no member may have more than one vote *or* dividends on stock may not exceed 8% per year; and (4) the value of products marketed for members must be greater than the value of products marketed for nonmembers. Many traditional state agricultural (and general purpose) cooperative statutes “hard-wire” compliance with Capper-Volstead by, for example, mandating the 8% dividend limit on equity. The LLC-Cooperative statutes, on the other hand, follow the general trend in unincorporated statutes by allowing a cooperative to *decide* whether to qualify for the antitrust protection provided by the Capper-Volstead Act. Thus, the 8% dividend limitation is not mandated by the LLC-Cooperative statutes.

Similarly, federal income tax law delineates requirements that associations must meet to qualify for taxation under Subchapter T of the Internal Revenue Code (patronage refunds not taxable at the cooperative level). The Code further delineates more requirements to qualify for tax treatment under Section 521 (for *farmer* cooperatives with additional tax benefits). Qualification for cooperative taxation, however, is inconsistent with tax treatment as a partnership. Thus, the LLC-Cooperative model allows flexibility for the organization to be taxed as a partnership or as a cooperative as the organization itself chooses. The LLC-Cooperative statutes enacted to date are an option to, not a replacement for, existing cooperative laws.

The Drafting Committee was established by the Conference at the 2003 Annual Meeting pursuant to a Study Report and met December 12-14, 2003. It has met each Spring and Fall since then. The first meeting of the Drafting Committee discussed substantive and general drafting and formatting issues, including the level of detail appropriate for the act and used the “Wyoming Processing Cooperative Law” as a model. The Committee determined that a higher level of detail than that found in the Wyoming law, following the general “look and feel” of general and traditional cooperative acts, was appropriate. Discussion at subsequent Drafting Committee meetings focused on substantive issues within the context of a draft following the Minnesota Cooperative Associations Act which integrated some of the substantive discussion from the first meeting.

The Drafting Committee was originally asked to prepare a “Uniform Agricultural and Agricultural Related Cooperatives Act.” However, at the 2005 NCCUSL Annual Meeting, the charge was amended to draft a “Uniform Cooperative Associations Act.” Thus the scope of the project was arguably expanded from a law targeted at agricultural cooperatives to one available to a wide range of enterprises. The reason for the change in scope sounded in both technical drafting and policy. *First*, the Conference struggled for nearly two years to devise a definition of “Agricultural and Agricultural Related” that was precise yet not both over and under inclusive. From that limited perspective the change in scope can be seen as a change in “inclusive/permissive” to “exclusive/prohibited” or, stated another way, from a positive to a negative definition. The foregoing change in approach was to remove ambiguity from the draft. *Second*, it was difficult to articulate a reasoned policy statement concerning why the act should be limited to “agricultural,” no matter how defined. *Finally*, the leading cooperative association laws as they currently exist are not limited to “agricultural” uses even though some notion of “agricultural” is included in their names. Thus, attempting to limit the application of the project to “agricultural” was inconsistent with existing acts and cast doubt about whether ULC could succeed its overarching organizational mission encouraging uniformity in state laws.

The current draft is the result of efforts by the Committee to move in this direction at a meeting held October 21-23, 2005. The Committee has had only limited opportunity to discuss the specific language of this draft and new issues raised by the change in the scope of this project. Moreover, the style committee has had the opportunity to review only select articles and while its suggestions have been largely incorporated in this articles, some of the “styled” provisions have been redrafted.

(3) Overview of this Draft

This draft draws from other organizational law including the Uniform Limited Partnership Act (2001), limited liability company acts, the Minnesota Cooperative Associations Act, several modern “traditional” cooperative acts, and the Model Business Corporation Act.

Even though the draft relies, in part, on general organizational law outside cooperatives, it makes every reasonable attempt to acknowledge the fact that cooperatives are a different kind of organization legally, historically, and functionally and that cooperative associations, in turn, add a dimension to traditional cooperatives. Thus, this draft has a strong member focus. For example, the bylaws must be amended by members and not the board of directors which is somewhat unusual even in cooperative law. The specific size and purpose of the cooperatives contemplated by this act, however, support the member focus. Moreover, unlike the trend in corporate law, this draft generally requires supermajority voting of members on fundamental matters.

On the other hand, this draft provides more flexibility for attracting capital from outside the community of agricultural producers and gives cooperatives the authority to erode producer capital lock-in in its organic rules. Thus, it allows wide latitude for both patron members (*e.g.* producers/users of the cooperative) and nonpatron members and provides, within limitations, for the sharing of net proceeds, surplus, or profit and governance participation between patron and nonpatron members. The constraints on investor participant participation in this draft are tighter than those found in most, if not all, the “new generation” cooperative statutes clearly distinguishing this cooperative draft from limited liability company statutes in an attempt to maintain the “co-op brand.”

The February 2006 Draft reflects a number of noteworthy Committee directions. For example:

(1) the nomenclature has changed from “member” to “participant”; from “nonpatron member” to “patron participant”;

(2) the term “association” has been inserted behind “cooperative” wherever appropriate both to avoid interpretive confusion and to emphasize this is a different type of cooperative within the umbrella term;

(3) this draft also changes the method of voting for purposes of Committee discussion in response to questions raised on the floor of the 2005 Annual Meeting such that fundamental changes require approval of both “classes” of participants;

(4) “conversions” have been added and another approach to integrate the term “consolidation” has been attempted by the reporters and, for the first time, the article on “sale of assets” has been drafted;

(5) the definitions have been completely reworked in light of the substantive changes made by the Committee in its on-going discussion (though a couple new ones including “business” and a term to replace the laundry list “net income” terms have yet to be discussed/proposed;

(6) the inconsistent treatment of proxy has been remedied (no proxies are allowed);

(7) the “Reporters Notes” on participant actions (derivative actions) and in selected other sections now reflect research conducted by the Reporter as requested by the Committee over the past two meetings; and,

(8) the “filings” were given substantial attention and editing though they need continued attention;

(9) the entire draft has undergone a heavy edit though the Style Committee will not be able to complete its review of this draft until after the February 2006 Committee Meeting.

This is a work still very much in process. There remain many technical drafting issues. For example this draft repeats the mantra “unless otherwise provided in the organic rules” almost endlessly instead of centralizing “nonwaivable” provisions by reference in a single section as *do* RUPA, ULPA, and ULLCA. For now, the repetition may be helpful to identify nonwaivable provisions for later centralization. The Reporters are cognizant that the repetition is troublesome and started to coalesce those references into a list. That effort was jettisoned, only for now, until the shape of the act continues to evolve. That remains a “thing to do” but beyond discussing the use in each section as the Committee does its work; the overarching task remains unripe. There, too, are probably errors in cross-referencing as the section numbers continue to change.

Although the entire draft has been heavily edited the Reporters concentrated on the substance of Articles 1, 2, 3, 5, and 9. Those articles, together with Article 7, contain the key concepts that define this act. A memorandum containing a suggested agenda will be sent to the Committee under authority of the Chair nearer the meeting date.

Finally please note that James B. Dean is new “Associate Reporter” and, as noted in the Committee memorandum for the October 2005 John Stieff is the Committee’s new liaison to the “Style Committee.”

1 **UNIFORM COOPERATIVE ASSOCIATION ACT**

2

3 **ARTICLE 1**

4 **GENERAL PROVISIONS**

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

7 **Reporter's Note**

8 The addition of “association” mitigates, to some extent, concerns that the Act be confused
9 with corporate based statutes. It did little to mitigate continuing concerns about co-op
10 “branding.”
11

12 **SECTION 102. DEFINITIONS.** In this [act]:

13 (1) “Articles of organization” includes initial, amended, and restated articles of
14 organization. In the case of a foreign cooperative, the term includes all records that:

15 (A) have a function similar to articles of organization; and

16 (B) are required to be filed in the office of the [Secretary of State] or other
17 official having custody of articles of organization in the state or country under whose law it is
18 organized.

19 (2) “Bylaws” includes initial, amended and restated bylaws.

20 (3) “Contribution” means a benefit that a person provides to a cooperative
21 association in order to become a participant or in the person’s capacity as a participant.

22 (4) “Cooperative” means a cooperative association or an entity organized under
23 any cooperative law.

1 (5) “Cooperative association” means an association organized under this [act].

2 (6) “Debtor in bankruptcy” means a person that is the subject of:

3 (A) an order for relief under 11 U.S.C. Section 101 et seq.; or

4 (B) an order comparable to an order described in subparagraph (A) under
5 federal, state, or foreign law governing insolvency.

6 (7) “Designated office” means the office designated under Section 117(a)(1).

7 (8) “Distribution” means a transfer of money or other property from a cooperative
8 association to a participant in the participant’s capacity as a participant or to a transferee because
9 of an right owned by the transferee.

10 (9) “Domestic entity” means an entity organized under the laws of this state.

11 (10) “Entity” means an association, business trust, company, corporation,
12 cooperative association, general partnership, limited liability company, limited liability limited
13 partnership, limited liability partnership, limited partnership, domestic or foreign.

14 (11) “Financial rights” means the right to participate in allocation and distribution
15 under [Article 9] but does not include rights or obligations under a marketing contract governed
16 by [Article 6].

17 (12) “Foreign cooperative” means a foreign entity organized under a law similar
18 to this [act] in another jurisdiction.

19 (13) “Foreign entity” means an entity that is not a domestic entity.

20 (14) “Governance rights” means the right to participate in governance of the
21 cooperative association under [Article 3].

22 (15) “Investor participant” means a person admitted as investor participant in

1 accordance with the organic rules and who is not permitted or required by the organic rules to
2 conduct patronage business with the cooperative association in order to receive financial rights or
3 distributions.

4 (16) “Organic law” means the statute providing for the creation of an entity or
5 principally governing its internal affairs.

6 (17) “Organic rules” means the articles of organization and the bylaws of a
7 cooperative association.

8 (18) “Participant” means a person that is a participant in a cooperative association
9 and includes patron and investor participants. The term does not include a person that has
10 dissociated as a participant.

11 (19) “Participants interest” means patron and investor interests.

12 (20) “Participants meeting” means a annual or special participants meeting.

13 (21) “Patron” means a person or entity that conducts economic activity with a
14 cooperative association on a patronage basis.

15 (22) “Patron participant” means a person admitted as a patron participant with the
16 organic rules and who is permitted or required by the organic rules to conduct patronage business
17 with the cooperative association in order to receive financial rights or distributions.

18 (23) “Patronage” means business transactions between a cooperative association
19 and a person which entitles this person to receive financial rights, distributions or payments from
20 the cooperative association based on the value or quantity of business done with the person
21 relative to the financial performance of the cooperative association.

22 (24) “Person” means an individual, entity, trust; governmental subdivision,

1 agency or instrumentality; or any other legal or commercial entity.

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

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

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

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

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

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

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

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

17 (31) “Voting participant” means a participant that under organic law or organic
18 rules has a right to vote on matters subject to vote by participants.

19 **Reporter’s Note**

20 The February 2006 draft has undergone extensive changes.

21
22 As discussed in greater detail in the Reporter’s Note to Section 404, the definitions need
23 tuning. In particular, “patron”, “patron member” and “nonpatron member” are currently under
24 reconsideration by the Drafting Committee. “Financial Interest” is used extensively in Article 4

1 but not defined. The term “financial interest”, as noted in the Reporter’s Note, is also being
2 reconsidered. It performs the same function as “transferable interest” in ULLCA, ULPA (2001),
3 and UPA (1997). Below are two rough definitional suggestions from the Reporter for discussion
4 purposes:

- 5
6 • “Patron membership interest” means the membership interest providing a patron
7 rights in governance and a transferable interest [financial interest] of the
8 cooperative as a member as established by the [Act]; and
9
- 10 • “Transferable interest” means the right to receive distributions to members but
11 does not include the right to receive payments based on a separate marketing
12 contract, if any, between the member and the cooperative.
13

14 Note that distributions are distinct from allocations in virtually all organizational statutes.
15 Distributions are actual payments of money or money’s worthwhile allocations are accounting
16 concepts, *e.g.*, the capital accounts of partners in a partnership.
17

18 An observer has suggested that the definition of “patronage” (subsection 21) be revised to
19 read as follows:
20

21 “Patronage” means business transactions between a cooperative
22 and a person which entitle the person to receive financial rights,
23 distributions, or payment from the cooperative based on the value
24 or quantity of such business, done with such person under a pre-
25 existing legal obligation to receive the amount paid, which is
26 determined by reference to the net earnings of the cooperative from
27 all business done with or for such persons.
28

29 All references to “cooperative plan” have been deleted consistent with prior and
30 continuing committee discussion.
31

32 The definition of “domestic cooperative” expressly includes cooperatives formed outside
33 this Act. *See, e.g.*, subsection 109(d). Is it necessary to define “designated office” for purposes
34 of the service of process provision?
35

36 The definition of Bylaws must be read in light of section 305.
37

38 “Financial Rights”: allocation and distribution includes the rights to distributions in
39 liquidation, rights to receive dividends if dividends are a method used to distribute funds, rights
40 to receive patronage allocations and dividends and per unit retains, redemption of retained
41 patronage allocations or per unit retains; rights to receive partnership allocations and
42 distributions. It does not include amounts to which a patron participant would be entitled under a
43 marketing contract.

1 “Governance Rights” include the right to vote, the right to receive notices of participant
2 meetings, the right to participate in meetings of a district or other subdivision of participants, and
3 the right to be represented by delegates from a district or other subdivision of participants.
4

5 **SECTION 103. KNOWLEDGE AND NOTICE.**

6 (a) A person knows a fact if the person has actual knowledge of it.

7 (b) A person has notice of a fact if the person:

8 (1) knows of it;

9 (2) has received notification of it; or

10 (3) has reason to know it exists from all of the facts known to the person
11 at the time in question.

12 (c) A person notifies or gives a notification to another person by taking steps
13 reasonably required to inform the other person in ordinary course, whether or not the other
14 person learns of the notification.

15 (d) A person receives a notification when the notification:

16 (1) comes to the person’s attention; or

17 (2) is delivered at the person’s place of business or at any other place held
18 out by the person as a place for receiving communications.

19 (e) A person other than an individual knows, has notice, or receives a notification
20 of a fact for purposes of a particular transaction when the individual conducting the transaction
21 for the person knows, has notice, or receives a notification of the fact, or in any event when the
22 fact would have been brought to the individual’s attention if the person had exercised reasonable
23 diligence. A person other than an individual exercises reasonable diligence if the person

1 maintains reasonable routines for communicating significant information to the individual
2 conducting the transaction for the person and there is reasonable compliance with the routines.
3 Reasonable diligence does not require an individual acting for the person to communicate
4 information unless the communication is part of the individual's regular duties or the individual
5 has reason to know of the transaction and that the transaction would be materially affected by the
6 information.

7 **Reporter's Note**

8 Source: Derived from ULPA (2001). The LLC Act Drafting Committee has spent much
9 time reworking and redrafting this Section. During that discussion, as in past meetings of this
10 Drafting Committee, the necessity of including this provision was questioned. This section
11 varies from ULPA (2001) because it does not need to deal with the unique statements under
12 limited partnership law. Therefore it is approximately one-third shorter than its limited
13 partnership analogue.
14

15 The LLC Act Drafting Committee included the following in a recent draft:
16

17 **SECTION 103. KNOWLEDGE AND NOTICE.**

18 (a) A person knows a fact when any of the following apply:

19 (1) the person is an individual who is consciously
20 aware of the fact;

21 (2) the person is deemed to know the fact under
22 subsection (b) or (e) or other law.

23 (b) A person that is not a member is deemed to know of a
24 limitation on authority to transfer real property as provided in
25 Section 302(4).

26 (c) A person has notice of a fact when any of the following
27 apply:

28 (1) the person has reason to know the fact from all
29 of the facts known to the person at the time in question;

30 (2) the person is deemed to have notice of it under
31 subsection (d) or (e);

32 (d) A person not a member has notice of:

33 (1) another person's dissociation as a member of a
34 member-managed limited liability company, 90 days after a
35 Section 604 statement of dissociation pertaining to the other person
36 becomes effective;

1 (2) another person's ceasing to be a manager of a
2 manager-managed limited liability company, 90 days after a
3 Section 412 statement of manager cessation pertaining to the other
4 person becomes effective;

5 (3) a limited liability company's dissolution, 90
6 days after a Section 710(1) statement of dissolution becomes
7 effective;

8 (4) a limited liability company's termination, 90
9 days after a Section 710(2) statement of termination becomes
10 effective; and

11 (5) a limited liability company's merger,
12 conversion, or domestications, 90 days after an [article 10]
13 statement of merger, conversion, or domestication becomes
14 effective.

15 (e) A limited liability company is deemed to know or have
16 notice of a fact relating to the limited liability company both as
17 provided by other law and when either of the following apply:

18 (1) in a member-managed limited liability company,
19 a member knows or has notice of the fact, except in the case of a
20 fraud on the limited liability company committed by or with the
21 consent of the member;

22 (2) in a manager-managed limited liability
23 company, a manager knows or has notice of the fact, except in the
24 case of a fraud on the limited liability company committed by or
25 with the consent of the manager.

26 (f) In a manager-managed limited liability company, a
27 member's knowledge or notice of a fact relating to the limited
28 liability company is not knowledge of or notice to the limited
29 liability company, except as provided:

30 (1) in subsection (e)(2);

31 (2) in Section 302 (statement of authority); and

32 (3) by law other than this [act].
33

34 **SECTION 104. COOPERATIVE ASSOCIATION SUBJECT TO AMENDMENT**

35 **OR REPEAL OF [ACT].** A cooperative association governed by this [act] is subject to any
36 amendment or repeal of this [act].

37 **Reporter's Note**

38 Tenn. Code. Annot. Section 43-38-102 states: "The general assembly has the power to

1 amend or repeal all or part of this chapter at any time and all domestic cooperatives subject to
2 this chapter shall be governed by such amendment in Appeal.

3
4 The revised language is taken from UPA (1997).
5

6 **SECTION 105. NATURE, PURPOSE, AND DURATION OF ENTITY.**

7 (a) A cooperative association is an entity distinct from its participants.

8 (b) A cooperative association may be organized under this [act] for any lawful
9 purpose, regardless of whether or not for profit except [designate prohibited purposes].

10 (c) A cooperative association has a perpetual duration.

11 **Reporter's Note**

12 Subsection (b) states "any lawful purpose" which is consistent with the unincorporated
13 acts promulgated by the Conference. It is also consistent with the general laws of cooperatives
14 which in some states reference or are included in not-for-profit acts. Finally, it is consistent with
15 the historical roots of cooperatives as mutual aid societies.

16
17 Subsection (b) reflects the decision by the Uniform Law Commission at the 2005 Annual
18 Meeting to delete any reference to "agricultural or agricultural related" and, instead, list specific
19 purposes for which cooperatives may not be used. The "except" language is similar to the
20 language in Section 3 of RULPA 1976/1985. The Committee may desire to consider inserting
21 "subject to any law of this state governing or regulating business" which is included in ULLCA
22 1996 (after the words "any lawful purpose").
23

24 The Minnesota Act states:

25
26 "[F]or any other purposes that cooperatives are authorized to
27 perform by law," Minn. Stat. Ann. § 308B. 201(3).
28

29 The Tennessee Act states:

30
31 "[A]nd other purposes that are related to the business of the
32 cooperatives; to provide supplies and services to its members and
33 for purposes are authorized by law." Tenn. Code. Ann. § 43-38-
34 201.
35

36 Minnesota's general cooperative law has the following purpose:

1 “[F]or the purposes of conducting an agricultural, dairy, marketing,
2 transportation, warehousing, commission, mechanical, mercantile,
3 electrical, heat, light, or power business, or for any other lawful
4 purpose. Minn. Stat. Ann. § 308A.101(1).
5

6 Even though it appears the general Minnesota Cooperative Act reflects a modern trend; at
7 least some states, maintain different cooperative statutes for different types of cooperatives.
8

9 South Dakota’s general cooperative statute (which was enacted in 1939 and amended in
10 1968 and 1978 states:
11

12 “Cooperatives may be organized under this chapter for any lawful
13 purpose except banking and insurance.” SDCL § 47-15-2.
14

15 **SECTION 106. POWERS.** A cooperative association has the power to do all things
16 necessary or convenient to carry on its activities, including the power to sue, be sued, and defend
17 in its own name and to maintain an action against a participant for harm caused to the
18 cooperative association by a violation of the organic law or organic rules of the cooperative
19 association or violation of a duty to the cooperative association.

20 **Reporter’s Note**

21 The formulation of powers in this draft is based upon unincorporated law models as
22 opposed to a more detailed listing of powers contained in corporate law. The Committee has
23 discussed this approach for powers only briefly and it is consistent with a general direction to
24 draft as efficiently as possible even though most cooperative acts tend to follow the more detailed
25 (and older) corporate model.
26

27 There was discussion at the October 2005 meeting focusing on two specific instances
28 concerning the remedy of specific instances concerning specific performance:
29

- 30 (1) agricultural marketing contracts; and
31 (2) utility co-ops and easements.
32

33 On the other hand, ULPA (2001) and the current draft of the ULLCA Revision Project
34 have simply stated, *e.g.*, “A limited liability company has the capacity to sue and be sued in its
35 own name and the power to do all things necessary or convenient to carry on its activities.”
36

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

2 (a) the internal affairs of a cooperative association, and

3 (b) the relations among the participants of a cooperative association and between
4 the participants and the cooperative association.

5 **SECTION 108. SUPPLEMENTAL PRINCIPLES OF LAW; RATE OF**
6 **INTEREST.**

7 (a) Unless displaced by particular provisions of this [act], the principles of law
8 and equity supplement this [act].

9 (b) If an obligation to pay interest arises under this [act] and the rate is not
10 specified, the rate is that specified in [applicable statute].

11 **Reporter's Note**

12 The Committee on Style, consistent with previous Committee discussion but not
13 Committee resolution, has “suggested” deleting subsection (a) and queries whether subsection
14 (b) is necessary.
15

16 **SECTION 109. NAME.**

17 (a) The name of a cooperative association must contain the word “association” or
18 its abbreviation and may contain the word “cooperative” or its abbreviation.

19 (b) Except as authorized by subsections (c) and (d), the name of a cooperative
20 association must be distinguishable upon the records of the [Secretary of State] from:

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

23 (2) a name reserved or registered under Section 110 or 111;

1 (3) a fictitious name approved for a foreign cooperative authorized to
2 transact business in this state.

3 (c) A cooperative association may apply to the [Secretary of State] for
4 authorization to use a name that is not distinguishable upon the records of the [Secretary of State]
5 from one or more of the names described in subsection (b). The [Secretary of State] shall
6 authorize use of the name applied for if:

7 (1) the present user, registrant, or owner of a name reserved or registered
8 under Section 110 or 111 consents in a record to the use and submits an undertaking in a form
9 satisfactory to the [Secretary of State] to change the name to a name that is distinguishable upon
10 the records of the [Secretary of State] from the name applied for; or

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

14 **Reporter's Note**

15 Subsection (d) has been deleted because it is governed by other law. Subsection (b)
16 seems flawed. This is an area where uniformity is unlikely because of variance in name
17 procedures and policies in the Office of the Secretaries of States. The ULLCA draft has the
18 equivalent of (a) and replaces the balance of the language under this draft with the following:

19 20 **SECTION 108. NAME.**

21 (a) The name of a limited liability company must contain
22 "limited liability company" or "limited company" or the
23 abbreviation "L.L.C.", "LLC", "L.C.", or "LC". "Limited" may be
24 abbreviated as "Ltd.", and "company" may be abbreviated as
25 "Co.".

26 [(b) Unless authorized by subsection (c), the name of a
27 limited liability company must be distinguishable in the records of
28 the [Secretary of State] from:

29 (1) the name of each person, other than an

individual, incorporated, organized, or authorized to transact business in this state; and

(2) each name reserved under Section 109 [or other state laws allowing the reservation or registration of business names, including fictitious name statutes].

(c) A limited liability company may apply to the [Secretary of State] for authorization to use a name that does not comply with subsection (b). The [Secretary of State] shall authorize use of the name applied for if, as to each conflicting name:

(1) the present user, registrant, or owner of the conflicting name consents in a signed record to the use and submits an undertaking in a form satisfactory to the [Secretary of State] to change the conflicting name to a name that complies with subsection (b) and is distinguishable in 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 of competent jurisdiction establishing the applicant's right to use in this state the name applied for.

(d) Subject to Section 805, this section applies to any foreign limited liability company transacting business in this state, having a certificate of authority to transact business in this state, or applying for a certificate of authority.]

Should this Act create a new abbreviation "CA or C.A." It does look like the postal abbreviation for California. Is there another short-hand that isn't an "abbreviation" covered by the existing language?

The use of the word "cooperative" under this draft is voluntary but may not be used by organizations that are not cooperatives under Section 112 which has been modified. An issue raised by the prior version of this section and its analogues under existing law was that there is *no* required designation or abbreviation to indicate the entity is a limited liability entity. For this reason the April 2005 draft now requires the use of "association" or its abbreviation. The required use of "association" also distinguishes this unincorporated agricultural cooperative from cooperatives governed by other state law.

The Reporters have adopted the Style Committee recommendation to delete "of competent jurisdiction" in (c)(2) in this draft.

SECTION 110. RESERVATION OF NAME.

(a) A person may reserve the exclusive use of the name of a cooperative

1 association, including a fictitious name for a foreign cooperative whose name is unavailable, by
2 delivering an application to the [Secretary of State] for filing. The application must set forth the
3 name and address of the applicant and the name proposed to be reserved. If the [Secretary of
4 State] finds that the name applied for is available, it must be reserved for the applicant's
5 exclusive use for a nonrenewable 60 day period.

6 (b) The owner of a name reserved for a cooperative association may transfer the
7 reservation to another person by delivering to the [Secretary of State] a signed notice of the
8 transfer which states the name and address of the transferee.

9 **Reporter's Note**

10 The Committee should discuss whether address needs to include both street and mailing
11 address.

12
13 The ULLCA Revision brackets this entire section and modifies it from ULPA (2001).
14

15 **SECTION 111. REGISTERED NAME OF FOREIGN COOPERATIVE.**

16 (a) A foreign cooperative may register its name pursuant to Section 109 if the
17 name is distinguishable upon the records of the [Secretary of State] from names that are
18 unavailable under Section 109.

19 (b) A foreign cooperative may register its name, or its name with any addition
20 required by Section 1205; by delivering to the [Secretary of State] for filing an application:

21 (1) setting forth its name, or its name with any addition required by
22 Section 1305, the state or country and date of its organization, and a brief description of the
23 nature of the affairs in which it is engaged; and

24 (2) accompanied by a certificate of existence, or a record of similar

1 import, from the state or country of organization.

2 (c) A foreign cooperative whose registration is effective may qualify as a foreign
3 cooperative under its name or consent in a record to the use of its name by a cooperative
4 association later organized under this [act] or by a foreign cooperative later authorized to transact
5 business in this state. The registration of the name terminates when the cooperative association
6 is organized or the foreign cooperative qualifies or consents to the qualification of another
7 foreign cooperative under the registered name.

8 **Reporter's Note**

9 The February 2006 draft changes (c) based on a query from the Style Committee
10 suggesting the "name" doesn't terminate but; rather, the registration terminates.
11

12 **SECTION 112. USE OF THE TERM "COOPERATIVE".**

13 (a) The use of the term "cooperative" or its abbreviation under this [act] is not a
14 violation of the provisions restricting the use of the term under [other law of this state].

15 (b) Cooperative associations and participants of cooperative associations under
16 this [act] have the power to enforce the restrictions on the use of the term "cooperative" under
17 this [act] [and other laws of this state].

18 **Reporter's Note**

19 Cooperative statutes include name protection provisions unique among organizational
20 law. The prior draft of this Section is typical of those provisions. Many such provisions also
21 contain bond and attorney's fees provisions but those provisions are not typically contained in
22 other organizational law.
23

24 This draft attempts to coordinate the name restrictions contained in other cooperative law
25 in the state, if any, with this Act without granting restrictions or rights not found elsewhere in
26 State law.
27

1 **SECTION 113. EFFECT OF ORGANIC RULES.**

2 (a) Except as otherwise provided in subsection (b), the organic rules govern
3 relations among and between the participants, the board of directors and the cooperative
4 association.

5 (b) The organic rules may not:

6 (1) vary a cooperative association's power under Section 106 to sue, be
7 sued, and defend in its own name;

8 (2) vary the law applicable to a association under Section 107;

9 (3) vary the requirements of Section 208;

10 (4) vary the information required to be kept under Section 114 or
11 unreasonably restrict the right to information under Section ____ or 721, but the organic rules may
12 impose reasonable restrictions on the availability and use of information obtained under those
13 Sections and may define appropriate remedies, including liquidated damages, for a breach of any
14 reasonable restriction on use;

15 (5) eliminate the duty of loyalty under Section ____, but the organic rules
16 may:

17 (A) identify specific types or categories of activities that do not
18 violate the duty of loyalty, if not manifestly unreasonable; and

19 (B) specify the number or percentage of participants necessary to
20 authorize or ratify, after full disclosure to all participants of all material facts, a specific act or
21 transaction that otherwise would violate the duty of loyalty;

22 (6) unreasonably reduce the duty of care under Section ____;

(7) eliminate the obligation of good faith and fair dealing under Sections ____ and ____, but the partnership agreement may prescribe the standards by which the performance of the obligation is to be measured, if the standards are not manifestly unreasonable;

(8) vary the power of a person to dissociate as a participant under Section ____ except to require that the notice under Section ____ be in a record;

(9) vary the power of a court to decree dissolution in the circumstances specified in Section ____;

(10) vary the requirement to wind up the cooperative association business pursuant to Section ____;

(11) unreasonably restrict the right to maintain an action under [Article] 11;

(12) restrict the right of a participant under Section ____ to approve a conversion or merger; or

(13) restrict rights under this [act] of a person other than a participant, transferee, or board of director participant.

Reporter's Note

Source: ULP (2001). This section provides a framework in which to place nonwaivable (mandatory provisions) as this draft evolves. Provisions concerning voting and distributions obviously need to be included as nonwaivable.

Subsection (a) was criticized by both the Style Committee (as ambiguous) and by an observer since the April 2005 meeting. Thus, it has been reworked. As reworked the Reporter has a sense that it places even more emphasis on subsection (b) though the previous formulation was, at least, inartful. It may be time to form a subcommittee to assist the Reporter in a careful review of, and for, subsection (b)'s exceptions. The Style Committee suggests "reduce" in (b)(6) may not be the best word choice but it is retained in this draft because the language has been approved in other conference products.

1 An observer has suggested that identifying mandatory provisions and attempting to place
2 them in subsection (b) seems to be “legislative quicksand” and suggested replacing (b) with a
3 “couple of succinct sentences about conflicts between the organic documents and the act stating
4 the law trumps. This, of course, would mean the final draft would retain myriad “unless
5 otherwise provided in the organic documents.” This and the former drafts have used those
6 phrases merely in an attempt to *begin* to identify sections to place in (b). To a great extent, this is
7 “only” a matter of drafting extent, this is “only” a matter of drafting style and reflects what is
8 referred to in some CLEs on broader organizational law as the unincorporated (or uniform laws)
9 approach versus the unincorporated (or Delaware) approach. On the other hand, to keep this draft
10 “moving” a decision needs to be made as soon as possible.
11

12 **SECTION 114. REQUIRED INFORMATION.** A cooperative association shall
13 maintain in a record at its principal office the following information:

14 (1) a current list showing the full name and last known street address, mailing
15 address, and term of office of each director and officer;

16 (2) a copy of the initial articles of organization and all amendments to and
17 restatements of the articles, together with signed copies of any powers of attorney under which
18 any articles, amendments, or restatement has been signed;

19 (3) a copy of the initial bylaws and all amendments to and restatement

20 (4) a copy of any filed articles of consolidation or merger;

21 (5) a copy of any financial statement of the cooperative association for the six
22 most recent years;

23 (6) a copy of the six most recent annual reports delivered by the cooperative
24 association to the [Secretary of State];

25 (7) a copy of the minutes of meetings of participants and records of all actions
26 taken by participants without a meeting for the three most recent years;

27 (8) a current list showing the full name and last known street and mailing

addresses, separately identifying the patron participants, in alphabetical order, and the investor participants, in alphabetical order;

(9) a copy of the federal, state, and local income tax returns and reports of the cooperative association, if any, for the six most recent years;

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

(11) a copy of the minutes of director's meetings and records of all actions taken by directors without a meeting for the three most recent years;

(12) a record stating:

(A) the amount of cash contributed and agreed to be contributed by each participant;

(B) a description and statement of the agreed value of other benefits contributed and agreed to be contributed by each participant;

(C) the times at which, or events on the happening of which, any additional contributions agreed to be made by each participant are to be made; and

(D) for a person that is both a patron participant and investor participant, a specification of the interest the person owns in each capacity;

(13) a copy of all communications in a record to participants as a group or to any class of participants as a group for the three most recent years.

Reporter's Note

This section has been completely reorganized in order to make the cause/no cause distinction later in the draft easier to understand. The only substantive change appears as (10) which replaces part of (7) in the prior draft. Prior (7) was bifurcated into (5) and (7). This shall

1 not be subject to restriction by agreement. The Committee also requested the Reporter to
2 compare (13) (in this draft) with the Revised Model Nonprofit Act. It is consistent. Section
3 16.01(e)(b) states: “all written communications to members generally within the last three
4 years...”.
5

6 **SECTION 115. BUSINESS TRANSACTIONS OF PARTICIPANT WITH**
7 **COOPERATIVE ASSOCIATION.** A participant may lend money to and transact other
8 business with the cooperative association and has the same rights and obligations with respect to
9 the loan or other transaction as a person that is not a participant subject to the organic rules or a
10 specific contract relating to the transaction.

11 **Reporter’s Note**

12 This language is consistent with the language used in ULP (2001). The language
13 beginning with “subject to” is added for Committee discussion to the February 2006 draft to
14 make clear that it is not intended to apply to, *e.g.*, marketing contracts which implicate article and
15 bylaw provisions governing participation (membership).
16

17 **SECTION 116. DUAL CAPACITY.** A person may be both a patron participant and a
18 investor participant. A person that is both a patron and investor participant has the rights,
19 powers, duties, and obligations provided by this [act] and the organic law in each of those
20 capacities. When the person acts as a patron participant, the person is subject to the obligations,
21 duties, and restrictions under this [act] and the organic law governing patron participants. When
22 the person acts as a investor participant, the person is subject to the obligations, duties, and
23 restrictions under this [act] and the organic law governing investor participants.

24 **Reporter’s Note**

25 The phrase “and rules” that appeared in the second, third and fourth sentences has been
26 deleted because everything can be varied by the rules unless specifically excepted. Is the deletion
27 appropriate in this circumstance?

1

2 **SECTION 117. OFFICE AND AGENT FOR SERVICE OF PROCESS.**

3 (a) A cooperative association and a foreign cooperative shall designate and

4 continuously maintain in this state:

5 (1) an office, which need not be a place of its activity in this state; and

6 (2) an agent for service of process.

7 (b) An agent for service of process of a cooperative association or foreign

8 cooperative must be an individual who is a resident of this state or other person authorized to do

9 business in this state.

10 **Reporter's Note**

11 There is a question of nomenclature. This draft uses the vetted NCCUSL language

12 “designated” even though traditional cooperative law and corporate formulation is registered.

13 They “mean” the same thing, functionally. Does “designated office” need to be a defined term?

14

15 **SECTION 118. CHANGE OF DESIGNATED OFFICE OR DESIGNATED**

16 **AGENT FOR SERVICE OF PROCESS.**

17 (a) In order to change its designated office, its agent for service of process, or the

18 address of its agent for service of process, a cooperative association or a foreign cooperative

19 association shall deliver to the [Secretary of State] for filing a statement of change containing:

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

21 (2) the street and mailing addresses of its current designated office;

22 (3) if the current designated office is to be changed, the street and mailing

23 addresses of the new designated office;

1 (4) the name and street and mailing addresses of its current agent for
2 service of process; and

3 (5) if the current agent for service of process or an address of the agent is
4 to be changed, the new information.

5 (b) Subject to Section 210, a statement of change is effective when filed by the
6 [Secretary of State].

7 **Reporter's Note**

8 Is subsection (b) surplusage, helpful or confusing? It's source is ULPA (2001).
9

10 The following comment was made at the annual meeting: "Do you need or desire an
11 electronic mailing address? Some states are moving to electronic filing. Even if not, the email
12 address would save state money by sending routine notices by electronic mail." This is a good
13 point but probably does not belong in the service of process provision.
14

15 **SECTION 119. RESIGNATION OF DESIGNATED AGENT FOR SERVICE OF** 16 **PROCESS.**

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

20 (b) After receiving a statement of resignation, the [Secretary of State] shall file it
21 and mail a copy to the principal office of the cooperative association or foreign cooperative and
22 another copy to the principal office if the address of the principal office appears in the records of
23 the [Secretary of State] and is different from the address of the designated office.

24 (c) An agency for service of process terminates 30 days after the [Secretary of
25 State] files the statement of resignation.

1 **SECTION 120. SERVICE OF PROCESS.**

2 (a) An agent for service of process appointed by a cooperative association or
3 foreign cooperative is an agent of the cooperative association or foreign cooperative for service
4 of any process, notice, or demand required or permitted by law to be served upon the cooperative
5 association or foreign cooperative.

6 (b) If a cooperative association or foreign cooperative does not appoint or
7 maintain an agent for service of process in this state or the agent for service of process cannot
8 with reasonable diligence be found at the agent's address, the [Secretary of State] is an agent of
9 the cooperative association or foreign cooperative upon whom process, notice, or demand may be
10 served.

11 (c) Service of any process, notice, or demand on the [Secretary of State] may be
12 made by delivering to and leaving with the [Secretary of State] duplicate copies of the process,
13 notice, or demand. If a process, notice, or demand is served on the [Secretary of State], the
14 [Secretary of State] shall forward one of the copies by registered or certified mail, return receipt
15 requested, to the cooperative association or foreign cooperative at its designated office.

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

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

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

21 (3) five days after the process, notice, or demand is deposited in the mail,
22 if mailed postpaid and correctly addressed.

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

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

6 **Reporter's Note**

7 Source: ULPA (2001). Is the term “mail” in section 120 (c) and (d)(3) ambiguous? The
8 Style Committee suggested the change to “with the United States Postal Service” in (c) and
9 (d)(3).

ARTICLE 2

FILING AND ANNUAL REPORTS

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

(a) Records delivered to the [Secretary of State] for filing pursuant to this [act] must be signed in the following manner:

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

(2) A statement of cancellation under Section 302(c) must be signed by each organizer that signed the initial articles of organization.

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

(4) A record filed on behalf of a dissolved cooperative association by a person winding up the activities under Section 1105 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 filed under this [act] may be signed by an authorized agent.

Reporter's Note

A question was asked at the October 2005 Drafting meeting concerning the certificate of cancellation. The Reporters, in answering that question, have revised the section to make it more comprehensive and more closely track the ULLCA Revision.

1 **SECTION 202. SIGNING AND FILING PURSUANT TO JUDICIAL ORDER.**

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

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

7 (2) the [Secretary of State] to file the record unsigned.

8 (b) If an aggrieved person under subsection (a) is not the cooperative association
9 or foreign cooperative to which the record pertains, the aggrieved person shall make the
10 cooperative association or foreign cooperative a party to the action. An aggrieved person under
11 subsection (a) may seek any or all of the remedies provided in subsection (a) in the same action.

12 (c) A record filed unsigned pursuant to this section is effective without being
13 signed.

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

16 (a) A record authorized to be delivered to the [Secretary of State] for filing under
17 this [act] must be captioned to describe the record's purpose, be delivered to the [Secretary of
18 State], in a medium and to the extent permitted by the [Secretary of State]. Unless the [Secretary
19 of State] determines that a record does not comply with the filing requirements of this [act], and
20 if all filing fees have been paid, the [Secretary of State] shall file the record [and send a copy of
21 the filed record and a receipt for the fees to the person on whose behalf the record was filed].

22 (b) Upon request and payment of a fee, the [Secretary of State] shall send to the

1 requester a certified copy of the requested record.

2 (c) Except as otherwise provided in Section 308, a record delivered to the
3 [Secretary of State] for filing under this [act] may specify an effective time and a delayed
4 effective date. Except as otherwise provided in this [act], a record filed by the [Secretary of
5 State] is effective:

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

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

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

13 (A) the specified date; or

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

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

17 (A) the specified date; or

18 (B) 90 days after the record is filed.

19 **Reporter's Note**

20 The cross-reference in (c) to Section 118 created a circularity problem. In (a) the
21 "medium" clause was repositioned and slightly expanded. The last clause in (a) is now bracketed
22 to provide flexibility to the myriad filing systems in existence in the states.
23
24

1 **SECTION 204. CORRECTING FILED RECORD.**

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

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

8 (1) describe the record to be corrected, including its filing date, or contain
9 an attached copy of the record as filed;

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

12 (3) correct the incorrect information or defective signature.

13 (c) When filed by the [Secretary of State], a statement of correction is effective
14 retroactively as of the effective date of the record the statement corrects, but the statement is
15 effective when filed as to persons relying on the uncorrected record and adversely affected by the
16 correction prior to its correction.

17 **SECTION 205. LIABILITY FOR FALSE INFORMATION IN FILED RECORD.**

18 If a record delivered to the [Secretary of State] for filing under this [act] and filed by the
19 [Secretary of State] contains false information, a person that suffers loss by reliance on the
20 information may recover damages for the loss from a person that signed the record, or caused
21 another to sign it on the person's behalf, and knew the information to be false at the time the
22 record was signed.

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(a) The [Secretary of State], upon application and payment of the required fee, shall furnish a certificate of existence for a cooperative association if the records filed in the [office of the Secretary of State] show that the [Secretary of State] has filed articles of organization is in good standing, and has not filed a statement of termination.

(c) Subject to any qualification stated in the certificate, a certificate of good standing or authorization issued by the [Secretary of State] may be relied upon as conclusive evidence that the cooperative association or foreign cooperative is in good standing or is authorized to transact business in this state.

At the Committee's direction:

35

1 this change “subject to future revision”. Finally, the Reporters, on their own motion, replaced
2 “request” with “application”.
3

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

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

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

8 (2) the street and mailing addresses of its designated office and the name
9 and street and mailing addresses of its agent for service of process in this state;

10 (3) in the case of a cooperative association, the street and mailing
11 addresses of its principal office if different than its designated office; and

12 (4) in the case of a foreign cooperative, the state or other jurisdiction
13 under whose law the foreign cooperative is formed and any alternative name adopted under
14 Section 1305.

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

17 (c) The first annual report must be delivered to the [Secretary of State] between
18 [January 1 and April 1] of the year following the calendar year in which a cooperative association
19 was formed or a foreign cooperative was authorized to transact business. An annual report must
20 be delivered to the [Secretary of State] between [January 1 and April 1] of each subsequent
21 calendar year.

22 (d) If an annual report does not contain the information required in subsection (a),
23 the [Secretary of State] shall promptly notify the reporting cooperative association or foreign

1 cooperative and return the report for correction. If the report is corrected to contain the
2 information required in subsection (a) and delivered to the [Secretary of State] within 30 days
3 after the effective date of the notice, it is timely delivered.

4 (e) If a filed annual report contains an address of a designated office or the name
5 or address of an agent for service of process which differs from the information shown in the
6 records of the [Secretary of State] immediately before the filing, the differing information in the
7 annual report is considered a statement of change under Section 117.

8 (f) A cooperative association that fails to file an annual report under this Section
9 must be dissolved by the [Secretary of State] under Section 1110.

10 (g) A foreign cooperative that fails to file an annual report under this Section
11 shall have its certificate of authority revoked under Section 1306.

12 **Reporter's Note**

13 Subsection (a) focuses the “three” address issues and highlights the fact that “designated
14 office” is not a defined term. There was discussion at the October 2005 meeting concerning
15 whether “if different” should be inserted between street and mailing address. If that is done,
16 should it be a global change?
17

18 **SECTION 208. FILING FEES; RULES AND REGULATIONS; ANNUAL**

19 **REPORTS.** The filing fee for records filed under this [Article] with the [Secretary of State] are
20 governed by [the general business corporation act] [the limited liability company act] [the general
21 cooperative act] of this state.

22 **Reporter's Note**

23 Consideration should be given to bracketing this section. Three bracketed references are
24 suggested as a source of fees. There are others, *e.g.*, the limited partnership act, not-for-profit
25 corporation act, *etc.*

1 The base source for much of this Article as originally drafted was ULPB (2001) which is
2 the latest pronouncement of the Conference on these matters.

1 **ARTICLE 3**

2 **FORMATION AND ARTICLES OF ORGANIZATION**

3
4 **Reporter's Note**

5 Article 2 of the 2005 Annual Meeting Draft has been bifurcated into Art. 2A "Formation
6 and Articles of Organization" and Art. 2. Article 2A will become a new Article 3 if the
7 Committee agrees with the division. The original Art. 2 numbers are retained in Article 2A
8 simply for ease of following the reorganization.

9
10 Article 2A consists of old sections 201, 202, 204 and 205. Each section in Art. 2A is
11 directly related to the organization of the cooperative.

12
13 "Old" Section 203 "Amendment or Restatement of Articles of Organization" has been
14 moved to Art. 13 as "new" Section 1309.

15
16 The numbering of the Sections in Articles 2 and 2A is for the October draft only. Article
17 2A will become Article 3 and all the numbers of the other articles will be changed accordingly.
18

19 **SECTION 301. ORGANIZATION.** A cooperative association may be organized by
20 two or more organizers who are individuals.

21 **Reporter's Note**

22 The issues raised in Section 301 have been discussed at length by the Committee but
23 consensus has not been reached on resolution of all the issues.

24
25 The Committee directed the Reporter to delete subsection (b) in the prior draft that
26 required the organizers to "intend" in "good faith" to become members (now participants) in the
27 cooperative. The February 2006 draft reflects that direction.

28
29 The Committee also directed that this draft should provide that only one organizer was
30 necessary for a wholly-owned subsidiary of an existing cooperative. Several unexplored issues
31 arose when the Reporters attempted to draft the language to effectuate that purpose. *First:* At
32 what point is "wholly-owned" measured? At the moment of formation? Is it an ongoing
33 requirement? *Second:* Was the Committee direction really intended to address the minimum
34 number of participants rather than the minimum number of organizers? The Reporters thought it
35 necessary to ask the Committee for clarification before further drafting on this Section.

1 Another issue raised in conjunction with this Section is whether the formation of “shelf”
2 cooperatives *should* be allowed. “Shelf” entities are those entities formed by promoters, or
3 others for possible future use without a specific current need for the entity. The tentative
4 conclusion of the Committee was not to allow for shelf cooperatives because they are
5 inconsistent with the member focus of cooperatives. For the same reason, two organizers are
6 required under this draft.

7
8 The Committee recognizes that the execution of that tentative conclusion is difficult and
9 raises other issues including the number of members necessary to avoid dissolution (which is
10 related to the first two general questions in this Note). This draft requires only a single member
11 for the latter purposes, in part, because of the current use of wholly owned subsidiaries of
12 cooperatives which are themselves cooperatives and because requiring more than a single
13 member increases the risk of inadvertent dissolution. On the other hand, like under partnership
14 law, it is difficult to conceive of a “cooperative” without more than one member.

15
16 This draft raises those, and no doubt other, fundamental issues. The Minnesota
17 Cooperative Associations Act allows for “one or more organizers... [who] need not be members.”
18 The Colorado Cooperative Act too, allows for one or more “incorporators.”
19

20 **SECTION 302. FORMATION OF COOPERATIVE ASSOCIATION; ARTICLES** 21 **OF ORGANIZATION.**

22 (a) To form a cooperative association, articles of organization must be delivered
23 to the [Secretary of State] for filing. The articles must state:

- 24 (1) the name of the cooperative association;
- 25 (2) the purposes for which the cooperative association was formed;
- 26 (3) the street and mailing addresses of the initial designated office and the
27 name; and street and mailing addresses of the agent for service of process;
- 28 (4) the name and the street and mailing addresses of each organizer;
- 29 (5) the term for which the cooperative association is to exist if other than
30 perpetual;
- 31 (6) the number and terms of directors or the method in which the number

1 and terms shall be determined; and

2 (7) any additional information required by [Article] 14.

3 (b) Articles of organization may contain any other matters.

4 (c) Unless the articles of organization state a delayed effective date, a cooperative
5 association is formed when there is substantial compliance with subsection (a) and the [Secretary
6 of State] files the articles of organization. If the articles state a delayed effective date, a
7 cooperative association is not formed if, before the articles take effect, one or more organizers
8 sign and deliver to the [Secretary of State] for filing a statement of cancellation.

9 **Reporter's Note**

10 The language beginning with "or" in subsection (a)(6) was added by the Reporters in the
11 February 2006 draft and need to be discussed by the Committee.
12

13 **SECTION 303. ORGANIZATION OF COOPERATIVE ASSOCIATION.** After the
14 effective date of the articles of organization:

15 (1) if initial directors are named in the articles of organization, the initial directors
16 shall hold an organizational meeting to appoint officers, adopt initial bylaws, and carry on any
17 other business brought before the meeting; and

18 (2) if initial directors are not named in the articles of organization, the organizers
19 shall designate the initial directors and call a meeting of them to adopt initial bylaws and carry on
20 any other business necessary or proper to complete the organization of the cooperative
21 association.

22 **Reporter's Note**

23 The February 2006 draft attempts to avoid the classic circularity problem concerning

1 which comes first: participants or the cooperative association. This same issue has been
2 discussed in the context of limited liability companies. There (probably) is no nice theoretical
3 solution to this very practical problem.
4

5 **SECTION 304. BYLAWS.**

6 (a) The bylaws must be in a record and, if not stated in the articles of
7 organization, include:

8 (1) a statement of the capital structure of the cooperative association,
9 including a statement of the classes and relative rights, preferences, and restrictions granted to or
10 imposed upon each group, class, or other type of participant interest, the rights to share in profits
11 or distributions of the cooperative association, and the method to admit participants;

12 (2) a statement designating the voting and governance rights, including
13 which participants have voting power and any limitations or restrictions on the voting power
14 under Section 412;

15 (3) a statement that participant interests held by a participant are
16 transferable only with the approval of the board of directors or as otherwise provided in the
17 organic rules; and

18 (4) if investor participants are authorized, a statement concerning how
19 profits and losses are apportioned and how distributions are made as between patron participants
20 and investor participants.

21 (b) The bylaws of the cooperative association may contain any provision for
22 managing and regulating the affairs of the cooperative association which is not inconsistent with
23 organic law or the articles of organization.

Reporter's Note

Governance rights is not yet defined. Are they more than voting rights? The Reporters believe the definitions of, conceptual limits on, “financial rights” (*e.g.* subsection (a)(4)) and “goveranncce rights” ((a)(2)) are now ripe and are necessary to complete the drafting of this act.

Section 205(a)(1) goes beyond what is typically considered capital structure in the corporate setting. The Drafting Committee considered alternatives but because this Act is membership based; because the articles and bylaws together constitute the agreement in traditional cooperative and in other unincorporated entities; and, on the other hand, because it desired the greater formality typical in cooperatives, this draft includes greater detail.

1 **ARTICLE 4**

2 **PARTICIPANTS**

3
4 **SECTION 401. PARTICIPANTS.** In order to commence business a cooperative
5 association must have [two] or more patron participants except a cooperative association may
6 have only one participant if the participant is a cooperative entity whether or not organized under
7 this [act].

8 **Reporter's Note**

9 There was Committee discussion as to whether it should be made clear that this section is
10 not intended to preclude common ownership of a patron participant and the Committee requested
11 the Reporter to consider the matter. Because the Act does not preclude common ownership the
12 Reporters recommend this question be left to the organic rules.
13

14 **SECTION 402. BECOMING A PARTICIPANT.** A person becomes a participant :

- 15 (1) as provided in the organic rules;
16 (2) as the result of merger or consolidation under [Article] 15; or
17 (3) with the consent of all the participants.

18 **Reporter's Note**

19 This section has engendered a great deal of discussion. The Reporter was directed to
20 delete the provision admitting participants after the dissociation of the last remaining participant
21 and this draft reflects that direction. The Reporter was also directed either to delete “with the
22 consent of all remaining members” or to add thereto “if the organic rules are silent”. Upon
23 further review the Reporters have done neither pending further direction of the Committee
24 because: (1) this act requires the admission of participants to be in a record and “if silence” raises
25 both circularity issues and sleeping theoretical issues and (2) all the participants almost certainly
26 have the right to amend the organic rules to admit anyone they want. This approach is consistent
27 with unincorporated law and vests ultimate authority in the participants which seems inherently
28 consistent with cooperative principles.
29

SECTION 403. NO RIGHT OR POWER AS PARTICIPANT TO BIND

COOPERATIVE ASSOCIATION. A participant does not have the right or power as a participant to act for or bind the cooperative association.

Reporter's Note

Source: ULPA (2001).

SECTION 404. NO LIABILITY AS PARTICIPANT FOR COOPERATIVE

ASSOCIATION OBLIGATIONS. Unless otherwise provided by the articles of organization, an obligation of a cooperative association whether arising in contract, tort, or otherwise, is not the obligation of a participant. A participant is not personally liable, by way of contribution or otherwise, for an obligation of the cooperative association solely by reason of being a participant.

Reporter's Note

Source: ULPA (2001). There has been some discussion about modifying the ULPA (2001) language to include the word “personal” in an attempt to make the provision clearer but it is not certain it does so and there is a cost associated with changing the language from one Act to another if the intent is the same. The phrase directly or indirectly has been deleted in accordance with Committee direction.

SECTION 405. RIGHT OF PARTICIPANT AND FORMER PARTICIPANT TO INFORMATION.

(a) On 10 days demand, made in a record received by the cooperative association, a participant may inspect and copy required information under Section 114(a)(1) through (7) during regular business hours in the cooperative association's principal office. A participant need not have any particular purpose for seeking the information. A participant may demand the same information under Section 114(a)(1) through (7) no more than once during a twelve month

1 period.

2 (b) On demand, made in a record received by the cooperative association, a
3 participant may obtain from the cooperative association and inspect and copy required
4 information under Section 114(a)(8) through (13) is just and reasonable if:

5 (1) the participant seeks the information for a proper purpose reasonably
6 related to the participant's interest as a participant;

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

9 (3) the information sought is directly connected to the participant's
10 purpose.

11 (c) Within 10 days after receiving a demand pursuant to subsection (b), the
12 cooperative association shall inform in a record the participant that made the demand:

13 (1) what information the cooperative association will provide in response
14 to the demand;

15 (2) a reasonable time and place that the cooperative association will
16 provide the information; and

17 (3) if the cooperative association declines to provide any demanded
18 information, the cooperative association's reasons for declining.

19 (d) Subject to subsection (f), a person dissociated as a participant may inspect and
20 copy required information during regular business hours in the cooperative association's
21 principal office if:

22 (1) the information pertains to the period during which the person was a

1 participant;

2 (2) the person seeks the information in good faith; and

3 (3) the person complies with subsection (b).

4 (e) The cooperative association shall respond to a demand made pursuant to
5 subsection (d) in the same manner as provided in subsection (c).

6 (f) If a participant dies, Section 903 applies.

7 (g) The cooperative association may impose reasonable restrictions, including
8 nondisclosure restrictions, on the use of information obtained under this Section. In a dispute
9 concerning the reasonableness of a restriction under this subsection, the cooperative association
10 has the burden of proving reasonableness.

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

13 (i) A participant or person dissociated as a participant may exercise the rights
14 under this Section through an attorney or other agent. A restriction imposed under subsection (g)
15 or by the organic rules on a participant or person dissociated as a participant applies both to the
16 attorney or other agent and to the participant or person dissociated as a participant.

17 (j) The rights stated in this Section do not extend to a person as transferee, but
18 may be exercised by the legal representative of an individual under legal disability who is a
19 participant or person dissociated as a participant.

20 **Reporter's Note**

21 (A) This section has been substantially redrafted for the February 2006 draft. It picks up
22 the cause/no cause concept and references the redrafted Section 114. It is generally consistent
23 with the RMBCA and The Model Nonprofit Corporation Act.

1 This draft does not, however, include any “right to go to court”. Neither, however, does
2 the Minnesota Cooperative Associations Act nor ULPA (2001). Likewise the Reporters have not
3 been able to find such a provision in either ULLCA (1995) or in the current revision for ULLCA.
4 On the other hand, the Tennessee Act, the Model Nonprofit Corporation Act, and the MBCA all
5 contain court-ordered provisions. The Tennessee Act provides as follows:
6

7 43-38-532. Enforcement of right to inspect and copy records.

8 (a) If a cooperative does not allow a member who complies
9 with § 43-38-530(a) to inspect and copy any records required by
10 that subsection to be available for inspection, a court in the county
11 where the cooperative’s principal executive office, or, if none in
12 this state, its registered office, is located may summarily order
13 inspection and copying of the records demanded at the
14 cooperative’s expense upon application of the member.

15 (b) If the court orders inspection and copying of the records
16 demanded, it shall also order the cooperative to pay the member’s
17 costs, including reasonable counsel fees, incurred to obtain the
18 order, if the member proves that the cooperative refused inspection
19 without a reasonable basis for doubt about the right of the member
20 to inspect the records demanded.
21

22 The Nonprofit Corporation Act section states:
23

24 Section 16.04. Court-Ordered Inspection.

25 (a) If a corporation does not allow a member who complies
26 with section 16.02(a) to inspect and copy any records required by
27 that subsection to be available for inspection, the [name or describe
28 court] in the county where the corporation’s principal office (or, if
29 none in this state, its registered office) is located may summarily
30 order inspection and copying of the records demanded at the
31 corporation’s expense upon application of the member.

32 (b) If a corporation does not within a reasonable time allow
33 a member to inspect and copy any other record, the member who
34 complies with subsections 16.02(b) and (c) may apply to the [name
35 or describe court] in the county where the corporation’s principal
36 office (or, if none in this state, its registered office) is located for
37 an order to permit inspection and copying of the records demanded.
38 The court shall dispose of an application under this subsection on
39 an expedited basis.

40 (c) If the court orders inspection and copying of the records
41 demanded, it shall also order the corporation to pay the member’s
42 costs (including reasonable counsel fees) incurred to obtain the
43 order unless the corporation proves that it refused inspection in

1 good faith because it had a reasonable basis for doubt about the
2 right of the member to inspect the records demanded.

3 (d) If the court orders inspection and copying of the records
4 demanded, it may impose reasonable restrictions on the use or
5 distribution of the records by the demanding member.
6

7 Section 16.05. Limitations on Use of Membership List

8 Without consent of the board, a membership list or any part
9 thereof may not be obtained or used by any person for any purpose
10 unrelated to a member's interest as a member. Without limiting
11 the generality of the foregoing, without the consent of the board a
12 membership list or any part thereof may not be:

13 (1) used to solicit money or property unless such money or
14 property will be used solely to solicit the votes of the members in
15 an election to be held by the corporation;

16 (2) used for any commercial purpose; or

17 (3) sold to or purchased by any person.
18

19 The Comments will include a discussion of reduction and nondisclosure. Finally, this
20 section cannot be reduced or eliminated by the organic rules.
21

22 (B) Upon further review the Reporters request the Committee's permission to revisit the
23 issue of a "Statement of Intent" and propose draft language to be added addressing such a
24 statement. The Minnesota Cooperative Associations Act mandates each member is entitled a
25 "Statement of Membership Interest." This draft does include much of the information mandated
26 by the Minnesota statute. The relevant portion of the Minnesota Act is set forth below for
27 discussion purposes:
28

29 308B.611. Nature of a membership interest and statement of
30 interest owned

31 ***

32 Subd. 2. Statement of membership interest. At the request of any
33 member, the cooperative shall state in writing the particular
34 membership interest owned by that member as of the date the
35 cooperative makes the statement. The statement must describe the
36 member's rights to vote, if any, to share in profits and losses, and
37 to share in distributions, restrictions on assignments of financial
38 rights under section 308B.605, subdivision 3, or voting rights
39 under section 308B.555 then in effect, as well as any assignment of
40 member's rights then in effect other than a security interest.
41

42 The interrelationship between this Section of the draft and the rights of dissociated
43 members and transferees has not yet been fully discussed.

1

2 **SECTION 406. ANNUAL PARTICIPANT’S MEETINGS.**

3 (a) The participants of the cooperative association shall meet annually as
4 provided in the organic rules or at the direction of the board of directors not inconsistent with the
5 organic rules.

6 (b) Annual participants’ meetings may be held in or out of this state at the place
7 stated in the organic rules or by the board of directors in accordance with the organic rules.

8 (c) The board of directors shall report, or cause to be reported at the annual
9 participants’ meeting, the business and financial condition as of the close of the most recent
10 fiscal year.

11 (d) Unless otherwise provided by the organic rules, the board of directors shall
12 designate the presiding officer of the annual participants’ meeting.

13 **Reporter’s Note**

14 This act follows cooperative law and corporate law in providing an annual meeting. This
15 provision should not be variable by the organic rules.
16

17 This section expands the MBCA provision to address issues, *e.g.* meeting chair and
18 financial reports, typically addressed in general cooperative law. Note that there is no time
19 period following the close of the fiscal year in which the meeting must necessarily be held.
20 Annual meetings are not required under general partnership law (*e.g.* UPA (1997)), limited
21 partnership law (*e.g.* ULPA (2001)) or limited liability company law (*e.g.* ULLCA). Best
22 practice would be to coordinate the dates of the meetings in the organic rules.
23

24 Although in the MBCA, could subsection (a) be deleted without harm?
25

26 Finally, this section mandates annual meetings. Should there be a provision for “regular”
27 non-annual meetings that do not need to comply with the special meeting notice provisions.
28

29 **SECTION 407. SPECIAL PARTICIPANTS’ MEETINGS.**

1 (a) Special participants' meetings shall be called:

2 (1) as provided in the organic rules;

3 (2) by a majority vote of the board of directors;

4 (3) by demand in a record signed by participants holding at least 10
5 percent of the votes of any class or group entitled to cast on the matter that is the purpose of the
6 meeting; or

7 (4) by demand in a record signed by participants holding at least 10
8 percent of all votes entitled to be cast on the matter that is the purpose of the meeting.

9 (b) Any voting member may withdraw its demand under subsection (a)(3) or
10 (a)(4) before the receipt by the cooperative association of demands sufficient to require a special
11 participants' meeting.

12 (c) A special participants' meeting may be held in or outside this state at the place
13 stated in the organic rules or by the board of directors in accordance with the organic rules.

14 (d) Only affairs within the purpose or purposes stated pursuant to Section 409(c)
15 may be conducted at a special participants' meeting.

16 (e) Unless otherwise provided by the organic rules, the presiding officer of the
17 meeting shall be designated by the board of directors.

18 **Reporter's Note**

19 To the Reporters' knowledge, the only current question that needs to be addressed is
20 whether subsections (a)(2)-(4) can be varied organically. For what its worth the Reporters would
21 generally suggest "yes" except one Reporter would require (a)(4) be mandatory; (d) "should" (!?)
22 be mandatory.

23
24 The MBCA allows the 10 percent minimum for demand to be varied upward to 25
25 percent if provided in the articles of incorporation.

1 Old section 308 (which followed this section has been deleted as redundant). The matter
2 was discussed by the Committee and it seemed ambivalent. Thus, the Reporters believed they
3 had Committee permission to use their discretion.
4

5 Neither this draft nor the general cooperative statutes consulted provide for any type of
6 “fiduciary duties” for representatives of districts even though agency principles could apply. The
7 Committee has not yet discussed this issue though it has discussed whether members, generally,
8 have fiduciary duties. There exists strong sentiment on the Committee that members, solely by
9 reason of being members, should not have fiduciary duties. A finer issue is whether members
10 owe (or should owe) the cooperative or other members a duty of good faith or fair dealing.
11

12 For the notice required of district meetings *see* Section 408(d).
13

14 **SECTION 408. NOTICE OF PARTICIPANTS’ MEETINGS.**

15 (a) The cooperative association shall notify each participant of the time, date, and
16 place of any annual or special participants’ meeting not less than [15 no more than 60] days
17 before the meeting.

18 (b) Unless the articles of organization otherwise provide, notice of an annual
19 participants’ meeting need not include [a description of] the purpose or purposes of the meeting.

20 (c) Notice of a special participants’ meeting must include [a description of] the
21 purpose or purposes of the meeting as contained in the demand under Section 407(a)(3) and
22 (a)(4) or as voted upon by the board of directors under Section 407(a)(2).

23 **Reporter’s Note**

24 This section is mandatory except (b). Is this correct? The “unless provided by this [act]
25 has been removed the only possible place that might be relevant is in mergers and in that context
26 it should be revisited. A question was raised at the 2005 Annual Meeting about the “description”
27 language. The Committee needs to decide whether (or not) to leave it in.
28

29 The Committee has discussed the bracketed 15 day notice and the long-end has been
30 added for discussion purposes. It is tentative.
31

32 Old subsection (d) has been moved.

1

2 **SECTION 409. WAIVER OF PARTICIPANT’S MEETING NOTICE.**

3 (a) A participant may waive notice of any meeting of the participants either

4 before, during, or after the meeting.

5 (b) A participant’s participation in a meeting is waiver of notice of that meeting

6 unless the participant objects to the meeting at the beginning of the meeting or promptly upon its

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

8 **SECTION 410. QUORUM OF PARTICIPANTS.** Unless the articles of organization

9 provide otherwise, the voting power of those participants present at an annual or special

10 participants’ meeting constitutes a quorum.

11 **Reporter’s Note**

12 This section states a default rule. The “unless the articles otherwise provide” will be

13 removed and it would not be listed as mandatory previous in the draft. The Reporters would

14 suggest that this be revisited to state a high quorum rule as a default.

15

16 The interaction of Sections 409 and 410 means that a member objecting to a meeting

17 under Section 409 is present for purposes of the quorum under 410. The quorum is low. The

18 quorum requirement could, of course, be bifurcated by the number of the cooperative’s members.

19 Is “voting power” a confusing term? Could it be replaced with “votes”?

20

21 **SECTION 411. VOTING BY PATRON PARTICIPANTS.**

22 (a) Each patron participant has one vote but the organic rules may provide

23 additional voting power to participants on the basis of patronage under Section 314(a) and may

24 provide for voting by district, group, or class under subsection (b).

25 (b) If a cooperative association has both patron and investor participants:

26 (1) the aggregate voting power of all patron participants may not be less

1 than [two-thirds] [three-fourths] of the entire voting power entitled to vote [but the organic rules
2 may reduce the collective voting power of patron participants to not less than a majority of the
3 entire voting power entitled to vote]; and

4 (2) the entire aggregate voting power of patron participants shall be voted
5 as determined by the majority vote of patron participants voting at the participants' meeting.

6 **Reporter's Note**

7 Old subsections (b) and (c) have been moved (consolidated) in another section dealing
8 with delegate voting.
9

10 This section needs to be revisited and discussed within the matrix of rights and powers.
11 As drafted the equity investors have fewer rights and less initial negotiating power than do
12 lenders who regularly require veto authority over a variety of matters. This goes to the heart of
13 the ability of this organization to reduce its cost of capital by seeking such investors. One
14 solution present in current cooperative association is permitting the patrons to have a minority
15 position.
16

17 As drafted, this act is the worst of both worlds for investors and patron members
18 attempting to reduce their cost of capital and formulate a viable economic organization. The
19 Committee needs to return to the idea of (a) reducing the patron majority block (making the
20 organization have the look and feel of an LLC); or, probably more viably, (b) at least providing
21 for true class voting providing the investors the ability to block/veto (like lenders) but not
22 dominate affirmative action. If the voting scheme more closely followed corporate-like class
23 voting it would also, at least conceptually, make the investors and this act look more like limited
24 partners in a limited partnership. The place within the act to place any such provisions would be
25 in subsection (b). It might also be drafted as an alternative though that compromise is probably
26 less than satisfying to the Committee. The class voting was suggested by a Commissioner on the
27 floor of the 2005 Annual Meeting.
28

29 Subsection (b) has been reformulated and redrafted. The general meeting notice
30 provisions should be equally applicable to (b)(2).
31

32 The quantum of voting reserved to patron members under subsection (b) is controversial
33 because it is a departure from the general law of cooperatives. It has been controversial in
34 Committee discussion. It is also one of the primary changes that allows for greater flexibility for
35 capital formation. Other "new generation" cooperative laws are far less restrictive than this draft.
36 For example, Minnesota substitutes fifteen (15) percent for the two bracketed alternatives and the
37 "majority" floor.

1 This section is mandatory.
2

3 **SECTION 412. ACTION WITHOUT A MEETING.**

4 (a) Unless otherwise provided by the organic rules, any action that may be taken
5 by the participants may be taken without a meeting if each participant entitled to vote on such
6 action consents to the action in a record.

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

10 (c) The consent record of any action may specify the effective date or time of the
11 action.

12 **Reporter's Note**

13 This Section states the general rule of unincorporated law and at least some traditional co-
14 op statutes and has been discussed by the Committee.
15

16 **SECTION 413. DETERMINATION OF VOTING POWER OF PATRON**

17 **PARTICIPANT.** The organic rules may provide additional voting power be allocated for each
18 patron participant for:

19 (1) actual, estimated, or potential patronage or any combination thereof;

20 (2) equity allocated or held by a patron participant in the cooperative association;

21 [or]

22 [(3) if the patron participant is a cooperative association, the number of patron
23 participants of the participant cooperative association]; or]

1 [(3)] [(4)] any combination of paragraphs (1), (2), and (3).

2 **Reporter’s Note**

3 Old subsection (b) has been consolidated to the new delegate section (412).

4
5 A question has been raised concerning (a)(2). It was suggested that “equity investments
6 by patron members must reflect an established patronage obligation”. The Reporter needs
7 additional explanation before suggesting any alteration.
8

9 It is hoped the definition of “patronage” in the February 2006 draft mitigates some of the
10 ambiguity of this question.
11

12 **SECTION 414. VOTING BY INVESTOR PARTICIPANTS.** If the organic rules
13 provide for investor participants, each investor participant has one vote except as otherwise
14 provided by the organic rules.

15 **Reporter’s Note**

16 Old subsection (b) stated: “(b) The collective voting power of nonpatron members is
17 subject to section 312(c).” The cross-reference is now 411(b). It is deleted here as surplusage.
18

19 **SECTION 415. MANNER OF VOTING.**

20 (a) Proxy voting by participants is prohibited.

21 (b) Delegate voting based on geographical district, group, or class is not voting by
22 proxy under this [Section].

23 (c) The organic rules may provide for participant voting by secret ballot delivered
24 by mail or other means.

25 **Reporter’s Note**

26 The Committee changed USPS to “mail”. The Reporters added “or other means”
27 consistent with Committee discussion concerning voting by facsimile, etc.
28

1 The Committee needs to decide whether this is mandatory or default. The Reporters
2 believe it should be default.

3
4 In some states proxy voting is not available and in others it is allowed. Perhaps most
5 traditionally, cooperative law often provides for mail ballots.

6
7 Corporate law generally provides for proxy voting. The Uniform Limited Partnership
8 Act (2001) provides for proxy voting (section 118). Any voting by proxy, however, seems to
9 dilute the deliberative function of a required meeting and is at odds with traditional co-op values
10 even though currently allowed by a significant number of states.

11
12 This issue was raised directly on the floor of the 2005 Annual Meeting: (a) a strong
13 opinion was expressed that no proxies be allowed for patron participants but the same
14 Commissioner was ambivalent as to investor participants; (b) the issue was obfuscated by the
15 question of whether an agent exercising the vote of an entity was a “proxy”. The Reporter agreed
16 to look at the question and informally report to the Drafting Committee in 2006.

17 18 **SECTION 416.**

19 **Reporter’s Note**

20 The Reporters request the Committee consider adding the following new section:

21 **ELECTRONIC PARTICIPATION IN MEETING.**

22 The organic rules may provide for participants to attend
23 meeting or conduct participant meetings through the use of any
24 means of communication if all participants attending the meeting
25 can simultaneously communicate with each other during the
26 meeting.

27
28 This is drafted as permissive and it is, therefore, already allowed under this draft.
29 Nonetheless, it avoids having a “default gap” in the statute. That is, it provides an answer where
30 a participant requests the electronic attendance but the organic rules are silent.

31 32 **SECTION 417. DISTRICTS AND DELEGATES.**

33 (a) The organic rules may provide:

34 (1) for the formation of districts and the conduct of participant meetings
35 by districts and that elections of directors may be held at district meetings; or

1 (2) that districts may elect district delegates to represent and vote for the
2 district in annual and special meetings of participants.

3 (b) A delegate selected under subsection (a) has one vote subject to subsection
4 (c).

5 (c) The organic rules may provide additional voting power be allocated to each
6 district, group, or class or delegate for the aggregate of the number of patron participants in each
7 district, group, or class as provided under Section 414.

8 **Reporter's Note**

9 As a matter of drafting this draft attempts to pull together "delegate voting" all in one
10 place. The substance of the section is derived from old sections 308(d), 411(b) and (c), and
11 414(b). A more detailed effort is set forth below:

12 (a) The organic rules may provide:

13 (1) for the formation of districts, units, groups, or classes of
14 participants;

15 (2) that districts, units, groups, or classes of participants
16 may elect district, unit, group or class delegates to represent and
17 vote for the district, unit, group or class in annual and special
18 meetings of participants and elect directors;

19 (3) that the delegates may vote on matters at the
20 participants meetings in the same manner as a participant.

21 (b) Delegates may only exercise the voting rights on a basis and
22 with the number of votes as prescribed in the organic rules.

23 (c) If the approval of a certain portion of the participants is
24 required for adoption of amendments, dissolution, merger,
25 consolidation, or the sale of assets, the votes of delegates shall be
26 counted as votes by the participants represented by the delegate.

27 (d) Except as provided in this Section or in the organic rules, a
28 delegate selected under subsection (a) has one vote subject to
29 subsection (c).

30 (e) The organic rules may provide additional voting power be
31 allocated to each district, group, or class or delegate for the
32 aggregate of the number of patron participants in each district,
33 group, or class as provided under Section 414.

34 (f) If the cooperative association has formed districts, units, groups,
35

1 or classes of participants that elect delegates, then all provisions of
2 this [Article] relating to meetings of participants shall be construed
3 to apply to the delegates and not to the participants except those
4 provisions shall remain applicable to participants with respect to
5 participants at meetings of the districts, units, groups, or classes of
6 participants.

1 **ARTICLE 5**

2 **PARTICIPANT INTERESTS**

3
4 **SECTION 501. PARTICIPANT INTEREST.** A participant's interest:

5 (1) consists of (a) governance rights under allocation and distributions; (b)
6 financial rights; and (c) the right or obligation, if any, to do business with the cooperative
7 association;

8 (2) is personal property; and

9 (3) may be in certificated or uncertificated form.

10 **Reporter's Note**

11 The first sentence of this Section was deleted at direction of the Committee. The
12 Committee instructed the Reporter to attempt to provide more clarity concerning the bundle of
13 rights a member possessed not only in this Section but throughout this Article. The balance of
14 the changes in this Section are an attempt to provide such clarity.

15
16 The purpose of this Section is to identify the universe of rights of a participant as
17 contemplated under the Act. Note that these rights may not be exclusive to a participant, even
18 though the participant has them. For example, a nonparticipant may have the ability ("right") to
19 pull up to a co-op gas pump and purchase gas (thus, do business with the cooperative
20 association). On the other hand, some cooperative associations contemplated by this act may
21 restrict the use of co-op serves only to participants (*e.g.* grocery purchasing cooperatives).
22 Further, some cooperative associations may obligate members to deliver a specified volume of
23 production. This Section does not address the rights of non-participants.

24
25 Confusion, if any, results from starting "backwards". Some cooperative associations
26 deem "membership" automatically if you use their services (*e.g.* telephones). The latter is more
27 appropriately viewed as a membership qualification and admission provision rather than as the
28 rights of a member. That is, once a member (participant), the individual has some combination
29 of the rights delineated in Subsection (a)(b) or (c).

30
31 Another related issue, that is probably a confounding variable but very important, is the
32 (using normative nomenclature) "non-member patron". This Section does not govern non-
33 members. At base, non-member patrons are a species of third-party contracts whose contract

rights may be delineated in the organic rules. Does there need to be something addressing this species of users in the organic rule article?

SECTION 502. PATRON AND NON PATRON PARTICIPANT INTERESTS.

(a) Subject to subsection (b), participant interests must be patron participant interests.

(b) The organic rules may establish investor participant interests.

Reporter's Note

The February 2006 Draft deletes a substantial amount of language from this Section as surplusage given the provisions found elsewhere, including new definitions under Article 1.

Previous Note:

Note that the draft give the organic rules broad flexibility to vest power in the board. One of the hallmarks of the act is flexibility but is this “too much”? Suggestions on how to make the language in (a) and (b) more parallel would be appreciated.

The draft of this section is conceptually consistent with the Minnesota Cooperative Associations Act. It differs, however, in that the Minnesota Act contains subsections governing the form of the board of resolution and a subsection detailing, without limitation, the kinds of rights and preferences difference classes might possess (*e.g.* cumulative distributions, distribution preferences, and voting rights).

If an agricultural cooperative governed by this draft had not provided for nonpatron interests, but after formation decided to do so, it would be required to amend either its articles or bylaws to so provide. This draft requires a two-thirds member vote for bylaw amendments dealing with members' relative rights and preferences and all article amendments require two-thirds vote (of those votes present at the members meeting).

In order to understand Article 4 it is necessary to reference Article 8 (“Contributions, Allocations and Distributions”). It may be necessary to add a definition (Section 102) for financial rights to clarify the intent of Articles 4 and 8. *See*, Section 404, Reporter's Note.

SECTION 503. TRANSFERABILITY OF PARTICIPANT INTERESTS.

(a) Unless otherwise provided in the organic rules and subject to subsection (b),

1 participant interests are not transferable. The terms of the restriction on transferability must be
2 set forth in the cooperative association organic rules, the participant records of the cooperative
3 association, and must be conspicuously noted on any certificates evidencing a participant's
4 interest.

5 (b) A participant may transfer its financial rights in the cooperative association
6 unless the transfer is restricted or prohibited by the organic rules.

7 (c) The transferee of a participant's financial rights has, to the extent transferred,
8 the right to share in the allocation of surplus, profits, or losses and to receive the distributions to
9 the participant transferring the interest.

10 (d) The transferee does not become a participant upon transfer of a participant's
11 financial rights unless it is admitted as a participant by the cooperative association.

12 (e) A cooperative association need not give effect to a transfer under this Section
13 until the cooperative association has notice of the transfer.

14 (f) A transfer of a participant's financial rights in violation of a restriction or
15 prohibition on transfer contained in the organic rules is void.

16 **Reporter's Note**

17 Prior subsection (d) repeated a concept dealt with in another Section in the draft but
18 stated it in different terms. It's deletion avoids interpretive mischief.

19
20 This Section (and article) is based on unincorporated organizational law. For purposes of
21 the 2005 Annual Meeting it remains unchanged; however, that should not be interpreted as a
22 Drafting Committee decision to confirm this language. There was much concern expressed
23 about the intent, operation, and drafting of this Article. As stated in the Reporter's Notes to other
24 sections the confusion is definitionally rooted. At least to some extent, any ambiguity in the
25 current draft reflects overlapping use of the terms in the industry.

26
27 Most broadly the solution rests in the following concepts: value given, allocated, or paid

1 based on:

2
3 (i) the use of the cooperative (*e.g.*, in a supply co-op the amount paid by a person
4 for petroleum products during the year) relative to the financial performance of the cooperative;

5
6 (ii) the delivery of products sold to (*e.g.*, marketing cooperatives) or services
7 rendered (*e.g.*, worker cooperatives) to or on behalf of the cooperative;

8
9 (iii) an allocation and/or distribution based on membership or investment in the
10 cooperative.

11
12 Even under existing traditional law there is a great deal of flexibility given cooperatives
13 to fashion these payments. For example: entering into a marketing contract (direct payment) with
14 a producer might require that producer to be a member of the cooperative (and membership may
15 require an investment – nominal or otherwise) and that any member may receive a year-end
16 allocation based on the value of product delivered under the contract (and any other additional
17 product accepted outside the contract) relative to the performance of the cooperative. Further,
18 under current corporate based statutes, “investors” might purchase preferred stock and, subject to
19 legal capital constraints, be guaranteed a return.

20
21 On the other hand, the cooperative may not require membership for entering to a
22 marketing contract but under its contractual terms promise participation in a defined financial
23 pool based on the value of the product at time of delivery.

24
25 Given these two scenarios a reasonable interpretation is that there can be *patron members*
26 (the producer with the marketing contract requiring membership); *nonpatron members*
27 (analogous to the preferred shareholder); and, *nonmember patrons* (the producer with the
28 marketing contract that does not require membership but whom receives a *contractual* payment
29 based on “business done”).

30
31 Under the current draft “membership” is not transferable. Thus the member cannot
32 transfer her voting rights. If a marketing contract *requires* membership as a condition precedent
33 then, as a practical matter the contract could not be assigned. (Note, however, that payments *on*
34 *account* of the contract would be subject to other law). If, however, the marketing contract does
35 *not* require membership; the assignability of the contract or the delegation of its performance
36 would be governed by contract law outside this draft (personal contract?, anti-assignment
37 clauses?, *etc.*).

38
39 Of course, the contract itself could state it is assignable with or without consent of the
40 cooperative. Likewise, the articles could allow transfer of the membership interest with or
41 without consent of the cooperative.

42
43 So the financial interest of the membership is highly contextual on the organic documents

1 and the “deal”. Nonetheless, there is a dichotomy between the membership interest and the
2 marketing contract and it seems in the typical the financial interest of the member would *not*
3 include right to payment under the marketing contract because that would be governed by
4 contract law.

5
6 The right *of a member as a member* to receive an allocation based on patronage (or
7 otherwise) under the default rule, however, would be a financial right.

8
9 Other uniform unincorporated acts use the term “transferable interest” which might cause
10 less confusion.
11

12 **SECTION 504. SECURITY INTEREST.**

13 (a) A participant or transferee may grant a security interest in financial rights in a
14 cooperative association, but not in the governance rights. The granting of a security interest in
15 financial rights is not considered a transfer for purposes of Section 503. Upon foreclosure of a
16 security interest in financial rights a person obtaining the financial rights shall only obtain
17 financial rights subject to the security interest and shall not obtain any governance rights or other
18 rights with respect to the cooperative association.

19 (b) The limitation of this Section to financial rights shall not apply in the case of
20 a participant interest that is not subject to a restriction or prohibition on transfer under the organic
21 rules.

22 **Reporter’s Note**

23 This Section pulls former Section 403(g) (security grant not a transfer) and is an attempt
24 to respond to Committee direction from the October 2005 meeting.
25

26 Two questions: (1) May the organic rules legally limit the effect of granting a security
27 interest under other law; (2) May the organic rules legally limit a participant from granting a
28 security interest under other law.
29

30 The issue of off-set is not addressed by this Section.
31

1 **SECTION 505. CHARGING ORDERS FOR A JUDGMENT CREDITOR OF**
2 **PARTICIPANT OR TRANSFEREE.**

3 (a) On application by a judgment creditor of a participant or transferee, a court
4 may enter a charging order against the financial rights of the judgment debtor for the unsatisfied
5 amount of the judgment. To the extent necessary to effectuate the collection of distributions
6 pursuant to the charging order, the court may:

7 (1) appoint a receiver of the share of the distributions due or to become
8 due to the judgment debtor in respect of the financial rights, with the power to make all inquiries
9 the judgment debtor might have made; and

10 (2) make all other orders which the circumstances of the case may require.

11 (b) A charging order constitutes a lien on the judgment debtor's financial rights
12 and requires the cooperative association to pay over to the person issued the charging order any
13 distribution that would otherwise be paid to the participant or transferee whose financial rights
14 are subject to the charging order. Upon a showing that distributions under the charging order
15 will not pay the judgment debt within a reasonable time, the court may foreclose the lien and
16 order the sale of the financial rights that are subject to a charging order. The purchaser at the
17 foreclosure sale:

18 (1) does not thereby become a participant;

19 (2) obtains only the financial rights; and

20 (3) unless the purchaser is the cooperative association or a person already
21 a participant, acquires the interest merely as a participant.

22 (c) At any time before foreclosure, the judgment debtor may extinguish the

1 charging order by satisfying the judgment and filing a certified copy of the satisfaction with the
2 court that issued the charging order.

3 (d) At any time before foreclosure, the cooperative association or one or more
4 participants financial rights not subject to the charging order may succeed to the charging order
5 by satisfying the judgment and filing with the court that issued the charging order a certified copy
6 of the satisfaction of judgment and an affidavit stating the amount paid to satisfy the judgment.
7 The participant may not use the cooperative association to satisfy the judgment under this
8 subsection. The cooperative association may act under this subdivision only with the consent of
9 all participants whose financial rights are not subject to the charging order.

10 (e) When a person succeeds to a charging order under this subsection:

11 (1) the amount of the lien is the amount paid to satisfy the judgment, plus
12 interest from the date of satisfaction at the rate applicable to judgments;

13 (2) the lien's priority with regard to other creditors of the participant or
14 transferee whose financial rights are subject to the charging order remains unchanged; and

15 (3) the successor has the same rights under this Section as the judgment
16 creditor that originally obtained the charging order but the successor's claim against the
17 participant or transferee whose financial right is subject to the charging order is limited to any
18 distributions the successor is entitled to under the charging order and to proceeds of any
19 foreclosure sale.

20 (f) This [act] does not deprive any participant or transferee of the benefit of any
21 exemption laws applicable to the participant or transferees financial rights.

22 (g) This section provides the exclusive remedy by which a person seeking to

1 enforce a judgment against a participant or transferee may, in the capacity of judgment creditor,
2 satisfy the judgment out of the judgment debtor's financial rights.

3 (h) The limitations of this Section to financial rights shall not apply in the case of
4 a participant interest that is not subject to a restriction or prohibition on transfer under the organic
5 rules.

6 **Reporter's Note**

7 This Section, except for subsection (h) is from the ULLCA revision project and is the best
8 treatment of the rights of judgment creditors that has been found by the Reporters.
9

10 The original Section was derived with minor modification from ULPA (2001). The
11 charging order provision has been the subject of much discussion in conjunction with the
12 Conference's current LLC drafting project. There is an ever growing body of literature (but only
13 a few cases) addressing charging orders of member's interests when the member is in
14 bankruptcy. The Reporter will be happy to discuss those cases if so requested.

15 Many cooperative acts address set-off by the cooperative of obligations owed it by the
16 members and establish priority in the cooperative for such set-off. This draft leaves set-offs to
17 other law. Several advisors remain uncomfortable with this decision but it has not been revisited
18 by the Drafting Committee. The Committee will do so sometime in 2005-2006. The issue
19 interrelates with UCC Art. 9, and other state creditor rights statutes. Set-off is expressly
20 provided under some banking law statutes. For purposes of uniformity, a more extensive search
21 of "modern" corporate-based cooperative statutes will be undertaken by the Reporter.
22

23 The distinction between *member's* financial interest and contractual rights under a
24 marketing contract (in those marketing cooperatives which choose to have market contracts) is
25 made in the definition of financial rights.
26

27 At the risk of being more confusing than helpful: The case where membership is required
28 in order to enter into a marketing contract is probably the most difficult case. If the cooperative
29 chooses to make membership transferable (a derivation from the default rule) it needs to carefully
30 define the "entitlement". For example, it might desire a consent right for the transfer of the
31 membership interest based on proven ability to produce its articles might more clearly delimit
32 that membership is a necessary but not sufficient precondition for actually entering the contract.
33

34 Nonetheless: If the membership interest *entitles* the member to enter into a contract and
35 the membership interest and the underlying contract are freely transferable; THEN those rights
36 and the value of those rights would be subject to sale at foreclosure. Payments made under an

1 existing contract, however, would be contract rights not financial rights not subject to this
2 Section and would be governed by that law.

3
4 Any other amounts allocated to a member *as a member* or any return of contributed
5 capital would also be subject to this Section (when paid in a charging order without foreclosure).

6
7 The assumption in the foregoing illustration:

8
9 (i) will occur only in marketing cooperatives that enter into marketing contracts;
10 and

11
12 (ii) will occur only where the cooperative has made a decision to deviate from the
13 default rule of nontransferability of membership interests (caveat: the bankruptcy courts are
14 currently struggling with this issue as a matter of LLC law).

15
16 In sum, it is highly contextual and most confusion will not be caused by the act under the
17 default rules because the cooperative has the ability to formulate the rules that frame the context.

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SECTION 601. AUTHORITY. Unless otherwise provided by organic rules, a cooperative association may contract with another party, who need not be a patron participant , requiring the other party to:

(1) sell, or deliver for sale or marketing on the person's behalf, a specified portion of the other party's agricultural product or specified commodity exclusively to, or through, the cooperative association or any facilities furnished by the cooperative association or authorize the cooperative association to act for the party in any manner with respect to the product; and

(2) buy or procure from or through the cooperative association or any facilities furnished by the cooperative association, all or a specified part of the goods or services to be bought or procured by the party or authorize the cooperative association to act for the party in any manner in the procurement of goods or the performance of services.

This language is adapted from *Or. Rev. Stat.* § 62.355. See, *West's Ann. Cal. Food & Agric. Code* §§ 54261-266.

Historically, the language of this article has been confined to agricultural marketing contracts. The language of this Section expands the concept to all kinds of marketing contracts and adds supply cooperatives to the provisions of the article. Questions the Committee should address are: (1) Should the types of contracts envisioned by this Section be available to all kinds of cooperatives organized under this statute? (2) If so, in connection with discussion of the breadth of the act, consideration should be given to whether the language is broad enough to cover the activities of housing cooperatives or worker owned cooperatives?

1 **SECTION 602. MARKETING CONTRACTS.**

2 (a) The contract may provide for sale of the product or commodity to the
3 cooperative association, and, if so, the sale transfers title absolutely to the cooperative association
4 except for security interests properly perfected under other law, upon delivery or at any other
5 specific time expressly provided by the contract.

6 (b) The contract may authorize the cooperative association to grant a security
7 interest in the product or commodity delivered, and may provide that the cooperative association
8 may sell the product or commodity delivered, and pay or distribute the sales price on a pooled or
9 other basis to the other party after deducting the following:

10 (1) selling, processing, overhead, and other costs and expenses; and

11 (2) reserves for the purposes set forth in Section 905.

12 **Reporter's Note**

13 The topics covered in this Section are common to all statutes but the language is novel
14 based upon discussion at the last Committee meeting. It is important because cooperatives need
15 to clearly ascertain whether the contract is a “buy-sell” or “agency” contract not only as a matter
16 of state law but because of issues raised by pending federal income taxation litigation under the
17 taxation of cooperatives. The tax issues become more complex if a cooperative under this draft
18 is taxed as a partnership. Moreover, there is at least one financial accounting issue which turns
19 on the type of contract.

20
21 Many of the current statutes stress “title” which in other contexts has been ceded to UCC
22 law so, at least arguably, language in the older statutes may be anachronistic though Committee
23 discussion observed the importance of “insurable title” to the cooperative. The Committee has
24 not vetted this particular language and the reporter has little confidence that this language is yet
25 “dialed-in” appropriately. If the act authorizes contracts for purposes other than marketing,
26 additional provisions or a separate section dealing with the other types of contracts may be
27 required.
28

29 **SECTION 603. TERM OF CONTRACT.** A single term of a contract may not exceed

1 10 years but may be renewable for additional periods not exceeding five years each subject to the
2 right of either party not to renew by giving record notice during a period of the current term as
3 specified in the contract.

4 **Reporter's Note**

5 The substance of this Section is common to many cooperative statutes.
6

7 **SECTION 604. REMEDIES FOR BREACH OF CONTRACT.**

8 (a) The contract or organic rules may establish a specific sum of money as
9 liquidated damages to be paid by a patron participant to the cooperative association. The
10 damages may be a percentage of the value of a specific amount per unit of the product, goods, or
11 services involved by the breach or a fixed sum of money.

12 (b) If there is a breach or threatened breach of a contract the cooperative
13 association is entitled to an injunction to prevent the breach and continuing breach and to a
14 judgment of specific performance. Pending the adjudication of the action, and upon filing
15 sufficient bond, the cooperative association is entitled to a temporary restraining order and a
16 preliminary injunction.

17 **Reporter's Note**

18 Source: *See generally* Minnesota Cooperatives Associations Act, Oregon Cooperative
19 Corporations Act. Former section 505 was entitled "Contract Interference and False Reports". A
20 version of section 505 now appears at section 1703 for ease of its discussion with related
21 provisions. Dependent on the resolution of the policy (and legislative enactment) discussion the
22 Committee is invited to decide where those provisions should appear in the act.
23

24 A number of State statutes provide significantly more detail regarding the possible
25 remedies available for a breach of contract and clearly specify that recovery of attorneys fees is to
26 be obtained if the cooperative is successful in pursuing the breach of contract claim.
27

1 [ARTICLE] 7

2 DIRECTORS AND OFFICERS

3
4 SECTION 701. EXISTENCE AND POWERS OF BOARD OF DIRECTORS.

5 (a) A cooperative association must have a board of directors consisting of three or
6 more directors as set forth in the organic rules unless the number of participants is less than three.
7 If there are fewer than three participants, the number of directors may not be less than the number
8 of participants in the cooperative association.

9 (b) The affairs of the cooperative association must be managed by, or under the
10 direction of, the board of directors.

11 (c) A director does not have agency authority on behalf of the cooperative
12 association solely by being a director.

13 Reporter's Note

14 The language used in subsection 601(a) is modeled on section 62.280(2) of the Oregon
15 Cooperative Corporation Act. Some statutes, for example, the California Nonprofit Association
16 Act require a minimum of three directors. This subsection allows the articles to establish the
17 number of directors at a number greater than three in all cases. The subsection does not limit the
18 number of directors to the number of participants where there are fewer than three participants .
19

20 The flexibility afforded to deviate below three directors recognizes the industry practice
21 of having wholly owned cooperative subsidiaries of a cooperative. In those circumstances the
22 Committee saw little necessity of having more than one director. Further, if there are two
23 participants the Committee decided that it would be ill-advised to require a minimum of three
24 directors. Thus, subsection 701(a) provides the participants great flexibility, but not unfettered
25 flexibility, in organizing their own board governance structure.
26

27 The word "may" in subsection (a) following "the number of directors" replaces the word
28 "shall" as a matter of style. The Committee may want to discuss this change.
29
30

SECTION 702. NO LIABILITY AS DIRECTOR FOR COOPERATIVE ASSOCIATION'S OBLIGATIONS. An obligation of a cooperative association, whether arising in contract, tort, or otherwise, is not the obligation of a director. A director is not personally liable, directly or indirectly, by way of contribution or otherwise, for an obligation of the cooperative association solely by reason of being a director.

Reporter's Note

Source: Derived from ULPA (2001). "New" to the law of cooperatives.

SECTION 703. QUALIFICATIONS OF DIRECTORS AND COMPOSITION OF BOARD.

(a) A director must be an individual.

(b) The organic rules may provide for qualification of directors subject to this Section.

(c) Except as otherwise provided in the organic rules and subject to subsections (d) and (e), each director must be a participant of the cooperative association or a designee of a participant that is not an individual.

(d) Unless otherwise provided in the organic rules, a director may be an officer or employee of the cooperative.

(e) If the cooperative association is permitted to have nonparticipant directors by its organic rules, the number of nonparticipant directors may not exceed:

(1) one director if there are two, three, or four directors; and

(2) one-fifth of the total number of directors if there are five or more

1 directors.

2 **Reporter's Note**

3 Subsections (c) and (e) reflect the consensus of the Committee. The word
4 “representative” in a prior draft has been replaced by the word “designee” in an attempt to cause
5 less confusion concerning to whom the director owes allegiance under this Act. There was no
6 prohibition that officers may not serve as directors and subject to discussion at the November
7 2004 meeting subsection (d) [formerly(c)] has been added. Note that the number of nonmember
8 directors is severely restricted and reflects a cooperative policy that is different than corporate
9 policy and at odds with the general thrust of federal securities laws for publicly traded
10 corporations.

11
12 An observer has suggested that the Committee should discuss the advisability of being
13 more explicit (perhaps by using separate Sections) about how directors may be elected solely by
14 participants if there are only participants and about how directors are elected if the cooperative
15 has both patron and investor participants utilizing classification of directors and giving similar
16 consideration to removal in section 707.

18 **SECTION 704. ELECTION OF DIRECTORS.**

19 (a) At least two-thirds of the board of directors of a cooperative association must
20 be elected exclusively by patron participants.

21 (b) The articles of organization may provide for the election of all or a specified
22 number of directors by the holders of one or more groups or classes of participants' interests.

23 (c) The organic rules may provide for the nomination or election of directors by
24 geographic district directly or by district delegates.

25 (d) Cumulative voting is prohibited unless otherwise provided in the articles of
26 organization.

27 (e) Except as otherwise provided by the organic rules under subsection (c) or in
28 Section 709, participant directors must be elected at an annual participants' meeting.

29 (f) Nonparticipant directors must be elected in the same manner as participant

1 directors unless the organic rules provide for a different method of selection.

2 **Reporter's Note**

3 Subsection (c) was new in the April 2005 draft and has been revised pursuant to
4 discussion at that meeting. Corporate statutes typically no longer define "cumulative voting".

5
6 Subsection (e) is new. Some advisors to the drafting committee suggested that the act
7 specifically acknowledge the use of an appointment process for nonparticipant directors. These
8 directors are used to provide special expertise on cooperative boards.

9
10 Subsection (f) allows the organic rules to provide for the selection of special
11 nonparticipant directors but such selection is not subject to further default rules. Because this
12 section is subject to the other general "participant" restrictions it may not "work". The
13 Committee should consider this provision.
14

15 **SECTION 705. TERMS OF DIRECTORS.**

16 (a) A director's term expires at the annual participants meeting following the
17 director's election unless otherwise provided in the articles of organization. The term of a
18 director may not exceed three years.

19 (b) Unless otherwise provided in the organic rules, a director may be reelected for
20 subsequent terms.

21 (c) A director continues to serve as director until a successor director is elected
22 and qualified or until the director is removed, resigns, or dies.

23 **Reporter's Note**

24
25 If a successor is not elected the director previously in the position would continue to serve
26 under the operation of this section. This section coordinates with section 709 ("Vacancy on
27 Board") Is "may" the correct choice in subsection (a) second sentence (again a matter of style
28 more than substance).
29

1 **SECTION 706. RESIGNATION OF DIRECTORS.**

2 (a) A director may resign at any time by giving notice in a record to the
3 cooperative association.

4 (b) A resignation is effective when notice is received by the cooperative
5 association unless the notice states a later effective date.

6 **Reporter's Note**

7 A distinction between the “power” to resign and the “right” to resign contained in prior
8 drafts has been removed as causing more substantive confusion than is necessary despite the
9 concept being consistent with ULLCA. “May” consistent with style has been utilized instead.
10

11 **SECTION 707. REMOVAL OF DIRECTORS BY PARTICIPANTS.**

12 (a) The participants may remove a director only for cause unless the organic rules
13 provide for removal without cause.

14 (b) A participant or participants holding an aggregate of 10 percent of the voting
15 power of the cooperative association may petition the board of directors for the removal of a
16 director by submitting a signed record to the officer of the cooperative association charged with
17 keeping its records, stating the alleged causes for removing the director, unless the organic rules
18 provide for removal without cause.

19 (c) Upon receipt of the petition for removal, the board of directors shall call a
20 special board meeting to determine whether the director should be removed.

21 (d) The director against whom a petition has been submitted:
22 (1) must be informed in a record of the petition before the board meeting
23 at which the board considers the petition; and

1 (2) is entitled to an opportunity at the meeting to be heard in person or by
2 representation and to present witnesses.

3 (e) The participant or participants signing the petition are entitled to the same
4 opportunity to be heard and present witnesses as provided the director in subsection (d)(2).

5 (f) A director may be removed by a majority vote of the directors not subject to
6 removal.

7 (g) If directors may only be removed for cause and all directors are subject to
8 removal, then removal for cause must be determined:

9 (1) by a nonparticipant director appointed pursuant to the organic rules; or

10 (2) if the organic rules do not provide for the appointment of a
11 nonparticipant director, by appointment of a committee composed of individuals who are not
12 directors under Section 717 or by independent legal counsel retained by the cooperative
13 association for that purpose.

14 (h) A director removed for cause under subsection (g) may require a special
15 participants meeting to determine removal by submitting a signed record to the cooperative
16 association. The procedure of the special participants meeting must provide the same
17 opportunities to be heard and present witnesses as are provided in subsections (d) and (e). The
18 director may be removed by the same affirmative vote and in the same manner as the director's
19 election.

20 **Reporter's Note**

21 Subsections (a) through (h) have been revised. They generally follow the procedure
22 established in West's California Code Annot. section 54150 (it is unclear whether California
23 requires "for cause" removal only because its statute uses the term "charge" rather than petition)

1 and Colorado Revised Statute section 7-56-404 (Colorado includes that the meeting must be held
2 within 90 days of receipt of the petition). Should “cause” removal be modifiable by organic
3 rule?
4

5 In response to discussion on the floor, subsection (g) has been created from what was the
6 second sentence of subsection (f) in the prior draft. The draft currently does not specify who
7 appoints the committee that would remove the director for “cause” under subsection (g)(2). This
8 should be given attention.
9

10 “Cause” is not defined in the act. Should it be? Does Section 608 define “cause” for
11 purposes of Section 607?
12

13 Subsection (h) should probably be revisited. The quantum of vote it requires is a vestige
14 from a prior version of this section that provided for both “cause” and “no cause” removal. The
15 Committee has not yet fully discussed the quantum requirement. Is “may” the correct word
16 choice in the last sentence of (h)?
17

18 The intent of the section as drafted is that the “10 percent” in (b) be participants of any
19 class but that the vote would be by only those participants who elected the director. Is that the
20 Committee’s intent?
21

22 An observer has raised two questions suggesting this Section and Section 708 need more
23 thought: (I) May the patron participants petition the Board for removal of a director elected by
24 nonpatrons, and vice versa? (ii) If a majority of the Board represents patron participants, should
25 those directors have the authority to remove a nonpatron participant director? These questions
26 may be especially relevant if removal without cause is permitted by the organic rules.
27

28 **SECTION 708. SUSPENSION OF DIRECTOR BY BOARD.**

29 (a) The board of directors may suspend a director if, considering the director’s
30 course of conduct and the inadequacy of other available remedies immediate suspension is
31 necessary for the best interests of the cooperative association and the director is engaged in:

32 (1) fraudulent conduct with respect to the cooperative association or its
33 participants;

34 (2) gross abuse of the position of the director; or

35 (3) intentional infliction of harm on the cooperative association.

(b) After suspension, a director may be removed pursuant to Section 707.

Reporter's Note

The Reporter was requested at the November 2004 meeting to draft different judicial removal of director alternative that would be the equivalent of “changing the locks” on cooperative management was instructed at the April 2005 meeting to delete judicial removal. The absence of judicial removal is inconsistent with other cooperative statutes, ULLCA, and RULPA. The reason for the deletion of judicial removal is to avoid the time and expense of going to court which is consistent with the *values* of cooperatives but not necessarily the cooperative statutes. Below is an example of a very short judicial removal proceeding provision. For purposes of discussion: (I) There is room for “control group” (oligarchy) abuse and majoritarian tyranny if judicial removal is not allowed; but, (ii) because of possible abuse through minority threat if it is allowed in the organic rules (assuming it is not statutorily allowed or required), would a court find a way to nonetheless remove a director. Should the act do something more affirmative?

REMOVAL OF DIRECTORS BY JUDICIAL PROCEEDING.

(a) On application by the cooperative the [appropriate court] may remove a director if considering the director's course of conduct and the inadequacy of other available remedies removal is in the best interest of the cooperative and the director engaged in:

- (1) fraudulent conduct with respect to the cooperative or its participants ;
- (2) gross abuse of the position of director; or
- (3) intentional infliction of harm on the cooperative.

(b) This section does not limit the equitable powers of the court to order other relief.

SECTION 709. VACANCY ON BOARD.

(a) Unless the organic rules otherwise provide, a vacancy on the board of directors must be filled:

- (1) by majority vote of the remaining directors until the next annual participants meeting or special participants meeting held for that purpose; and
- (2) for the unexpired term by participants at the next annual participants' meeting or special participants meeting called for that purpose.

(b) If the vacating director was elected by a group or class of participants interest

or by group, class, or district:

(1) the appointed director must be of that group, class, or district; and

(2) the election of the director for the unexpired term must be conducted

in the same manner as would the election for that position without a vacancy.

Reporter's Note

This Section does not appear to address replacing a nonparticipant director. This subject would need to be addressed in the organic rules that establish the appointment or election of nonparticipant directors under subsection 604(f).

SECTION 710. COMPENSATION OF DIRECTORS. Unless the organic rules otherwise provide, the board of directors may fix the remuneration of directors and nondirector committee participants appointed under Section 717(b).

Reporter's Note

Source: MBCA section 8.11. In effect this is an “opt-out” statute, *i.e.*, unless the organic rules prohibit. It could also be drafted as an opt-in, *i.e.*, the organic rules would need to allow the directors to set their own remuneration. One question concerns whether the term “remuneration” is the best word choice. It is intended to be a broad term including both director’s fees and expenses. Obviously this has become an important topic in publicly traded corporations. The fiduciary duties applicable to other board decisions are generally applicable here, too. Unlike many corporate acts this act does not give express power to make loans to insiders. An example of an alternative provision discussed by the Committee is found in Or. Rev. Stat. Section 62.300 and is set forth below:

62.300 Compensation and benefits to directors, officers and employees. (1) Unless the bylaws provide otherwise, only the members of the cooperative may establish compensation or other benefits for a director, not available generally to officers and employees, for services as a director.

(2) Unless the bylaws provide otherwise, no director shall hold during the term as director any position in the cooperative on regular salary.

(3) Unless the bylaws provide otherwise, the board may provide, for prior or future services of any officer or employee, reasonable

1 compensation, pension or other benefits to such officer or employee
2 and pension or other benefits to a member of the family of the officer
3 or employee. No officer or employee who is a director may take part
4 in any vote on the compensation of the officer or employee for
5 services rendered or to be rendered the cooperative.
6

7 **SECTION 711. MEETINGS.**

8 (a) The board of directors shall meet at least annually and may hold meetings in
9 or outside this state.

10 (b) Unless otherwise provided in the organic rules, the board of directors may
11 permit directors to attend board meetings or conduct board meetings through the use of any
12 means of communication if all directors attending the meeting can communicate with each other
13 during the meeting.

14 **Reporter's Note**

15 The purpose of this section is to provide maximum meeting flexibility. Deletion of
16 simultaneously was to remove the implication that everyone needed to be permitted to speak and
17 hear each other at the same time as opposed to being able to speak and hear one person at a time.
18

19 **SECTION 712. ACTION WITHOUT MEETING.**

20 (a) Unless prohibited by the organic rules, any action that may be taken by the
21 board of directors may be taken without a meeting if each director consents to action in a record.

22 (b) Consent under subsection (a) may be withdrawn by a director in a record at
23 any time before the cooperative association receives a record of consent from each director.

24 (c) The record of consent for any action may specify the effective date or time of
25 the action.

26 **Reporter's Note**

1 The definition of record is in Section 102 and includes electronic medium.
2

3 **SECTION 713. MEETINGS AND NOTICE.**

4 (a) Unless otherwise provided by the organic rules, the board of directors may
5 establish a time and place for regular board meetings and notice of the time, place, or purpose of
6 those meetings is not required.

7 (b) Unless otherwise provided by the organic rules, special meetings of the board
8 of directors must be preceded by at least three days notice of the time, date, and place of the
9 meeting. The notice must contain a statement of the purpose of the special meeting and the
10 meeting must be limited to the matters contained in the statement.

11 **Reporter's Note**

12 Subsection (b) was more closely conformed to RMBCA Section 8.22 (b). At its April
13 (2005) drafting meeting, however, the Committee decided to require the notice to state the
14 purpose of the meeting.
15

16 Best practices might suggest that at least some reminder of a regular meeting and a
17 proposed agenda be given directors prior to the meeting. This draft does not require any such
18 notice because (1) any additional requirements subvert certainty of action taken at meetings; and,
19 (2) it conforms to the purpose of this act to provide a flexible entity to meet the unique needs of
20 different groups organized under it.
21

22 Section 714(a) requires a waiver for the notice in 713(b) to be in a record. This is new
23 following the April (2005) drafting meeting. How well does this work if the meeting is by
24 telephone or other nontraditional means?
25

26 The reporter was directed at the February 2004 Committee meeting to move the following
27 subsection to a Reporter's Note as a matter of economy and for further discussion of its
28 necessity.
29

30 (d) A director who is present at a meeting of the
31 board of directors when action is taken shall be
32 deemed to have assented to the action taken unless:
33 (1) the director objects at the beginning of

1 the meeting or promptly upon the directors arrival at
2 the meeting and does not thereafter vote for or
3 assent to action taken at the meeting;
4 (2) the directors assent or abstention from
5 the action is made in a record
6 (A) in the minutes of the meeting; or
7 (B) the director
8 (i) does not vote for or assent
9 to the action taken at the meeting; and
10 (ii) delivers notice in a record
11 to the presiding officer of the meeting before
12 adjournment or to the cooperative immediately after
13 adjournment of the meeting.
14

15 **SECTION 714. WAIVER OF NOTICE OF MEETING.**

16 (a) Unless otherwise provided in the organic rules, a director may waive any
17 required notice of a meeting of the board of directors in a record before, during, or after the
18 meeting.

19 (b) Unless otherwise provided in the organic rules, a director's participation in a
20 meeting is waiver of notice of that meeting unless the director objects to the meeting at the
21 beginning of the meeting or promptly upon the director's arrival at the meeting and does not
22 thereafter vote for or assent to action taken at the meeting.

23 **Reporter's Note**

24 This Section is typical of corporate-like statutes. There has been strong minority dissent
25 in the Committee concerning "and does not thereafter vote for or...".

26 On the floor a question was presented about what happens if a director attends a special
27 meeting, thereby waiving notice, and a matter is brought up that was not included in the notice.
28 Has the director waived the right to object to the consideration of that matter at the meeting? It
29 was represented the Committee would look at the issue. An additional question from the floor
30 was whether the language made it more beneficial for a member to attend and vote against a
31 proposition rather than object to the meeting and remain silent.

1 **SECTION 715. QUORUM.**

2 (a) Unless otherwise provided in the articles of organization, a majority of the
3 fixed number of directors on the board of directors constitutes a quorum for the management of
4 the affairs of the cooperative association.

5 (b) If a quorum is in attendance at the beginning of the meeting, any action taken
6 by the board of directors present is valid even if the withdrawal of directors originally present
7 results in the number of directors being less than the number required for a quorum.

8 **Reporter's Note**

9 The Committee is concerned that “attendance” in subsection (b) may not be the correct
10 word choice. Given the waiver provisions of section 714 the term “presence” seems even less
11 satisfying. As a point of reference, “attendance” is used in the RMBCA.
12

13 **SECTION 716. VOTING.** Each director has one vote for purposes of decisions made
14 by the board of directors.

15 **Reporter's Note**

16 The sense of the drafting committee is that one-director/one-vote as mandatory and
17 cannot be varied by the organic rules. A prior draft allowed weighted voting and would have
18 moved a cooperative under this act closer to a manager-managed LLC in form. Such flexibility,
19 however, creates both drafting and conceptual operational concerns concerning the voting
20 restrictions protecting patron participants. It is also inconsistent with traditional cooperative law
21 and may be seen as a tool to abuse traditional cooperative values.
22

23 **SECTION 717. COMMITTEES.**

24 (a) Unless otherwise provided by the organic rules, a board of directors may
25 create one or more committees and appoint one or more individuals to serve on a committee.

26 (b) Unless otherwise provided by the organic rules, an individual appointed to

1 serve on committees need not be a director or participant of the cooperative association. An
2 individual serving on a committee has the same rights, duties, and obligations as a director
3 serving on a committee.

4 (c) Unless otherwise provided by the organic rules, each committee may exercise
5 the powers as delegated by the board of directors except that no committee may:

6 (1) approve allocations or distributions except according to a formula or
7 method prescribed by the board of directors;

8 (2) approve or propose to participants action requiring approval of
9 participants; or

10 (3) fill vacancies on the board of directors or any of its committees.

11 **Reporter's Note**

12 Special litigation committee, audit committee; Minnesota allows non-directors to be
13 members of a committee. This draft allows nonparticipants to serve on committees. *See* section
14 707(g). This is an important policy decision.

15
16 This draft does not expressly allow executive committees but many cooperative statutes
17 do so. Nothing herein intentionally prohibits establishing an executive committee. Because this
18 draft does not expressly contain reference to an executive committee it does not put a prohibition
19 on nondirectors serving thereon.

20
21 Subsection (c)(1): The Reporter was directed by the Committee to replace the word
22 “distribution” with “allocation”. For discussion purposes both terms remain in this draft. It
23 seems the approval of distributions would be the kind of decision that should be made by the
24 entire board just as the allocation is such a decision.

25
26 There was an interesting discussion concerning cooperative practice and tradition as it
27 relates to nondirector members [now participants] observing board meetings. The comments to
28 this section will reference that issue. In part it appears both the historical roots of some
29 cooperatives in the nonprofit sector and, perhaps, other regulatory law for cooperatives
30 performing regulated functions might be the source of this tradition. This draft implicitly allows
31 the board to “close” board meetings and other law (*e.g.* employment law) might, in effect, require
32 the board to do so.

1 **SECTION 718. STANDARDS OF CONDUCT AND LIABILITY.**

2 (a) Except as provided in Sections 720 and 722, the discharge of the duties of a
3 director or a participant of a committee of the board of directors is governed by [the State
4 Cooperative Corporation Act] [the State Nonprofit Cooperative Act] [the General Business
5 Corporation Act of this State] [as amended].

6 (b) Except as otherwise provided in Sections 720 and 722, the liability of a
7 director or a participant of a committee of the board of directors is governed by [the State
8 Cooperative Corporation Act] [the State Nonprofit Cooperative Act] [the General Business
9 Corporation Act of this State] [as amended].

10 **Reporter's Note**

11 The substance of Sections 718 (“Standards of Conduct and Liability”), 719 (“Conflict of
12 Interest”), 720 (“Limitations of Directors’ Duties”), and 722 (“Other Considerations of
13 Directors”) have been discussed extensively by the Committee. Together these sections form the
14 core of fiduciary duties in this entity.

15
16 The approach taken to Sections 718 and 719 recognizes that (1) states take fundamentally
17 different approaches to fiduciary duties within unincorporated organizations of the same kind; (2)
18 there is variety among the states in their approach within corporate statutes; and (3) there is
19 variety among the states in their approach in cooperative laws. The existing cooperative statutes
20 appear to follow corporate fiduciary duty formulations. The enactment dates of exiting
21 traditional cooperative statutes, however, result in very little uniformity in either detail or
22 language.

23
24 The Minnesota Cooperatives Associations Act (a non-corporate cooperative act) cleaves
25 closely to the corporate model. This draft act, too, establishes an unincorporated cooperative.
26 Although an unincorporated entity, the board of directors function more analogously to the
27 corporate board than the managers in a manager-managed LLC or general partners in a limited
28 partnership (and, indeed, the flexibility of the LLC allows the operating agreement to establish a
29 corporate-like board). Finally, the Committee considered the traditional operation of a
30 cooperative, member expectation, and advice that the insurance industry was comfortable with
31 the standards, liability and indemnification provided by the more corporate formulation.

32
33 Unfortunately, the wide variety among the states makes uniformity difficult to achieve

1 and creates adoption difficulty. For these reasons the Committee has adopted a “junction box”
2 approach similar to META. These sections need a legislative note but that note has not yet been
3 drafted pending further discussion on the approach taken.
4

5 This approach makes the draft significantly shorter than including detailed provisions.
6 Moreover, it allows the fiduciary duty of cooperatives to keep pace with statutory changes made
7 in corporation law.
8

9 The Minnesota Act’s “conduct” section uses the phrase, “ordinarily prudent person in a
10 like position would exercise under similar circumstances” without including the MBCA’s
11 modification “would reasonably believe appropriate.”
12

13 The phrase “as amended” has been placed in brackets in this Section and throughout the
14 2005 Annual Meeting Draft for the first time because the Style Committee saliently pointed-out
15 that it (unintentionally) raises a delegation issue in some states. This change has not yet been
16 vetted by the Drafting Committee.
17

18 **SECTION 719. CONFLICT OF INTEREST.** Except as otherwise provided in
19 Section 720, [the State Cooperative Corporation Act] [the State Nonprofit Corporation Act of
20 this State] [the General Business Corporation Act of this State] [as amended] governs conflicts of
21 interests between a director or participant of a committee of the board of directors and the
22 cooperative association.

23 **Reporter’s Note**

24 See the Reporter’s Note to Section 718.
25

26 A comment was made on the floor that as drafted there is no guidance which could result
27 in mischief in the enactment process especially in states that do not have provisions in other laws
28 to which reference could be made.
29

30 **SECTION 720. LIMITATION OF DIRECTOR’S DUTIES.** The articles of
31 organization may vary the standards under Sections 718 and 719 except that the articles may not:

32 (1) eliminate the provisions concerning conflict of interest under Section 719, but

1 may:

2 (A) identify specific types of categories or activities that are not conflicts
3 of interest, if not manifestly unreasonable; and

4 (B) specify the number or percentage of voting power necessary to
5 authorize or ratify, after disclosure, a specific act or transaction that would otherwise be a
6 conflict of interest;

7 (2) unreasonably reduce the standard of conduct under Section 718; or

8 (3) eliminate any obligation of good faith under Section 718, but the articles may
9 prescribe the standards by which the performance of the obligation is to be measured, if the
10 standards are not manifestly unreasonable.

11 **Reporter's Note**

12 This Section, but for a couple style changes, mirrors the provisions found in the other
13 uniform unincorporated acts and is somewhat similar to Minnesota's provision on limitation of
14 director liability. It allows greater flexibility than corporate law consistent with the uniqueness
15 of an unincorporated cooperative association.
16

17 **SECTION 721. RIGHT OF DIRECTOR TO INFORMATION.** A director may
18 obtain, inspect, and copy all information regarding the state of activities and financial condition
19 of the cooperative association and other information regarding the activities of the cooperative
20 association reasonably related to the performance of the director's duties as director but not for
21 any other purpose or in any manner that would violate any duty to the cooperative association.

22 **Reporter's Note**

23 Should this "right" be extended to non-board committee members under 717?

24
25 Similar provisions are found in most entity laws. It limits the use of the information, as

1 well as a directors access, to the director acting as director. Duties would include confidentiality,
2 professional privilege, etc.
3

4 **SECTION 722. OTHER CONSIDERATIONS OF DIRECTORS.** Unless otherwise
5 provided in the organic rules, a director, in determining the best interests of the cooperative
6 association, may consider the interests of employees, customers, and suppliers of the cooperative
7 association and of the communities in which the cooperative association operates, and the long-
8 term and short-term interests of the cooperative association and its participants.

9 **Reporter's Note**

10 The Minnesota Cooperative Associations Act, like this draft, does not limit this provision
11 to mergers; but Oregon's Cooperative Corporation Act does. The language suggests that the
12 original source of this provision is from corporate "anti-takeover acts" in various states (*e.g.*
13 Pennsylvania). The Committee noted that this is consistent with traditional cooperative values.
14 It may be another, though incomplete, way of communicating the idea of a "cooperative plan"
15 which is used in state law without definition (the term "cooperative plan" is not used in this
16 draft).
17

18 **SECTION 723. APPOINTMENT AND AUTHORITY OF OFFICERS.**

19 (a) A cooperative association has the offices provided in its organic rules or
20 established by the board of directors consistent with the organic rules.

21 (b) The organic rules or the board of directors must designate one of the officers
22 for preparing all records required by Section 114 and for the authentication of records.

23 (c) Officers have the authority and perform the duties as the organic rules
24 prescribe or as the board of directors determines is consistent with the organic rules.

25 (d) The election or appointment of an officer does not of itself create a contract
26 with the officer.

(e) Unless otherwise provided in the organic rules, an individual may simultaneously hold more than one office in the cooperative association.

Reporter's Note

Almost all current cooperative acts follow pre-1984 business corporation law either requiring or expressly permitting named offices. This draft does not do so. Rather, it is consistent with the flexibility of the law of unincorporated organizations and provides the flexibility present in many cooperative statutes in a more (word) efficient way. Thus it is closer to post-1984 business corporation law than the existing cooperative statutes based on pre-1984 corporate law. It also follows unincorporated law in the flexibility it provides. Nonetheless, because directors are not agents because of director status, the cooperative (through its board) will be required to have agents. The language of this draft requires at least one of these agents to be designated an officer under subsection (b).

SECTION 724. RESIGNATION AND REMOVAL OF OFFICERS.

(a) The board of directors may remove an officer at any time with or without cause.

(b) An officer may resign at any time in a record giving notice to the cooperative association. The resignation is effective when the notice is given unless the notice specifies a later time.

Reporter's Note

Note that this draft 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. Thus, this draft 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 very well 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).

The “power” language in Subsection (a) raises a power-right dichotomy similar to the one raised in Section 706. As a matter of style, it has been urged to delete such language and replace

1 it with the word “may”.

1 [ARTICLE] 8

2 INDEMNIFICATION

3
4 **SECTION 801. INDEMNIFICATION.** Indemnification of any individual who has
5 incurred liability, is a party, or is threatened to be made a party because of the performance of
6 duties to, or activity on behalf of, the cooperative association is governed by [the State
7 Cooperative Corporation Act] [the State Nonprofit Cooperative Act] [the General Business
8 Corporation of this State] [as amended].

9 **Reporter's Note**

10 The topic of indemnification has been discussed at length by the Committee and it
11 compared corporate, unincorporated, and cooperative statutes as well as agency law. It
12 concluded that any formulation not referencing other law in adopting states would lead to lack of
13 uniformity not only in substance but also as a matter of style. Moreover, because state's have an
14 existing body of law reflecting unique policy decisions there was strong opinion that any other
15 formulation might inhibit enactability. Finally, every other alternative added *pages* to the text of
16 the Draft. Note, however, the comment from the floor in the Reporter's Note to Section 719.

1 [ARTICLE] 9

2 CONTRIBUTIONS, ALLOCATIONS, AND DISTRIBUTIONS

3
4 SECTION 901. PARTICIPANTS CONTRIBUTIONS. The organic rules may

5 establish the amount, manner, or method of determining any participant contribution
6 requirements for participants or may authorize the board of directors to establish the manner and
7 terms of any contributions for participants.

8 Reporter's Note

9 Source: Derived from the Oregon Cooperative Corporation Act and ULP (2001). The
10 Committee has not discussed a suggested change from "shall" to "may". The NCCUSL "Style"
11 is a "must". This Draft continues the use of "shall" because there are no default rules. The intent
12 of the Reporters is to consider the marginal benefit of aggregating all these mandatory
13 requirements in Article 2 after the substance of the provisions is fully discussed. Relatedly, the
14 marginal cost of distributing what is variable within the substantive provisions must be
15 considered. After the information is gathered the issue will be ripe for the Committee.

16
17 A prior draft expressly contained a provision requiring the organic rules to set forth
18 "accounting procedures". The Committee directed it be taken out (and therefore made
19 permissive) because of possible confusion. The comment to this section needs to point out that
20 using a corporate-like structure without "checking-the-box" to be taxed as a corporation under
21 the current tax scheme may cause unintended consequences and is a relatively sophisticated
22 technique that is already bedeviling under LLC law.

23
24 This draft contemplates but does not mandate capital accounts based on decisions made
25 by the Conference and individual estates in other unincorporated acts.

26
27 This draft does not *expressly* provide for stock or use the corporate capital accounting
28 model which allows the board of directors, for example, to establish par value. This draft
29 follows unincorporated law which is far more general, and less detailed than corporate law. The
30 draft does contemplate that the organic rules may establish a more corporate-like capital
31 structure. See Section 205(a)(1). Although it does not expressly address certificated ownership
32 interests is that enough? In that regard, is capital formation inhibited by "lack of stock like a
33 corporation" and, if so, is there any way around the problem? Thus, this draft more closely
34 follows the unincorporated organizational model and is, therefore, arguably more contractually or
35 agreement based. Paradoxically, the entity contemplated by this draft is more flexible upon

1 formation but gives the board of directors less power to establish new classes or voting interests
2 than in a business corporation. This mix is consistent with stronger member control.

3
4 At the direction of the Committee the word “fees” has been deleted. Will the deletion
5 cause problems in service cooperatives? How are such fees usually accounted in fee-based
6 cooperatives?

7
8 Does a comment to this section need to discuss equity certificates and, if so, suggestions?
9

10 **SECTION 902. FORMS OF CONTRIBUTION AND VALUATION.**

11 (a) Unless otherwise provided in the organic rules, the contributions of a
12 participant may consist of tangible or intangible property or other benefit to the cooperative
13 association, including money, services performed or to be performed, promissory notes, other
14 agreements to contribute cash or property, and contracts to be performed.

15 (b) The receipt and acceptance of contributions and the valuation of contributions
16 must be reflected in the cooperative association’s required records pursuant to Section 114.

17 (c) Unless otherwise provided in the organic rules, the board of directors shall
18 value the contributions received or to be received. The determination by the board of directors
19 on valuation is conclusive for purposes of determining whether the participant’s contribution
20 obligation has been fully paid.

21 **Reporter’s Note**

22 The Minnesota Cooperative Associations Act contains detailed provisions requiring the
23 restatement of the value of contributions under certain circumstances. Those provisions effect
24 both liquidating distributions and federal partnership income tax consequences (the so-called
25 “book-up”). This draft follows the Conference’s general treatment of such matters in its other
26 unincorporated entity acts by leaving them to agreement among the members in an organic rule.
27 Even a default rule could cause unintended consequences though a book-up would *generally*
28 seem admissible given the purpose of the draft.

29
30 The Comment (or is it more appropriate in a legislative note) needs to note that some

1 state constitutions may place restrictions on the types of property that may be contributed. The
2 Reporters need guidance on whether, and if so, how, a legislative note needs to be prepared on
3 this issue.
4

5 **SECTION 903. CONTRIBUTION AGREEMENTS.**

6 (a) A contribution agreement entered into before formation of the cooperative
7 association is irrevocable for six months unless:

8 (1) otherwise provided by the agreement; or

9 (2) all parties to the agreement consent to the revocation.

10 (b) Upon default by a party to a contribution agreement entered into before
11 formation, the cooperative association, once formed, may:

12 (1) collect the amount owed as any other debt; or

13 (2) unless otherwise provided in the agreement, rescind the agreement if
14 the debt remains unpaid more than 20 days after the cooperative association demands payment
15 from the party in a record.

16 **Reporter's Note**

17 This Section is taken almost directly from the listed sources.

18 Query: Should the contribution agreement be able to vary the terms of this Section?
19 Would subsection (a)(2) bring in third-party beneficiaries?
20

21 Source: Oregon Cooperative Corporation Act; conceptually similar to the Minnesota
22 Cooperative Associations Act, the MBCA and ULPA (2001).
23
24
25

26 **SECTION 904. ALLOCATIONS OF NET PROCEEDS, MARGINS, SAVINGS,** 27 **PROFITS, AND LOSSES.**

28 (a) Subject to subsection (b), the organic rules must provide for the allocation of

1 net proceeds, savings, margins, profits, and losses between classes or groups of participants.

2 (b) Unless the articles of organization otherwise provide, patron participants must
3 be allocated all of the net proceeds, savings, margins, profits, and losses in any fiscal year. The
4 articles may not reduce the percentage allocated to patron participants to less than 30 percent.

5 (c) Unless otherwise provided in the organic rules, in order to determine the
6 amount of net proceeds, savings, margins and profits, the board of directors may set aside a
7 portion of the revenue, whether or not allocated to participants, after accounting for other
8 expenses for purposes of:

9 (1) creating or accumulating a capital reserve; and

10 (2) creating or accumulating reserves for specific purposes, including
11 expansion and replacement of capital assets.

12 (d) Subject to subsection (e) and the organic rules, the board of directors shall
13 allocate the amount remaining after the allocations under subsections (a) through (c):

14 (1) to patron participants annually in accordance with the ratio of each
15 participant's patronage during the period to total patronage of all patron participants during the
16 period; and

17 (2) to investor participants, if any, in accordance with the ratio of each
18 investor participant's limited contribution to the total initial contribution of all investor
19 participants.

20 (e) For purposes of allocation of net proceeds, savings, margins, profits, and
21 losses to patron participants, the organic rules may establish allocation units based on function,
22 division, district, department, allocation units, pooling arrangements, participants' contributions,

1 or other methods.

2 **Reporter's Note**

3
4 Throughout this Section the following list has been used: “net proceeds, savings, margins,
5 and profits”. This raises two issues. The first is whether the list is as good as it can be (*e.g.*, net
6 proceeds). The second is clumsiness in drafting its resulting confusion. Two observers
7 volunteered at the October 2005 meeting to solve both issues by attempting to draft a defined
8 term.

9
10 The Reporters were not given direction to change “30 percent” in subsection (b) but it
11 was discussed (again) at the October 2005 drafting meeting. An observer has suggested that this
12 remains a sticking-point in the draft for significant industry interests unless the patron
13 participants are allocated at least “50 percent”.

14
15 Subsections (c), (d) and (e) are carried over from a separately numbered section in a
16 previous draft. Patron members’ allocations under the default rule are based on patronage
17 business done with the cooperative. The alternative default is to allocate based on member’s
18 contribution and carve out a patronage pool that is shared by all patrons of the cooperative
19 whether patron members or nonmember patrons (“participating patrons”). A glaring gap in this
20 Section exists for non-participant participating patrons. This is true to the fundamental
21 cooperative principles but may differ from industry practice in at least larger corporate
22 cooperatives. It also differs from the Minnesota model and needs to be revisited by the
23 Committee.

24
25 The organization contemplated by this draft is flexible enough to allow a patronage
26 member to also own nonpatronage membership interests just as a general partner may also own
27 limited partnership interests. Under this draft it is the nonpatronage members whom receive a
28 return on “invested capital”.

29
30 The comment to this section needs to provide examples and illustrations of subsection (b)
31 including a calculation where you might have “agency” cooperative arrangements but no sales.
32 The 100/30 “solution” has been questioned and subject to much discussion. Legislation
33 introduced in Wisconsin is consistent. The existing state statute at play in Minnesota is 50/15.
34 Consider a comment noting that, perhaps, debt will be replaced by equity such that the fixed
35 return otherwise going to debt will need to pay for the use of equity money. In the latter regard
36 the general purpose of this act mirrors the original historical purpose of limited partnership law.
37 The language used to express this decision in subsection (b) still seems somewhat inartful.

38
39 “Allocated” is a term of art in both cooperative and unincorporated law. “Net proceeds”,
40 “net margins”, and “net savings” are terms of art in cooperative law. The comment to this
41 section will need to address those terms.
42

1 **SECTION 905. DISTRIBUTIONS.**

2 (a) Unless otherwise provided by the organic rules and subject to Section 807, the
3 board of directors may authorize, and the cooperative association may make, distributions to
4 participants.

5 (b) Unless otherwise provided by the organic rules, distributions to participants
6 may be made in the form of cash, capital credits, allocated patronage equities, revolving fund
7 certificates, the cooperative association's own or other securities, or in any other manner.

8 **Reporter's Note**

9 A Commissioner, not on this Committee, has very serious reservations about subsection
10 (b). He suggests that the act is certainly flexible enough to allow these items but, if listed in the
11 text, they must be defined.
12

13 **SECTION 906. REDEMPTION OF EQUITY.** Subject to Section 907 and unless the
14 articles of organization otherwise provide, a cooperative association:

15 (a) may redeem a patron participant's equity; and

16 (b) may not redeem an investor participant's equity.

17 **Reporter's Note**

18 How is the redemption price determined? This draft is silent and does not address the
19 value of good will or appreciating assets: a significant gap. At least two Commissioners raised
20 this and the related "book-up" idea at the 2005 annual meeting. Is a result, is a valuation
21 procedure advisable? Is equity too broad a term? Would it be better to add according "to a plan"
22 and have the comment specifically address revolving equity?
23

24 This Section may be needless repetition of other authority for distributions under this
25 draft but, on the other hand, it may make the draft more user-friendly for those cooperatives
26 which contemplate "stock" or certificated interests. It is important to note that this Section is
27 permissive at the discretion of the cooperative and does not give any member a put right.
28

1 **SECTION 907. LIMITATIONS ON DISTRIBUTIONS.**

2 (a) A cooperative association may not make a distribution if, after the
3 distribution:

4 (1) the cooperative association would not be able to pay its debts as they
5 become due in the ordinary course of the cooperative association's activities; or

6 (2) the cooperative association's assets would be less than the sum of its
7 total liabilities.

8 (b) A cooperative association may base a determination that a distribution is not
9 prohibited under subsection (a) on financial statements prepared on the basis of accounting
10 practices and principles that are reasonable in the circumstances or on a fair valuation or other
11 method that is reasonable in the circumstances.

12 (c) Except as otherwise provided in subsection (d), the effect of a distribution
13 allowed under subsection (b) is measured:

14 (1) in the case of distribution by purchase, redemption, or other
15 acquisitions of financial rights in the cooperative association, as of the date money or other
16 property is transferred or debt incurred by the cooperative association; and

17 (2) in all other cases, as of the date:

18 (A) the distribution is authorized, if the payment occurs within
19 120 days after that date; or

20 (B) the payment is made, if payment occurs more than 120 days
21 after the distribution is authorized.

22 (d) If indebtedness is issued as a distribution, each payment of principal or

1 interest on the indebtedness is treated as a distribution, the effect of which is measured on the
2 date the payment is made.

3 **Reporter's Note**

4 This limiting language is based on ULPA (2001) and, generally, cooperative acts do not
5 deal with this issue with this level of detail. Nonetheless, it seems the same policy and
6 governance issues are raised in cooperatives, limited partnerships, and corporations. The
7 language of this section is difficult to read but it is consistent with ULPA (2001). Query the cost
8 benefit in attempting to redraft it.
9

10 This Section also raises another issue specific to this draft: Who is liable? Under typical
11 unincorporated law it is possible to require members to return a proportionate amount of an
12 unlawful distribution. It is one of the few bright-line areas for director liability under corporate
13 law.
14

15 An accounting question about subsection (a)(2) was raised at the 2005 Annual meeting.
16 The basic premise was: "I thought assets by accounting convention always equaled liabilities;
17 therefore, what does (a)(2) mean?" It was promised an answer would be provided, at least, in the
18 Final Comments.
19

20 A question was also raised at the 2005 Annual meeting about subsection (d). The
21 Reporters' have discussed the matter and suggest that the Committee determine whether this
22 matter should be revisited.
23

24 **[SECTION 908. ALTERNATIVE DISTRIBUTION OF UNCLAIMED**
25 **PROPERTY, DISTRIBUTIONS, REDEMPTIONS, OR PAYMENTS.** A cooperative
26 association may distribute unclaimed property, distributions, redemptions, or payments under
27 [citation to the applicable provision in the law governing cooperative associations not formed
28 under this [act] in this state].

29 **Reporter's Note**

30
31 The Reporter's Note formerly included the text of the Oregon Statute (§ 62.425). The
32 Committee determined this is an important substantive provision for states which already include
33 it in their cooperative statutes and many of the leading cooperative states have a provision
34 dealing with a cooperative's unclaimed property. On the other hand it is unique to cooperative

1 law and the provision could be a major adoption stumbling block in those states which do not
2 already have existing cooperative law.

1 [ARTICLE] 10

2 DISSOCIATION

3
4 SECTION 1001. PARTICIPANT'S DISSOCIATION.

5 (a) A participant does not have a right to withdraw as a participant of a
6 cooperative but has the power to withdraw.

7 (b) Unless otherwise provided by the organic rules, a participant is dissociated
8 from a cooperative association upon the occurrence of any of the following events:

9 (1) the cooperative association's having notice in a record of the person's
10 express will to withdraw as a participant or to withdraw on a later date specified by the person;

11 (2) an event provided in the organic rules as causing the person's
12 dissociation as a participant;

13 (3) the person's expulsion as a participant pursuant to the organic rules;

14 (4) the person's expulsion as a participant by the board of directors if:

15 (A) it is unlawful to carry on the cooperative association's
16 activities with the person as a participant;

17 (B) subject to Section 503(g), there has been a transfer of all of the
18 person's financial rights in the cooperative association;

19 (C) the person is a corporation or cooperative association whether
20 or not organized under this act and:

21 (i) the cooperative association notifies the person that it
22 will be expelled as a participant because it has filed a public document of dissolution, it has been

1 administratively or judicially dissolved, its charter has been revoked, or its right to conduct
2 business has been suspended by the jurisdiction of its incorporation; and

3 (ii) within 90 days after the person receives the notification
4 described in subsubparagraph (i), there is no revocation of the certificate of dissolution or no
5 reinstatement of its charter or its right to conduct business; or

6 (D) the person is a limited liability company, cooperative
7 association whether or not organized under this act, or partnership that has been dissolved and
8 whose business is being wound up;

9 (5) in the case of a person who is an individual, the person's death;

10 (6) in the case of a person that is a trust, distribution of the trust's entire
11 financial rights in the cooperative association, but not merely by the substitution of a successor
12 trustee;

13 (7) in the case of a person that is an estate, distribution of the estate's
14 entire financial interest in the cooperative association, but not merely by the substitution of a
15 successor personal representative;

16 (8) termination of a participant that is not an individual, partnership,
17 limited liability company, cooperative association whether or not organized under this act,
18 corporation, trust, or estate;

19 (9) the cooperative association's participation in a consolidation or
20 merger, if under the plan of merger as approved under [Article] 15, the person ceases to be a
21 participant.

22 **Reporter's Note**

1 Source: Closely derived from ULPA (2001) § 601. Subsection (b)(5) follows ULPA in
2 that it does not state incompetency as an event of dissociation but see Section 1003 which can be
3 read inconsistently. The Comments to this Section need to explain the difference between
4 subsection (b)(5) and (b)(7). An individual is dissociated upon death under (b)(5) and her estate
5 has the powers conferred by Section 1003. Subsection (b)(7) applies where the (an) estate is
6 carrying on business and becomes a participant by admission. Example: An individual who was
7 not a participant of the cooperative association dies. Her estate anticipates carrying on farming
8 business for three years before it closes. The estate could become a member of the cooperative
9 association pursuant to the organic rules of the cooperative association for admission of
10 participants. The issue raised by incompetency needs yet to be vetted. See section 1003 which
11 as currently drafted is inconsistent with subsection (b)(8). Subsection (b)(4)(C) has been revised
12 and the language is now different than ULPA (2001).

13
14 Subsection 1001(b)(4)(B) has been changed to refer to subsection 503(g) which is the
15 security interest exception for transfers.

16
17 Section 1001(b) contemplates expulsion by the organic rules but there is no default rule
18 for expulsion. Former subsection (b)(5) read:

19
20 (5) on application by the cooperative, the person's expulsion as a
21 member by judicial order because:

22 (A) the person engaged in wrongful conduct that adversely
23 and materially affected the cooperative's activities;

24 (B) the person willfully or persistently committed a
25 material breach of the organic rules or [this act]; or

26 (C) the person engaged in conduct relating to the
27 cooperative's activities which makes it not reasonably practicable
28 to carry on the activities with the person as member.
29

30 This Article was discussed in detail at the October 2005 Committee meeting. Changes
31 have been made in accordance with decisions made by the Committee. The Committee directed
32 the Reporter to give more examination to whether subsection (b)(4)(B) should be altered or
33 removed depending on the meaning of "financial rights." With more detail having been provided
34 in the definition of "financial rights" in Section 102, the Reporter respectfully requests to revisit
35 this subsection.
36

37 The Reporters also suggest the Committee should revisit this Article in conjunction with
38 further examination of the composition and election of the Board and the division of financial
39 results among participants. The Reporters believe these three areas are what can differentiate a
40 cooperative association under this act from all other types of organizations. Various observers
41 have raised questions and have made suggestions and requests in these three areas. These areas
42 are the ones in which conflicts between traditional cooperative associations with a focus on
43 member service and investor capital with a focus on financial returns from investment need to be

1 balanced. Questions that have been raised regularly for consideration are: (i) Should there be
2 different rules in the act for small versus large cooperative associations in these areas? (ii)
3 Should there be different rules in the act for investor participants and patron participants? (iii) Is
4 it sufficient to leave these areas to the organic rules or should the act provide some guidance by
5 default rules or otherwise?
6

7 **SECTION 1002. EFFECT OF DISSOCIATION AS PARTICIPANT.**

8 (a) Upon a person's dissociation as a participant:

9 (1) subject to Section 1003, the person does not have further rights as a
10 participant; and

11 (2) subject to Section 1003 and [Article] 15, any financial rights owned by
12 the person in the person's capacity as a participant immediately before dissociation is owned by
13 the person as a transferee who is not admitted as a participant after dissociation.

14 (b) A person's dissociation as a participant does not of itself discharge the person
15 from any obligation to the cooperative association which the person incurred while a participant.

16 **Reporter's Note**

17 Source: ULPA (2001) § 602. The ULPA (2001) counterpart includes a subsection that
18 refers only to specifically cross-referenced obligations of good faith and fair dealing and that
19 subsection has been deleted under this draft. "[O]r other members" was also deleted in (b),
20 which is consistent, because under this act there is no specific participant to participant duty
21 (similar to the basic resolution of duties to limited partners but in ULPA there is a sliding scale
22 where a limited partner undertakes management obligations). The Comment to this section will
23 include both reference and discussion of the four possible sources of financial return of a
24 participant: (1) under a production (or other) contract; (2) patronage distributions; (3) patronage
25 retains; (4) return on invested capital. Subsection (b) is important in the context of obligations
26 under a marketing contract.
27

28 At the October 2005 Committee meeting it was determined that so long as it is permitted
29 by other state law, a person acting under a durable power of attorney could continue to act for a
30 participant without a change to this act.
31

SECTION 1003. POWER OF ESTATE OF PARTICIPANT. Unless otherwise provided in the organic rules, if a participant dies or is adjudged incompetent, the participant’s personal representative or other legal representative may exercise the rights of a transferee and the participant’s financial rights as provided in Section 503 and, for purposes of settling the estate of a deceased participant, may exercise the informational rights of a current participant under Section 405.

Reporter's Note

Source: ULPA (2001) § 704. *See* Reporter’s Note to section 1001 concerning the absence of incompetency as a cause of dissociation by a participant. The Committee suggests that the guardian of an incompetent will be treated for all purposes the same as an estate through the law of guardianship but that issue should be left to other law. Other law will also channel obligations between those that must be personally performed and those that may be “assigned”. It might be advisable for the Comment to suggest this issue (and a related one concerning nonadjudicated durable powers) be contemplated by the organic rules and the terms of the marketing contract, if any. Whether incompetency effects the contract will depend, in some instances, on the classification of the contractual duty as delegable.

At the October 2005 Committee meeting, it was suggested that “power” be substituted for rights. Because of the different appropriate implications of the two words, both have been utilized.

1 [ARTICLE] 11

2 DISSOLUTION

3
4 **SECTION 1101. DISSOLUTION.** A cooperative association may be dissolved:

- 5 (1) nonjudicially under Section 1102;
- 6 (2) judicially under Section 1103; or
- 7 (3) administratively under Section 1110.

8 **SECTION 1102. NONJUDICIAL DISSOLUTION.** Except as otherwise provided in

9 Section 1103, a cooperative association is dissolved and its activities must be wound up only

10 upon the occurrence of any of the following:

- 11 (1) the happening of an event or the coming of a time specified in the articles of
- 12 organization;
- 13 (2) the action of the organizers, board of directors, or participants under Sections
- 14 1104 and 1105;
- 15 (3) the passage of 90 days after the dissociation of a participant, resulting in the
- 16 cooperative association having less than two participants, unless before the end of the period the
- 17 cooperative association admits at least one participant in accordance with its organic rules; or
- 18 (4) the filing of a determination by the [Secretary of State] under Section 1110.

19 **Reporter's Note**

20 Source: ULPA (2001) § 801. It has been modified because cooperatives do not bifurcate

21 membership between general and limited partners even though under this draft patron and

22 nonpatron participants are authorized. Subsection (3) of this Section has been modified pursuant

23 to action taken by the Committee. This is a bit of a trapdoor. Where does the draft state there

24 must be two members? Comments to previous Sections need to make this clear. This Section

1 errs on the side of continuity of life though it is inconsistent with matters of formation.
2

3 **SECTION 1103. JUDICIAL DISSOLUTION.** The [appropriate court] may dissolve a
4 cooperative association or order any action that under the circumstances is appropriate and
5 equitable:

6 (1) in a proceeding by the [attorney general], if it is established that:

7 (A) the cooperative association obtained its articles of organization
8 through fraud; or

9 (B) the cooperative association has continued to exceed or abuse the
10 authority conferred upon it by law;

11 (2) in a proceeding by a participant, if it is established that:

12 (A) the directors are deadlocked in the management of the cooperative
13 association affairs, the participants are unable to break the deadlock, and irreparable injury to the
14 cooperative association is occurring or is threatened because of the deadlock;

15 (B) the directors or those in control of the cooperative association have
16 acted, are acting, or will act in a manner that is illegal, oppressive, or fraudulent;

17 (C) the participants are deadlocked in voting power and have failed, for a
18 period that includes at least two consecutive annual participants' meetings, to elect successors to
19 directors whose terms have expired; or

20 (D) the assets of the cooperative association are being misapplied or
21 wasted; or

22 (3) in a proceeding by the cooperative association to have its voluntary

1 dissolution continued under judicial supervision.

2 **Reporter's Note**

3 As emphasized by the following paragraph, mere holders of financial rights have no
4 standing to attempt to dissolve the entity. That is important under both unincorporated law (*see*
5 ULP A) and corporate law.

6
7 This section on judicial dissolution is derived from the MBCA but conceptually tracks the
8 current LLC draft being considered by the Conference. Substantively, note: (1) Subsection (2) no
9 longer authorizes transferees to bring an action to dissolve the cooperative (in addition to
10 members); (2) Subsection 2(A) does not include the MBCA phrase, “or the business and affairs
11 of the [cooperative] can no longer be conducted to the advantage of the ... [members] generally”
12 (but is consistent with the directors ability to consider other constituencies under Article 6); and,
13 (3) the MBCA provides for an action for dissolution by a creditor of the corporation (here the
14 cooperative) if the claim has been reduced to judgment and the entity is insolvent (perhaps that is
15 best left to bankruptcy law).

16
17 After discussion at the April 2005 Committee meeting “or a transferee of a member” was
18 deleted from Section 1003(2). It was pointed out that it gave transferees greater power than they
19 have under almost all unincorporated law, that there was no similar provision in traditional
20 cooperative law, and that it gave transferees the power to unreasonably interfere with the
21 operation of the cooperative by filing suit.

22
23 Arguably the broadest provisions in the entire draft for individual participant rights are
24 subsections (2)(B) and (2)(D). The Committee discussed these provisions but they need to be
25 discussed further. The language has the same effect as provided by Section 801(6) (ii) of UPA
26 (1997) for at-will partnerships. ULP A Section 802 is much shorter and more restrictive:

27
28 On application by a partner the [appropriate court] may order a
29 dissolution of a limited partnership if it is not reasonably
30 practicable to carry on the activities of the limited partnership in
31 conformity with the partnership agreement.

32
33 This section also adds the phrase “or order any action which under the circumstances is
34 appropriate and equitable” to the flush language thereby expressly authorizing the court to,
35 illustratively, appoint provisional directors or force a buy-out for interests. This follows what
36 appears to be a trend in both statutory and case law of corporations.

37
38 Subsection (2)(B) states a different (and lower) standard for judicial dissolution than for
39 the removal of a director under Section 707 which includes “grossly abusive” and “intentionally
40 harmful.”
41

1 Finally, though it is included in the MBCA, the committee has not addressed Subsection
2 (2)(C). It does not require any showing of damage to the cooperative association and follows
3 corporate law. Finally, subsection (2)(c) seems to require that the meetings have been held.
4 While salutary because it prohibits a participant from manipulating quorum requirements, if any,
5 is this the result the Committee intends?
6

7 **SECTION 1104. VOLUNTARY DISSOLUTION BEFORE COMMENCEMENT**
8 **OF ACTIVITY.** A majority of the organizers or initial directors of a cooperative association
9 that has not yet begun activity or the conduct of its affairs may dissolve the cooperative
10 association.

11 **Reporter's Note**

12 This Section subscribes to the initial approach of avoiding the term "business." Other
13 provisions now use that term and the Committee has discussed the issue elsewhere. As an aside,
14 should "business" be a defined term?
15

16 **SECTION 1105. VOLUNTARY DISSOLUTION BY THE BOARD AND**
17 **PARTICIPANTS.** In order to voluntarily dissolve:

18 (a) a resolution to dissolve must be approved by a majority vote of the board of
19 directors unless a greater vote is required by the organic rules;

20 (b) the board of directors shall mail or otherwise transmit or deliver a record to
21 each participant:

22 (1) the resolution required by subsection (a);

23 (2) a recommendation that the participants vote in favor of the resolution
24 unless the board determines because of conflict of interest or other special circumstances it
25 should not make such a recommendation;

26 (3) if the board makes no recommendation, the basis of that decision; and

1 (4) give notice of the meeting in the same manner as a special participants
2 meeting.

3 (c) Subject to Section 312, the resolution to dissolve must be approved by at least
4 a two-thirds vote of patron participants voting at the meeting and at least two-thirds vote of
5 investor participants voting at the meeting.

6 (d) Unless otherwise provided in the resolution, the cooperative association is
7 dissolved upon approval in subsection (c).

8 **Reporter's Note**

9 This Section is new to the February 2006 draft having been formerly reserved. It follows
10 logically from the articles concerning amendments to organic rules and conversion, merger or
11 consolidation.
12

13 **SECTION 1106. WINDING UP.**

14 (a) A cooperative association continues after dissolution only for purposes of
15 winding up its activities.

16 (b) In winding up its activities, the cooperative association:

17 (1) shall discharge its liabilities, settle and close its activities, and marshal
18 and distribute its assets; and

19 (2) file a statement of dissolution indicating it is winding up pursuant to
20 Section 203, preserve the cooperative association or its property as a going concern for a
21 reasonable time, prosecute and defend actions and proceedings, transfer cooperative association
22 property, settle disputes by mediation or arbitration, and perform other necessary acts.

23 (c) On the application of the cooperative association, any participant, or a holder

1 of financial rights, the [appropriate court] may order judicial supervision of the winding up,
2 including the appointment of a person to wind up the dissolved cooperative association's
3 activities, if:

4 (1) after a reasonable time, the cooperative association has not executed
5 winding up under subsection (b); or

6 (2) the applicant establishes other good cause.

7 **Reporter's Note**

8 The term "holder of financial rights" replaces "transferee" in the February 2006 draft.
9 Should creditors have standing to seek judicial supervision?
10

11 **SECTION 1107. DISTRIBUTION OF ASSETS IN WINDING UP**
12 **COOPERATIVE ASSOCIATION.**

13 (a) In winding up a cooperative association's business, the assets of the
14 cooperative association must be applied to discharge its obligations to creditors, including
15 participants who are creditors. Any remaining assets must be applied to pay in money the net
16 amount distributable to participants in accordance with their right to distributions under
17 subsection (b).

18 (b) Each participant is entitled to a distribution from the cooperative association
19 of any remaining assets in the proportion of the participant's financial interests to the total
20 financial interests of participants of the cooperative association after all other obligations are
21 satisfied.

22 **Reporter's Note**

23 Best practice would provide detail in the organic rules. The Committee tentatively

1 decided to delete the phrase “unless otherwise provided by the organic rules” in subsection (b).
2 The import of that deletion should be revisited. The Minnesota Cooperative Associations Act is
3 silent as to liquidating distributions in its dissolution provisions. Section 308B.721 of the
4 Minnesota law, however, generally governs distributions and allocations and it states: “The
5 bylaws shall prescribe...”.

6
7 The Colorado Cooperative Act (a “traditional” act) provides:

8
9 (2) Unless otherwise stated in the articles or bylaws, the assets
10 shall be used to pay, in the following order:

11 (a) Liquidation expenses, including reasonable payment and
12 reimbursement for the time and expenses of the trustees in
13 liquidation and their consultants;

14 (b) All debts and liabilities according to their respective
15 priorities;

16 (c) Amounts invested in the cooperative that have a specific
17 preference in liquidation over other amounts invested in the
18 cooperative;

19 (d) Without priority and on a pro rata basis amounts
20 invested in the cooperative, whether as membership fees, common
21 stock, or otherwise, which are required by the cooperative to be
22 invested in order for a person to be a member or to be subject to
23 per unit retains or be entitled to participate in the allocation of net
24 margins on terms and conditions established in the cooperative’s
25 bylaws or by the cooperative’s board;

26 (e) Without priority and on a pro rata basis, retained
27 patronage, per unit retains, other amounts withheld from or
28 allocated to a patron of the cooperative or any direct contributions
29 to the capital of the cooperative not described in paragraph (d)...,
30 all as shown on the books and records of the cooperative;

31 (f) Any remaining assets, including reserves, if any, shall be
32 distributed among such members of the cooperative, without
33 priority and on a pro rata basis, as shall be practicable as
34 determined by the trustees in liquidation. In making heir
35 determination, the trustees in liquidation may limit those persons
36 entitled to share in the distribution to persons entitled to share in
37 the allocation of the cooperative’s net margins during a limited
38 specified period of time;

39 (g) With respect to paragraphs (e) and (f), the amounts to be
40 distributed shall be paid to the persons entitled to them as promptly
41 as reasonably possible after the filing of the articles of dissolution
42 by the secretary of state, but in no event shall the distributions be
43 made later than seven years following the filing of the articles of

1 dissolution by the secretary of state, unless distribution is
2 prevented by circumstances beyond the control of the trustees in
3 liquidation.
4

5 By way of comparison, ULPA (2001) § 812 states:
6

7 (a) In winding up a limited partnership's activities, the assets of the
8 limited partnership, including the contributions required by this
9 Section, must be applied to satisfy the limited partnerships
10 obligations to creditors, including, to the extent permitted by law,
11 partners that are creditors.

12 (b) Any surplus remaining after the limited partnership complies
13 with subsection (a) must be paid in cash as a distribution.
14

15 ***

16 In turn, ULPA Section 503 states:
17

18 A distribution by a limited partnership must be shared among
19 partners on the basis of the value, as stated in the required records
20 when the limited partnership decides to make the distribution, of
21 the contributions the limited partnership has received from each
22 partner.
23

24 At the October 2005 Committee meeting it was mentioned that subsection (b) would be limited
25 to a seven year look-back rule in electric cooperative law. The Reporters would like a bit more
26 guidance on how to use this information.
27

28 **SECTION 1108. KNOWN CLAIMS AGAINST DISSOLVED COOPERATIVE**
29 **ASSOCIATION.**

30 (a) A dissolved cooperative association may dispose of the known claims against
31 it by following the procedure described in subsection (b).

32 (b) A dissolved cooperative association may notify its known claimants of the
33 dissolution in a record. The notice must:

34 (1) specify the information required to be included in a claim;

35 (2) provide a mailing address to which the claim is to be sent;

1 (3) state the deadline for receipt of the claim, which may not be less than
2 120 days after the date the notice is received by the claimant; and

3 (4) state that the claim will be barred if not received by the deadline.

4 (c) A claim against a dissolved cooperative association is barred if the
5 requirements of subsection (b) are met and:

6 (1) the cooperative association has not been notified in a record of the
7 specified deadline; or

8 (2) in the case of a claim that is timely received but rejected by the
9 dissolved cooperative association, the claimant does not commence an action to enforce the
10 claim against the cooperative association within 90 days after the receipt of the notice of the
11 rejection.

12 (d) This section does not apply to a claim based on an event occurring after the
13 date of dissolution or a liability that is contingent on that date.

14 **Reporter's Note**

15 The substance of this section and that of the remainder of this article is contained in both
16 corporate and LLC law. The base model for the drafting of these provisions was ULLCA.

17
18 Subsection (c)(1) has been revised pursuant to Committee direction in the October 2005
19 meeting. Does the revision make the use of the word "claim" inconsistent with (b) and (c). A
20 suggestion/question concerning the flush language of (b)b was also made at that meeting but no
21 revision has yet been made because it raises the deletion of the article about notice and
22 notification. The Committee needs to return to that question.
23

24 **SECTION 1109. OTHER CLAIMS AGAINST DISSOLVED COOPERATIVE** 25 **ASSOCIATION.**

26 (a) A dissolved cooperative association may publish notice of its dissolution and

1 request persons having claims against the cooperative association to present them in accordance
2 with the notice.

3 (b) The notice must:

4 (1) be published at least once in a newspaper of general circulation in the
5 [county] in which the dissolved cooperative association's principal office is located or, if it has
6 none in this state, in the [county] in which the cooperative association's designated office is or
7 was last located;

8 (2) describe the information required to be contained in a claim and
9 provide a mailing address to which the claim is to be sent; and

10 (3) state that a claim against the cooperative association is barred unless
11 an action to enforce the claim is commenced within three years after publication of the notice.

12 (c) If a dissolved cooperative association publishes a notice in accordance with
13 subsection (b), the claim of each of the following claimants is barred unless the claimant
14 commences an action to enforce the claim against the dissolved cooperative association within
15 three years after the publication date of the notice:

16 (1) a claimant that did not receive notice in a record under Section 1108;

17 (2) a claimant whose claim was timely sent to the dissolved cooperative
18 association but not acted on; and

19 (3) a claimant whose claim is contingent or based on an event occurring
20 after the effective date of dissolution.

21 (d) A claim not barred under this Section may be enforced:

22 (1) against the dissolved cooperative association, to the extent of its

1 undistributed assets; or

2 (2) if the assets have been distributed in liquidation, against a participant
3 or transferee of financial rights to the extent of that person's proportionate share of the claim or
4 the cooperative association's assets distributed to the participant or transferee in liquidation,
5 whichever is less, but a person's total liability for all claims under this subsection does not
6 exceed the total amount of assets distributed to the person as part of the winding up of the
7 dissolved cooperative association.

8 **SECTION 1110. COURT PROCEEDING.**

9 (a) A dissolved cooperative association that has published a notice under
10 subsection 1109(c) may file an application with the court where the dissolved cooperative
11 association's principal office is located or a determination of the amount and form of security to
12 be provided for payment of claims that are contingent or have not been made known to the
13 dissolved cooperative association or that are based on an event occurring after the effective date
14 of dissolution but that, based on the facts known to the dissolved cooperative association, are
15 reasonably estimated to arise after the effective date of dissolution.

16 (b) Notice of the proceeding shall be given by the dissolved cooperative
17 association to each known claimant holding a contingent claim within 10 days after the filing of
18 the application of the cooperative association.

19 (c) The court may appoint a guardian ad litem to represent all claimants whose
20 identities are unknown in any proceeding brought under this section. The reasonable fees and
21 expenses of such guardian, including all reasonable expert witness fees, shall be paid by the
22 dissolved cooperative association.

1 (d) Provision by the dissolved cooperative association for security in the amount
2 and the form ordered by the court under section 1109(c) shall satisfy the dissolved cooperative
3 association's obligations with respect to claims that are contingent, have not been made known to
4 the dissolved cooperative association or are based on an event occurring after the effective date
5 of dissolution, and such claims may not be enforced against a participant who received a
6 distribution.

7 **Reporter's Note**

8 This Section is new to the February 2006 draft. It was discussed at the October 2005
9 meeting. Is "guardian ad litem" the correct word choice in subsection (c)? A comparative memo
10 on this provision has been completed and will be available at the February 2006 meeting.
11

12 **SECTION 1111. ADMINISTRATIVE DISSOLUTION.**

13 (a) The [Secretary of State] may dissolve a cooperative association
14 administratively if the cooperative association does not, within 60 days after the due date:

15 (1) pay any fee, tax, or penalty due to the [Secretary of State] under this
16 [act] or other law; or

17 (2) deliver its annual report to the [Secretary of State].

18 (b) If the [Secretary of State] determines that a ground exists for administratively
19 dissolving a cooperative association, the [Secretary of State] shall file a record of the
20 determination and serve the cooperative association with a copy of the filed record.

21 (c) If, within 60 days after service of the copy, the cooperative association does
22 not correct each ground for dissolution or demonstrate to the reasonable satisfaction of the
23 [Secretary of State] that each uncorrected ground determined by the [Secretary of State] does not

1 exist, the [Secretary of State] shall administratively dissolve the cooperative association by
2 preparing, signing, and filing a declaration of dissolution that states the grounds for dissolution.
3 The [Secretary of State] shall serve the cooperative association with a copy of the filed
4 declaration.

5 (d) A cooperative association administratively dissolved continues its existence
6 but may carry on only activities necessary to wind up its activities and liquidate its assets under
7 Section 1106 and to notify claimants under Sections 1108 and 1109.

8 (e) The administrative dissolution of a cooperative association does not terminate
9 the authority of its agent for service of process.

10 **Reporter's Note**

11 An issue that needs to be discussed by the Committee is whether the number of days are
12 appropriate. The choice in the April 2005 draft conforms to ULPA (2001) and is not changed
13 from the 2004 annual meeting draft. The 60 day period also mirrors RMBCA section 14.20.
14 This section combines ULPA (2001) sections 809 and 810.
15

16 **SECTION 1112. REINSTATEMENT FOLLOWING ADMINISTRATIVE** 17 **DISSOLUTION.**

18 (a) A cooperative association that has been administratively dissolved may apply
19 to the [Secretary of State] for reinstatement within two years after the effective date of
20 dissolution. The application must be delivered to the [Secretary of State] for filing and state:

21 (1) the name of the cooperative association and the effective date of its
22 administrative dissolution;

23 (2) that the grounds for dissolution either did not exist or have been
24 eliminated; and

1 (3) that the cooperative association's name satisfies the requirements of
2 Section 109.

3 (b) If the [Secretary of State] determines that an application contains the
4 information required by subsection (a) and that the information is correct, the [Secretary of State]
5 shall:

6 (1) prepare a declaration of reinstatement that states this determination;

7 (2) sign and file the original of the declaration of reinstatement; and

8 (3) serve the cooperative association with a copy.

9 (c) When reinstatement becomes effective, it relates back to and takes effect as of
10 the effective date of the administrative dissolution, and the cooperative association may resume
11 or continue its activities as if the administrative dissolution had never occurred.

12 **Reporter's Note**

13 Source: ULPA, ULLCA, generally follows the MBCA.

14
15 This Section needs to be discussed regarding the rather detailed instructions it contains
16 for the secretary to state. Consideration should be given to conforming it with the provision
17 governing the articles of organization. At the Committee's direction the phrase "or continue"
18 was added to subsection (c). The Comments need to explain the effect on third parties. It is
19 unintended, in that regard, to be completely consistent with corporate and unincorporated law.
20

21 **SECTION 1113. APPEAL FROM DENIAL OF REINSTATEMENT.**

22 (a) If the [Secretary of State] denies a cooperative association's application for
23 reinstatement following administrative dissolution, the [Secretary of State] shall prepare, sign,
24 and file a notice that explains the reason or reasons for denial and serve the cooperative
25 association with a copy of the notice.

1 (b) Within 30 days after service of the notice of denial, the cooperative
2 association may appeal the denial of restatement by petitioning the [appropriate court] to set
3 aside the dissolution. The petition must be served on the [Secretary of State] and contain a copy
4 of the [Secretary of State's] declaration of dissolution, the cooperative association's application
5 for reinstatement, and the [Secretary of State's] notice of denial.

6 (c) The court may summarily order the [Secretary of State] to reinstate the
7 dissolved cooperative association or may take other action the court considers appropriate.

8 **Reporter's Note**

9 Source: ULPA § 811. This article is also conceptually consistent with existing
10 cooperative law. It is also a point where the "unclaimed and abandoned property" provision
11 might apply. The Reporter has been directed by the Drafting Committee to determine if it is
12 appropriate and consistent with other conference products to include the language for a filing and
13 fees section.
14

15 **SECTION 1114. STATEMENT OF DISSOLUTION.**

16 (a) A cooperative association that has dissolved or is about to dissolve may
17 deliver to the [Secretary of State] for filing a Statement of Dissolution that states:

18 (1) the name of the cooperative association;

19 (2) the date that the cooperative association dissolved or when it will
20 dissolve;

21 (3) any other information it deems relevant;

22 (b) A person has notice of a cooperative association's dissolution the later of 90
23 days after the filing of the statement or the effective date under subsection (a)(2).

24 **Reporter's Note**

1 This Section is new and it, and this Note, should be read in conjunction with Section
2 1115 and its Note. The Reporters added this Section on their own motion for discussion at the
3 February 2006 meeting because the prior draft and note was inconsistent and, worse,
4 affirmatively confusing. Both this Section and Section 1115 are elective filings. ULPA (2001)
5 has an elective statement of termination but not of dissolution.
6

7 Under modern corporate law (*e.g.*, MBCA) the articles of dissolution are mandatory in
8 that the articles are “the only filing required for voluntary dissolution.” Official Comment,
9 MBCA §14.03. “Required,” however, is misleading because if a corporation were voluntarily
10 dissolved but articles were not filed the secretary of state would (eventually) administratively
11 dissolve the corporation.
12

13 Further, the comments to that Section state:
14

15 The act of filing the articles of dissolution makes the decision to
16 dissolve the corporation a matter of public record and establishes
17 the time when the corporation must begin the process of winding
18 up and cease carrying on its business except to the extent necessary
19 to wind up.
20

21 The limited partnership scheme is different because the certificate of limited partnership
22 is not a governing document but purely a notice one (like the articles of organization in most
23 LLC Acts). As such, the appropriate way to give notice is in an amendment to the certificate
24 itself. Such an amendment is required under ULPA when a third-party is appointed to wind-up
25 the partnership. Where a third party is not appointed, a fair reading of Section 202, at least
26 allows an amendment upon dissolution. Section 202 states:
27

28 (c) A general partner that knows that any information in a filed
29 certificate of limited partnership was false when the certificate was
30 filed or has become false due to changed circumstances shall
31 promptly:

- 32 (1) cause the certificate to be amended; or
33 (2) if appropriate, deliver to the [Secretary of State] for
34 filing a statement of change pursuant to Section 115 or a statement
35 of correction pursuant to Section 207.
36

37 The problem is this: the certificate is not required to state that it is “not dissolved.” Thus, it is
38 not required to file a notice document upon dissolution under ULPA though a certificate “may
39 also contain any other matters...”.
40

41 **SECTION 1115. STATEMENT OF TERMINATION.**

1 (a) A dissolved cooperative association that has completed winding up may
2 deliver to the [Secretary of State] for filing a statement of termination that states:

3 (1) the name of the cooperative association;

4 (2) the date of filing of its initial articles of organization.

5 (b) The filing of the statement of termination does not terminate the cooperative
6 association.

7 **Reporter's Note**

8 This Section was formerly numbered Section 207. Subsection (b) is new to the February
9 2006 draft.

10
11 There was discussion at the 2004 annual meeting suggesting that the statement of
12 termination was a throwback to older versions of the MBCA and that this Act should follow the
13 current MBCA provisions for filing the articles of dissolution. Because this is an unincorporated
14 entity, however, it (now at least) follows ULPA (2001). No filing is required under this
15 provision nor in this article requiring a filing for dissolution or winding-up. This statement is
16 simply an elective statement that may be filed. The November 2004 draft more closely followed
17 ULLCA (1996).

18
19 Termination is a very different creature than dissolution. Upon termination the entity,
20 and its liability shield, ends.

21
22 Several questions should be addressed by the Committee:

23
24 (1) a prior draft included a third item in the list providing for the addition of any
25 other information;

26
27 (2) the placement of this Section (and Section 1114) here rather than in Article 2;
28 and, most importantly

29
30 (3) the effect of filing such a statement. For example, ULPA (2001) expressly
31 provides (Section 103) for the effect of its filing (*e.g.*, constructive notice? ULPA says it is after
32 it has been filed for 90 days). *See* Section 1114. The latter is an issue in at least two practical
33 contexts. The first is opinion letter drafting and the experience with statements of authority
34 under RUPA. The second is whether its filing would have any bearing on the “certificate of good
35 standing” and require the secretary of state to search its records.

1 [ARTICLE] 12

2 ACTIONS BY PARTICIPANTS

3
4 Reporter's Preliminary Note to Article 12

5 (1) Placement of Derivative Sections. The Reporter was requested to conduct preliminary
6 research regarding the comparative placement of derivative action within state statutory schemes.
7 According to a secondary source approximately eleven states place rules on derivative
8 proceedings in their rules of civil procedure. In corporate law about 30 states place their
9 derivative "rules" in the corporate statute (16 of those states adopted the MBCA provisions).
10 Maryland does not, apparently, deal with derivative actions by statute. The balance, according to
11 the source, have some combination or expressly cross-reference the civil procedure rules.
12

13 (2) Additional Background-Direct v. Derivative. Case law about the distinction is almost
14 entirely from corporate law through some law is now developing under LLC statutes. Professor
15 Kleinberger gave a CLE presentation about derivative actions in the context of LLCs at the
16 Spring 2005 meeting of the ABA Business Section. Therein he provided several observations
17 that apply to this project:
18

19 (a) Analysis of the operation of the rules must take into account the closely-held
20 versus public ownership distinction;

21 (b) Courts follow three general approaches ("direct harm," "special injury," "duty
22 owed/rights infringed"); and,

23 (c) The ALI Principles of Corporate governance suggest there be no distinction
24 between direct and derivative actions in closely-held corporations.
25

26 In the LLC context he suggested that courts follow the "direct harm" approach
27 supplemental by a "purpose and effect" exception in closely-held LLCs where the majority is
28 using the entity to abuse a particular minority owner. Both ULPA (2001) and "Re-ULLCA"
29 adopt the "direct harm" approach.
30

31 (3) Court Approval for Discontinuance. The Reporter was also requested to conduct
32 preliminary research concerning court approval of discontinuance or settlement of derivative
33 proceedings. The MBCA and the Federal Rules of Civil Procedure require such approval. The
34 Section 7.45 of the RMBCA reads as follows:
35

36 A derivative proceeding may not be discontinued or settled without
37 the court's approval. If the court determines that a proposed
38 discontinuance or settlement will substantially affect the interests
39 of the corporation's shareholders or a class of shareholders, the

1 court shall direct that notice be given to the shareholders affected.

2
3 The Conference products do not address court supervision of settlement (ULLCA, Re-
4 ULLCA current draft, ULPA, UPA).
5

6 **SECTION 1201. DIRECT ACTION BY PARTICIPANT.**

7 (a) Subject to subsection (b), a participant may maintain a direct action against
8 the cooperative association, an officer, or a director, to enforce the rights and otherwise protect
9 the interests of the participant, including rights and interests under the organic rules or organic
10 law.

11 (b) A participant maintaining a direct action under this Section is required to
12 plead and prove an actual or threatened injury that is not solely the result of an injury suffered or
13 threatened to be suffered by the cooperative association.

14 **Reporter's Note**

15 Source: § 1001 ULPA (2001) (modified) and “Re-ULLCA” (May 15, 2005, Draft). The
16 February 2006 Draft deleted a subsection (c) that dealt with an accounting action. The deletion
17 more closely follows LLC and traditional cooperative law than partnership law. The reference to
18 accounting was ripe for deletion because no Committee discussion suggested an accounting
19 action should be expressly statuted as a statutory matter. Does this Draft’s Supplemental
20 Principles” (Section 108) adequately cover this? A prior draft included a direct right to sue
21 another member based on unincorporated entity law (in former section 1101). Directors are
22 included to raise the issue of “primary” shareholder litigation in the corporate context and to
23 better reflect the operation of the provision under ULPA. Query whether this merely reflects
24 current law; or causes or alleviates confusion. Finally, query whether the provision on direct
25 action is necessary. Current corporate and cooperative acts do not make this statutory distinction.
26 Unincorporated laws, however, include this because, historically, the individual partner could not
27 sue directly outside an accounting action. The direct-derivative distinction is currently in the
28 ULLCA draft being discussed by another committee of the Conference. A Comment needs to be
29 included explaining subsection (c).
30

31 **SECTION 1202. DERIVATIVE ACTION.** A participant may maintain a derivative

1 action to enforce a right of a cooperative association if the participant adequately represents the
2 interests of the cooperative and if:

3 (1) the participant first makes a demand on the cooperative association,
4 requesting that it bring an action to enforce the right, and the cooperative association does not
5 bring the action within a reasonable time; and

6 (2) 90 days have expired from the date the demand was made unless the
7 participant has earlier been notified that the demand has been rejected by the cooperative
8 association or unless irreparable injury to the cooperative association would result by waiting for
9 the expiration of the time.

10 **Reporter's Note**

11 Source: § 1002 ULPA (2001). Section 1102 modifies the ULPA (2001) formulation by
12 adding the requirement that the member adequately represents the interests of the cooperative; by
13 adding a 90 day time period after demand before suit may be commenced; and by deleting
14 excused demand because of futility. The 90 day period may be excused if the waiting period
15 would result in irreparable harm to the cooperative under subsection 1102(2). These
16 modifications generally follow the law of the Model Business Corporations Act.

17
18 Is 90 days too long, *but see* the Reporter's Note following section 1104. Oregon uses 20
19 days. *See* section 1104. This draft does not contain a futility exception. Subsection (1) formerly
20 required a writing, the Committee discussed replacing it with record, this draft goes back to the
21 language in ULPA (2001). For purposes of comparison, a recent draft in the "Re-ULLCA"
22 project includes "futility" (as does ULPA) and is silent as to the time limit. Neither does it
23 include "adequately represents the interests" in the flush language.

24
25 The Committee has discussed (briefly) the inclusion of a provision about special litigation
26 committees. To date the Committee is satisfied that the flexibility for Committees and other
27 appointments elsewhere in the draft adequately address the issue. The Minnesota Cooperative
28 Association Act has a specific provision on the topic as does the RMBCA. A recent draft of
29 "Re-ULLCA" included such a provision for discussion purposes only. The discussion draft
30 follows the corporate formulation but note that it specifically addresses the standard to be used
31 for the Committee's business judgment:

32
33 Section 905. SPECIAL LITIGATION COMMITTEE.

1 (a) When a limited liability company is named as a party in
2 a derivative proceeding, the limited liability company may appoint
3 a special litigation committee to investigate claims asserted in the
4 proceeding and determine whether pursuing the proceeding is in
5 the best interests of the limited liability company. If the limited
6 liability company appoints a special litigation committee, on
7 motion by the committee, made in the name of the limited liability
8 company, the court shall stay discovery for the amount of time
9 reasonably necessary to permit the committee to make its
10 investigation.

11 (b) A special litigation committee may be composed of one
12 or more persons, who may, but need not be, members. A special
13 litigation committee may be appointed:

14 (1) in a member-managed limited liability company,
15 by the consent of a majority of those members who are not named
16 as defendants in the proceeding and, if there are none, by a
17 majority of members; and

18 (2) in a manager-managed limited liability
19 company, by:

20 (A) a majority of those managers that are not
21 named as defendants in the proceeding; and

22 (B) if there are none, by a majority of
23 members that are not named as defendants in the proceeding; and

24 (C) if there are none, by a majority of the
25 managers.

26 (c) After appropriate investigation, a special litigation
27 committee may determine that it is in the best interests of the
28 limited liability company that the proceeding:

29 (1) continue under the control of the plaintiff;
30 (2) continue under the control of the special
31 litigation committee;

32 (3) be settled on terms determined by the special
33 litigation committee; or

34 (4) be dismissed.

35 (d) After making a determination under subsection (c), the
36 special litigation shall file with the court a statement of its
37 determination and its report supporting its determination, giving
38 notice to the plaintiff. The court shall determine whether the
39 special litigation committee conducted its investigation and made
40 its recommendation in good faith and with reasonable care, with
41 the special litigation committee having the burden of proof. If the
42 court finds that the special litigation committee acted in good faith
43 and with reasonable care, the court shall adopt and enforce the

1 determination of the special litigation committee.

2
3 At the direction of the Committee the Reporters referenced the Revised Model Nonprofit
4 Corporation Act: it contains no reference to time periods except the complainant must notify the
5 attorney general within ten days of filing the complaint if it “involves a public benefit
6 corporation or assets held in a charitable trust by a mutual benefit corporation.” Moreover, the
7 Model Nonprofit Act deals with the demand as follows:

8
9 A complaint in a proceeding brought in the right of a corporation
10 must be verified and alleged with particularity the demand made, if
11 any , to obtain action by the directors and either why the
12 complainants could not obtain the action or why they did not make
13 the demand. If a demand for action was made and the
14 corporation’s investigation of the demand is in progress when the
15 proceeding is filed, the court may stay the suit until the
16 investigation is completed.

17
18 RMBCA §6.30(c).

19
20 The Nonprofit Corporation Act also provides a threshold standing requirement of the
21 lesser of “five percent or more of the voting power or by fifty members.” Any director also has
22 standing (§6.30(a)).

23
24
25 **SECTION 1203. PROPER PLAINTIFF.** A derivative action may be maintained only
26 by a person that is a participant at the time the action is commenced and:

- 27 (1) that was a participant when the conduct giving rise to the action occurred; or
28 (2) whose status as a participant devolved upon the person by operation of law

29 from a person that was a participant at the time of the conduct.

30 **Reporter’s Note**

31 Source: § 1003 ULPA (2001). Query whether the requirement that the person bringing a
32 suit be a member at the time of commencement is advisable or necessary. Most corporate
33 statutes so provide. It is consistent with other conference products. A Comment or Legislative
34 Note should direct states to determine the placement of derivative actions within their own codes.
35 South Dakota’s derivative procedures, for example, appear in it’s code of civil procedure. The
36 South Dakota provision and, some other corporate codes, require that the plaintiff “fairly
37 represents” the interest of the corporation. This draft does as well.

1
2 **SECTION 1204. PLEADING.** In a derivative action, the complaint must state with
3 particularity:

4 (1) the date and content of the plaintiff's demand and the cooperative
5 association's response to the demand; and

6 (2) if 90 days have not expired under Section 1202(2), that irreparable injury to
7 the cooperative association would result by waiting for the expiration of the time.

8 **SECTION 1205. PROCEEDS AND EXPENSES.**

9 (a) Except as otherwise provided in subsection (b):

10 (1) any proceeds or other benefits of a derivative action, whether by
11 judgment, compromise, or settlement, belong to the cooperative association and not to the
12 derivative plaintiff; and

13 (2) if the derivative plaintiff receives any proceeds, the derivative plaintiff
14 shall immediately remit them to the cooperative association.

15 (b) If a derivative action is successful in whole or in part, the court may award the
16 plaintiff reasonable expenses, including reasonable attorney's fees, from the recovery of the
17 cooperative association.

18 **Reporter's Note**

19 Source: § 1005 ULPA (2001).

1 [ARTICLE] 13

2 FOREIGN COOPERATIVES

3
4 SECTION 1301. GOVERNING LAW.

5 (a) The laws of the state or other jurisdiction under which a foreign cooperative is
6 organized govern relations among the participants of the foreign cooperative and between the
7 participants and the foreign cooperative.

8 (b) A foreign cooperative may not be denied a certificate of authority by reason of
9 any difference between the laws of the jurisdiction under which the foreign cooperative is
10 organized and the laws of this state.

11 (c) A certificate of authority does not authorize a foreign cooperative to engage in
12 any activity or exercise any power that a cooperative may not engage in or exercise in this state.

13 Reporter's Note

14 This article needs examination by the Committee with respect to whether any type of
15 cooperative organization organized in another state should be permitted to obtain a certificate of
16 authority under this act. "Foreign cooperative" is defined in this draft as a "foreign entity [not a
17 domestic entity] organized under a law *similar* to this [act] in another jurisdiction" [emphasis
18 supplied]. How "similar" is "similar"? A number of states have specialized cooperative statutes,
19 *e.g.*, cooperatives for agriculture, cooperatives for rural power, cooperatives for housing, but do
20 not have a general cooperative statute. If a traditional cooperative formed in a state that permits
21 cooperatives to be organized for many purposes seeks to qualify in a state with only specialized
22 statutes, the cooperative will need to qualify as a for profit or non-profit corporation that does not
23 fit the cooperative "mold." Should this act offer an alternative? A traditional cooperative could
24 be organized under this act for any purpose except that will be specifically excluded. In this
25 draft, the Reporters have assumed "similar" means a cooperative association of a type formed
26 under a statute that would clearly be seen as "similar" to this act meaning the same kind of
27 statute. This article would clearly be seen as "similar" to this act meaning the same kind of
28 statute. This article would currently have limited use by cooperative organizations organized in
29 other states unless organized under an act which is essentially the same as this one, currently
30 Wyoming, Minnesota, Iowa and Tennessee.

1 In keeping with the change of terminology from “member” to “participant” throughout
2 this draft, the terminology has been changed in this article. Is that appropriate in this article? If
3 another state uses “member” could it have an adverse effect on attempting to qualify under this
4 act?
5

6 **SECTION 1302. APPLICATION FOR CERTIFICATE OF AUTHORITY.**

7 (a) A foreign cooperative may apply for a certificate of authority to transact
8 business in this state by delivering an application to the [Secretary of State] for filing. The
9 application must state:

10 (1) the name of the foreign cooperative and, if the name does not comply
11 with Section 109, an alternative name adopted pursuant to Section 1305;

12 (2) the name of the state or other jurisdiction under whose law the foreign
13 cooperative is organized;

14 (3) the street and mailing addresses of the foreign cooperative’s
15 designated office and, if the laws of the jurisdiction under which the foreign cooperative is
16 organized require the foreign cooperative to maintain an office in that jurisdiction, the street and
17 mailing addresses of the required office;

18 (4) the name and street and mailing addresses of the foreign cooperative’s
19 agent for service of process in this state; and

20 (5) the name and street and mailing addresses of each of the foreign
21 cooperative’s current directors and officers.

22 (b) A foreign cooperative shall deliver with the completed application a
23 certificate of good standing or existence or a similar record signed by the [Secretary of State] or
24 other official having custody of the foreign cooperative’s publicly filed records in the state or

1 other jurisdiction under whose law the foreign cooperative is organized.

2 **SECTION 1303. ACTIVITIES NOT CONSTITUTING TRANSACTING**
3 **BUSINESS.**

4 (a) Activities of a foreign cooperative which do not constitute transacting
5 business in this state within the meaning of this [Article] include:

6 (1) maintaining, defending, and settling an action or proceeding;

7 (2) holding meetings of its participants or carrying on any other activity
8 concerning its internal affairs;

9 (3) maintaining accounts in financial institutions;

10 (4) maintaining offices or agencies for the transfer, exchange, and
11 registration of the foreign cooperative's own securities or maintaining trustees or depositories
12 with respect to those securities;

13 (5) selling through independent contractors;

14 (6) soliciting or obtaining orders, whether by mail or electronic means or
15 through employees or agents or otherwise, if the orders require acceptance outside this state
16 before they become contracts;

17 (7) creating or acquiring indebtedness, mortgages, or security interests in
18 real or personal property;

19 (8) securing or collecting debts or enforcing mortgages or other security
20 interests in property securing the debts, and holding, protecting, and maintaining property so
21 acquired;

22 (9) conducting an isolated transaction that is completed within 30 days

1 and is not one in the course of similar transactions of a like manner; and

2 (10) transacting business in interstate commerce.

3 (b) For purposes of this [Article], the ownership in this state of income-producing
4 real property or tangible personal property, other than property excluded under subsection (a),
5 constitutes transacting business in this state.

6 (c) This Section does not apply in determining the contacts or activities that may
7 subject a foreign cooperative to service of process, taxation, or regulation under any other law of
8 this state.

9 **Reporter's Note**

10 Source: ULPB (2001) § 903. The Style Committee has asked whether "of a like manner"
11 in subsection (a)(9) is surplusage.
12

13 The Committee requested alternative suggestions for the occurrence and concurrent
14 ownership requirements. The ALI Principles of Corporate Governance provide more specific
15 guidelines. Section § 7.02(a) (particularly subsection (1)) states:
16

17 (a) A holder [§ 1.22] of an equity security [§ 1.20] has standing to
18 commence and maintain a derivative action if the holder:

19 (1) Acquired the entity security either (A) before the
20 material facts relating to the alleged wrong were publicly disclosed
21 or were known by, or specifically communicated to, the holder, or
22 (B) by devolution of law, directly or indirectly, from a prior holder
23 who acquired the security as described in the preceding Clause (A);

24 (2) Continues to hold the equity security until the time of
25 judgment, unless the failure to do so is the result of corporate
26 action in which the holder did not acquiesce, and either (A) the
27 derivative action was commenced prior to the corporate action
28 terminating the holder's status, or (B) the court finds that the
29 holder is better able to represent the interests of the shareholders
30 than any other holder who has brought suit;

31 (3) Has complied with the demand requirement of § 7.03
32 (Exhaustion of Intracorporate Remedies: The Demand Rule) or
33 was excused by its terms; and

34 (4) Is able to represent fairly and adequately the interests of

1 the shareholders.

2
3 The California Corporate Code is somewhat similar but adds more “procedure.” Section
4 800(b)(1) specifically addresses the issue as follows:

5
6 (b) No action may be instituted or maintained in right of any
7 domestic or foreign corporation by any holder of shares of voting
8 trust certificates of the corporation unless both of the following
9 conditions exist:

10 (1) The plaintiff alleges in the complaint that plaintiff was a
11 shareholder, of record or beneficially, or the holder of voting trust
12 certificates at the time of the transaction or any part thereof of
13 which plaintiff complains or that plaintiff’s shares or voting trust
14 certificates thereafter devolved upon plaintiff by operation of law
15 from a holder who was a holder at the time of the transaction or
16 any part thereof complained of; provided, that any shareholder who
17 does not meet these requirements may nevertheless be allowed in
18 the discretion of the court to maintain the action on a preliminary
19 showing to and determination by the court, by motion and after a
20 hearing, at which the court shall consider such evidence, by
21 affidavit or testimony, as it deems material, that (I) there is a strong
22 prima facie case in favor of the claim asserted on behalf of the
23 corporation, (ii) no other similar action has been or is likely to be
24 instituted, (iii) the plaintiff acquired the shares before there was
25 disclosure to the public or to the plaintiff of the wrongdoing of
26 which plaintiff complains, (iv) unless the action can be maintained
27 the defendant may retain a gain derived from defendant’s willful
28 breach of a fiduciary duty, and (v) the requested relief will not
29 result in unjust enrichment of the corporation or any shareholder of
30 the corporation; and...

31
32 **SECTION 1304. FILING OF CERTIFICATE OF AUTHORITY.** Unless the
33 [Secretary of State] determines that an application for a certificate of authority does not comply
34 with the filing requirements of this [act], the [Secretary of State], upon payment of all filing fees,
35 shall file the application, prepare, sign, and file a certificate of authority to transact business in
36 this state, and send a copy of the filed certificate, together with a receipt for the fees, to the
37 foreign cooperative or its representative.

1 **Reporter's Note**

2 Source: ULPA (2001) § 904.

3
4 **SECTION 1305. NONCOMPLYING NAME OF FOREIGN COOPERATIVE.**

5 (a) A foreign cooperative whose name does not comply with Section 109 may not
6 obtain a certificate of authority until it adopts, for the purpose of transacting business in this
7 state, an alternative name that complies with Section 111. A foreign cooperative that adopts an
8 alternative name under this subsection and then obtains a certificate of authority with the name
9 need not comply with [fictitious name statute]. After obtaining a certificate of authority with an
10 alternative name, a foreign cooperative shall transact business in this state under the name unless
11 the foreign cooperative is authorized under [fictitious name statute] to transact business in this
12 state under another name.

13 (b) If a foreign cooperative authorized to transact business in this state changes its
14 name to one that does not comply with Section 109, it may not thereafter transact business in this
15 state until it complies with subsection (a) and obtains an amended certificate of authority.

16 **Reporter's Note**

17 Source: ULPA (2001) § 905. In subsection (a): Would it change the meaning of the first
18 sentence if “the purpose” were replaced by “purposes”?
19

20 **SECTION 1306. REVOCATION OF CERTIFICATE OF AUTHORITY.**

21 (a) A certificate of authority of a foreign cooperative to transact business in this
22 state may be revoked by the [Secretary of State] in the manner provided in subsections (b) and (c)
23 if the foreign cooperative does not:

1 (1) pay, within 60 days after the due date, any fee, tax, or penalty due to
2 the [Secretary of State] under this [act] or other law;

3 (2) deliver, within 60 days after the due date, its annual report required
4 under Section 207;

5 (3) appoint and maintain an agent for service of process as required by
6 Section 117; or

7 (4) deliver for filing a statement of a change under Section 118 within 30
8 days after a change has occurred in the name or address of the agent.

9 (b) To revoke a certificate of authority, the [Secretary of State] must prepare,
10 sign, and file a notice of revocation and send a copy to the foreign cooperative's registered agent
11 for service of process in this state, or if the foreign cooperative does not appoint and maintain an
12 agent for service of process in this state, to the foreign cooperative's designated office. The
13 notice must state:

14 (1) the revocation's effective date, which must be at least 60 days after the
15 date the [Secretary of State] sends the copy; and

16 (2) the foreign cooperative's noncompliance with subsection (a) which is
17 the reason for the revocation.

18 (c) The authority of the foreign cooperative to transact business in this state
19 ceases on the effective date of the notice of revocation unless before that date the foreign
20 cooperative cures each failure to comply with subsection (a) stated in the notice. If the foreign
21 cooperative cures the failures, the [Secretary of State] shall so indicate on the filed notice.

22 **Reporter's Note**

1 Source: ULPA (2001) § 906.

2
3 **SECTION 1307. CANCELLATION OF CERTIFICATE OF AUTHORITY;**
4 **EFFECT OF FAILURE TO HAVE CERTIFICATE.**

5 (a) To cancel its certificate of authority to transact business in this state, a foreign
6 cooperative must deliver to the [Secretary of State] for filing a notice of cancellation. The
7 certificate is canceled when the notice becomes effective under Section 203.

8 (b) A foreign cooperative transacting business in this state may not maintain an
9 action or proceeding in this state unless it has a certificate of authority to transact business in this
10 state.

11 (c) The failure of a foreign cooperative to have a certificate of authority to
12 transact business in this state does not impair the validity of a contract or act of the foreign
13 cooperative or prevent the foreign cooperative from defending an action or proceeding in this
14 state.

15 (d) A participant of a foreign cooperative is not liable for the obligations of the
16 foreign cooperative solely by reason of the foreign cooperative's having transacted business in
17 this state without a certificate of authority.

18 (e) If a foreign cooperative transacts business in this state without a certificate of
19 authority or cancels its certificate of authority, it appoints the [Secretary of State] as its agent for
20 service of process for rights of action arising out of the transaction of business in this state.

21 **Reporter's Note**

22 Source: ULPA (2001) § 907.

SECTION 1308. 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].

Reporter's Note

Source: ULP A (2001) § 908.

1 [ARTICLE] 14

2 AMENDMENT OF ORGANIC RULES

3
4 Preliminary Reporters' Note to Article 14

5 As in other articles, this draft now attempts "class voting." *See e.g.* Section 1405.

6
7 SECTION 1401. AUTHORITY TO AMEND ORGANIC RULES.

8 (a) A cooperative association may amend its organic rules under this [Article].

9 (b) A participant of a cooperative association does not have vested rights in any
10 provision in the organic rules.

11 Reporter's Note

12 This article attempts to consolidate the amendment and restatement procedures for both
13 the articles of organization and bylaws. This section simply grants a general authority to amend.
14 Subsection (b) is in the MBCA and is the analogue of the effect of a change or amendment of
15 underlying law provided in Section 104. Concerning subsection (b): Do cooperatives sometimes
16 have marketing contract provisions in by-laws? If so, is subsection (b) a problem? It doesn't
17 seem to cause a problem in corporate law even though there may be financial contract rights set
18 forth therein (*e.g.*, preferred dividends). The Committee has yet to address whether this is a
19 default or mandatory provision. This issue is an important one because under the corporate law
20 of most states the directors alone may amend the by-laws. This draft more closely follows LLC
21 law. It is also consistent with the Oregon Cooperative Act (§ 62.135).
22

23 SECTION 1402. NOTICE AND ACTION ON AMENDMENT OF ARTICLES OF
24 ORGANIZATION OR BYLAWS. To amend its organic rules:

25 (a) a proposed amendment must be approved by a majority vote of the board of
26 directors unless a greater vote is required by the organic rules;

27 (b) the board of directors shall mail or otherwise transmit or deliver in a record to

1 each participant:

2 (1) the proposed amendment:

3 (2) a recommendation that the participants approve the amendment unless
4 the board determines because of conflict of interest or other special circumstances it should not
5 make such a recommendation;

6 (3) if the board makes no recommendation, the basis of that decision;

7 (4) any condition of its submission of the amendment to the participants;

8 and

9 (5) give notice of the meeting in the same manner as a special
10 participants' meeting.

11 **Reporter's Note**

12 This Section is consistent with the article on conversion, merger or consolidation.
13 Subsection (b)(5) has been revised to remove annual meeting for notice because, for practical
14 purposes, it does not require detailed notice of agenda (etc.).
15

16 **SECTION 1403. METHOD OF VOTING.** Participants may vote in the same manner
17 as provided in Section 415.

18 **Reporter's Note**

19 This section is derived from Colorado section 7-55-110. The known inconsistency
20 concerning proxies in this draft, the Reporters believe, have been fixed in the February 2006
21 draft. Under this draft proxies are not allowed. That is a major policy decision that the
22 Committee has only tentatively made. The Committee needs to reach resolution of this policy
23 issue.
24

25 **SECTION 1404. CHANGE TO AMENDMENT AT MEETING.**

26 (a) No substantive change to the proposed amendment of the organic rules may

1 not be made at the participants' meeting at which the vote occurs.

2 (b) Subject to subsection (a) any amendment of the amendment need not be
3 separately voted upon by the board of directors.

4 (c) The vote to adopt an amendment to the amendment is the same as that
5 required to pass the proposed amendment.

6 **Reporter's Note**

7 At the November 2004 meeting the term "germane" was suggested instead of
8 "substantive" in subsection (a). Is subsection (b) clear? This Section received comment from the
9 floor at the 2005 Annual Meeting. A commissioner stated that Robert's Rules of Order should
10 take care of this and queried about "substitute amendments." In response to the latter comment
11 the February 2006 draft broadens the language slightly from "amendment to amendment" to
12 "change."
13

14 **SECTION 1405. APPROVAL OF AMENDMENT.**

15 (a) Subject to Sections 411 and 1406, an amendment to the articles of
16 organization must be approved by at least a two-thirds vote of participants voting at the meeting.

17 (b) Subject to Sections 411 and 1406, an amendment to the bylaws must be
18 approved by at least a majority vote of participants voting at the meeting and by at least a
19 majority of investor participants voting at the meeting, but a two-thirds vote of patron
20 participants and a two-thirds vote of investor participants is required for any amendment
21 modifying:

22 (1) the capital structure of the cooperative association, including the
23 relative rights, preferences, and restrictions granted or imposed upon any group or class of
24 participants, and the rights of the cooperative association's participants to share in profits,
25 surplus, or distributions;

- 1 (2) the terms for admission of new participants;
- 2 (3) quorum for a meeting and rights of voting and governance;
- 3 (4) the transferability of participants' interests; or
- 4 (5) the manner or method of allocation of net proceeds, savings, margins,
- 5 profits, and losses among participants.

6 **Reporter's Note**

7 The Reporter was requested to consider several suggested revisions at the November
8 2004 meeting included separate voting by patronage and nonpatronage members. There are two
9 reasons such revisions are not included in this draft which was discussed at the April 2005
10 Committee meeting. THIS MUST BE DISCUSSED. This draft presents "class" voting
11 provisions for Committee discussion based loosely on discussion at the April 2005 Committee
12 meeting and a comment on the floor at the 2005 Annual meeting. An important discussion, that
13 is now ripe, is how to "tune" governance rights. "Class" voting is either a part of the solution or
14 a part of the problem. Previous to the February 2006 draft the investor participants were,

15
16 Many cooperative acts allow the board of directors to amend the bylaws, some do not. It
17 is the tentative general sense of the committee to be protective of members and this draft is
18 consistent with that sense. It would be possible to make (b) a default rule rather than mandatory
19 (*See* Colorado Rev. Stat. § 7-56-208).

20
21 The allocation of provisions between the articles of organization and bylaws, even given
22 the foregoing, is a unique feature of cooperatives. In many ways it seems that the bylaws of
23 some cooperative serve an analogous role of the operating agreement under LLC law, albeit far
24 easier to amend. In order to address the real function of the bylaws in a cooperative association
25 this Section sets forth several actions that require a higher vote quantum no matter whether they
26 are in the bylaws or articles of organization. Whether the effect of changing of district
27 boundaries is included in subsection (b) as drafted needs to be considered (and the evils of
28 gerrymandering in this context are equal to those in other contexts).

29
30 **SECTION 1406. VOTING BY GROUP, CLASS, OR DISTRICT PARTICIPANTS.**

31 (a) If a proposed amendment affects a group, class, or district of participants in
32 one or more of the ways described in Section 1403, those participants shall vote as a separate
33 group.

1 (b) Unless otherwise provided in the organic rules, if a proposed amendment
2 affects more than one group, class, or district of participants in the same or a substantially similar
3 way, the participants of those groups, classes, or districts shall vote on the proposed amendment
4 as a single group.

5 (c) A group, class, or district of participants has the rights provided in this section
6 even if those participants are not otherwise entitled to vote under the organic rules.

7 **Reporter's Note**

8 Query whether (b) is/should be limited to patron participants. This is part of the
9 balancing issue discussed in the previous note and elsewhere and needs Committee direction.

10
11 Subsection (c) entitles “nonvoting” participants the right to vote concerning fundamental
12 changes to the terms of their participation. The interrelationship between subsection (c) and the
13 rights of creditors and transferees of economic rights needs to be explored.

14
15 This section should not be interpreted to extend voting rights to transferees (now:
16 “holders of financial rights”).
17

18 **SECTION 1407. PROPOSAL OF AMENDMENT BY PARTICIPANTS.**

19 (a) Participants may propose amendments to the organic rules to be considered by
20 the board of directors by demand in a record signed by participants holding at least 10 percent of
21 all votes entitled to be cast on the matter.

22 (b) The board of directors shall report its action on the proposed amendment at
23 the next annual participant meeting or any special meeting for that purpose held under Section
24 407.

25 **Reporter's Note**

26 Previous provisions allow 10 percent of the votes of any class or group to call a special
27 meeting so the board can be forced to report through the special meeting process. Note that the

1 proposal under this section requires 10 percent of all votes (not of a class). Inconsistency in
2 detail is a trap unless there is a substantive reason for doing so.

3
4 This section, like corporate law and limited partnership law, provides a central role for
5 the board of directors and does not allow a pure referendum. The relationship between this
6 Section and the board of directors removal provision needs to be discussed.
7

8 **SECTION 1408. EMERGENCY BYLAWS.**

9 (a) Unless the articles of organization provide otherwise, the board of directors
10 may adopt bylaws to be effective only in an emergency described in subsection (d). The
11 emergency bylaws may be amended or repealed by the participants and may make all provisions
12 necessary for managing the cooperative association during the emergency, including:

13 (1) procedures for calling a meeting of the board of directors;

14 (2) quorum requirements for the meeting; and

15 (3) designation of additional or substitute directors.

16 (b) The regular bylaws consistent with the emergency bylaws remain effective
17 during the emergency. The emergency bylaws are not effective after the emergency ends.

18 (c) Action taken by the cooperative association in good faith in accordance with
19 the emergency bylaws:

20 (1) binds the cooperative association; and

21 (2) may not be used to impose liability on a director, officer, employee, or
22 agent of the cooperative association.

23 (d) An emergency exists for purposes of this section if a quorum of the board of
24 directors cannot readily be assembled because of a catastrophic event.

25 **Reporter's Note**

1 This Section was formerly numbered Section 206.

2
3 Emergency bylaw provisions are common in cooperative law. Similar provisions are not
4 typically found in unincorporated entity law. Corporate law, however, frequently contains such
5 provisions. Indeed, according to the annotated version of the MBCA the corporation law of
6 approximately 40 states contains some provision for emergency bylaws.

7
8 The Committee thought it important, therefore, to mirror existing cooperative law.
9 Subsection (d) needs to be revisited by the Committee as there is some variety in its expression in
10 corporate law.
11

12 **SECTION 1409. RESTATED ARTICLES.** A cooperative association, by action taken
13 under this [article] required for amendment of its organic rules, may adopt restated articles that
14 contain the original articles as currently amended. Restated articles supersede the existing
15 articles and all amendments upon filing under [Article] 2.

16 **Reporter's Note**

17 There needs to be a cross-reference in the Comments to Section 1310(e).
18

19 **SECTION 1410. AMENDMENT OR RESTATEMENT OF ARTICLES OF**
20 **ORGANIZATION.**

21 (a) To amend its articles of organization, a cooperative association must deliver
22 to the [Secretary of State] for filing an amendment or articles of conversion, merger or
23 consolidation pursuant to [Article 15], stating:

- 24 (1) the name of the cooperative association;
25 (2) the date of filing of its initial articles of organization; and
26 (3) the changes the amendment makes to the articles of organization as
27 most recently amended or restated.

1 (b) A cooperative association shall promptly deliver to the [Secretary of State] for
2 filing an amendment to the articles of organization to reflect the appointment of a person to wind
3 up the cooperative association's activities under Section 1106.

4 (c) An organizer that knows that any information in a filed articles of
5 organization was false when the articles were filed or has become false due to changed
6 circumstances shall promptly:

7 (1) cause the articles to be amended; or

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

10 (d) Articles of organization may be amended at any time for any other proper
11 purpose as determined by the cooperative association.

12 (e) Restated articles of organization may be delivered to the [Secretary of State]
13 for filing in the same manner as an amendment.

14 (f) Subject to Section 203, an amendment or restated article is effective when
15 filed by the [Secretary of State].

16 **Reporter's Note**

17 This Section was formerly numbered Section 203. Is subsection (c) too broad? There
18 needs to be a cross-reference in the Comments for subsection (e) back to Section 1309.

1 [ARTICLE] 15

2 CONVERSION, MERGER OR CONSOLIDATION

3
4 SECTION 1501. DEFINITIONS. In this [Article]:

5 (1) “Constituent cooperative association” means a cooperative association that is
6 a party to a consolidation or merger.

7 (2) “Constituent organization” means an organization that is party to a
8 consolidation or merger.

9 (3) “Converted organization” means the organization into which a converting
10 organization converts pursuant to Sections 1502 through 1505.

11 (4) “Converting cooperative association” means a converting organization that is
12 a cooperative association.

13 (5) “Converting organization” means an organization that converts another
14 organization pursuant to Section 1502.

15 (6) “Governing statute” of an organization means the statute that governs the
16 organization’s internal affairs.

17 (7) “Organization” means a cooperative association, cooperative governed by law
18 other than this [act], general partnership, limited liability partnership, limited partnership, limited
19 liability limited partnership, limited liability company, business trust, corporation, or any other
20 person having a governing statute. The term includes domestic and foreign organizations whether
21 or not organized for profit.

22 (8) “Personal liability” means personal liability for a debt, liability, or other

1 obligation of an organization which is imposed on a person that co-owns, has an interest in, or is
2 a participant of the organization:

3 (A) by the organization’s governing statute solely by reason of co-owning,
4 having an interest in, or being a participant of the organization; or

5 (B) by the organization’s organizational documents under a provision of
6 the organization’s governing statute authorizing those documents to make one or more specified
7 persons liable for all or specified debts, liabilities, and other obligations of the organization
8 solely by reason of co-owning, having an interest in, or being a participant of the organization.

9 (9) “Surviving organization” means an organization into which one or more other
10 organizations are merged. A surviving organization may exist before the merger or be created by
11 the merger.

12 **Reporter’s Note**

13 Perhaps the best way to deal with the Model Entity Transactions Act (META) would be
14 to provide a legislative note to accompany this act setting forth the necessary revisions to this act
15 if META is in place. Such a note would also provide rough guidance for states that have a non-
16 model “junction box” type of statutes. In the latter regard the final section in this article
17 (“nonexclusivity”) may also be helpful.

18
19 Legislative notes accompany META for suggested amendments to plug into other acts
20 (a.k.a. “trailing amendments”) when META is adopted in a state. The basic idea of META is
21 that it will replace the existing transactions dispersed throughout the entities as they relate to
22 trans-entity transactions and provide default rules for those entities that do not contemplate a
23 transaction allowed by META (*e.g.* divisions) in their own governing law. Nonetheless, the
24 individual laws (*e.g.* this act) will govern the cooperative association side of any transaction to
25 the extent it addresses it (*e.g.*, the vote quantum for merging a cooperative association will trump
26 any META default rules for the voting provision in META).

27
28 After Committee discussion of this article, perhaps it would want to direct the Reporters
29 to draft the “META” legislative note for review at the next Committee meeting.

30
31 As a preliminary matter this Article allows a cooperative formed under this draft

flexibility to combine with the full panoply of other organizations whether domestic or foreign. It does not allow “share exchanges” or divisions but “conversions” are added to the February 2006 draft. A separate article exists for the sale of assets. This section is based largely on ULPA (2001) section 1101. The terms “co-owns” and “co-owning” appear in ULPA.

Does this article need a definition for “organizational documents”? The language, most especially in (7)(A) needs work.

SECTION 1502. CONVERSION.

(a) An organization other than a cooperative association may convert to a cooperative association and a cooperative association may convert to another organization pursuant to this Section and Sections 1503 through 1505 and a plan of conversion, if:

- (1) the other organization’s governing statute authorizes the conversion;
- (2) the conversion is not prohibited by the law of the jurisdiction that enacted the governing statute; and
- (3) the other organization complies with its governing statute in effecting the conversion.

- (b) A plan of conversion must be in a record and must include:
- (1) the name and form of the organization before conversion;
 - (2) the name and form of the organization after conversion; and
 - (3) the terms and conditions of the conversion, including the manner and basis for converting interests in the converting organization into any combination of money, interests in the converted organization, and other consideration; and
 - (4) the organizational documents of the converted organization.

Reporter’s Note

1 Source: ULPA (2001) § 1102.
2

3 **SECTION 1503. ACTION ON PLAN OF CONVERSION BY CONVERTING**
4 **COOPERATIVE ASSOCIATION.**

5 (a) A plan of conversion must be consented to by at least two-thirds vote of
6 patron participants voting under Section 410 and by at least two-thirds vote of investor
7 participants, if any, voting under Section 414. If as a result of the conversion any participant of
8 the cooperative association has personal liability as a result of the conversion, consent in a record
9 of that participant.

10 (b) Subject to Section _____ any contractual rights, after a conversion is approved,
11 and at any time before a filing is made under Section 1504, a converting cooperative association
12 may amend the plan or abandon the planned conversion:

- 13 (1) as provided in the plan; and
14 (2) except as prohibited by the plan, by the same consent as required to
15 approve the plan.

16 **Reporter's Note**

17 The special "consent" by those being burdened by personal liability is drafted differently
18 in ULPA (2001). It is pulled out into a separate section (§1110) and that section makes clear tht
19 the special consent provisions trump any general provisions in the organic rules regarding their
20 amendment. The Committee should discuss this matter.
21

22 **SECTION 1504. FILINGS REQUIRED FOR CONVERSION; EFFECTIVE**
23 **DATE.**

24 (a) After a plan of conversion is approved:

1 (1) a converting cooperative association shall deliver to the [Secretary of
2 Sate] for filing articles of conversion, which must include:

3 (A) a statement that the cooperative association has been
4 converted into another organization;

5 (B) the name and form of the organization and the jurisdiction of
6 its governing statute;

7 (C) the date the conversion is effective under the governing statute
8 of the converted organization;

9 (D) a statement that the conversion was approved as required by
10 this [act];

11 (E) a statement that the conversion was approved as required by
12 the governing statute of the converted organization; and

13 (F) if the converted organization is a foreign organization not
14 authorized to transact business in this State, the street and mailing address of an office which the
15 [Secretary of State] may use for the purposes of Section 1505(c); and

16 (2) if the converting organization is not a converting cooperative
17 association, the converting organization shall deliver to the [Secretary of State] for filing articles
18 of organization, which must include, in addition to the information required by Section ____:

19 (A) a statement that the cooperative association was converted
20 from another organization;

21 (B) the name and form of the organization and the jurisdiction of
22 its governing statute; and

1 (C) a statement that the conversion was approved in a manner that
2 complied with the organization's governing statute.

3 (b) A conversion becomes effective:

4 (1) if the converted organization is a cooperative association, when the
5 certificate of limited partnership takes effect; and

6 (2) if the converted organization is not a cooperative association, as
7 provided by the governing statute of the converted organization.

8 **Reporter's Note**

9 Source: ULPB (2001) §1104.
10

11 **SECTION 1505. EFFECT OF CONVERSION.**

12 (a) An organization that has been converted pursuant to this [article] is for all
13 purposes the same entity that existed before the conversion.

14 (b) When a conversion takes effect:

15 (1) all property owned by the converting organization remains vested in
16 the converted organization;

17 (2) all debts, liabilities, and other obligations of the converting
18 organization continue as obligations of the converted organization;

19 (3) an action or proceeding pending by or against the converting
20 organization may be continued as if the conversion had not occurred;

21 (4) except as prohibited by other law, all of the rights, privileges,
22 immunities, powers, and purposes of the converting organization remain vested in the converted

1 organization;

2 (5) except as otherwise provided in the plan of conversion, the terms and
3 conditions of the plan of conversion take effect; and

4 (6) except as otherwise agreed, the conversion does not dissolve a
5 converting cooperative association for the purposes of [Article 11].

6 (c) A converted organization that is a foreign organization consents to the
7 jurisdiction of the courts of this State to enforce any obligation owed by the converting
8 cooperative association if before the conversion the converting cooperative association was
9 subject to suit in this State on the obligation. A converted organization that is a foreign
10 organization and not authorized to transact business in this State appoints the [Secretary of State]
11 as its agent for service of process for purposes of enforcing an obligation under this subsection.
12 Service on the [Secretary of State] under this subsection is made in the same manner and with the
13 same consequences as in Section 117(c) and (d).

14 **Reporter's Note**

15 Source: ULPB (2001) § 1105.

16
17 **SECTION 1506. MERGER.**

18 (a) A cooperative association may merge with one or more other constituent
19 organizations pursuant to this [Article] and a plan of merger if:

20 (1) the governing statute of each the other organizations authorizes the
21 merger;

22 (2) the merger is not prohibited by the law of a jurisdiction that enacted

1 any of those governing statutes; and

2 (3) each of the other organizations complies with its governing statute in
3 effecting the merger.

4 (b) A plan of merger must be in a record and must include:

5 (1) the name and form of each constituent organization;

6 (2) the name and form of the surviving organization and, if the surviving
7 organization is to be created by the merger, a statement to that effect;

8 (3) the terms and conditions of the merger, including the manner and basis
9 for converting the interests in each constituent organization into any combination of money,
10 interests in the surviving organization, and other consideration;

11 (4) if the surviving organization is to be created by the merger, the
12 surviving organization's organizational documents;

13 (5) if the surviving organization is not to be created by the merger, any
14 amendments to be made by the merger to the surviving organization's organizational documents;
15 and

16 (6) if a participant of a constituent cooperative association will have
17 personal liability with respect to a surviving organization, the identity by descriptive class or
18 other reasonable manner of the participant.

19 **SECTION 1507. NOTICE AND ACTION ON PLAN OF MERGER BY**
20 **CONSTITUENT COOPERATIVE ASSOCIATION.**

21 (a) Unless otherwise provided in the organic rules, the plan of merger must be
22 approved by a majority vote of the board of directors.

1 (b) The board of directors shall mail or otherwise transmit or deliver in a record
2 to each participant:

- 3 (1) the plan of merger;
- 4 (2) a recommendation that the participants approve the plan of
5 consolidation or merger unless the board makes a determination because of conflicts of interest
6 or other special circumstances that it should not make such a recommendation;
- 7 (3) if the board makes no recommendation, the basis for that decision;
- 8 (4) any condition of its submission of the plan of merger to the
9 participants; and
- 10 (5) notice of the meeting in the same manner as special participants'
11 meeting.

12 **SECTION 1508. APPROVAL AND ABANDONMENT OF MERGER BY**
13 **PARTICIPANTS OF CONSTITUENT COOPERATIVE ASSOCIATION.**

14 (a) Unless the organic rules provide for a greater quantum and subject to Section
15 411, a plan of merger must be approved by at least a two-thirds vote of patron participants voting
16 under Section 410 by at least two-thirds vote of investor participants, if any, voting under Section
17 414. If as a result of the merger any participant of the cooperative association has personal
18 liability as a result of the merger, consent in a record of that participant.

19 (b) Subject to any contractual rights, after a merger is approved, and at any time
20 before a filing is made under Section 1506, a constituent cooperative association may amend the
21 plan of merger or abandon the planned merger:

- 22 (1) as provided in the plan; and

1 (2) except as prohibited by the plan, with the same consent as was
2 required to approve the plan.

3 **Reporter's Note**

4 Is "filing" the appropriate measuring date in subsection (b)?
5

6 **SECTION 1509. MERGER OF SUBSIDIARY.**

7 (a) Unless the organic rules of the cooperative association or the organic law or
8 organic rules of the other organization otherwise provide, a cooperative association that owns at
9 least 90 percent of each class of the voting power of a subsidiary organization may merge the
10 subsidiary into itself or into another subsidiary.

11 (b) The cooperative association owning at least 90 percent of the subsidiary
12 organization before the merger shall notify each other owner of the subsidiary, if any, of the
13 merger within 10 days after the effective date of the merger.

14 **SECTION 1510. FILINGS REQUIRED FOR MERGER; EFFECTIVE DATE.**

15 (a) After each constituent organization has approved a merger, articles of merger
16 must be signed on behalf of each other preexisting constituent organization, by an authorized
17 representative.

18 (b) The articles of merger must include:

19 (1) the name and form of each constituent organization and the
20 jurisdiction of its governing statute;

21 (2) the name and form of the surviving organization, the jurisdiction of its
22 governing statute, and, if the surviving organization is created by the merger, a statement to that

1 effect;

2 (3) the date the merger is effective under the governing statute of the
3 surviving organization;

4 (4) if the surviving organization is to be created by the merger:

5 (A) if it will be a cooperative association, the cooperative
6 association's articles of organization; or

7 (B) if it will be an organization other than a cooperative
8 association, the organizational document that creates the organization;

9 (5) if the surviving organization preexists the merger, any amendments
10 provided for in the plan of merger for the organizational document that created the organization;

11 (6) a statement as to each constituent organization that the merger was
12 approved as required by the organization's governing statute;

13 (7) if the surviving organization is a foreign organization not authorized to
14 transact business in this state, the street and mailing addresses of an office which the [Secretary
15 of State] may use for the purposes of Section [service of process]; and

16 (8) any additional information required by the governing statute of any
17 constituent organization.

18 (c) Each constituent cooperative association shall deliver the articles of merger
19 for filing in the [office of the Secretary of State].

20 (d) A merger becomes effective under this [Article]:

21 (1) if the surviving organization is a cooperative association, upon the
22 later of:

- 1 (A) compliance with subsection (c); or
- 2 (B) subject to Section [203(c)], as specified in the articles of
- 3 consolidation or merger; or
- 4 (2) if the surviving organization is not a cooperative association, as
- 5 provided by the governing statute of the surviving organization.

6 **SECTION 1511. EFFECT OF MERGER.**

- 7 (a) When a merger becomes effective:
- 8 (1) the surviving organization continues or comes into existence;
- 9 (2) each constituent organization that merges into the surviving
- 10 organization ceases to exist as a separate entity;
- 11 (3) all property owned by each constituent organization that ceases to
- 12 exist vests in the surviving organization;
- 13 (4) all debts, liabilities, and other obligations of each constituent
- 14 organization that ceases to exist continue as obligations of the surviving organization;
- 15 (5) an action or proceeding pending by or against any constituent
- 16 organization that ceases to exist may be continued as if the merger had not occurred;
- 17 (6) except as prohibited by other law, all of the rights, privileges,
- 18 immunities, powers, and purposes of each constituent organization that ceases to exist vest in the
- 19 surviving organization;
- 20 (7) except as otherwise provided in the plan of merger, the terms and
- 21 conditions of the plan take effect;
- 22 (8) except as otherwise agreed, if a constituent cooperative association

1 ceases to exist, the merger does not dissolve the cooperative association for purposes of [Article]
2 11;

3 (9) if the surviving organization is created by the merger:

4 (A) if it is a cooperative association, the articles of organization
5 become effective; or

6 (B) if it is an organization other than a cooperative association, the
7 organizational document that creates the organization becomes effective; and

8 (10) if the surviving organization exists before the merger, any
9 amendments provided for in the articles of merger for the organizational document that created
10 the organization become effective.

11 **Reporter's Note**

12 Source: ULPB (2001). The plan will by necessity address the pre-merger terms of the
13 directors and board officers.
14

15 **SECTION 1512. CONSOLIDATION.**

16 (a) The cooperative associations may agree to substitute the word
17 "consolidations" for the term "merger" under this [article] if:

18 (1) each constituent organization is a cooperative association or its
19 governing statute expressly provides consolidation; and,

20 (2) the surviving organization is a cooperative association or its governing
21 statute expressly provides for a consolidation.

22 (b) All provisions governing mergers or using the term merger in this [act] shall
23 apply equally to mergers that the constituent organizations choose to name consolidations under

1 subsection (a).

2 **Reporter's Note**

3 This is the Reporter's second attempt to draft "consolidations" into the draft at the
4 direction of the Committee. The first attempt simply defined "consolidation" in Section 1501.
5 Unfortunately that attempt was, at best, confusing. This attempt still stops short of segregating
6 and repeating all of the sections governing merger.

7
8 One reason to avoid the repetition is length.

9
10 The most important reason, however, is to avoid creating inconsistencies between this act
11 and the overwhelming majority of both corporate and unincorporated statutes which no longer
12 distinguish between "mergers" and "consolidations" and which use the term "mergers" to
13 encompass all combinations. This is more than a mere drafting issue because: (a) if
14 "consolidation" is not deemed to be a merger under this act many constituent organizations will
15 be unable to combine in the precise form of "consolidation" as provided herein because the
16 statutory authorization in their statute will not authorize it; and (b) it is assumed many secretaries
17 of state will have filing issues for articles of consolidation if the constituents or survivor is
18 anything but a cooperative association formed under this act or the other law expressly provides
19 for a filing with a "consolidation" caption.

20
21 For the foregoing reasons, this Section requires all organizations involved in a
22 "consolidation" to be cooperative association have express authority to use the term
23 "consolidation" under their governing law. It should be reported that there was a question
24 generally consistent with this note from the floor of the 2005 Annual Meeting asserting the draft
25 used archaic language.

26
27
28 **SECTION 1513. METHOD OF VOTING.** Participants may vote in the same manner
29 as provided in Section 415.

30 **Reporter's Note**

31 The February 2006 draft alleviates the prior inconsistency between this Section and the
32 voting provisions in Article 3 regarding proxies. Proxies are not allowed under this draft but
33 "secret ballot by mail or other means" may be allowed by the organic rules.

34
35 **SECTION 1514. [ARTICLE] NOT EXCLUSIVE.** This [article] does not preclude a
36 cooperative association from being converted, consolidated, or merged under other law.

Reporter's Note

Most of this article is based on the merger provisions found in Article 11, ULP (2001). There are two major differences with the ULP formulation. *First*, this draft does not provide for conversions although it provides for the same result through merger of a cooperative *into* another type of entity. *Second*, it allows for short-form merger where cooperative owns at least 90 percent of the voting power of the subsidiary. The first difference is a matter of degree depending on decisions made in the Model Entity Transactions Act. It may be important to discuss the advisability of conversion-like processes here, however, squarely within the context of cooperatives to identify any specific concerns caused by META.

One change incorporated in this draft is the use of both the terms “merger” and “consolidation”. The advisors to this act have urged that the term “consolidation” be used where the surviving entity is a new organization. The Minnesota Cooperative Association Act deals with “consolidations” by definition like a prior draft of this [act]. That approach, at the direction of the Committee, has been reviewed by the Reporters and a different approach is attempted in the February 2006 draft. *See* the Reporter’s Note to the previous Section.

1 **ARTICLE 16**

2 **DISPOSITION OF ASSETS**

3
4 **SECTION 1601. DISPOSITION OF ASSETS NOT REQUIRING PARTICIPANT**

5 **APPROVAL.** Unless the articles of organization otherwise provide, no participant approval
6 under Section 1602 is required for a cooperative association to:

7 (a) sell, lease, exchange, or otherwise dispose of all or any part of the assets of the
8 cooperative association; or

9 (b) mortgage, pledge, dedicate to the repayment of indebtedness or encumber in
10 any way all or any part of the assets of the cooperative association.

11 **Reporter's Note**

12 This Section is new to the February 2006 draft and is similar to the MBCA formulation
13 except the term "ordinary" has replaced "usual and regular" to conform to the language used in
14 other conference products. The Model Business Corporation Act contains two additional
15 subsections which were not included in the text of this draft. They are:

16
17 (3) to transfer any or all of the corporation's assets to one or more
18 corporations or other entities all of the shares or interests which are
19 owned by the corporation; or

20 (4) to distribute assets pro rata to the holders of one or more classes
21 or series of the corporation's shares.
22

23 Subsection (3) of the MBCA allows the transfer of all the assets to wholly owned subsidiaries.
24 The Comments for subsection (4) state that it applies to traditional spin-offs but not split-offs
25 ("non pro rata distribution of shares of a sub to some or all shareholders in exchange for some of
26 their shares") or split-ups (which would be governed by the dissolution provisions rather than the
27 disposition section.
28

29 **SECTION 1602. PARTICIPANT APPROVAL OF OTHER DISPOSITION OF**

30 **ASSETS.** Subject to Section 1601 and unless otherwise provided in the articles of organization,

1 a sale, lease, exchange, or other disposition of assets requires approval of the cooperative
2 association's participants under Sections 1603 through 1605 if the disposition leaves the
3 cooperative association without significant continuing business activity.

4 **Reporter's Note**

5 Source: MBCA Section 12.02.

6 The MBCA provides greater textual detail as follows:

7 If a corporation retains a business activity that represented at least
8 25 percent of total assets at the end of the most recently completed
9 fiscal year, and 25 percent of either income from continuing
10 operations before taxes or revenues from continuing operations for
11 that fiscal year, in each case of the corporation and its subsidiaries
12 on a consolidated basis, the corporation will conclusively be
13 deemed to have retained a significant continuing business activity.

14
15 Another alternative is to replace Sections 1601 and 1602 with language similar to older corporate
16 statutes, something like:

17
18 The sale, lease, exchange, mortgage, pledge, dedication of
19 indebtedness or other encumbrance of substantially all of the assets
20 of the cooperative association not in the ordinary course of
21 business must be approved by the participants under Sections
22 _____ through _____.
23

24 **SECTION 1603. NOTICE AND ACTION ON DISPOSITION OF ASSETS.** To
25 dispose of assets subject to Section 1602:

26 (a) the proposed disposition must be approved by a majority vote of the board of
27 directors unless a greater vote is required by the organic rules;

28 (b) the board of directors shall mail or otherwise transmit or deliver in a record to
29 each participant:

30 (1) the terms of the proposed disposition;

1 (2) a recommendation that the participants approve the disposition unless
2 the board determines because of conflict of interest or other special circumstances it should not
3 make such a recommendation;

4 (3) if the board makes no recommendation, the basis of that decision;

5 (4) any condition of its submission of the proposed disposition to the
6 participants; and,

7 (5) give notice of the meeting in the same manner as a special participants
8 meeting under Section ____.

9 **Reporter's Note**

10 This Section is consistent with the provisions governing amendment of the organic rules.

11 Should the next draft provide that the vote shall take place at a special participant
12 meeting?
13
14

15 **SECTION 1604. METHOD OF VOTING.** Participants may vote in the same manner
16 as provided in Section 415.

17 **SECTION 1605. ACTION ON DISPOSITION OF ASSETS.** The proposed
18 disposition of assets must be consented to by:

19 (a) at least two-thirds vote of patron participants voting under Section 410;

20 (b) at least two-thirds vote of investor participants, if any, under Section 414.

21 **Reporter's Note**
22

23 This is substantively consistent with mergers, consolidations, and conversions though in a
24 slightly different format. *See, e.g.,* Section 1503(a). Note that it does not include any of the
25 abandonment machinery that is included in Article 15. *See, e.g.,* Section 1503(b).
26
27

1 **[DELETED: ARTICLE 17**

2 **DISSENTERS RIGHTS]**

3 **Reporter's Note**

4 Dissenters' appraisal rights are a traditional corporate remedy. Some traditional
5 cooperative statutes have adopted them (*see* Colo. Rev. Stat. § 7-56-608) others have not (*Cf.*,
6 Or. Rev. Stat. § 62.613(2)).

7
8 The April 2005 draft included a fully drafted article on dissenters' rights that has been
9 deleted at the direction of the Committee. This is consistent with unincorporated law but the
10 voting quantum defaults in unincorporated law are generally higher and, therefore, unless altered,
11 default voting may provide back-door protection.

12
13 The probable effect of the deletion of dissenters rights (sometimes known as "appraisal
14 rights") is to strengthen governance by majority, particularly in fundamental change transactions
15 (Consolidations, Mergers, Sale of Assets). It probably also enhances centralized management in
16 the board of directors because it lessens flight-of-capital concerns in those kinds of decisions that
17 corporate law would provide such rights. Arguably this result is consistent with the historical
18 root values of cooperatives.

19
20 The organic rules, of course, may provide for such rights and in capital intensive
21 cooperative associations with investor participants it is probable those members will demand the
22 inclusion of such rights to avoid capital lock-in. In any event, the directors are subject to duties
23 of care and loyalty and could be held responsible under those duties.

1 [ARTICLE] 18

2 MISCELLANEOUS PROVISIONS

3
4 SECTION 1801. EXEMPTION FROM SECURITIES LAWS. Participant interests
5 offered or sold by a cooperative association are exempt from the securities laws of this state to
6 the extent interests offered or sold by other types of cooperative organizations are exempt under
7 [citation to the provision applicable to other existing forms of cooperative associations].

8 Reporter's Note

9
10 The language of the statutes vary greatly by state. Many state laws contain exemptions
11 from securities regulation either in the law governing cooperatives or in their securities acts. To
12 avoid the necessity of each state renegotiating both the policy and nonuniform statutory language
13 during the adoption of this Act this draft simply applies those existing exemptions by reference.
14 *See generally*, Reporters' Note to Section 909 of this draft.

15
16 The language has been modified from prior drafts in response to concerns expressed on
17 the floor at the 2005 annual meeting that the former language could have broader implications
18 than intended.

19
20 The Uniform Securities Act (2002) contains a limited exemption at USA § 201(8). It is
21 limited to "nonprofit membership cooperatives" and, even there, does *not* apply to "a member's
22 or owner's interest, retention certificate, or like security sold to persons other than bona fide
23 members of the cooperative." Comment 8 to Section 201 states:

24
25 "The 1956 Act... had instead provided: 'insert any desired
26 exemption for cooperatives'. The Reporter for the 1956 Act had
27 found such sharp variation among the 18 states that then had
28 adopted a cooperative exemption that 'no common patter can be
29 found.' Louis Loss, Commentary on the Uniform Securities Act
30 118 (1976).

31
32 The Committee suggests it unlikely to achieve further uniformity than that proposed by
33 the USA (2002) and that states have already made policy decisions that are unlikely to change
34 based upon anything stated in this limited purpose unincorporated cooperative act. A strong
35 legislative not should be drafted.
36

1 **SECTION 1802. EXEMPTION FROM RESTRAINT OF TRADE AND**
2 **ANTITRUST LAWS.** Cooperative associations have the same immunities, rights, and
3 privileges provided cooperative associations formed under [other law of this state] and are
4 governed by [citation to the applicable restraint of trade and antitrust provisions] and shall be
5 exempt from those laws to the extent, but only to the extent, cooperatives organized under [other
6 law of this state] are exempt.

7 **Reporter's Note**

8
9 It is most certainly *not* the intent of this Section to expand any such exemptions beyond
10 the purposes provided in those other laws. The addition is intended to clarify that, but more
11 consideration may need to be given to the wording as was suggested from the floor at the 2005
12 annual meeting. See the last paragraph of this Note. A question of both interpretation and policy
13 is raised, however, by a slippery-slope hypothetical. Assume the referenced statute states
14 “controlled by agricultural producers” versus “exclusively owned and controlled by agricultural
15 producers.”
16

17 See the Note to Section 1801. Section 1803, and to a lesser extent Section 1802, might
18 be better placed in Article 6 (“Marketing Contract”) but are in Article 18 of this draft for
19 purposes of discussion.
20

21 In any event, these sections will require a strong legislative note. One of the issues that
22 needs to be addressed by the legislative note is how to conform the provision to apply to this Act
23 if it is not completely self-executing. *E.g.*, if it simply states that “cooperatives complying
24 with...”.
25

26 **SECTION 1803. INDUCING BREACH OF MARKETING OR PURCHASE**
27 **CONTRACTS.** The remedies provided by [citation to the applicable statutory provisions] apply
28 to cooperative associations.

29 **Reporter's Note**

30
31 See the Note to Section 1802.
32

SECTION 1804. 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.

[SECTION 1805. Deleted].

Reporter's Note

The Committee on Style suggested former Section 1705 [Severability] is unnecessary. It remained in the 2005 Annual Meeting Draft only because a similar provision is included in ULPB (2001) and, therefore, it seems it should be briefed by the Reporter and discussed by the Drafting Committee. In doing so, the Reporter fully understands the position of the Committee on Style, and the implicit agreement by the Conference, that a severability clause should be used only where there is genuine doubt concerning constitutionality and its inclusion here should not be interpreted as disagreeing with those well-reasoned positions.

The October 2005 draft conforms to a second suggestion by the Style Committee for its deletion but does not yet renumber subsequent sections pending Committee discussion.

SECTION 1806. 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 this [act] 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)).

SECTION 1807. EFFECTIVE DATE. This [act] takes effect [effective date].

SECTION 1808. SAVINGS CLAUSE. This [act] does not affect an action or proceeding commenced, or right accrued before [this [act] takes effect].