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FOR DISCUSSION ONLY

UNIFORM COOPERATIVE ASSOCIATION ACT

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UNIFORM COOPERATIVE ASSOCIATION ACT

WITH PREFATORY NOTE AND REPORTERS' NOTES

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UNIFORM COOPERATIVE ASSOCIATION ACT

Prefatory Note

(1) This Draft attempts to provide an unincorporated and flexible organizational structure buttressed and combined with cooperative principles and values in order to obtain an increased equity investment opportunity necessary for both capital intensive and start-up businesses. It is an alternative to other cooperative and unincorporated structures already available under state laws.

It attempts to provide a flexible breastwork of mandatory and default rules that are grounded in cooperative values and participant governance. Nonetheless, the flexibility in this draft is not necessarily "hard-wired" such that it will in all cases be qualified as a cooperative, for example, under definitions of "cooperative" for various federal law provisions. *See generally* (3), *infra*.

To the extent it is already possible to qualify as a "cooperative" for federal purposes without being organized as a state law cooperative, other flexible forms of business organizations, like the LLC, may be used for cooperative purposes. This Draft, however, provides an efficient default template that encourages planners to utilize tested cooperative principles for a broad range of entities and purposes.

(2) 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 for 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 have had 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 cooperative's 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 statues based on the Minnesota Act. Wisconsin has introduced similar legislation the past three years and it passed the legislature this year only to be vetoed by the Governor on technical revenue grounds. The Governor, however, expressed his general support and stated he would sign a similar bill that fixed the revenue problem if it was presented him. At the time of the writing of these notes it is the Reporters' understanding the corrected version has again passed the two houses of the Wisconsin legislature. Similar legislation was introduced in Vermont and Missouri but not passed.

(3) 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, Minnesota, Tennessee, and Iowa) 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. The forerunners to this project 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 no means

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 laws and regulations. The primary "other laws" are anti-trust law, taxation, securities law, and access to special cooperative loan provisions and institutions like 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, the federal income tax law as of 2005 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) as of 2005. 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 for the first time 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 closely

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 issues 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 project should be limited to "agricultural," no matter how defined. *Finally*, the leading cooperative association laws as they currently exist were not limited to "agricultural" uses even though some notion of "agricultural" remains 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. The Committee has had only limited opportunity to discuss the specific language of this draft and continues to discuss the appropriateness of exclusions, if any from the draft.

(4) Further Background on Flexibility and Current Non-Law Constraints

In numerous discussions of the Committee, it has been observed that it is important for Cooperative Associations that would be created under the Uniform Cooperative Associations Act (the "Act") to maintain qualification or exemption status available to traditional cooperative organizations. This discussion is intended to focus those issues without being an in-depth research report regarding any of them. It will identify some of the relevant federal statutes and pose an issue under each of them and will provide, as an example, more discussion of the application of Subchapter T of the Internal Revenue Code as a prototypical analytical approach undertaken under other federal statutes.

Despite a desire on the part of some people to try to preserve qualification or exemption requirements for purposes of other law (non-state) for Cooperative Associations under the Act, some have suggested that is not likely to happen with organizations organized under the Act. A bit of research suggests there are reasons to believe there exists (to some degree) mitigating conditions that narrow the concerns that associations formed under the Act will be unable to meet the qualification requirements for co-ops under other law.

This part of the Preliminary Note focuses, for illustration, on the question of whether an entity will qualify for a qualification or exemption under statutes based on the quantity of business done by the entity with members and patrons. It does not look at other requirements for qualification or exemption, such as whether the entity is required to allocate and distribute patronage refunds, whether the entity has one member-one vote, whether the entity must be involved in agriculture and its members be agricultural producers, whether patron members are the only ones allowed to vote or whether an entity must be a corporation.

The following five (5) statutes have a quantitative requirement:

(1) 7 U.S.C. § 291 (quantitative requirement in definition of cooperative in Capper-Volstead federal antitrust exemption);

(2) 12 U.S.C. § 1141j(a) (quantitative requirement in definition of cooperative for farm credit purposes);

(3) 12 U.S.C. § 2129 (quantitative requirement in definition of cooperative for borrowing from bank for cooperatives);

(4) 49 U.S.C. § 303(b) (quantitative requirement in definition of cooperative for ICC exemption); and

(5) 12 U.S.C. § 3015 (§105 (a), Pub.L. 95-351, 92 Stat. 499, 506 (August 20, 1978)) (quantitative requirement in definition of cooperative in National Consumer Cooperative Bank Act).

(Taken from *Conway County Farmers Association v. U.S.*, 588 F.2d 592, 1978 U.S. App. LEXIS 7273, 78-2 U.S. Tax Cas. (CCH) P9840, 42 A.F.T.R. 2d (RIA) 6323.)

Generally, each of the listed statutes require the association to conduct a specified quantity of business (usually more than 50%) with members and/or patrons than with non-members to be a "cooperative" for purposes of the statute.

Thus, if a Cooperative Association were structured and operated to meet the required quantitative amount of business with members/patrons, it would meet the qualification. *For this purpose only*, outside investment in the entity is not relevant although such investment may be relevant may be for voting requirements or other requirements.

From a federal income tax standpoint, the Internal Revenue Service took the position that to be "a corporation operating on a cooperative basis" under Subchapter T (§1381(a)(2)) required the corporation to conduct more business with members and patrons than with non-members. Rev. Rul. 72-602, 1972-2 Cum. Bull. 511. The Service did not prevail on this requirement in three cases: *Conway County Farmers Ass'n v. U.S.*, 588 F.2d 592 (8th Cir. 1978); *Columbus*

Food & Veg. Coop v. U.S., 7 Claims Ct. 561 (1985); *Geauga Landmark, Inc. v. U.S.*, #81-942 (Nor. Dist. Ohio 1985).

As a result, the Service dropped this requirement and has said the "member/patron" portion of a cooperative corporation's business (and patronage refunds resulting from it) could receive patronage refund treatment under Subchapter T but the net profits/losses from the non-member/patron business would be taxable in the same manner as a non-cooperative corporation.

"Whether a nonexempt cooperative is entitled to the benefits of Subchapter T depends upon the finding that it is 'operating on a cooperative basis' under 26 U.S.C. § 1381 (a)(2)." Geauga Landmark, Inc., supra. This determination obviously needs to be made on a case by case factual basis.

The point of this is the Cooperative Associations Act could hardwire results for certain other law but in doing so it could eliminate the flexibility of the statute. It is likely the ultimate results under other will need to be left to practitioners and users of the Act to craft structures that will obtain the benefits of various other statutes as desired. This may require knowledge and skill and leave a trap for the unwary, but to accomplish one of the primary goals of the Act, this may be necessary. It may ultimately require administrative determinations and rulings for final guidance in specific instances.

(5) 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, for example, this draft has a strong participant/member focus. Illustratively, 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 users and gives cooperatives the authority to erode producer capital lock-in in its organic rules. Thus, it allows wide latitude for both patron members/participants (*e.g.* producers/users of the cooperative) and investor member/participants, within limitations, to provide for the sharing of net proceeds, surplus, or profit and governance participation between patron and investor member/participants. The constraints on investor participant participation in

this draft are tighter than those found in most, if not all, the "new generation" cooperative statutes. This clearly distinguishes this cooperative draft from limited liability company statutes in an attempt to maintain the "co-op brand." Over the evolutionary course of this project the default rules have probably moved closer to the look and feel of mid-twentieth century corporate-like cooperatives.

The 2006 Annual Meeting Draft contains substantial and numerous revisions from the 2005 Annual Meeting Draft reflecting Committee decisions at its Fall 2005 and Spring 2006 meetings.

The drafting decisions made and directed at the Spring 2006 meeting are reflected in this Draft and include, most substantially, a revision of the participant voting provisions, derivative actions, and board of director organization. Other significant decisions made at the Spring meeting concerned the financial rights of participants.

The February 2006 Draft reflected a number of noteworthy Committee directions. For example the nomenclature changed from "member" to "participant"; from "nonpatron member" to "investor participant"; the term "association" was inserted behind the word "cooperative" wherever appropriate to avoid interpretive confusion and to emphasize that this is a different type of cooperative within the umbrella term; the February 2006 draft also changed 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; "conversions" were added; another approach to integrate the term "consolidation" has been attempted by the reporters; and, for the first time, the article on "sale of assets" was included; the definitions were completely reworked in light of the substantive changes made by the Committee in its on-going discussion the inconsistent treatment of proxy has been remedied (no proxies are allowed); the "Reporters Notes" on participant actions (derivative actions) and under selected other sections now reflect research conducted by the reporters as requested by the Committee over the past two meetings; and, the "filings" were given substantial attention and editing though they may need continued attention.

The entire draft has twice undergone a heavy Style Committee edit since the 2005 Annual Meeting.

This is a work still in process. There remain both technical drafting issues and substantive policy ones that may need to be revisited and confirmed. 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 is beyond discussing the use in each section as the Committee does its work; the overarching task remains unripe though it will

quickly ripen for the Reporters and Committee following the 2006 Annual Meeting. There, too, are probable errors in cross-referencing as the section numbers continue to change though it is hoped less appear in this draft than previous drafts. Nonetheless substantial progress has been made by the Committee since the 2005 Annual Meeting. Finally, the Reporters' Notes contain more, rather than fewer questions, as the draft matures to address finer grained issues. These questions should be viewed as evidence of progress and maturity and not a lack of either. Moreover, some questions are retained in the Notes for future reference in drafting Comments even though the Committee has resolved them.

Please note that James B. Dean joined the project as a new "Associate Reporter" in Fall 2005 and, as noted in the Committee memorandum for the October 2005 meeting, John Stieff is the Committee's new liaison to the "Style Committee."

UNIFORM COOPERATIVE ASSOCIATION ACT

ARTICLE 1

GENERAL PROVISIONS

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

Reporters' Note

The addition of "association" mitigates, to some extent, concerns that the Act be confused with corporate based statutes. It did little to mitigate continuing concerns about co-op "branding." Drop in name memo: add mixed, hybrid, unincorporated, expanded.

SECTION 102. DEFINITIONS. In this [act]:

(1) "Articles of organization" means initial, amended, or restated articles of organization of a cooperative association containing the information required or permitted in Section 302. In the case of a foreign cooperative, the term includes all records that:

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

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

(2) "Bylaws" means initial, amended, or restated bylaws of a cooperative association as provided in Section 304.

(3) "Contribution" means a benefit that a person provides to a cooperative association in order to become a participant or in the person's capacity as a participant.

(4) "Cooperative" means a cooperative association or an entity organized under any cooperative law of any jurisdiction.

(5) "Cooperative association" means an association organized under this [act].

(6) "Debtor in bankruptcy" means a person that is the subject of:

(A) an order for relief under Article 11 of the United States Code or comparable order under a successor statute of general application; or

(B) comparable relief under federal, state, or foreign law governing insolvency.

(7) "Designated office" means the office designated under Section 116(a)(1).

(8) "Distribution" means a transfer of money or other property from a cooperative association to a participant because of the participant's financial rights or to a transferee of a participant's financial rights.

(9) "Domestic entity" means an entity organized under the laws of this state.

(10) "Entity" means a person other than an individual, whether domestic or foreign.

(11) "Financial rights" means the right to participate in allocations and distributions under [Article] 9 but does not include rights or obligations under a marketing contract governed by [Article] 6.

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

(13) "Foreign entity" means an entity that is organized under the laws of a jurisdiction other than this state.

(14) "Governance rights" means the right to participate in governance of a cooperative association under [Article] 4.

(15) "Investor participant" means a person admitted as a participant who is not required by the organic rules to conduct patronage business with a cooperative association in order to receive financial rights.

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

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

(18) "Participant" means a person that is a patron participant or an investor participant in a cooperative association. The term does not include a person that has dissociated as a participant.

(19) "Participants' interest" means the interest of a patron participant or an investor participant under Section 501.

(20) "Participants' meeting" means an annual or special participants' meeting.

(21) "Patron" means a person that conducts economic activity with a cooperative association which entitles the person to receive financial rights based on patronage.

(22) "Patron participant" means a person admitted as a participant that is permitted or required to conduct patronage with the cooperative association in order to receive financial rights.

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

(24) "Person" means an individual, corporation, business trust, estate, trust, partnership,

limited liability company, cooperative, association, joint venture, public corporation, or government or governmental subdivision, agency, or instrumentality, or any other legal or commercial entity.

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

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

(27) "Required information" means the information a cooperative association is required to maintain under Section 113.

(28) "Sign" means, with the present intent to authenticate a record:

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

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

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

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

(31) "Voting participant" means a participant that, under the organic law or organic rules of a cooperative association, has a right to vote on matters subject to vote by participants.

Reporters' Note

The February 2006 draft has undergone extensive changes.

As discussed in greater detail in the Reporter's Note to Section 404, the definitions need tuning. In particular, "patron", "patron member" and "nonpatron member" are currently under reconsideration by the Drafting Committee. "Financial Interest" is used extensively in Article 4 but not defined. The term "financial interest", as noted in the Reporter's Note, is also being reconsidered. It performs the same function as "transferable interest" in ULLCA, ULPA (2001), and UPA (1997). Below are two rough definitional suggestions from the Reporter for discussion purposes:

- "Patron membership interest" means the membership interest providing a patron rights in governance and a transferable interest [financial interest] of the cooperative as a member as established by the [Act]; and

- "Transferable interest" means the right to receive distributions to members but does not include the right to receive payments based on a separate marketing contract, if any, between the member and the cooperative.

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

An observer has suggested that the definition of "patronage" (subsection 21) be revised to read as follows:

> "Patronage" means business transactions between a cooperative and a person which entitle the person to receive financial rights, distributions, or payment from the cooperative based on the value or quantity of such business, done with such person under a pre-existing legal obligation to receive the amount paid, which is determined by reference to the net earnings of the cooperative from all business done with or for such persons.

All references to "cooperative plan" have been deleted consistent with prior and continuing committee discussion.

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

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

"Financial Rights": allocation and distribution includes the rights to distributions in liquidation, rights to receive dividends if dividends are a method used to distribute funds, rights to receive patronage allocations and dividends, redemption of retained patronage allocations or

per unit retains; rights to receive partnership allocations and distributions. It does not include amounts to which a patron participant would be entitled under a marketing contract.

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

Section 102 (3): The comment should include reference to the *Stafford* case, include examples, and, state that some states may limit the definition of "Contribution" by Constitutional provision.

There was discussion at the last meeting about whether "organic rules" should be expanded. No modification was made here but see Article 5.

Is "financial rights" used appropriately in (21) and (23)?

Section 102(5): See Section 103.

Reporters' Note on Notice

At the direction of the Committee prior Section 103 ("Knowledge and Notice") is deleted in this draft. It is governed by other law.

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

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

> SECTION 103. KNOWLEDGE AND NOTICE.
>
> (a) A person knows a fact when any of the following apply:
>
> (1) the person is an individual who is consciously aware of the fact;
>
> (2) the person is deemed to know the fact under subsection (b) or (e) or other law.
>
> (b) A person that is not a member is deemed to know of a limitation on authority to transfer real property as provided in Section 302(4).
>
> (c) A person has notice of a fact when any of the following apply:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Reporters' Note

Tenn. Code. Annot. Section 43-38-102 states: "The general assembly has the power to amend or repeal all or part of this chapter at any time and all domestic cooperatives subject to this chapter shall be governed by such amendment in Appeal.

The revised language is taken from UPA (1997) and is present in ULLCA, ULLCA II, ULPA (2001). Its purpose is to avoid Constitutional Contract Clause issues. The Committee specifically voted on leaving this in the draft on reconsideration.

SECTION 104. NATURE, PURPOSE, AND DURATION OF COOPERATIVE ASSOCIATION.

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

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

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

Reporters' Note

Subsections (a) and (c) seem well settled as does most of Subsection (b). Indeed, much of Subsection (b) has been long accepted by the Committee.

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

Subsection (b) also reflects the decision by the Uniform Law Commission at the 2005 Annual Meeting to delete any reference to "agricultural or agricultural related" and, instead, list

specific purposes for which cooperatives may not be used. The "except" language is similar to the language in Section 3 of RULPA 1976/1985. The Committee may desire to consider inserting "subject to any law of this state governing or regulating business" which is included in ULLCA 1996 (after the words "any lawful purpose").

The Minnesota Cooperative Association Act states:

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

Minnesota's general cooperative law has the following purpose:

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

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

South Dakota's general cooperative statute (which was enacted in 1939 and amended in 1968 and 1978 states:

> "Cooperatives may be organized under this chapter for any lawful purpose except banking and insurance." SDCL § 47-15-2.

The "whether or not for profit" language comes from other unincorporated entity law to avoid problems associated with the word "business" in general partnership law (primarily because of the question whether a not-for-profit or governmental entity was authorized to conduct business and, secondarily, because of questions by estate and family business planners about whether "business" allowed the mere holding of property). Traditional cooperatives may, in many states, organize under not-for-profit or "business" (for-profit general); corporation acts. Cooperative values, however, are probably attuned to a "third-way" that is neither for-profit or "not-for-profit" (mutual benefit of their members; *perhaps* that is the meaning of operating at cost under statements of cooperative principles or operating on a "cooperative plan" under statutes using that phrase without further definition.

The Style Committee suggested the draft might be better if it somehow described a cooperative association for users of the resulting Act.

The Drafting Committee has not had a chance to discuss the comment by the Style Committee. Nonetheless, a first attempt by the Reporters to provide language for discussion follows:

A cooperative association organized under this Act is an unincorporated entity that combines:

(A) cooperative principles of (i) ownership, financing and control by persons using the association, and (ii) provision of benefits to those persons based on the amount of their use of the association; with

(B) returns on investment and a share of control for persons providing separate investments in the association.

See James B. Dean and Ryan M. Stern, "Cooperative Business," COLORADO BUSINESS ORGANIZATIONS HANDBOOK (2004).

Note: Not even the reporters can come to complete agreement on this matter.

SECTION 105. POWERS. A cooperative association has the power to do all things necessary or convenient to carry on its activities, including the power to:

(1) sue and be sued;

(2) defend an action in its own name; and

(3) maintain an action against a participant for harm caused to the cooperative association by a violation of a duty to the association or the organic law or organic rules of the association.

Reporters' Note

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

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

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

The first item is resolved in the draft's provisions concerning marketing contracts (Article 6). The second item is not resolved by this draft following the sense of the Committee's discussion. ULPA (2001) and the current draft of the ULLCA Revision Project have simply stated, *e.g.*, "A limited liability company has the capacity to sue and be sued in its own name and the power to do all things necessary or convenient to carry on its activities."

SECTION 106. GOVERNING LAW. The law of this state governs:

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

(2) the relations among the participants of an association and between the participants and the association.

SECTION 107. SUPPLEMENTAL PRINCIPLES OF LAW. Unless displaced by particular provisions of this [act], the principles of law and equity supplement this [act].

Reporters' Note

The Committee on Style, consistent with previous Committee discussion but not Committee resolution, recommends deleting subsections (a) and (b). For purposes of this draft (b) was deleted but "old" (a) remains because of the distinctive approaches to related issues in other unincorporated law (e.g. Delaware and others pure contract approach to LLCs and LPs).

SECTION 108. NAME.

(a) In this section, "available" means distinguishable upon the records of the [Secretary of State] from:

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

(2) a name reserved or registered under Section 109 or 110; and

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

(b) The name of a cooperative association must contain the word "association" or its abbreviation and may contain the word "cooperative" or its abbreviation.

(c) Except as authorized by subsection (d), the name of a cooperative association must be available.

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

(1) the name is reserved or registered under Section 109 or 110 and the user, registrant, or owner of the name consents in a record to the use and submits an undertaking in a form satisfactory to the [Secretary of State] to change the reserved or registered name to a name that is distinguishable upon the records of the [Secretary of State] from the name applied for; or

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

Reporters' Note

This Section has been modified by the Reporters' consistent with extensive comments from the Style Committee.

The ULLCA draft has the equivalent of (a) and replaces the balance of the language under this draft with the following:

> SECTION 108. NAME.
>
> (a) The name of a limited liability company must contain "limited liability company" or "limited company" or the abbreviation "L.L.C.", "LLC", "L.C.", or "LC". "Limited" may be abbreviated as "Ltd.", and "company" may be abbreviated as "Co.".
>
> [(b) Unless authorized by subsection (c), the name of a limited liability company must be distinguishable in the records of the [Secretary of State] from:

(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 111 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.

SECTION 109. RESERVATION OF NAME.

(a) A person may reserve the exclusive use of the name of a cooperative association, including a fictitious name for a foreign cooperative whose name is not available under Section

108, by delivering an application to the [Secretary of State] for filing. The application must set forth the name and address of the applicant and the name proposed to be reserved. If the [Secretary of State] finds that the name applied for is available under Section 108, it must be reserved for the applicant's exclusive use for a nonrenewable 60-day period.

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

Reporters' Note

The current ULLCA II draft has adopted a 120-day period rather than a 60-day period.

"Style" questioned whether "fictitious name" is clear.

SECTION 110. REGISTERED NAME OF FOREIGN COOPERATIVE.

(a) A foreign cooperative may register its name pursuant to Section 109 if the name is available under Section 108.

(b) A foreign cooperative may register its name, or its name with any addition required by Section 1305, by delivering to the [Secretary of State] for filing an application:

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

(2) accompanied by a certificate of good standing, or a similar record, from the state or country of organization.

(c) A foreign cooperative whose name is registered under subsection (a) may qualify as a foreign cooperative under its name or consent in a record to the use of its name by a cooperative association later organized under this [act] or by a foreign cooperative later authorized to transact business in this state. The registration of the name terminates when the foreign cooperative qualifies, the cooperative association is organized, or consent is given to use of the name by the foreign cooperative later authorized to transact business in this state.

Reporters' Note

The 2007 Annual Meeting Draft has been conformed with the Style Committees comments by the Reporters.

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

SECTION 111. USE OF THE TERM "COOPERATIVE".

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

[(b)] A cooperative association and a participant may enforce the restrictions on the use of the term "cooperative" under this [act] [and cross-reference to other laws of this state].

Reporters' Note

Subsection (a) has been bracketed because not all states have this provision in other laws.

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

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

SECTION 112. EFFECT OF ORGANIC RULES.

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

(b) Organic rules may not:

(1) vary a cooperative association's power under Section 105 to sue, be sued, and defend in its own name;

(2) vary the law applicable to an association under Section 106;

(3) vary the requirements of Section [yet to be determined by Committee];

(4) vary the information required to be kept under Section 113 or unreasonably restrict the right to information under Section 405 or 721, but the organic rules may impose reasonable restrictions on the availability and use of information obtained under those sections and may define appropriate remedies, including liquidated damages, for a breach of any reasonable restriction on use;

(5) eliminate the duty [of loyalty] under Section 718, but the organic rules may:

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

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

(6) unreasonably reduce the duty of care under Section 718;

(7) eliminate the obligation of good faith and fair dealing under Section 718, but

the organic rules may prescribe 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 1001 except to require that the notice under paragraph 1001(b)(1) be in a record;

(9) vary the power of a court to decree dissolution in the circumstances specified in Section 1103;

(10) vary the requirement to wind up an association's business pursuant to Sections 1106 and 1107;

(11) unreasonably restrict the right to maintain an action under [Article] 12;

(12) restrict the right of a participant under Article 15 to approve a conversion or merger; or

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

Reporters' Note

Source: ULPA (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. The Reporters humbly suggest this Section is not ripe for further discussion or revision at the 2006 Annual Meeting and that floor time could be better spent on other provisions.

Style Committee suggests that "reduce" be replaced with "limit" in Subsection (b)(6).

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.

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

In any event subsections (b)(3), (5), (6), and (7) need to be conformed to this Act.

SECTION 113. REQUIRED INFORMATION. A cooperative association shall maintain in a record at its principal office the following information:

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

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

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

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

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

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

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

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

each participant, 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 association, if any, for the six most recent years;

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

(11) a copy of the minutes of directors' 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 contribution agreed to be made by each participant is 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; and

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

Reporters' Note

This section was completely reorganized for the February 2006 Drafting Committee meeting 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 not be subject to restriction by agreement. The Committee also requested the Reporter to compare (13) (in this draft) with the Revised Model Nonprofit Act. It is consistent. Section 16.01(e)(b) states: "all written communications to members generally within the last three years...".

SECTION 114. BUSINESS TRANSACTIONS OF PARTICIPANT WITH COOPERATIVE ASSOCIATION. A participant may lend money to and transact other business with the cooperative association and has the same rights and obligations with respect to the loan or other transaction as a person that is not a participant subject to the organic rules or a specific contract relating to the transaction.

Reporters' Note

Would this be better placed in Article 4 or 5?

Is the language following "subject to" necessary. Style suggests deletion.

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

SECTION 115. DUAL CAPACITY. A person may be both a patron participant and an investor participant. A person that is both a patron participant and an investor participant has the rights, powers, duties, and obligations provided by this [act] and the organic law in each of those capacities. When the person acts as a patron participant, the person is subject to the obligations, duties, and restrictions under this [act] and the organic rules governing patron participants. When the person acts as an investor participant, the person is subject to the obligations, duties and restrictions under this [act] and the organic rules governing investor participants.

Reporters' Note

Would this be better placed in Article 4 or 5?

SECTION 116. DESIGNATED OFFICE AND AGENT FOR SERVICE OF PROCESS.

(a) A cooperative association shall designate and continuously maintain in this state:

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

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

(b) A foreign cooperative that has a certificate of authority under Section 1304 shall designate and continuously maintain in this state an agent for service of process.

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

Reporters' Note

There is a question of nomenclature. This draft uses the vetted NCCUSL language "designated" even though traditional cooperative law and corporate formulation is registered. They "mean" the same thing, functionally. Note that principal office is where the required information must be kept and "principal" and "designated" offices are separate concepts though they may be the same location. Both are defined terms.

SECTION 117. CHANGE OF DESIGNATED OFFICE OR DESIGNATED AGENT FOR SERVICE OF PROCESS.

(a) Except as otherwise provided in Section 207(e), to change its designated office, its agent for service of process, or the address of its agent for service of process, a cooperative association or a foreign cooperative shall deliver to the [Secretary of State] for filing a statement

of change containing:

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

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

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

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

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

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

Reporters' Note

The source of Subsection (b) is ULPA (2001).

The following comment was made at the 2005 Annual Meeting. "Do you need or desire an electronic mailing address? Some states are moving to electronic filing. Even if not, the email address would save state money by sending routine notices by electronic mail." This is a good point. Perhaps a definition of address needs to be considered. The Style Committee raised the same point in conjunction with Section 118. The Committee has discussed this matter but is awaiting further information from the secretaries of state.

SECTION 118. RESIGNATION OF DESIGNATED AGENT FOR SERVICE OF PROCESS.

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

(b) After receiving a statement of resignation under subsection (a), the [Secretary of State] shall file it and deposit a copy for delivery by the United States Postal Service to the designated office of the cooperative association or foreign cooperative and, if the address of the principal office appears in the records of the [Secretary of State] and is different from the address of the designated office, a copy to the principal office.

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

SECTION 119. SERVICE OF PROCESS.

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

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

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

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

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

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

(3) five days after the process, notice, or demand is deposited for delivery by the United States Postal Service, if mailed postpaid and correctly addressed.

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

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

Reporters' Note

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

Subsection(d) is contained in the other NCCUSL products and, therefore, appears here. In at least some states issues of when service is effective are in the law or rules governing procedure. There is a joint NCCUSL-ABA Study Committee on an Omnibus Business Code and it is anticipated that this kind of issue will be within the scope of any project that results from that Study. Thus, it is arguable that change to the existing language in this draft act is beyond the scope of the Uniform Cooperative Association Act Drafting Committee. Finally, there may be a distinction in policy in the operation of Subsection (d) as applied to foreign versus domestic cooperative associations.

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 as follows:

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

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

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

(4) A record filed on behalf of a dissolved association must be signed by a person winding up the activities under Section 1106 or a person appointed under Section 1106 to wind up those activities.

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

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

Reporters' 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.

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

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

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

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

(b) If an aggrieved person under subsection (a) is not the cooperative association or foreign cooperative to which the record pertains, the aggrieved person shall make the cooperative association or foreign cooperative a party to the action.

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

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

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

(b) Upon request and payment of a fee set by the [Secretary of State] [law of this state], the [Secretary of State] shall send to the requester a certified copy of any record filed with the

[Secretary of State] under this [act].

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

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

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

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

(A) the specified date; or

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

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

(A) the specified date; or

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

Reporters' Note

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

The Committee on Style has requested specific citations/cross-references be added in subsection (c). The Committee has not discussed this as of the 2006 Annual Meeting. The reporters will raise this at the next Drafting Committee Meeting. Any hesitation is purely a

matter of fearing clerical error. "Style" also suggested that "a delayed" be deleted wherever it appears and that the flush language of (c) include the phrase "later than the date of filing." The Reporters request they be given time to check the language used in other NCCUSL products before integrating the latter suggestion.

SECTION 204. CORRECTING FILED RECORD.

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

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

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

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

(3) correct the incorrect information or defective signature.

(c) When filed by the [Secretary of State], a statement of correction is effective retroactively as of the effective date of the record the statement corrects, but the statement is effective when filed as to persons relying on the false or erroneous information or defective signature before its correction and adversely affected by the correction.

Reporter's Note

See, e.g., Section 117(b).

SECTION 205. LIABILITY FOR FALSE INFORMATION IN FILED RECORD.

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

Reporters' Note

The February 2006 draft deleted a significant amount of this section consistent with the Committee's direction.

SECTION 206. CERTIFICATE OF GOOD STANDING OR AUTHORIZATION.

(a) The [Secretary of State], upon application and payment of the required fee, shall furnish a certificate of good standing 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 and the association is in good standing and has not filed a statement of termination.

(b) The [Secretary of State], upon application and payment of the required fee, shall furnish a certificate of authorization for a foreign cooperative if the records filed in the [office of the Secretary of State] show that the [Secretary of State] has filed a certificate of authority, has not revoked the certificate of authority, and has not filed a notice of cancellation pursuant to Section 1307.

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

state.

Reporters' Note

At the Committee's direction:

(1) The name of the "certificate of existence" in the prior draft has been changed to "certificate of good standing"; and, Subsections (a)(1) through (a)(8) and (b)(1) through (b)(6) have been deleted. The prior draft tracked the current ULLA Revision Draft and ULPA (2001) to a lesser extent, ULLCA (1995) and the RMBCA. Is this a place for a legislative note? At least one junction box statute confines (c) to the facts stated in the certificate. The Committee adopted this change "subject to future revision". Finally, the Reporters, on their own motion, replaced "request" with "application".

(2) The Reporters respectfully request information concerning that for which a "certificate of good standing" attests among the various states.

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

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

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

(2) the street and mailing addresses of the association's or cooperative's designated office and the name and street and mailing addresses of its agent for service of process in this state;

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

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

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

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

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

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

(f) If a cooperative association fails to file an annual report under this Section, the [Secretary of State] shall proceed under Section 1111 against the association.

(g) If a foreign cooperative fails to file an annual report under this section, the [Secretary of State] may proceed under Section 1306 against the cooperative.

Reporters' Note

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

Is subsection (d) clear? This Draft leaves the determination of the deemed effective date of notice here, and elsewhere, to other law.

Would (f) and (g) be better placed in sections 1111 and 1306, respectively?

SECTION 208. FILING FEES; RULES AND REGULATIONS; ANNUAL REPORTS. The filing fee for records filed under this [Article] with the [Secretary of State] is governed by [the general business corporation act] [the limited liability company act] [the general cooperative act] of this state.

Reporters' Note

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

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

ARTICLE 3

FORMATION AND ARTICLES OF ORGANIZATION

Reporters' Note

Article 2 of the 2005 Annual Meeting Draft has been bifurcated into Art. 2A "Formation and Articles of Organization" and Art. 2. Article 2A is now Article 3.

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

SECTION 301. ORGANIZERS. A cooperative association must be organized by two or more organizers who are individuals.

Reporters' Note

The issues raised in Section 301 have been discussed at length by the Committee.

The Committee directed the Reporter to delete subsection (b) in the prior draft that required the organizers to "intend" in "good faith" to become members (now participants) in the cooperative.

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

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

The Committee recognizes that the execution of that tentative conclusion is difficult and

raises other issues including the number of members necessary to avoid dissolution. This draft requires only a single member for the latter purposes, in part, because of the current use of wholly owned subsidiaries of cooperatives which are themselves cooperatives and because requiring more than a single member increases the risk of inadvertent dissolution. On the other hand, like under partnership law, it is difficult to conceive of a "cooperative" without more than one member.

The Minnesota Cooperative Associations Act allows for "one or more organizers... [who] need not be members." The Colorado Cooperative Act too, allows for one or more "incorporators."

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

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

(1) the name of the association;

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

(3) the street and mailing addresses of the association's initial designated office and the name and street and mailing addresses of the association's agent for service of process;

(4) the name and street and mailing addresses of each organizer;

(5) the term for which the association is to exist if other than perpetual; and

(6) the number and terms of directors, or the method by which the number and terms are determined, or a statement that the number and terms are determined as provided in the bylaws.

(b) Articles of organization may contain any other information in addition to that required by subsection (a).

(c) A cooperative association is formed on the date when articles of organization that

substantially comply with subsection (a) and:

(1) the [Secretary of State] files the articles of organization; or

(2) if the articles of organization state a delayed effective date, the arrival of the delayed effective date.

(d) If the articles state a delayed effective date, a cooperative association is not formed if, before the articles take effect, the organizers who signed the initial articles of organization sign and deliver to the [Secretary of State] for filing a statement of cancellation.

Reporters' Note

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

The Committee on Style suggested deletion of "for filing" in subsection (a). It has been retained because of a need to direct the Secretary of State as to what to do with the delivered document. That Committee also suggested deletion of "initial" in paragraph (a)(3). It was left in to avoid any implication that, despite other provisions in the act, that any change in the designated office would require an amendment to the articles of organization.

SECTION 303. ORGANIZATION OF COOPERATIVE ASSOCIATION. After the effective date of the articles of organization of a cooperative association:

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

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

Reporters' Note

The February 2006 draft attempts to avoid the classic circularity problem concerning which comes first: participants or the cooperative association. This same issue has been discussed in the context of limited liability companies. There (probably) is no nice theoretical solution to this very practical problem.

The following suggestion was made in the context of the LLC project by two advisors:

(1) A limited liability company is formed when a certificate of organization is filed and it has at least one member.

(2) If a person becomes a member and files a membership acknowledgment (see parenthetical in (3) below) within 60 days from the filing of the certificate of organization the LLC shall be conclusively presumed to have been formed upon the date of the filing of the certificate of organization [or, stated another way, the membership acknowledgment relates back to the date of the filing of the LLC certificate].

(3) If a certificate of organization does not name (or state the existence of) an initial member and a membership acknowledgment is not filed within 60 days of the date of its filing the certificate of organization lapses and becomes void.

Note #1 - This is not meant to be the draft or to be comprehensive (*e.g.* it does not deal with delayed effective date, etc.). It is concept only.

Note #2 - In an odd sort of way this concept is similar to the security agreement/financing statement dichotomy in UCC Article 9.

Note #3 - This is not a perfect nor a particularly elegant solution but it may be a solution.

The advisors made the suggestion because they were apprehensive about unintended consequences of the shelf LLC and the continuing trend line that, over time, makes an LLC less distinguishable from a corporation.

From their perspective, convergence between some features of LLCs and corporations is inevitable and on balance very beneficial. Nonetheless, they raised concern about the possible long-term confounding effect and possible erosion of the perceived contractual nature of the LLC by the shelf provisions in ULLCA. The contractual basis for the LLC viewed, by these advisors is important in the real estate and estate planning areas and is the underlying rationale for many benefits available for those and other purposes under both LLC and other law.

The Co-op Association Drafting Committee might want to consider returning to

this issue dependent upon the final formulation of the ULLCA project at the 2006 Annual Meeting.

SECTION 304. BYLAWS OF A COOPERATIVE ASSOCIATION.

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

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

(A) a statement of the classes and relative rights, preferences, and restrictions granted to or imposed upon each group, class, or other type of participant interest;

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

(C) the method to admit participants;

(2) a statement designating the voting and governance rights, including which participants have voting power and any restriction on the voting power under Sections 411-413;

(3) a statement that participant interests held by a participant are transferable only with the approval of the association's board of directors or as otherwise provided in the organic rules;

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

(5) the number and terms of directors or the method by which the number and terms will be determined.

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

articles of organization.

(c) In addition to amendments permitted under [Article] 14, the initial board of directors of the cooperative association may amend the bylaws of the association by a majority vote of the directors at any time before the admission of participants in the association.

Reporters' Note

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.

Subsection (c) has been added at the direction of the Committee. It could also be added to the amendment provisions in Article 14 but was placed here as part of the organizational process.

ARTICLE 4

PARTICIPANTS

SECTION 401. PARTICIPANTS. To begin business, a cooperative association must have [two] or more patron participants unless the sole participant is a cooperative.

Reporters' Note

There was Committee discussion as to whether it should be made clear that this section is not intended to preclude common ownership of a patron participant and the Committee requested the Reporter to consider the matter. Because the Act does not preclude common ownership the Reporters recommend this question be left to the organic rules. Other law, including community property law, may affect the operation of this Section. Moreover, it is not the intention of this Section to effect provisions of Tax Laws.

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

(1) as provided in the organic rules;

(2) as the result of merger or consolidation under [Article] 15; or

(3) with the consent of all the participants.

Reporters' Note

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

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.

Reporters' Note

Source: ULPA (2001).

SECTION 404. NO LIABILITY AS PARTICIPANT FOR COOPERATIVE ASSOCIATION OBLIGATIONS. Unless the articles of organization otherwise provide, 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 association solely by reason of being a participant.

Reporters' 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.

The Comment to this Section needs to explain it does not apply to contractual guarantees and unfulfilled contribution obligation. Those are separate personal obligations apart from an obligation of a cooperative.

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

(a) Within 10 business days of receipt by a cooperative association of a demand made in a record, a participant may obtain, inspect and copy required information under Section 113(1) through (7) during regular business hours in the association's principal office. A participant need

not have any particular purpose for seeking the information. The association shall not be required to provide the same information under Section 113(2) through (7) more than once during a six-month period.

(b) On demand made in a record received by the cooperative association, a participant may obtain from the association and inspect and copy from the association information required under Section 113(8) through (13) if:

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

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

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

(4) the demand is just and reasonable.

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

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

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

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

(2) if the association declines to provide any demanded information, the association's reasons for declining.

(d) Subject to subsection (f), a person dissociated as a participant may inspect and copy

information required under Section 113 during regular business hours in the cooperative association's principal office if:

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

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

(3) the person complies with this Section.

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

(f) If a participant dies, Section 1003 applies.

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

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

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

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

Reporters' Note

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

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

> 43-38-532. Enforcement of right to inspect and copy records.
>
> (a) If a cooperative does not allow a member who complies with § 43-38-530(a) to inspect and copy any records required by that subsection to be available for inspection, a court in the county where the cooperative's principal executive office, or, if none in this state, its registered office, is located may summarily order inspection and copying of the records demanded at the cooperative's expense upon application of the member.
>
> (b) If the court orders inspection and copying of the records demanded, it shall also order the cooperative to pay the member's costs, including reasonable counsel fees, incurred to obtain the order, if the member proves that the cooperative refused inspection without a reasonable basis for doubt about the right of the member to inspect the records demanded.

The Nonprofit Corporation Act section states:

> Section 16.04. Court-Ordered Inspection.
>
> (a) If a corporation does not allow a member who complies with section 16.02(a) to inspect and copy any records required by that subsection to be available for inspection, the [name or describe court] in the county where the corporation's principal office (or, if none in this state, its registered office) is located may summarily order inspection and copying of the records demanded at the corporation's expense upon application of the member.
>
> (b) If a corporation does not within a reasonable time allow a member to inspect and copy any other record, the member who complies with subsections 16.02(b) and (c) may apply to the [name or describe court] in the county where the corporation's principal office (or, if none in this state, its registered office) is located for an order to permit inspection and copying of the records demanded.

The court shall dispose of an application under this subsection on an expedited basis.

(c) If the court orders inspection and copying of the records demanded, it shall also order the corporation to pay the member's costs (including reasonable counsel fees) incurred to obtain the order unless the corporation proves that it refused inspection in good faith because it had a reasonable basis for doubt about the right of the member to inspect the records demanded.

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

Section 16.05. Limitations on Use of Membership List

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

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

(2) used for any commercial purpose; or

(3) sold to or purchased by any person.

The Comments will include a discussion of nondisclosure. Finally, this section cannot be reduced or eliminated by the organic rules. *See* Section 112.

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

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

***

Subd. 2. Statement of membership interest. At the request of any member, the cooperative shall state in writing the particular membership interest owned by that member as of the date the cooperative makes the statement. The statement must describe the member's rights to vote, if any, to share in profits and losses, and to share in distributions, restrictions on assignments of financial

rights under section 308B.605, subdivision 3, or voting rights under section 308B.555 then in effect, as well as any assignment of member's rights then in effect other than a security interest.

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

SECTION 406. ANNUAL PARTICIPANTS' MEETINGS.

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

(b) Annual participants' meetings may be held inside or outside of this state at the place stated in the organic rules or by the cooperative association's board of directors in accordance with the organic rules.

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

(d) Unless the organic rules otherwise provide, a cooperative association's board of directors shall designate the presiding officer of the association's annual participants' meeting.

Reporters' Note

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

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

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

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

SECTION 407. SPECIAL PARTICIPANTS' MEETINGS.

(a) Special participants' meetings must be called:

(1) as provided in the organic rules;

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

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

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

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

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

(d) Only affairs within a purpose stated pursuant to Section 408(c) may be conducted at a special participants' meeting.

(e) Unless the organic rules otherwise provide, the presiding officer of a special participants' meeting shall be designated by the cooperative association's board of directors.

Reporters' Note

Discussion at the February 2006 meeting reached a consensus that this Section is not subject to variation by the organic rules and answered the issues in the following paragraph to this note.

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

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

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

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

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

SECTION 408. NOTICE OF PARTICIPANTS' MEETINGS.

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

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

(c) Notice of a special participants' meeting must include [a description of] the purpose or purposes of the meeting as contained in the demand under Section 407(a)(3) or (a)(4) or as

voted upon by the cooperative association's board of directors under Section 407(a)(2).

Reporters' Note

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

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

Old subsection (d) has been moved.

SECTION 409. WAIVER OF PARTICIPANTS' MEETING NOTICE.

(a) A participant may waive notice of any meeting of the participants before, during, or after the meeting.

(b) A participant's participation in a meeting is a waiver of notice of that meeting unless the participant objects to the meeting at the beginning of the meeting or promptly upon its arrival at the meeting and does not thereafter vote for or assent to action taken at the meeting.

SECTION 410. QUORUM OF PARTICIPANTS. Unless the organic rules otherwise provide, the voting power of those participants present at an annual or special participants' meeting constitutes a quorum.

Reporters' Note

This section states a default rule.

The interaction of Sections 409 and 410 means that a member objecting to a meeting under Section 409 is present for purposes of the quorum under 410. The quorum is low. The quorum requirement could, of course, be bifurcated by the number of the cooperative's members. Is "voting power" a confusing term?

SECTION 411. VOTING BY PATRON PARTICIPANTS.

(a) Unless the organic rules otherwise provide, each patron participant has one vote. The organic rules may allocate voting power among patron participants as provided in Section 412.

(b) The organic rules may provide for the location of patron participant voting power by district, group, or class.

Reporters' Note

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

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

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

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

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

This section is mandatory.

SECTION 412. DETERMINATION OF VOTING POWER OF PATRON PARTICIPANT. The organic rules may allocate voting power among patron participants on the basis of:

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

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

[(3) if the patron participant is an association, the number of patron participants of the participant association; or]

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

Reporters' Note

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

A question has been raised concerning (a)(2). It was suggested that "equity investments by patron members must reflect an established patronage obligation". The definition of patron participant in the 2006 Annual Meeting Draft (Subsection 102(22) addresses this question and assures that the financial rights of all patron participants are based on patronage. Thus, the financial allocation provisions assure that patron participants have a patronage obligation.

However, voting allocated under subsection two will or may reflect, in some way, cumulative patronage not restricted to patronage on a current basis. It also provides a measure of flexibility.

SECTION 413. VOTING BY INVESTOR PARTICIPANTS. If the organic rules provide for investor participants, each investor participant has one vote, except as otherwise provided by the organic rules.

SECTION 414. VOTING REQUIREMENTS FOR PARTICIPANTS. If a cooperative association has both patron and investor participants:

(1) the aggregate voting power of all patron participants may not be less than two-thirds of the entire voting power entitled to vote; and

(2) action on any matter is approved only:

(A) upon the affirmative vote of at least a majority of all participants voting at the meeting unless a higher vote is required by [Articles] 14 through 16 or in the organic rules; and

(B) if at least one-half of the affirmative votes cast are cast by patron participants.

Reporters' Note

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

SECTION 415. MANNER OF VOTING.

(a) At a participants' meeting:

(1) proxy voting by participants is prohibited; and

(2) delegate voting based on geographical district, group, or class is not voting by proxy under this section.

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

(c) The organic rules may provide for participants to attend meeting or conduct participants meetings through the use of any means of communication if all participants attending the meeting can simultaneously communicate with each other during the meeting.

Reporters' Note

Subsection (d) is new to the 2006 Annual Meeting Draft. The Committee expressly assumed the availability of electronic voting when deciding that proxy voting is prohibited although there was not explicit direction to the Reporters to include electronic voting in this

draft.

The Committee changed USPS to "mail". The Reporters added "or other means" consistent with Committee discussion concerning voting by facsimile, etc.

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

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

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

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

SECTION 416. ACTION WITHOUT A MEETING.

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

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

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

Reporters' Note

The Colorado LLC Act allows action without a meeting to be taken without unanimous consent.

This Section states the general rule of unincorporated law and at least some traditional co-

op statutes and has been discussed by the Committee.

SECTION 417. DISTRICTS AND DELEGATES.

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

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

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

(b) A delegate elected under subsection (a)(2) has one vote unless voting power is otherwise allocated under Section 411(b).

Reporters' Note

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

> (a) The organic rules may provide:
> (1) for the formation of districts, units, groups, or classes of participants;
> (2) that districts, units, groups, or classes of participants may elect district, unit, group or class delegates to represent and vote for the district, unit, group or class in annual and special meetings of participants and elect directors;
> (3) that the delegates may vote on matters at the participants meetings in the same manner as a participant.
> (b) Delegates may only exercise the voting rights on a basis and with the number of votes as prescribed in the organic rules.
> (c) If the approval of a certain portion of the participants is required for adoption of amendments, dissolution, merger, consolidation, or the sale of assets, the votes of delegates shall be counted as votes by the participants represented by the delegate.
> (d) Except as provided in this Section or in the organic rules, a

delegate selected under subsection (a) has one vote subject to subsection (c).

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

(f) If the cooperative association has formed districts, units, groups, or classes of participants that elect delegates, then all provisions of this [Article] relating to meetings of participants shall be construed to apply to the delegates and not to the participants except those provisions shall remain applicable to participants with respect to participants at meetings of the districts, units, groups, or classes of participants.

ARTICLE 5

PARTICIPANT INTEREST

SECTION 501. PARTICIPANT INTEREST.

(a) A participant's interest:

(1) is personal property;

(2) consists of:

(A) governance rights;

(B) financial rights; and

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

(3) may be in certificated or uncertificated form.

(b) A participant's interest is a contractual relationship with the cooperative association. Subject to organic law and the organic rules, the contract includes:

(1) the articles of organization;

(2) the bylaws;

(3) the membership agreement, if any;

(4) a marketing contract, if any; and

(5) any other agreements in a record defining a part of the relationship of a participant to the association.

Reporters' Note

2006 Annual Meeting Draft:

Subsection (b) is new and reflects Committee comment at the February 2006 meeting. There is a body of cooperative common law that establishes that the basis of the relationship between a cooperative and its members (and in that context, but not as drafted, between members). This is an attempt to codify existing cooperative law. Speculatively this would seem to support the cooperative principle that a cooperative is for the mutual benefit of its members and may well reflect that the anthropological roots of cooperative law pre-date modern corporate law (as well as the idea from Economics that all organizations can be reduced to a nexus of contracts). The Drafting Committee has not yet reviewed this language. Subsection (b)(5) is intended to include, *e.g.*, proprietary leases in a housing cooperative.

Prior Drafts:

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

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

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

Another related issue, that is probably a confounding variable but very important, is the (using normative nomenclature) "non-member patron". This Section does not govern non-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 INVESTOR PARTICIPANT INTEREST. Unless the organic rules establish investor participant interests, participant interests must be patron

participant interests.

Reporters' Note

The February 2006 Draft deleted a substantial amount of language from this Section as surplusage given the provisions found elsewhere, including new definitions under Article 1. The 2006 Annual Meeting Draft reflects the comments from the Style Committee.

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 INTEREST.

(a) Unless otherwise provided in the organic rules otherwise provide, participant interests other than financial rights are not transferable. The terms of the restriction on transferability must be:

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

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

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

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

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

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

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

Reporters' Note

2006 Annual Meeting Draft:

Subsection (e) has been much discussed by the Committee and a decision was made (without reaching consensus) to retain (e) in the draft. The Comments will reflect that "notice" under (e) is determined by other law (including common law).

Prior Draft:

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

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

Most broadly the solution rests in the following concepts: value given, allocated, or paid based on:

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

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

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

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

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

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

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

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

So the financial interest of the membership is highly contextual on the organic documents and the "deal". Nonetheless, there is a dichotomy between the membership interest and the marketing contract and it seems in the typical the financial interest of the member would *not* include right to payment under the marketing contract because that would be governed by contract law.

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

Other uniform unincorporated acts use the term "transferable interest" which might cause less confusion.

SECTION 504. SECURITY INTEREST AND SET-OFF.

(a) Subject to subsection (b), a participant or transferee may grant a security interest only in financial rights in a cooperative association. The granting of a security interest in financial rights is not a transfer for purposes of Section 503. The limitation contained in this subsection shall not apply to a participant's interest that may be transferred in its entirety under the organic rules.

(b) The organic rules may restrict or eliminate the granting of a security interest in financial rights and may permit a security interest to be granted in governance rights. The limitation of this section to financial rights does not apply in the case of a participant's interest that is not subject to a restriction or prohibition on transfer under the organic rules.

(c) A cooperative association has a continued perfected security interest in the financial rights of a participant to secure payment of any indebtedness or other obligation of the participant to the association. Notwithstanding Sections [9-308 and 9-309 of UCC Article 9], the security interest has priority over all other perfected security interests. The association may enforce its security interest by set-off against any distributions from the association. Unless the organic

rules otherwise provide, a participant may not compel an association to offset financial rights against any indebtedness or obligation owed to the association.

Reporters' Note

The 2006 Annual Meeting Draft reflects the general direction and intent of the Drafting Committee but the Drafting Committee has not yet vetted the language.

The Committee discussed, among other issues, two questions: (1) May the organic rules legally limit the effect of granting a security interest under other law; (2) May the organic rules legally limit a participant from granting a security interest under other law.

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

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

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

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

(2) make all other orders that the circumstances of the case require.

(b) A charging order issued under subsection (a) constitutes a lien on the judgment debtor's financial rights and requires the cooperative association to pay over to the judgment creditor or receiver, to the extent necessary to satisfy the judgment, any distribution that would otherwise be paid to the participant or transferee whose financial rights are subject to the

charging order. Upon a showing that distributions under the charging order will not pay the judgment debt within a reasonable time, the court may foreclose the lien and order the sale of the financial rights that are subject to a charging order. The purchaser at the foreclosure sale:

(1) does not by the purchase become a participant;

(2) obtains only the financial rights that are subject to the charging order; and

(3) unless the purchaser is the association or is a participant before the purchase, acquires the interest only as a transferee.

(c) Before foreclosure under subsection (b), a judgment debtor may extinguish the charging order by satisfying the judgment and filing a certified copy of the satisfaction with the court that issued the charging order.

(d) Before foreclosure under subsection (b), the cooperative association or one or more participants whose financial rights are not subject to the charging order may succeed to the charging order by satisfying the judgment and filing with the court that issued the charging order a certified copy of the satisfaction of judgment and an affidavit stating the amount paid to satisfy the judgment. The cooperative association may act under this subdivision only with the consent of all participants whose financial rights are not subject to the charging order.

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

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

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

(3) the successor has the same rights under this section as the judgment creditor

that originally obtained the charging order, but the successor's claim against the participant or transferee whose financial right is subject to the charging order is limited to any distributions to which the successor is entitled under the charging order and to proceeds of any foreclosure sale.

(f) This [act] does not affect exemption laws applicable to a participant's or transferee's financial rights.

(g) This section provides the exclusive remedy by which a judgment creditor or receiver may satisfy the judgment out of the judgment debtor's financial rights in a cooperative association.

(h) The limitations of this section to financial rights do not apply to the extent that the organic rules provide for the transfer of the participant's interest in addition to financial rights.

Reporters' Note

This Section, except for subsection (h) is from the ULLCA revision project and is the best treatment of the rights of judgment creditors that has been found by the Reporters. At its February 2005 meeting the ULLCA Drafting Committee decided to direct its reporters to redraft the charging order provisions to answer many operational issues under the provisions in UPA (1997) and ULLCA (1996) which closely cleaved to the provisions in ULPA (1917). Since that time the ULLCA Committee has continued to modify the provision that has been grafted into this Act. The reporters to the Uniform Cooperative Association Drafting Committee suggest the Committee revisit this Section after the ULLCA project becomes final (a final reading is scheduled for the 2006 Annual Meeting) and the unrevised ULLCA February 2006 Drafting Committee Draft follows for purposes of information and initial comparison.

Section 503. CHARGING ORDER.

(a) On application by a judgment creditor of a member or transferee, a court may enter a charging order against the transferable interest of the judgment debtor for the unsatisfied amount of the judgment. A charging order constitutes a lien on a judgment debtor's transferable interest and requires the limited liability company to pay over to the person to which the charging order was issued any distribution that would otherwise be paid to the member or transferee whose transferable interest is subject to

the charging order.

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

(1) appoint a receiver of the distributions subject to the charging order, with the power to make all inquiries the judgment debtor might have made; and

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

(c) Upon a showing that distributions under the charging order will not pay the judgment debt within a reasonable time, the court may foreclose the lien and order the sale of the transferable interest. The purchaser at the foreclosure sale obtains only the transferable interest, does not thereby become a member.

(d) At any time before foreclosure, the member or transferee whose transferable interest is subject to a charging order under subsection (a) may extinguish the charging order by satisfying the judgment and filing a certified copy of the satisfaction with the court that issued the charging order.

(e) At any time before foreclosure, a limited liability company or one or more members whose transferable interests are not subject to the charging order may succeed to the charging order by satisfying the judgment and filing with the court that issued the charging order a certified copy of the satisfaction of judgment and an affidavit stating the amount paid to satisfy the judgment. The members may not use limited liability company property to satisfy the judgment under this subsection. The limited liability company may act under this subsection only with the consent of all members whose transferable interests are not subject to the charging order.

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

(1) the successor has the same rights under this section as the judgment creditor that originally obtained the charging order;

(i) the amount of the lien of the charging order is the amount paid to satisfy the judgment, plus interest from the date of satisfaction at the rate applicable to judgments; and

(ii) the lien's priority with respect to other creditors of the person whose transferable interest is subject to the charging order remains unchanged;

and

(2) upon application by the successor to the court that issued the charging order, the court shall record a judgment in the successor's favor and against the former judgment debtor in the amount paid to satisfy the original judgment.

(g) This [act] does not deprive any member or transferee of the benefit of any exemption laws applicable to the member's or transferee's transferable interest.

(h) This section provides the exclusive remedy by which a person seeking to enforce a judgment against a member or transferee may, in the capacity of judgment creditor, satisfy the judgment out of the judgment debtor's transferable interest.

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

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

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

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

Nonetheless: If the membership interest *entitles* the member to enter into a contract and the membership interest and the underlying contract are freely transferable; THEN those rights and the value of those rights would be subject to sale at foreclosure. Payments made under an existing contract, however, would be contract rights not financial rights not subject to this

Section and would be governed by that law.

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

The assumption in the foregoing illustration:

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

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

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

ARTICLE 6

MARKETING CONTRACTS

SECTION 601. AUTHORITY. In this [article], "marketing contract" means a contract between a cooperative association and another person, that need not be a patron participant, requiring the other person to:

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

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

Reporters' Note

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?

SECTION 602. MARKETING CONTRACTS.

(a) If a marketing contract provides for sale of a product or commodity to the cooperative association, upon delivery or at any other specific time expressly provided by the contract, the sale transfers title absolutely to the association, except for security interests perfected under other law.

(b) A marketing contract may:

(1) authorize the cooperative association to grant a security interest in the product or commodity delivered; and

(2) allow the association to sell the product or commodity delivered, and pay or distribute the sales price on a pooled or other basis to the other person after deducting:

(A) selling costs, processing costs, overhead, and other costs and expenses; and

(B) reserves for the purposes set forth in subsection 904(c).

Reporters' Note

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

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

The Committee on Style suggested the deletion of the last clause in subsection (a). In doing so is there a question left as to the time when title passes?

SECTION 603. DURATION OF MARKETING CONTRACT. The duration of a marketing contract may not exceed 10 years but is extended for additional periods not exceeding five years each, subject to the right of either party not to extend by giving notice in a record during the current term in a manner specified in the contract.

Reporters' Note

The substance of this Section is common to many cooperative statutes. The Style Committee has requested the Drafting Committee to vett this section at its Fall 2006 meeting.

SECTION 604. REMEDIES FOR BREACH OF CONTRACT.

(a) A marketing contract or the organic rules may establish a specific or readily calculable sum of money as liquidated damages to be paid to the cooperative association by the other contracting person upon a breach of the contract. The damages may be a percentage of the value of a specified amount per unit of the product, commodity, goods, or services involved in the breach or a fixed or readily calculable sum of money.

(b) A cooperative association may seek an injunction to prevent a threatened or continuing breach of a marketing contract or other contract described in this [article] and a judgment for specific performance of the contract. Pending adjudication of the action, the association may seek a temporary restraining order and a preliminary injunction.

Reporters' Note

Source: *See generally* Minnesota Cooperatives Associations Act, Oregon Cooperative Corporations Act.

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

SECTION 605. INDUCING BREACH OF MARKETING OR PURCHASE CONTRACTS.

The remedies provided by [citation to the applicable statutory provisions] apply to cooperative associations.

Reporters' Note

See the Note to Section 1802.

A former Section 505 was entitled "Contract Interference and False Reports". A version of Section 505 that now appears as Section 605 in this draft had appeared at Section 1803 of the February 2006 draft for ease of its discussion with related provisions. Dependent on the resolution of the policy (and legislative enactment) discussion the Committee is invited to decide exactly where this provision should appear in this act.

[ARTICLE] 7

DIRECTORS AND OFFICERS

SECTION 701. EXISTENCE AND POWERS OF BOARD OF DIRECTORS.

(a) Unless the number of participants is fewer than three, a cooperative association must have a board of directors consisting of three or more individuals. If there are fewer than three participants, the number of directors may not be less than the number of participants.

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

(c) An individual does not have agency authority on behalf of a cooperative association solely by being a director.

Reporters' Note

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

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

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

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. An individual is not personally liable, directly or indirectly, by way of contribution or otherwise, for an obligation of the association solely by reason of being a director.

Reporters' Note

Source: Derived from ULPA (2001). "New" to the law of cooperatives as a positive statement of law but not as a statement of principle.

SECTION 703. QUALIFICATIONS OF DIRECTORS AND COMPOSITION OF BOARD.

(a) A director of a cooperative association must be an individual.

(b) Subject to this section, the organic rules may provide for qualification of directors subject to this section.

(c) Unless the organic rules otherwise provide and subject to subsections (d) and (e), each director of a cooperative association must be a participant of the association or an individual designated by a participant that is not an individual.

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

(e) If a cooperative association has nonparticipant directors, 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 directors.

Reporters' Note

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

Subsection (e)(2) needs to be revisited. Illustratively, what happens when there are seven directors (thus allowing one and two-fifths directors to be non-participants).

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

SECTION 704. ELECTION OF DIRECTORS.

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

(b) Subject to subsection (a), the articles of organization may provide for the election of all or a specified number of directors by the holders of one or more groups or classes of participants.

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

(d) Cumulative voting for directors of a cooperative association is allowed only if provided in the articles of organization.

(e) Except as otherwise provided by the organic rules or in Section 709, participant

directors of a cooperative association must be elected at an annual participants' meeting.

(f) Unless the organic rules provide for a different method of selection, nonparticipant directors of a cooperative association must be elected in the same manner as participant directors.

Reporters' Note

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

Subsection (d) may be prohibited by state constitution in some states. The Comments will illustrate both the advantages and disadvantages of cumulative voting.

Subsection (e) is in response to advisors to the drafting committee who suggested that the act specifically acknowledge the use of an appointment process for nonparticipant directors. These directors are used to provide special expertise on cooperative boards.

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

SECTION 705. TERM OF DIRECTOR.

(a) Unless the organic rules otherwise provide, the term of a director of a cooperative association expires at the annual participants' meeting following the director's election. The term of a director may not exceed three years.

(b) Unless the organic rules otherwise provide, a director may be reelected for subsequent terms.

(c) A director continues to serve until a successor director is elected and qualified or the director is removed, resigns, is declared incompetent by a court with jurisdiction, or dies.

Reporters' Note

If a successor is not elected the director previously in the position would continue to serve

under the operation of this section. This section coordinates with section 709 ("Vacancy on Board") Is "may" the correct choice in subsection (a) second sentence (again a matter of style more than substance).

SECTION 706. RESIGNATION OF DIRECTOR.

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

(b) Unless the notice states a later effective date, a resignation is effective when notice is received by the cooperative association unless the notice states a later effective date.

Reporters' Note

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

SECTION 707. REMOVAL OF DIRECTOR.

(a) Unless the organic rules provide for removal without cause, a director may be removed only for cause.

(b) A participant or participants holding an aggregate of 10 percent of the voting power of a cooperative association, or one-third or more of the board of directors of the association, may petition the board of directors for the removal of a director by a signed record submitted to the officer of the association charged with keeping its records. Unless the organic rules provide for removal without cause, the record must state the alleged cause for removal.

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

(d) A director against whom a petition has been submitted:

(1) must be informed in a record of the petition within a reasonable time before the board meeting at which the board considers the petition; and

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

(e) A participant who signs a petition for removal of a director is entitled to an opportunity at the hearing on the petition to be heard in person or by representation and to present witnesses as provided the director in subsection (d)(2).

(f) A director may be removed by a majority vote of the directors who are not the subject of the removal petition.

(g) If a director may be removed for cause and all directors are the subject of removal petition, the removal for cause must be determined:

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

(2) if the organic rules do not provide for the appointment of a nonparticipant director, by a committee appointed under Section 712 composed of individuals who are not directors or by independent legal counsel retained by the cooperative association.

(h) By submitting a signed record to the cooperative association, a director removed for cause under subsection (g) may require a special participants' meeting to be called by the remaining directors to determine whether the director requesting reinstatement should be reinstated as director. The director and a participant who signed the petition for removal must have the same opportunities to be heard and present witnesses at the special participants' meeting as are provided in subsections (d) and (e). The director may be reinstated only by the same

affirmative vote required for and in the same manner as the director's election.

Reporters' Note

Subsections (a) through (h) have been revised. They generally follow the procedure established in West's California Code Annot. section 54150 (it is unclear whether California requires "for cause" removal only because its statute uses the term "charge" rather than petition) and Colorado Revised Statute section 7-56-404 (Colorado includes that the meeting must be held within 90 days of receipt of the petition). Should "cause" removal be modifiable by organic rule?

In response to discussion on the floor during the 2005 Annual Meeting, subsection (g) has been created from what was the second sentence of subsection (f) in the prior draft. The draft currently does not specify who appoints the committee that would remove the director for "cause" under subsection (g)(2). This should be given attention. A related question has been raised by a member of the Drafting Committee concerning subsection (g)(1). The quick answer to the latter question is that the organic rules might appoint a specific non-participant to make the determination or delegate to that non-participant the duty of appointing another individual to make the determination whether the answer is satisfactory has not yet been discussed by the Committee.

"Cause" is not defined in the act. Should it be? Does Section 608 define "cause" for purposes of Section 707?

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

The intent of the section as drafted is that the "10 percent" in (b) be participants of any class but that the vote would be by only those participants who elected the director. Is that the Committee's intent?

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

SECTION 708. SUSPENSION OF DIRECTOR BY BOARD.

(a) A cooperative association's board of directors may suspend a director of the

association if, considering the director's course of conduct and the inadequacy of other available remedies, immediate suspension is necessary for the best interests of the association and the director is engaged in:

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

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

(3) intentional infliction of harm on the association.

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

(c) A suspension is effective for thirty days unless a petition for removal is submitted before the end of the thirty day period pursuant to Section 707(b).

Reporters' 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.

An observer has requested the Committee consider adding a new subsection (a)(4) addressing "conviction of a felony".

SECTION 709. VACANCY ON BOARD.

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

(1) by majority vote of the remaining directors until the next annual participants, meeting or special participants' meeting called 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 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.

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

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

SECTION 711. MEETINGS.

(a) The board of directors of a cooperative association shall meet at least annually and may hold meetings inside or outside this state.

(b) Unless the organic rules otherwise provide, a cooperative association's board of directors may permit directors to attend board meetings or conduct board meetings through the use of any means of communication, if all directors attending the meeting can communicate with each other during the meeting.

Reporters' Note

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

SECTION 712. ACTION WITHOUT MEETING.

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

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

(c) A record of consent for any action under subsection (a) may specify the effective date or time of the action.

Reporters' Note

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

SECTION 713. MEETINGS AND NOTICE.

(a) Unless the organic rules otherwise provide, a cooperative association's board of directors may establish a time, date, and place for regular board meetings and notice of the time, date, place, or purpose of those meetings is not required.

(b) Unless the organic rules otherwise provide, notice of the time, date, and place of a special meeting of a cooperative association's board of directors must be given to all directors at least three days before the meeting. The notice must contain a statement of the purpose of the special meeting, and the meeting is limited to the matters contained in the statement.

Reporters' Note

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

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

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

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

> (d) A director who is present at a meeting of the board of directors when action is taken shall be deemed to have assented to the action taken unless:
>
> (1) the director objects at the beginning of the meeting or promptly upon the directors arrival at the meeting and does not thereafter vote for or assent to action taken at the meeting;
>
> (2) the directors assent or abstention from the action is made in a record
>
> (A) in the minutes of the meeting; or
>
> (B) the director
>
> (i) does not vote for or assent to the action taken at the meeting; and
>
> (ii) delivers notice in a record to the presiding officer of the meeting before adjournment or to the cooperative immediately after adjournment of the meeting.

SECTION 714. WAIVER OF NOTICE OF MEETING.

(a) Unless the organic rules otherwise provide, a director of a cooperative association may waive any required notice of a meeting of the association's board of directors in a record before, during, or after the meeting.

(b) Unless the organic rules otherwise provide, a director's participation in a meeting is a

waiver of notice of that meeting unless the director objects to the meeting at the beginning of the meeting or promptly upon the director's arrival at the meeting and does not thereafter vote for or assent to action taken at the meeting.

Reporters' Note

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

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

Finally, what should be the effect on the quorum of a director attending the meeting without waiving notice infinity? *See* Reporters' Note to § 715.

SECTION 715. QUORUM.

(a) Unless the articles of organization otherwise provide, a majority of the fixed number of directors on a cooperative association's board of directors constitutes a quorum for the management of the affairs of the association.

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

Reporters' Note

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

SECTION 716. VOTING. Each director of a cooperative association has one vote for purposes of decisions made by the board of directors of the association.

Reporters' Note

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

SECTION 717. COMMITTEES.

(a) Unless the organic rules otherwise provide, a cooperative association's board of directors may create one or more committees and appoint one or more individuals to serve on a committee.

(b) Unless the organic rules otherwise provide, an individual appointed to serve on a committee of a cooperative association need not be a director or participant of the association. An individual serving on a committee has the same rights, duties, and obligations as a director serving on a committee.

(c) Unless the organic rules otherwise provide, each committee of a cooperative association may exercise the powers delegated by the association's board of directors, but a committee may:

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

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

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

Reporters' Note

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

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

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

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

SECTION 718. STANDARDS OF CONDUCT AND LIABILITY. Except as otherwise provided in Sections 720 and 722,

(1) the discharge of the duties of director or a participant of a committee of the board of directors of a cooperative association is governed by [the State Cooperative Corporation Act] [the State Nonprofit Cooperative Act] [the General Business Corporation Act of this State] [as amended]; and

(2) the liability of director or a participant of a committee of the board of directors is governed by [the State Cooperative Corporation Act] [the State Nonprofit Cooperative Act] [the

General Business Corporation Act of this State] [as amended].

Reporters Note

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

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

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

Unfortunately, the wide variety among the states makes uniformity difficult to achieve and creates adoption difficulty. For these reasons the Committee has adopted a "junction box" approach similar to META. These sections need a legislative note but that note has not yet been drafted pending further discussion on the approach taken.

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

The Minnesota Act's "conduct" section uses the phrase, "ordinarily prudent person in a like position would exercise under similar circumstances" without including the MBCA's modification "would reasonably believe appropriate."

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

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

Reporters' Note

See the Reporter's Note to Section 718.

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

SECTION 720. LIMITATION OF DIRECTOR'S DUTIES. The articles of organization may vary the standards under Sections 718 and 719, but the articles may not:

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

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

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

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

(3) eliminate any obligation of good faith under Section 718, but the articles may prescribe the standards by which the performance of an obligation is to be measured, if the

standards are not manifestly unreasonable.

Reporters' Note

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

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

Reporters' Note

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

Similar provisions are found in most entity laws. It limits the use of the information, as well as a directors access, to the director acting as director. Duties would include confidentiality, professional privilege, etc.

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

Reporters' Note

The Minnesota Cooperative Associations Act, like this draft, does not limit this provision to mergers; but Oregon's Cooperative Corporation Act does. The language suggests that the

original source of this provision is from corporate "anti-takeover acts" in various states (*e.g.* Pennsylvania). The Committee noted that this is consistent with traditional cooperative values. It may be another, though incomplete, way of communicating the idea of a "cooperative plan" which is used in state law without definition (the term "cooperative plan" is not used in this draft).

SECTION 723. APPOINTMENT AND AUTHORITY OF OFFICERS.

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

(b) The organic rules or the board of directors of a cooperative association shall designate one of the association's officers for preparing all records required by Section 113 and for the authentication of records.

(c) Officers of a cooperative association have the authority and obligation to perform the duties the organic rules prescribe or as the association's board of directors determines is consistent with the organic rules.

(d) The election or appointment of an officer of a cooperative association does not of itself create a contract between the association and the officer.

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

Reporters' 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 of a cooperative association may remove an officer at any time with or without cause.

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

Reporters' 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).

There was "power" language in Subsection (a) in a prior draft which raised the 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 it with the word "may". The suggestion was heeded here but not elsewhere.

[ARTICLE] 8

INDEMNIFICATION

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

Reporters' Note

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

Note, however, the comment from the floor in the Reporter's Note to Section 719.

[ARTICLE] 9

CONTRIBUTIONS, ALLOCATIONS, AND DISTRIBUTIONS

SECTION 901. PARTICIPANTS' CONTRIBUTIONS. The organic rules may establish the amount, manner, or method of determining any participant contribution requirements for participants or may authorize the board of directors of a cooperative association to establish the manner and terms of any contributions for participants.

Reporters' Note

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

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

This draft does not *expressly* provide for stock or use the corporate capital accounting model which allows the board of directors, for example, to establish par value. This draft follows unincorporated law which is far more general, and less detailed than corporate law. The draft does contemplate that the organic rules may establish a more corporate-like capital structure. See Section 205(a)(1). Thus, this draft more closely follows the unincorporated organizational model and is, therefore, more contractually or agreement based. This hasn't seemed to cause any reported problems in the use of LLCs. Paradoxically, the entity contemplated by this draft is more flexible upon formation but gives the board of directors less power to establish new classes or voting interests than in a business corporation. This mix is consistent with stronger member control.

At the direction of the Committee the word "fees" has been deleted. Will the deletion cause problems in service cooperatives? How are such fees usually accounted in fee-based cooperatives?

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

SECTION 902. FORMS OF CONTRIBUTION AND VALUATION.

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

(b) The receipt and acceptance of contributions and the valuation of contributions must be reflected in the cooperative association's records required under Section 113.

(c) Unless the organic rules otherwise provide, the board of directors of a cooperative association shall determine the value of a participant's contributions received or to be received. The determination by the board of directors of valuation is conclusive for purposes of determining whether the participant's contribution obligation has been fully paid.

Reporters' Note

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

The Comment (or is it more appropriate in a legislative note) needs to note that some state constitutions may place restrictions on the types of property that may be contributed. The Reporters need guidance on whether, and if so, how, a legislative note needs to be prepared on this issue.

SECTION 903. CONTRIBUTION AGREEMENTS.

(a) An agreement by a person to make a contribution to a cooperative association entered into before formation of the association is irrevocable for six months unless:

(1) otherwise provided by the agreement; or

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

(b) A person's obligation to make a contribution under subsection (a) is not excused by the person's death, disability, or other inability to perform personally.

(c) If a person does not make a required contribution under the agreement in subsection (a) of property or services to the cooperative association:

(1) the person or the person's estate is obligated, at the option of the association, once formed, to contribute money equal to the value of that portion of the contribution that has not been made, and the obligation may be enforced as a debt to the association; or

(2) unless otherwise provided in the agreement, the association, once formed, may rescind the agreement if the debt remains unpaid more than 20 days after the association demands payment from the person or the person's estate.

Reporters' Note

Subsections (b) and (c) are new to the 2006 Annual Meeting Draft. It is an amalgamation of various entity laws.

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

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

SECTION 904. ALLOCATIONS OF PROFITS AND LOSSES.

(a) Subject to subsection (b), the organic rules must provide for the allocation of profits of the cooperative association among participants. Unless the organic rules otherwise provide, losses of the association must be allocated in the same proportion as profits.

(b) Unless the organic rules otherwise provide, all the profits and losses must be allocated to patron participants. If the cooperative association has investor participants, the organic rules may not reduce the percentage of profits from patronage allocated to patron participants to less than 50 percent.

(c) Unless the organic rules otherwise provide, in order to determine the amount of profits of a cooperative association, the association's board of directors may set aside a part of the revenue, whether or not allocated to participants, after accounting for other expenses to:

(1) create or accumulate a capital reserve; and

(2) create or accumulate reserves for specific purposes, including expansion and replacement of capital assets, education, training, and information concerning principles of cooperation and community responsibility and development.

(d) Subject to subsection (e) and the organic rules, the board of directors of a cooperative association shall further allocate the amounts determined pursuant to subsections (a) and (b):

(1) to the patron participants in the ratio of each participant's patronage to the total patronage of all patron participants during the period; and

(2) to the investor participants, if any, in the ratio of each investor participant's contribution to the total contribution of all investor participants.

(e) For purposes of allocation of profits and losses of a cooperative association to patron participants, the organic rules may establish allocation units based on function, division, district, department, allocation units, pooling arrangements, participants' contributions, or other equitable methods.

Reporters' Note

After February 2006 meeting:

This Section was discussed at length t the February 2006 Drafting Meeting and the Reporters were directed to attempt to revise the Section in accordance with their sense of the Committee. The only two revisions on which there was little or no direct discussion are adding subsection (c)(3) and deleting "initial" in subsection (d)(2). Language similar to that found in (c)(3) is common in cooperative statutes. The addition is meant to be aspirational and is wholly consistent with many comments at the February 2006 meeting.

Subsection (b) is technical and must be read closely with the definitions. Note there are other ways that participants may receive money from a cooperative (just like in other organizations; leases, loans, services for pay, etc.). The Comment will include illustrations discussed at the February 2006 meeting.

Preliminary Illustrations

Introduction. The suggested change in the language from "net proceeds, savings, margins and profits" to "profits and losses" is more than just wordsmithing. It dances around a fundamental substantive issue and suggests another issue in need of discussion.

Substantive Issue. The substantive issue has been described in previous Committee meetings as "agency v. sale" arrangements. "Net proceeds" draws attention to this distinction and the distinction has importance for measuring the "30 percent" floor for allocations to investor participants in this section.

> **Ex 1.** Assume a "typical" producer cooperative. The members deliver product to the co-op and get paid a market price. There is a product sale. At the end of the year the books are closed and the price paid to producers for product is subtracted (as "cost of goods sold" in the books of the cooperative association) to help determine "profit."
>
> Thus, if gross revenue were $1,600 and the only "expenses" were the costs of the product to the co-op association (assume $1,000) and administrative expenses of $100; the "profit" would be $500. If the organic documents allocate 50% to patron participants and 50% to investor participants each group would receive $250. The patron participants therefore received the market price for the product $1,000 plus a profit allocation of $250 for a total of $1250. The investor participants would be allocated $250. This is the "sale" method.
>
> **Ex 2.** Now assume an agency method (according to AICPA Audit Guidelines 2002, this method is used most frequently for specialty produce). Here, there is

no market price contract between the co-op association and the producer. Rather the association acts as an agent for the producer. The association sells the product (gross revenue) for $1,600 (as in Ex. 1). However, there is no "cost of goods sold" because the co-op association did not contract for the product with the producer. Thus the only expense was an administrative expense of $100. Assuming the same 50-50 split as in Ex. 1 the investor participants and the patron participants would be allocated $750.

Ex 3. A value added pasta production facility will cost $2,000,000 to construct. To become a patron participant requires a 5 year delivery contract and an investment of $10,000 under the organic rules. Forty producers become patron members (and their aggregate investment, therefore, is $400,000 or 20% of the necessary investment). A commercial pasta maker agrees to contribute $600,000 (30% of the necessary investment) and supply manufacturing management for 5 years. In order to get the remaining $1,000,000 from traditional lending sources the pasta maker agrees to execute a $300,000 stand-by letter of credit.

(a) One "50-50" allocation split of a first year "profit" of $100,000 (after paying the producers $200,000 for under their delivery contracts) would be $50,000 to investor participants and $50,000 to patron participants. The patron participants also receive $200,000 under contract for a total of $250,000.

(b) In what category is the $400,000 patron "investment"? *Maybe* each patron participant is in dual capacity. Thus, the $400,000 investment could be categorized as each patron participant also being an investor participant to the extent of the up-front investment. If so the results:

(1) Patron participants as patron participants $50,000 (on patronage basis).
(2) Patron participants own 40% of the investor participant interests so they receive $20,000 in that capacity.
(3) Patron participants receive $200,000 under their contracts.
(4) As a result participants whom are patrons receive $270,000.
(5) Nonpatron investor participants receive $30,000.

Ex 4. Assume the same facts as in Example 3, (a) except it is an agency (net proceeds) arrangement. This means the patron participants will not receive the $200,000 under the delivery contract. Thus, "profit" is $100,000 plus $200,000. This $300,000 would be allocated 50-50. Investor participants and patron participants would be allocated $150,000 each (assuming patron "investment" is not investor participation, see Es. 3(b)).

Ex 5. Assume the same facts as in example 4 except pasta maker contracts to manage the

manufacturing plant for $200,000 annually. So XYZ again has $100,000 profit split 50-50 but the pasta maker receives $200,000 under the management contract (rather than the producers receiving that amount for their product as in example 3(a)). Patron participants would be allocated $50,000. Investor participants would be allocated $50,000 but also receive a $200,000 management fee for a total of $250,000 (but see Ex. 3(b)).

The results in examples 3 through 5 would meet the 50-50 test provided by the organic rules but the results vary as follows:

- Ex. 3(a): Investor participants (IP) $50,000; patron participants (PP) $250,000.

- Ex. 3(b): Non dual capacity IPs, $30,000; PP (but including their dual IP-PP capacity), $270,000.

- Ex. 4: IP, $150,000; PP, $150,000.

- Ex. 5: IP, $250,000; PP, $50,000.

The range for IPs is from $30,000 to $250,000; for PPs from $50,000 to $270,000 even though each variation meets the hypothetical 50-50 split. Please note that the numbers are "out of thin air." They can easily be manipulated (using the "sale" method) to illustrate situations where almost all the risk of loss, and little upside gain, accrues to investor participants. Now compare another variation as set forth in Example 6, below.

Ex. 6. Same facts as in example 5 but the $200,000 value on the management contract is categorized as patronage service. "Profit" is $300,000. Assuming the $400,000 patron participation contribution is not IP and, further, "agency" accounting: the PPs would receive 50% of the $300,000 profit which is $150,000.

However, both IPs as service PPs ($200,000 of "worker" product) would share the $150,000 equally on a patronage basis. So IPs (as PPs) would be allocated $75,000 and PPs would be allocated $75,000. The other $150,000 would be allocated to IPs as IPs. Thus IPs in their dual role would receive $225,000 and "producer" PPs would be allocated $75,000 (even though the "value" of the product on a "contract" basis is $200,000).

The Committee positively answered the substantive question, therefore is whether these results are consistent with its intention. Any other answer seriously implicates operational tax and secured lending issues, *e.g.*, if the act "forces" a "sale" arrangement. This is flexible but not without boundary. It is also an issue that does not seem to have been focused on in the existing Acts.

Prior to February 2006 meeting:

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

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

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

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

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

"Allocated" is a term of art in both cooperative and unincorporated law.

SECTION 905. DISTRIBUTIONS.

(a) Unless the organic rules otherwise provide and subject to Section 907, the board of directors may authorize, and the association may make, distributions to participants.

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

Reporters' Note

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

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

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

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

Reporters' Note

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

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

SECTION 907. LIMITATIONS ON DISTRIBUTIONS.

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

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

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

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

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

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

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

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

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

(d) If indebtedness is issued as a distribution, each payment of principal or interest on the indebtedness is treated as a distribution, the effect of which is measured on the date the payment is made.

Reporters' Note

This limiting language is based on ULPA (2001) and, generally, cooperative acts do not deal with this issue with this level of detail. Nonetheless, it seems the same policy and governance issues are raised in cooperatives, limited partnerships, and corporations. The language of this section is difficult to read but it is consistent with ULPA (2001). Query the cost benefit in attempting to redraft it.

This Section also raises another issue specific to this draft: Who is liable? Under typical unincorporated law it is possible to require members to return a proportionate amount of an unlawful distribution. It is one of the few bright-line areas for director liability under corporate law.

An accounting question about subsection (a)(2) was raised at the 2005 Annual meeting. The basic premise was: "I thought assets by accounting convention always equaled liabilities; therefore, what does (a)(2) mean?" It was promised an answer would be provided, at least, in the Final Comments. The quick answer is that the basic accounting equation is "assets equals liabilities plus owners equity." Even though owners equity is a liability upon liquidation it is not a fixed amount because owners are the residual claimants. The subsection basically means that no distributions are allowed if a negative owners equity account is necessary to balance the books.

A question was also raised at the 2005 Annual meeting about subsection (d). The Reporters' have discussed the matter and suggest that the Committee determine whether this matter should be revisited.

The interrelationship with "redemption" is an important one to note.

[SECTION 908. ALTERNATIVE DISTRIBUTION OF UNCLAIMED PROPERTY, DISTRIBUTIONS, REDEMPTIONS, OR PAYMENTS. A cooperative association may distribute unclaimed property, distributions, redemptions, or payments under [citation to the applicable provision in the law governing cooperative associations not formed under this [act] in this state].

Reporters' Note

The Reporter's Note formerly included the text of the Oregon Statute (§ 62.425). The Committee determined this is an important substantive provision for states which already include

it in their cooperative statutes and many of the leading cooperative states have a provision dealing with a cooperative's unclaimed property. On the other hand it is unique to cooperative law and the provision could be a major adoption stumbling block in those states which do not already have existing cooperative law. The Committee's decision considered both practical and policy concerns. As a practical matter many existing co-ops have revolving equity that is paid upon time or dates certain and contingent on the financial condition of the co-op. Moreover, their membership is fluid and may include many very small equity (capital) accounts for patron members. If equity is not paid or cancelled it becomes practically almost impossible, and certainly inefficient, to find those members. The policy reason for "where it goes" is based on "traditional cooperative principles." Interestingly, this could probably be engineered by individual cooperative associations by organic rule and contract.

[ARTICLE] 10

DISSOCIATION

SECTION 1001. PARTICIPANT'S DISSOCIATION.

(a) A participant does not have a right to dissociate as a participant of a cooperative association but has the power to dissociate.

(b) Unless the organic rules otherwise provide, a participant is dissociated from a cooperative association as a participant upon the occurrence of any of the following:

(1) the association's receives notice in a record of the participant's express will to dissociate as a participant, unless a later date is specified in the record;

(2) an event provided in the organic rules as causing the participant's dissociation as a participant;

(3) the participant's expulsion as a participant pursuant to the organic rules;

(4) the participant's expulsion as a participant by the association's board of directors if:

(A) it is unlawful to carry on the association's activities with the participant as a participant;

(B) subject to Section 504(a), there has been a transfer of all the participant's financial rights in the association;

(C) the participant is a corporation or cooperative, and:

(i) the association notifies the participant that it will be expelled as a participant because it has filed a public document of dissolution, it has been administratively or

judicially dissolved, its charter has been revoked, or its right to conduct business has been suspended by the jurisdiction of its organization or incorporation; and

(ii) within 90 days after the participant receives the notification, there is no revocation of the certificate of dissolution, or its charter or its right to conduct business is not reinstated; or

(D) the participant is a limited liability company, association, whether or not organized under this [act], or partnership and it has been dissolved and its business is being wound up;

(5) in the case of a participant who is an individual, the individual's death;

(6) in the case of a participant that is a trust, distribution of the trust's entire financial rights in the association, but not merely by the substitution of a successor trustee;

(7) in the case of a participant that is an estate, distribution of the estate's entire financial interest in the association, but not merely by the substitution of a successor personal representative;

(8) termination of a participant that is not an individual, partnership, limited liability company, cooperative corporation, trust, or estate; or

(9) the association's participation in a consolidation or merger, if under the plan of merger as approved under [Article] 15, the participant ceases to be a participant.

Reporters' Note

(The Comment needs to explain large versus small group dynamics; partnerships include all kinds of partnerships. Note: "Notice" is governed by other law under this draft (see subsection (b)(1).)

Source: Closely derived from ULPA (2001) § 601. Subsection (b)(5) follows ULPA in

that it does not state incompetency as an event of dissociation but see Section 1003 which can be read inconsistently. The Comments to this Section need to explain the difference between subsection (b)(5) and (b)(7). An individual is dissociated upon death under (b)(5) and her estate has the powers conferred by Section 1003. Subsection (b)(7) applies where the (an) estate is carrying on business and becomes a participant by admission. Example: An individual who was not a participant of the cooperative association dies. Her estate anticipates carrying on farming business for three years before it closes. The estate could become a member of the cooperative association pursuant to the organic rules of the cooperative association for admission of participants. The issue raised by incompetency needs yet to be vetted. See section 1003 which as currently drafted is inconsistent with subsection (b)(8). Subsection (b)(4)(C) has been revised and the language is now different than ULPA (2001).

Subsection 1001(b)(4)(B) has been changed to refer to subsection 503(g) which is the security interest exception for transfers.

Section 1001(b) contemplates expulsion by the organic rules but there is no default rule for expulsion. Former subsection (b)(5) read:

> (5) on application by the cooperative, the person's expulsion as a member by judicial order because:
>
> (A) the person engaged in wrongful conduct that adversely and materially affected the cooperative's activities;
>
> (B) the person willfully or persistently committed a material breach of the organic rules or [this act]; or
>
> (C) the person engaged in conduct relating to the cooperative's activities which makes it not reasonably practicable to carry on the activities with the person as member.

This Article was discussed in detail at the October 2005 Committee meeting. Changes have been made in accordance with decisions made by the Committee. The Committee directed the Reporter to give more examination to whether subsection (b)(4)(B) should be altered or removed depending on the meaning of "financial rights." With more detail having been provided in the definition of "financial rights" in Section 102, the Reporter respectfully requests to revisit this subsection.

The Reporters also suggest the Committee should revisit this Article in conjunction with further examination of the composition and election of the Board and the division of financial results among participants. The Reporters believe these three areas are what can differentiate a cooperative association under this act from all other types of organizations. Various observers have raised questions and have made suggestions and requests in these three areas. These areas are the ones in which conflicts between traditional cooperative associations with a focus on member service and investor capital with a focus on financial returns from investment need to be balanced. Questions that have been raised regularly for consideration are: (i) Should there be

different rules in the act for small versus large cooperative associations in these areas? (ii) Should there be different rules in the act for investor participants and patron participants? (iii) Is it sufficient to leave these areas to the organic rules or should the act provide some guidance by default rules or otherwise? At the February 2006 meeting the Committee directed the Reporters to address these issues in the Comments.

The Comments to this Section will make clear that the term "partnership" includes general partnership, limited partnership, or limited liability partnership.

SECTION 1002. EFFECT OF DISSOCIATION AS PARTICIPANT.

(a) Upon a person's dissociation as a participant:

(1) subject to Section 1003, the person has no further rights as a participant; and

(2) subject to Section 1003 and [Article] 15, any financial rights owned by the person in the person's capacity as a participant immediately before dissociation are owned by the person as a transferee who is not admitted as a participant after dissociation.

(b) A person's dissociation as a participant does not of itself discharge the person from any obligation to the cooperative association which the person incurred while a participant.

Reporters' Note

Source: ULPA (2001) § 602. The ULPA (2001) counterpart includes a subsection that refers only to specifically cross-referenced obligations of good faith and fair dealing and that subsection has been deleted under this draft. "[O]r other members" was also deleted in (b), which is consistent, because under this act there is no specific participant to participant duty (similar to the basic resolution of duties to limited partners but in ULPA there is a sliding scale where a limited partner undertakes management obligations). The Comment to this section will include both reference and discussion of the four possible sources of financial return of a participant: (1) under a production (or other) contract; (2) patronage distributions; (3) patronage retains; (4) return on invested capital. Subsection (b) is important in the context of obligations under a marketing contract.

The Committee has suggested that dissociation needs to be explained in the context of a marketing agreement, at least in the Comments.

At the October 2005 Committee meeting it was determined that so long as it is permitted

by other state law, a person acting under a durable power of attorney could continue to act for a participant without a change to this act.

The Comments will provide illustrations for subsection (b).

SECTION 1003. POWER OF ESTATE OF PARTICIPANT. Unless the organic rules otherwise provide, 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 the deceased participant, may exercise the informational rights of a current participant under Section 405.

Reporters' 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.

Note: This does not prevent an estate from becoming a member.

The estate itself, however, may be admitted as a participant. The case of an inter vivos trust is left to other law and is dependent on whether the participant's interest is held under that other law to be transferred.

ARTICLE 11

DISSOLUTION

SECTION 1101. DISSOLUTION. A cooperative association may be dissolved:

(1) nonjudicially under Section 1102;

(2) judicially under Section 1103; or

(3) administratively under Section 1111.

SECTION 1102. NONJUDICIAL DISSOLUTION. Except as otherwise provided in Section 1103, a cooperative association is dissolved and its activities must be wound up only upon:

(1) the happening of an event or the coming of a time specified in the articles of organization;

(2) the action of the association's organizers, board of directors, or participants under Sections 1104 and 1105;

(3) the passage of 90 days after the dissociation of a participant, resulting in the association having fewer than two participants, unless the association has a sole participant that is a cooperative or before the end of the 90 days the association admits at least one participant in accordance with its organic rules or is the wholly owned subsidiary of a cooperative pursuant to Section 302; or

(4) the filing of a determination by the [Secretary of State] under Section 1111.

Reporters' Note

Source: ULPA (2001) § 801. It has been modified because cooperatives do not bifurcate

membership between general and limited partners even though under this draft patron and nonpatron participants are authorized. Subsection (3) of this Section has been modified pursuant to action taken by the Committee. This is a bit of a trapdoor. Where does the draft state there must be two members? *need cite* Comments to previous Sections need to make this clear. This Section errs on the side of continuity of life.

SECTION 1103. JUDICIAL DISSOLUTION. The [appropriate court] may dissolve a cooperative association or order any action that under the circumstances is appropriate and equitable:

(1) in a proceeding initiated by the [Attorney General], if it is established that:

(A) the association obtained its articles of organization through fraud; or

(B) the association has continued to exceed or abuse the authority conferred upon it by law;

(2) in a proceeding initiated by a participant, if it is established that:

(A) the directors are deadlocked in the management of the association's affairs, the participants are unable to break the deadlock, and irreparable injury to the association is occurring or is threatened because of the deadlock;

(B) the directors or those in control of the association have acted, are acting, or most likely will act in a manner that is illegal, oppressive, or fraudulent;

(C) the participants are deadlocked in voting power and have failed, for a period that includes at least two consecutive annual participants' meetings, to elect successors to directors whose terms have expired; or

(D) the assets of the association are being misapplied or wasted; or

(3) in a proceeding initiated by the association to have its voluntary dissolution continued

under judicial supervision.

Reporters' Note

As emphasized by the following paragraph, mere holders of financial rights have no standing to attempt to dissolve the entity. That is important under both unincorporated law (*see* ULPA) and corporate law.

This section on judicial dissolution is derived from the MBCA but conceptually tracks the current LLC draft being considered by the Conference. Substantively, note: (1) Subsection (2) no longer authorizes transferees to bring an action to dissolve the cooperative (in addition to members); (2) Subsection 2(A) does not include the MBCA phrase, "or the business and affairs of the [cooperative] can no longer be conducted to the advantage of the ... [members] generally" (but is consistent with the directors ability to consider other constituencies under Article 6); and, (3) the MBCA provides for an action for dissolution by a creditor of the corporation (here the cooperative) if the claim has been reduced to judgment and the entity is insolvent (perhaps that is best left to bankruptcy law).

After discussion at the April 2005 Committee meeting "or a transferee of a member" was deleted from Section 1003(2). It was pointed out that it gave transferees greater power than they have under almost all unincorporated law, that there was no similar provision in traditional cooperative law, and that it gave transferees the power to unreasonably interfere with the operation of the cooperative by filing suit.

Arguably the broadest provisions in the entire draft for individual participant rights are subsections (2)(B) and (2)(D). The Committee discussed these provisions but they need to be discussed further. The language has the same effect as provided by Section 801(6) (ii) of UPA (1997) for at-will partnerships. ULPA Section 802 is much shorter and more restrictive:

> On application by a partner the [appropriate court] may order a dissolution of a limited partnership if it is not reasonably practicable to carry on the activities of the limited partnership in conformity with the partnership agreement.

This section also adds the phrase "or order any action which under the circumstances is appropriate and equitable" to the flush language thereby expressly authorizing the court to, illustratively, appoint provisional directors or force a buy-out for interests. This follows what appears to be a trend in both statutory and case law of corporations.

Subsection (2)(B) states a different (and lower) standard for judicial dissolution than for the removal of a director under Section 707 which includes "grossly abusive" and "intentionally harmful."

Finally, though it is included in the MBCA, the committee has not addressed Subsection (2)(C). It does not require any showing of damage to the cooperative association and follows corporate law. Finally, subsection (2)(c) seems to require that the meetings have been held. While salutary because it prohibits a participant from manipulating quorum requirements, if any, is this the result the Committee intends?

SECTION 1104. VOLUNTARY DISSOLUTION BEFORE COMMENCEMENT OF ACTIVITY. A majority of the organizers or initial directors of a cooperative association that has not yet begun activity or the conduct of its affairs may dissolve the cooperative association.

Reporters' Note

This Section subscribes to the initial approach of avoiding the term "business." Other provisions now use that term and the Committee has discussed the issue elsewhere. As an aside, should "business" be a defined term?

SECTION 1105. VOLUNTARY DISSOLUTION BY THE BOARD AND PARTICIPANTS. In order for a cooperative association to voluntarily dissolve:

(1) a resolution to dissolve must be approved by a majority vote of the board of directors unless a greater vote is required by the organic rules;

(2) the association's board of directors must call a special meeting of participants to consider the resolution to be held within ninety days after adoption of the resolution required by subsection (a); and

(3) the board of directors must mail or otherwise transmit or deliver to each participant in a record that complies with Section 408:

(A) the resolution required by subsection (a);

(B) a recommendation that the participants vote in favor of the resolution or, if

the board determines because of conflict of interest or other special circumstances, that it should not make such a favorable recommendation, the basis of that decision; and

(C) give notice of the participants' meeting, in the same manner as a notice of a special participants' meeting is given.

(4) The resolution to dissolve must be approved by at least a two-thirds vote of patron participants voting at the meeting.

Reporters' Note

This Section is new to the February 2006 draft having been formerly reserved. It follows logically from the articles concerning amendments to organic rules and conversion, merger or consolidation.

SECTION 1106. WINDING UP.

(a) A cooperative association continues after dissolution only for purposes of winding up its activities.

(b) In winding up its activities, a cooperative association:

(1) shall discharge its liabilities, settle and close its activities, and marshal and distribute its assets;

(2) file with the [Secretary of State] a statement of dissolution indicating it is winding up its activities;

(3) preserve the cooperative association or its property as a going concern for a reasonable time;

(4) prosecute and defend actions and proceedings;

(5) transfer association property;

(6) settle disputes by mediation or arbitration; and

(7) perform other necessary acts.

(c) Upon application of a cooperative association, any participant, or a holder of financial rights, the [appropriate court] may order judicial supervision of the winding up of the association, including the appointment of a person to wind up the dissolved association's activities, if:

(1) after a reasonable time, the association has not executed winding up; or

(2) the applicant establishes other good cause.

Reporters' Note

The term "holder of financial rights" replaces "transferee" in the February 2006 draft. Should creditors have standing to seek judicial supervision?

SECTION 1107. DISTRIBUTION OF ASSETS IN WINDING UP COOPERATIVE ASSOCIATION.

(a) In winding up a cooperative association's business, the association must apply its assets to discharge its obligations to creditors, including participants who are creditors. Any remaining assets must be applied to pay in money the net amount distributable to participants in accordance with their right to distributions under subsection (b).

(b) Each participant is entitled to a distribution from the cooperative association of any remaining assets in the proportion of the participant's financial interests to the total financial interests of participants of the association after all other obligations are satisfied.

Reporters' Note

Best practice would provide detail in the organic rules. The Committee tentatively decided to delete the phrase "unless otherwise provided by the organic rules" in subsection (b). The import of that deletion should be revisited. The Minnesota Cooperative Associations Act is

silent as to liquidating distributions in its dissolution provisions. Section 308B.721 of the Minnesota law, however, generally governs distributions and allocations and it states: "The bylaws shall prescribe...".

The Colorado Cooperative Act (a "traditional" act) provides:

> (2) Unless otherwise stated in the articles or bylaws, the assets shall be used to pay, in the following order:
>
> (a) Liquidation expenses, including reasonable payment and reimbursement for the time and expenses of the trustees in liquidation and their consultants;
>
> (b) All debts and liabilities according to their respective priorities;
>
> (c) Amounts invested in the cooperative that have a specific preference in liquidation over other amounts invested in the cooperative;
>
> (d) Without priority and on a pro rata basis amounts invested in the cooperative, whether as membership fees, common stock, or otherwise, which are required by the cooperative to be invested in order for a person to be a member or to be subject to per unit retains or be entitled to participate in the allocation of net margins on terms and conditions established in the cooperative's bylaws or by the cooperative's board;
>
> (e) Without priority and on a pro rata basis, retained patronage, per unit retains, other amounts withheld from or allocated to a patron of the cooperative or any direct contributions to the capital of the cooperative not described in paragraph (d)..., all as shown on the books and records of the cooperative;
>
> (f) Any remaining assets, including reserves, if any, shall be distributed among such members of the cooperative, without priority and on a pro rata basis, as shall be practicable as determined by the trustees in liquidation. In making heir determination, the trustees in liquidation may limit those persons entitled to share in the distribution to persons entitled to share in the allocation of the cooperative's net margins during a limited specified period of time;
>
> (g) With respect to paragraphs (e) and (f), the amounts to be distributed shall be paid to the persons entitled to them as promptly as reasonably possible after the filing of the articles of dissolution by the secretary of state, but in no event shall the distributions be made later than seven years following the filing of the articles of dissolution by the secretary of state, unless distribution is prevented by circumstances beyond the control of the trustees in

liquidation.

By way of comparison, ULPA (2001) § 812 states:

> (a) In winding up a limited partnership's activities, the assets of the limited partnership, including the contributions required by this Section, must be applied to satisfy the limited partnerships obligations to creditors, including, to the extent permitted by law, partners that are creditors.
> (b) Any surplus remaining after the limited partnership complies with subsection (a) must be paid in cash as a distribution.

***

In turn, ULPA Section 503 states:

> A distribution by a limited partnership must be shared among partners on the basis of the value, as stated in the required records when the limited partnership decides to make the distribution, of the contributions the limited partnership has received from each partner.

At the October 2005 Committee meeting it was mentioned that subsection (b) would be limited to a seven year look-back rule in electric cooperative law. The Reporters would like a bit more guidance on how to use this information.

SECTION 1108. KNOWN CLAIMS AGAINST DISSOLVED COOPERATIVE ASSOCIATION.

(a) Subject to subsection (d), a dissolved cooperative association may dispose of the known claims against it by following the procedure in subsection (b).

(b) A dissolved cooperative association may notify its known claimants of the dissolution in a record. The notice must:

(1) specify the information required to be included in a claim;

(2) provide a mailing address to which the claim must be sent;

(3) state the deadline for receipt of the claim, which may not be less than 120

days after the date the notice is received by the claimant; and

(4) state that the claim will be barred if not received by the deadline.

(c) A claim against a dissolved cooperative association is barred if the requirements of subsection (b) are met, and:

(1) the association is not notified of the claimant's claim, in a record, by the specified deadline; or

(2) in the case of a claim that is timely received but rejected by the dissolved association, the claimant does not commence an action to enforce the claim against the association within 90 days after receipt of the notice of the rejection.

(d) This section does not apply to a claim based on an event occurring after the date of dissolution or a liability that is contingent on that date.

Reporters' Note

The substance of this section and that of the remainder of this article is contained in both corporate and LLC law. The base model for the drafting of these provisions was ULLCA.

Subsection (c)(1) has been revised pursuant to Committee direction in the October 2005 meeting. Does the revision make the use of the word "claim" inconsistent with (b) and (c). A suggestion/question concerning the flush language of (b)b was also made at that meeting but no revision has yet been made because it raises the deletion of the article about notice and notification. The Committee needs to return to that question.

SECTION 1109. OTHER CLAIMS AGAINST DISSOLVED COOPERATIVE ASSOCIATION.

(a) A dissolved cooperative association may publish notice of its dissolution and request persons having claims against the cooperative association to present them in accordance with the notice.

(b) A notice under subsection (a) must:

(1) be published at least once in a newspaper of general circulation in the [county] in which the dissolved cooperative association's principal office is located or, if it has none in this state, in the [county] in which the cooperative association's designated office is or was last located;

(2) describe the information required to be contained in a claim and provide a mailing address to which the claim is to be sent; and

(3) state that a claim against the association is barred unless an action to enforce the claim is commenced within three years after publication of the notice.

(c) If a dissolved cooperative association publishes a notice in accordance with subsection (b), the claim of each of the following claimants is barred unless the claimant commences an action to enforce the claim against the dissolved association within three years after the publication date of the notice:

(1) a claimant that is entitled to but did not receive notice in a record under Section 1108;

(2) a claimant whose claim is timely sent to the dissolved cooperative association but not acted on; and

(3) a claimant whose claim is contingent or based on an event occurring after the effective date of dissolution.

(d) A claim not barred under this section may be enforced:

(1) against the dissolved cooperative association, to the extent of its undistributed assets; or

(2) if the assets have been distributed in liquidation, against a participant or transferee of financial rights to the extent of that person's proportionate share of the claim or the association's assets distributed to the participant or transferee in liquidation, whichever is less, to the extent the person's total liability for all claims under this subsection does not exceed the total amount of assets distributed to the person as part of the winding up of the association.

Reporters' Note

This Section is based on ULPA (2001) § 807 and ULLCA § 808. It is similar to MBCA § 14.07 and Re-ULLCA § 704.

SECTION 1110. COURT PROCEEDING.

(a) A dissolved cooperative association that has published a notice under Section 1109 may file an application with the court in the [county] where the association's principal office is located for a determination of the amount and form of security to be provided for payment of claims that are contingent or have not been made known to the dissolved association or that are based on an event occurring after the effective date of dissolution but that, based on the facts known to the dissolved association, are reasonably estimated to arise after the effective date of dissolution.

(b) Within 10 days after filing an application pursuant to subsection (a), a dissolved cooperative association shall give notice of the proceeding to each known claimant holding a contingent claim.

(c) The court may appoint a guardian ad litem in any proceeding brought under this section to represent all claimants whose identities are unknown. The reasonable fees and expenses of the guardian, including all reasonable expert witness fees, shall be paid by the

dissolved cooperative association.

(d) Provision by the dissolved cooperative association for security in the amount and the form ordered by the court satisfies the dissolved association's obligations with respect to claims that are contingent, have not been made known to the dissolved association, or are based on an event occurring after the effective date of dissolution, and such claims may not be enforced against a participant who received a distribution.

Reporters' Note

This Section is new to the February 2006 draft. It was discussed at the October 2005 meeting. Is "guardian ad litem" the correct word choice in subsection (c)?

SECTION 1111. ADMINISTRATIVE DISSOLUTION.

(a) The [Secretary of State] may dissolve a cooperative association administratively if the association does not:

(1) within 60 days after the due date pay any fee, tax, or penalty due to the [Secretary of State] under this [act] or other law; or

(2) deliver its annual report to the [Secretary of State] as required by Section 207.

(b) If the [Secretary of State] determines that a ground exists for administratively dissolving a cooperative association, the [Secretary of State] shall file a record of the determination and serve the association with a copy of the record.

(c) If, within 60 days after service of a copy of the [Secretary of State's] determination that a ground exists for dissolving cooperative association, the association does not correct each ground for dissolution or demonstrate to the reasonable satisfaction of the [Secretary of State] that each uncorrected ground determined by the [Secretary of State] does not exist, the [Secretary

of State] shall administratively dissolve the association by preparing, signing, and filing a declaration of dissolution that states the grounds for dissolution. The [Secretary of State] shall serve the association with a copy of the declaration.

(d) A cooperative association administratively dissolved continues its existence but may carry on only activities necessary to wind up its activities and liquidate its assets under Section 1106 and to give the notice to claimants provided in Sections 1108 and 1109.

(e) The administrative dissolution of a cooperative association does not terminate the authority of its agent for service of process.

Reporters' Note

An issue that needs to be discussed by the Committee is whether the number of days are appropriate. The choice in the April 2005 draft conforms to ULPA (2001) and is not changed from the 2004 annual meeting draft. The 60 day period also mirrors RMBCA section 14.20. This section combines ULPA (2001) sections 809 and 810.

SECTION 1112. REINSTATEMENT FOLLOWING ADMINISTRATIVE DISSOLUTION.

(a) A cooperative association that has been administratively dissolved may apply to the [Secretary of State] for reinstatement within two years after the effective date of dissolution. The application must be delivered to the [Secretary of State] for filing and state:

(1) the name of the association and the effective date of its administrative dissolution;

(2) that the grounds for dissolution either did not exist or have been eliminated; and

(3) that the association's name satisfies the requirements of Section 108.

(b) If the [Secretary of State] determines that an application contains the information required by subsection (a) and that the information is correct, the [Secretary of State] shall:

(1) prepare a declaration of reinstatement that states this determination;

(2) sign and file the original of the declaration of reinstatement; and

(3) serve the cooperative association with a copy.

(c) When reinstatement under this section becomes effective, it relates back to and takes effect as of the effective date of the administrative dissolution, and the cooperative association may resume or continue its activities as if the administrative dissolution had never occurred.

(d) If the [Secretary of State] denies a cooperative association's application for reinstatement following administrative dissolution, the [Secretary of State] shall prepare, sign, and file notice that explains the reason or reasons for denial and serve the association with a copy of the notice.

Reporters'Note

Source: ULPA, ULLCA, generally follows the MBCA.

This Section needs to be discussed regarding the rather detailed instructions it contains for the secretary to state. Consideration should be given to conforming it with the provision governing the articles of organization. At the Committee's direction the phrase "or continue" was added to subsection (c). The Comments need to explain the effect on third parties. It is intended, in that regard, to be completely consistent with corporate and unincorporated law.

SECTION 1113. DENIAL OF REINSTATEMENT; APPEAL.

(a) If the [Secretary of State] denies a cooperative association's application for reinstatement following administrative dissolution, the [Secretary of State] shall prepare, sign, and file a notice that explains the reason or reasons for denial and serve the association with a

copy of the notice.

(b) Within 30 days after service of a notice of denial of reinstatement by the [Secretary of State] under Section 1112, a cooperative association may appeal the denial by petitioning the [appropriate court] to set aside the dissolution. The petition must be served on the [Secretary of State] and contain a copy of the [Secretary of State's] declaration of dissolution, the cooperative association's application for reinstatement, and the [Secretary of State's] notice of denial.

(c) Upon receipt of a petition under subsection (a), the court may summarily order the [Secretary of State] to reinstate the dissolved cooperative association or may take other action the court considers appropriate.

Reporters' Note

Source: ULPA § 811. This article is also conceptually consistent with existing cooperative law. It is also a point where the "unclaimed and abandoned property" provision might apply. The Reporter has been directed by the Drafting Committee to determine if it is appropriate and consistent with other conference products to include the language for a filing and fees section.

SECTION 1114. STATEMENT OF DISSOLUTION.

(a) A cooperative association that has dissolved or is about to dissolve may deliver to the [Secretary of State] for filing a statement of dissolution that states:

(1) the name of the association;

(2) the date that the association dissolved or when it will dissolve; and

(3) any other information the association deems relevant.

(b) A person has notice of a cooperative association's dissolution 90 days after a statement of dissolution is filed or the effective date stated in the statement of dissolution,

whichever is later.

Reporters' Note

This Section is new and it, and this Note, should be read in conjunction with Section 1115 and its Note. The Reporters added this Section on their own motion for discussion at the February 2006 meeting because the prior draft and note was inconsistent and, worse, affirmatively confusing. Both this Section and Section 1115 are elective filings. ULPA (2001) has an elective statement of termination but not of dissolution.

Under modern corporate law (*e.g.*, MBCA) the articles of dissolution are mandatory in that the articles are "the only filing required for voluntary dissolution." Official Comment, MBCA §14.03. "Required.," however, is misleading because if a corporation were voluntarily dissolved but articles were not filed the secretary of state would (eventually) administratively dissolve the corporation.

Further, the comments to that Section state:

> The act of filing the articles of dissolution makes the decision to dissolve the corporation a matter of public record and establishes the time when the corporation must begin the process of winding up and cease carrying on its business except to the extent necessary to wind up.

The limited partnership scheme is different because the certificate of limited partnership is not a governing document but purely a notice one (like the articles of organization in most LLC Acts). As such, the appropriate way to give notice is in an amendment to the certificate itself. Such an amendment is required under ULPA when a third-party is appointed to wind-up the partnership. Where a third party is not appointed, a fair reading of Section 202, at least allows an amendment upon dissolution. Section 202 states:

> (c) A general partner that knows that any information in a filed certificate of limited partnership was false when the certificate was filed or has become false due to changed circumstances shall promptly:
>
> (1) cause the certificate to be amended; or
>
> (2) if appropriate, deliver to the [Secretary of State] for filing a statement of change pursuant to Section 115 or a statement of correction pursuant to Section 207.

The problem is this: the certificate is not required to state that it is "not dissolved." Thus, it is not required to file a notice document upon dissolution under ULPA though a certificate "may also contain any other matters...".

SECTION 1115. STATEMENT OF TERMINATION.

(a) A dissolved cooperative association that has completed winding up may deliver to the [Secretary of State] for filing a statement of termination that states:

(1) the name of the association; and

(2) the date of filing of its initial articles of organization.

(b) The filing of a statement of termination does itself not terminate the cooperative association.

Reporters' Note

This Section was formerly numbered Section 207. Subsection (b) is new to the February 2006 draft.

There was discussion at the 2004 annual meeting suggesting that the statement of termination was a throwback to older versions of the MBCA and that this Act should follow the current MBCA provisions for filing the articles of dissolution. Because this is an unincorporated entity, however, it (now at least) follows ULPA (2001). No filing is required under this provision nor in this article requiring a filing for dissolution or winding-up. This statement is simply an elective statement that may be filed. The November 2004 draft more closely followed ULLCA (1996).

Termination is a very different creature than dissolution. Upon termination the entity, and its liability shield, ends.

Several questions should be addressed by the Committee:

(1) a prior draft included a third item in the list providing for the addition of any other information;

(2) the placement of this Section (and Section 1114) here rather than in Article 2; and, most importantly

(3) the effect of filing such a statement. For example, ULPA (2001) expressly provides (Section 103) for the effect of its filing (*e.g.,* constructive notice? ULPA says it is after it has been filed for 90 days). *See* Section 1114. The latter is an issue in at least two practical

contexts. The first is opinion letter drafting and the experience with statements of authority under RUPA. The second is whether its filing would have any bearing on the "certificate of good standing" and require the secretary of state to search its records.

ARTICLE 12

ACTIONS BY PARTICIPANTS

Reporter's Preliminary Note to Article 12

(1) Placement of Derivative Sections. The Reporter was requested to conduct preliminary research regarding the comparative placement of derivative action within state statutory schemes. According to a secondary source approximately eleven states place rules on derivative proceedings in their rules of civil procedure. In corporate law about 30 states place their derivative "rules" in the corporate statute (16 of those states adopted the MBCA provisions). Maryland does not, apparently, deal with derivative actions by statute. The balance, according to the source, have some combination or expressly cross-reference the civil procedure rules.

(2) Additional Background-Direct v. Derivative. Case law about the distinction is almost entirely from corporate law through some law is now developing under LLC statutes. Professor Kleinberger gave a CLE presentation about derivative actions in the context of LLCs at the Spring 2005 meeting of the ABA Business Section. Therein he provided several observations that apply to this project:

(a) Analysis of the operation of the rules must take into account the closely-held versus public ownership distinction;

(b) Courts follow three general approaches ("direct harm," "special injury," "duty owed/rights infringed"); and,

(c) The ALI Principles of Corporate governance suggest there be no distinction between direct and derivative actions in closely-held corporations.

In the LLC context he suggested that courts follow the "direct harm" approach supplemental by a "purpose and effect" exception in closely-held LLCs where the majority is using the entity to abuse a particular minority owner. Both ULPA (2001) and "Re-ULLCA" adopt the "direct harm" approach.

(3) Court Approval for Discontinuance. The Reporter was also requested to conduct preliminary research concerning court approval of discontinuance or settlement of derivative proceedings. The MBCA and the Federal Rules of Civil Procedure require such approval. The Section 7.45 of the RMBCA reads as follows:

> A derivative proceeding may not be discontinued or settled without the court's approval. If the court determines that a proposed discontinuance or settlement will substantially affect the interests of the corporation's shareholders or a class of shareholders, the

court shall direct that notice be given to the shareholders affected.

The Conference products do not address court supervision of settlement (ULLCA, Re-ULLCA current draft, ULPA, UPA). It was decided by the Committee at its Sprint 2006 meeting to include court approval of settlements. See Section 1205.

(4) It is anticipated that much of this Article will be bracketed and/or the subject of a legislative note because several states' provisions on derivative proceedings, generally, are contained in the statute or rules governing civil procedure. For example, a secondary source lists the following states as including derivative proceedings in the state's rules of civil procedure: Alabama, District of Columbia, Kansas, Louisiana, Minnesota, Missouri, Nevada, Ohio, Oklahoma, South Dakota, and South Carolina. According to the same secondary source, other states *corporate* acts sometimes reference their rules of civil procedure, *see, e.g.,* California, New York, Illinois.

SECTION 1201. DIRECT ACTION BY PARTICIPANT.

(a) Subject to subsection (b), a participant may maintain a direct action against a cooperative association, an officer, or a director, to enforce the rights and otherwise protect the interests of the participant, including rights and interests under the organic rules or organic law.

(b) To maintain a direct action under this section, a participant must plead and prove an injury or threatened injury that is not solely the result of an injury suffered or threatened to be suffered by the cooperative association.

Reporters' Note

Source: § 1001 ULPA (2001) (modified) and "Re-ULLCA" (May 15, 2005, Draft). The February 2006 Draft deleted a subsection (c) that dealt with an accounting action. The deletion more closely follows LLC and traditional cooperative law than partnership law. The reference to accounting was ripe for deletion because no Committee discussion suggested an accounting action should be expressed as a statutory matter. Does this Draft's Supplemental Principles" (Section 108) adequately cover this? A prior draft included a direct right to sue another member based on unincorporated entity law (in former section 1101). Directors are included under this section to raise the issue of "primary" shareholder litigation in the corporate context and to better reflect the operation of the provision under ULPA. Query whether this merely reflects current law; or causes or alleviates confusion. Finally, query whether the provision on direct action is necessary. Current corporate and cooperative acts do not make this statutory distinction.

Unincorporated laws, however, include this because, historically, the individual partner could not sue directly outside an accounting action. The direct-derivative distinction is currently in the ULLCA draft being discussed by another committee of the Conference.

SECTION 1202. DERIVATIVE ACTION. A participant may maintain a derivative action to enforce a right of a cooperative association if:

(1) the participant adequately represents the interests of the association;

(2) the participant demands that the association bring an action to enforce the right; and

(3) any of the of following occur:

(A) the association does not agree to bring the action under paragraph (2) within 90 days after the participant makes the demand under paragraph (2);

(B) the association notifies the participant that it has rejected the demand;

(C) irreparable injury to the association would result by waiting 90 days after the participant makes the demand under paragraph (2); or

(D) if the association agreed to bring an action under subparagraph (3)(A), the association fails to bring the action within a reasonable time under paragraph (2).

Reporters' Note

This Section has been revised pursuant to Committee direction for the 2006 Annual Meeting.

Source: § 1002 ULPA (2001). Section 1102 modifies the ULPA (2001) formulation by adding the requirement that the member adequately represents the interests of the cooperative; by adding a 90 day time period after demand before suit may be commenced; and by deleting excused demand because of futility. The 90 day period may be excused if the waiting period would result in irreparable harm to the cooperative under subsection 1102(2). These modifications generally follow the law of the Model Business Corporations Act.

Is 90 days too long, *but see* the Reporter's Note following section 1104. Oregon uses 20 days. *See* section 1104. This draft does not contain a futility exception. Subsection (1) formerly

required a writing, the Committee discussed replacing it with record, this draft goes back to the language in ULPA (2001). For purposes of comparison, a recent draft in the "Re-ULLCA" project includes "futility" (as does ULPA) and is silent as to the time limit. Neither does it include "adequately represents the interests" in the flush language.

The Committee has discussed (briefly) the inclusion of a provision about special litigation committees. To date the Committee is satisfied that the flexibility for Committees and other appointments elsewhere in the draft adequately address the issue. The Minnesota Cooperative Association Act has a specific provision on the topic as does the RMBCA. A recent draft of "Re-ULLCA" included such a provision for discussion purposes only. The discussion draft follows the corporate formulation but note that it specifically addresses the standard to be used for the Committee's business judgment:

> Section 905. SPECIAL LITIGATION COMMITTEE.
>
> (a) When a limited liability company is named as a party in a derivative proceeding, the limited liability company may appoint a special litigation committee to investigate claims asserted in the proceeding and determine whether pursuing the proceeding is in the best interests of the limited liability company. If the limited liability company appoints a special litigation committee, on motion by the committee, made in the name of the limited liability company, the court shall stay discovery for the amount of time reasonably necessary to permit the committee to make its investigation.
>
> (b) A special litigation committee may be composed of one or more persons, who may, but need not be, members. A special litigation committee may be appointed:
>
> (1) in a member-managed limited liability company, by the consent of a majority of those members who are not named as defendants in the proceeding and, if there are none, by a majority of members; and
>
> (2) in a manager-managed limited liability company, by:
>
> (A) a majority of those managers that are not named as defendants in the proceeding; and
>
> (B) if there are none, by a majority of members that are not named as defendants in the proceeding; and
>
> (C) if there are none, by a majority of the managers.
>
> (c) After appropriate investigation, a special litigation committee may determine that it is in the best interests of the limited liability company that the proceeding:
>
> (1) continue under the control of the plaintiff;

(2) continue under the control of the special litigation committee;

(3) be settled on terms determined by the special litigation committee; or

(4) be dismissed.

(d) After making a determination under subsection (c), the special litigation shall file with the court a statement of its determination and its report supporting its determination, giving notice to the plaintiff. The court shall determine whether the special litigation committee conducted its investigation and made its recommendation in good faith and with reasonable care, with the special litigation committee having the burden of proof. If the court finds that the special litigation committee acted in good faith and with reasonable care, the court shall adopt and enforce the determination of the special litigation committee.

At the direction of the Committee the Reporters referenced the Revised Model Nonprofit Corporation Act: it contains no reference to time periods except the complainant must notify the attorney general within ten days of filing the complaint if it "involves a public benefit corporation or assets held in a charitable trust by a mutual benefit corporation." Moreover, the Model Nonprofit Act deals with the demand as follows:

> A complaint in a proceeding brought in the right of a corporation must be verified and alleged with particularity the demand made, if any , to obtain action by the directors and either why the complainants could not obtain the action or why they did not make the demand. If a demand for action was made and the corporation's investigation of the demand is in progress when the proceeding is filed, the court may stay the suit until the investigation is completed.

RMBCA §6.30(c).

The Nonprofit Corporation Act also provides a threshold standing requirement of the lesser of "five percent or more of the voting power or by fifty members." Any director also has standing (§6.30(a)).

SECTION 1203. PROPER PLAINTIFF. A derivative action to enforce a right of a cooperative association may be maintained only by a person that is a participant at the time the action is commenced, and:

(1) was a participant when the conduct giving rise to the action occurred; or

(2) whose status as a participant or transferee of a participant devolved upon the person by operation of law from a person that was a participant at the time of the conduct.

Reporters' Note

Source: § 1003 ULPA (2001). Query whether the requirement that the person bringing a suit be a member at the time of commencement is advisable or necessary. Most corporate statutes so provide. It is consistent with other conference products. A Comment or Legislative Note should direct states to determine the placement of derivative actions within their own codes. South Dakota's derivative procedures, for example, appear in it's code of civil procedure. The South Dakota provision and, some other corporate codes, require that the plaintiff "fairly represents" the interest of the corporation. This draft does as well.

The words "or transferee of a participant" were added by the Reporters without express direction by the Committee for purposes of discussion only. The status of "participant" does not devolve upon a person by operation of law under the default rules of the 2006 Annual Meeting Draft.

The Committee requested alternative suggestions for the occurrence and concurrent ownership requirements. The ALI Principles of Corporate Governance provide more specific guidelines. Section § 7.02(a) (particularly subsection (1)) states:

> (a) A holder [§ 1.22] of an equity security [§ 1.20] has standing to commence and maintain a derivative action if the holder:
>
> (1) Acquired the entity security either (A) before the material facts relating to the alleged wrong were publicly disclosed or were known by, or specifically communicated to, the holder, or (B) by devolution of law, directly or indirectly, from a prior holder who acquired the security as described in the preceding Clause (A);
>
> (2) Continues to hold the equity security until the time of judgment, unless the failure to do so is the result of corporate action in which the holder did not acquiesce, and either (A) the derivative action was commenced prior to the corporate action terminating the holder's status, or (B) the court finds that the holder is better able to represent the interests of the shareholders than any other holder who has brought suit;
>
> (3) Has complied with the demand requirement of § 7.03 (Exhaustion of Intracorporate Remedies: The Demand Rule) or was excused by its terms; and
>
> (4) Is able to represent fairly and adequately the interests of

the shareholders.

The California Corporate Code is somewhat similar but adds more "procedure." Section 800(b)(1) specifically addresses the issue as follows:

> (b) No action may be instituted or maintained in right of any domestic or foreign corporation by any holder of shares of voting trust certificates of the corporation unless both of the following conditions exist:
>
> (1) The plaintiff alleges in the complaint that plaintiff was a shareholder, of record or beneficially, or the holder of voting trust certificates at the time of the transaction or any part thereof of which plaintiff complains or that plaintiff's shares or voting trust certificates thereafter devolved upon plaintiff by operation of law from a holder who was a holder at the time of the transaction or any part thereof complained of; provided, that any shareholder who does not meet these requirements may nevertheless be allowed in the discretion of the court to maintain the action on a preliminary showing to and determination by the court, by motion and after a hearing, at which the court shall consider such evidence, by affidavit or testimony, as it deems material, that (I) there is a strong prima facie case in favor of the claim asserted on behalf of the corporation, (ii) no other similar action has been or is likely to be instituted, (iii) the plaintiff acquired the shares before there was disclosure to the public or to the plaintiff of the wrongdoing of which plaintiff complains, (iv) unless the action can be maintained the defendant may retain a gain derived from defendant's willful breach of a fiduciary duty, and (v) the requested relief will not result in unjust enrichment of the corporation or any shareholder of the corporation; and...

SECTION 1204. PLEADING. In a derivative action to enforce a right of a cooperative association, the complaint must state with particularity:

(1) the date and content of the plaintiff's demand and the association's response to the demand;

(2) if 90 days have not expired since the demand, how irreparable injury to the association would result by waiting for the expiration of 90 days; and

(3) if the association agreed to bring an action under 1202(3)(a), that the action has not been brought within a reasonable time.

SECTION 1205. COURT APPROVAL FOR DISCONTINUANCE OR SETTLEMENT. A derivative action to enforce a right of a cooperative association may not be discontinued or settled without the court's approval.

Reporters' Note

Source: RMBCA § 7.45.

The RMBCA provision also requires notice be given shareholders under certain circumstances. See Preliminary Note to Article 12, *supra*. The additional corporate language is thought unnecessary.

SECTION 1206. PROCEEDS AND EXPENSES.

(a) Except as otherwise provided in subsection (b):

(1) any proceeds or other benefits of a derivative action to enforce a right of a cooperative association, whether by judgment, compromise, or settlement, belong to the association and not to the derivative plaintiff; and

(2) if the derivative plaintiff receives any proceeds, the plaintiff shall immediately remit them to the association.

(b) If a derivative action to enforce a right of cooperative association is successful in whole or in part, the court may award the plaintiff reasonable expenses, including reasonable attorney's fees, from the recovery of the association.

Reporters' Note

Source: § 1005 ULPA (2001); *see* § 906 Re-ULLCA (February 2006 Draft).

[ARTICLE] 13

FOREIGN COOPERATIVES

SECTION 1301. GOVERNING LAW.

(a) The law of the state or other jurisdiction under which a foreign cooperative is organized governs relations among the participants of the foreign cooperative and between the participants and the foreign cooperative.

(b) A foreign cooperative may not be denied a certificate of authority by reason of any difference between the laws of the jurisdiction under which the foreign cooperative is organized and the law of this state.

(c) A certificate of authority does not authorize a foreign cooperative to engage in any activity or exercise any power that a cooperative may not engage in or exercise in this state.

Reporters' Note

This article needs examination by the Committee with respect to whether any type of cooperative organization organized in another state should be permitted to obtain a certificate of authority under this act. "Foreign cooperative" is defined in this draft as a "foreign entity [not a domestic entity] organized under a law *similar* to this [act] in another jurisdiction" [emphasis supplied]. How "similar" is "similar"? A number of states have specialized cooperative statutes, *e.g.,* cooperatives for agriculture, cooperatives for rural power, cooperatives for housing, but do not have a general cooperative statute. If a traditional cooperative formed in a state that permits cooperatives to be organized for many purposes seeks to qualify in a state with only specialized statutes, the cooperative will need to qualify as a for profit or non-profit corporation that does not fit the cooperative "mold." Should this act offer an alternative? A traditional cooperative could be organized under this act for any purpose except that will be specifically excluded. In this draft, the Reporters have assumed "similar" means a cooperative association of a type formed under a statute that would clearly be seen as "similar" to this act meaning the same kind of statute. This article would clearly be seen as "similar" to this act meaning the same kind of statute. This article would currently have limited use by cooperative organizations organized in other states unless organized under an act which is essentially the same as this one, currently Wyoming, Minnesota, Iowa and Tennessee.

In keeping with the change of terminology from "member" to "participant" throughout this draft, the terminology has been changed in this article. Is that appropriate in this article? If another state uses "member" could it have an adverse effect on attempting to qualify under this act?

SECTION 1302. APPLICATION FOR CERTIFICATE OF AUTHORITY.

(a) A foreign cooperative may apply for a certificate of authority to transact business in this state by delivering an application to the [Secretary of State] for filing. The application must state:

(1) the name of the foreign cooperative and, if the name does not comply with Section 108, an alternative name adopted pursuant to Section 1305;

(2) the name of the state or other jurisdiction under whose law the cooperative is organized;

(3) the street and mailing addresses of the cooperative's designated office and, if the laws of the jurisdiction under which the cooperative is organized require the cooperative to maintain an office in that jurisdiction, the street and mailing addresses of the required office;

(4) the name and street and mailing addresses of the cooperative's agent for service of process in this state; and

(5) the name and street and mailing addresses of each of the cooperative's current directors and officers.

(b) A foreign cooperative shall deliver with a completed application under subsection (a) a certificate of good standing [or existence] or a similar record signed by the [Secretary of State] or other official having custody of the cooperative's publicly filed records in the state or other jurisdiction under whose law the cooperative is organized.

SECTION 1303. ACTIVITIES NOT CONSTITUTING TRANSACTING BUSINESS.

(a) Activities of a foreign cooperative which do not constitute transacting business in this state under this [article] include:

(1) maintaining, defending, and settling an action or proceeding;

(2) holding meetings of its participants or carrying on any other activity concerning its internal affairs;

(3) maintaining accounts in financial institutions;

(4) maintaining offices or agencies for the transfer, exchange, and registration of the cooperative's own securities or maintaining trustees or depositories with respect to those securities;

(5) selling through independent contractors;

(6) soliciting or obtaining orders, whether by mail or electronic means, through employees, agents, or otherwise, if the orders require acceptance outside this state before they become contracts;

(7) creating or acquiring indebtedness, mortgages, or security interests in real or personal property;

(8) securing or collecting debts or enforcing mortgages or other security interests in property securing the debts, and holding, protecting, and maintaining property so acquired;

(9) conducting an isolated transaction that is completed within 30 days and is not one in the course of similar transactions of a like manner; and

(10) transacting business in interstate commerce.

(b) For purposes of this [article], the ownership in this state of income-producing real property or tangible personal property, other than property excluded under subsection (a), constitutes transacting business in this state.

(c) This section does not apply in determining the contacts or activities that may subject a foreign cooperative to service of process, taxation, or regulation under any law of this state, other than this [act].

Reporters' Note

Source: ULPA (2001) § 903. The Style Committee has asked whether "of a like manner" in subsection (a)(9) is surplusage.

The Committee requested alternative suggestions for the occurrence and concurrent ownership requirements. The ALI Principles of Corporate Governance provide more specific guidelines. Section § 7.02(a) (particularly subsection (1)) states:

> (a) A holder [§ 1.22] of an equity security [§ 1.20] has standing to commence and maintain a derivative action if the holder:
>
> (1) Acquired the entity security either (A) before the material facts relating to the alleged wrong were publicly disclosed or were known by, or specifically communicated to, the holder, or (B) by devolution of law, directly or indirectly, from a prior holder who acquired the security as described in the preceding Clause (A);
>
> (2) Continues to hold the equity security until the time of judgment, unless the failure to do so is the result of corporate action in which the holder did not acquiesce, and either (A) the derivative action was commenced prior to the corporate action terminating the holder's status, or (B) the court finds that the holder is better able to represent the interests of the shareholders than any other holder who has brought suit;
>
> (3) Has complied with the demand requirement of § 7.03 (Exhaustion of Intracorporate Remedies: The Demand Rule) or was excused by its terms; and
>
> (4) Is able to represent fairly and adequately the interests of the shareholders.

The California Corporate Code is somewhat similar but adds more "procedure." Section 800(b)(1) specifically addresses the issue as follows:

(b) No action may be instituted or maintained in right of any domestic or foreign corporation by any holder of shares of voting trust certificates of the corporation unless both of the following conditions exist:

(1) The plaintiff alleges in the complaint that plaintiff was a shareholder, of record or beneficially, or the holder of voting trust certificates at the time of the transaction or any part thereof of which plaintiff complains or that plaintiff's shares or voting trust certificates thereafter devolved upon plaintiff by operation of law from a holder who was a holder at the time of the transaction or any part thereof complained of; provided, that any shareholder who does not meet these requirements may nevertheless be allowed in the discretion of the court to maintain the action on a preliminary showing to and determination by the court, by motion and after a hearing, at which the court shall consider such evidence, by affidavit or testimony, as it deems material, that (I) there is a strong prima facie case in favor of the claim asserted on behalf of the corporation, (ii) no other similar action has been or is likely to be instituted, (iii) the plaintiff acquired the shares before there was disclosure to the public or to the plaintiff of the wrongdoing of which plaintiff complains, (iv) unless the action can be maintained the defendant may retain a gain derived from defendant's willful breach of a fiduciary duty, and (v) the requested relief will not result in unjust enrichment of the corporation or any shareholder of the corporation; and...

SECTION 1304. FILING OF CERTIFICATE OF AUTHORITY. Unless the [Secretary of State] determines that an application for a certificate of authority does not comply with the filing requirements of this [act], the [Secretary of State], upon payment of all filing fees, shall file the application, prepare, sign, and file a certificate of authority to transact business in this state, and send a copy of the filed certificate, together with a receipt for the fees, to the foreign cooperative or its representative.

Reporters' Note

Source: ULPA (2001) § 904.

SECTION 1305. NONCOMPLYING NAME OF FOREIGN COOPERATIVE.

(a) A foreign cooperative whose name does not comply with Section 108 may not obtain a certificate of authority until it adopts, for the purpose of transacting business in this state, an alternative name that complies with Section 110. A foreign cooperative that adopts an alternative name under this subsection and then obtains a certificate of authority with that name need not comply with [fictitious name statute]. After obtaining a certificate of authority with an alternative name, a foreign cooperative's business in this state must be transacted under that name unless the cooperative is authorized under [fictitious name statute] to transact business in this state under another name.

(b) If a foreign cooperative authorized to transact business in this state changes its name to one that does not comply with Section 108, it may not thereafter transact business in this state until it complies with subsection (a) and obtains an amended certificate of authority.

Reporters' Note

Source: ULPA (2001) § 905. In subsection (a): Would it change the meaning of the first sentence if "the purpose" were replaced by "purposes"?

SECTION 1306. REVOCATION OF CERTIFICATE OF AUTHORITY.

(a) A certificate of authority of a foreign cooperative to transact business in this state may be revoked by the [Secretary of State] in the manner provided in subsections (b) and (c) if the cooperative does not:

(1) pay, within 60 days after the due date, any fee, tax, or penalty due to the [Secretary of State] under this [act] or law of this state other than this [act];

(2) deliver, within 60 days after the due date, its annual report required under

Section 207;

(3) appoint and maintain an agent for service of process as required by Section 116; or

(4) deliver for filing a statement of change under Section 117 within 30 days after a change has occurred in the name or address of the agent.

(b) To revoke a certificate of authority of a foreign cooperative to transact business in this state, the [Secretary of State] must prepare, sign, and file a notice of revocation and send a copy to the cooperative's registered agent for service of process in this state or, if the cooperative does not appoint and maintain an agent for service of process in this state, to the cooperative's designated office. The notice must state:

(1) the revocation's effective date, which must be at least 60 days after the date the [Secretary of State] sends the copy; and

(2) the cooperative's noncompliance with subsection (a) which is the reason for the revocation.

(c) The authority of a foreign cooperative to transact business in this state ceases on the effective date of the notice of revocation unless before that date the cooperative cures each failure to comply with subsection (a) stated in the notice. If the cooperative cures the failures, the [Secretary of State] shall so indicate on the filed notice.

Reporters' Note

Source: ULPA (2001) § 906.

SECTION 1307. CANCELLATION OF CERTIFICATE OF AUTHORITY; EFFECT OF FAILURE TO HAVE CERTIFICATE.

(a) To cancel its certificate of authority to transact business in this state, a foreign cooperative must deliver to the [Secretary of State] for filing a notice of cancellation. The certificate is canceled when the notice becomes effective under Section 203.

(b) A foreign cooperative transacting business in this state may not maintain an action or proceeding in this state unless it has a certificate of authority to transact business in this state.

(c) The failure of a foreign cooperative to have a certificate of authority to transact business in this state does not impair the validity of a contract or act of the foreign cooperative or prevent the foreign cooperative from defending an action or proceeding in this state.

(d) A participant of a foreign cooperative is not liable for the obligations of the foreign cooperative solely by reason of the foreign cooperative's having transacted business in this state without a certificate of authority.

(e) If a foreign cooperative transacts business in this state without a certificate of authority or cancels its certificate of authority, it appoints the [Secretary of State] as its agent for service of process for action arising out of the transaction of business in this state.

Reporters' Note

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].

Reporters' Note

Source: ULPA (2001) § 908.

[ARTICLE] 14

AMENDMENT OF ORGANIC RULES

Preliminary Reporters' Note to Article 14

As in other articles, this draft now attempts a modified "class voting" system. *See e.g,* Section 1405.

SECTION 1401. AUTHORITY TO AMEND ORGANIC RULES.

(a) A cooperative association may amend its organic rules under this [article].

(b) A participant does not have vested rights in any provision in the organic rules.

Reporters' Note

This article attempts to consolidate the amendment and restatement procedures for both the articles of organization and bylaws. This section simply grants a general authority to amend. Subsection (b) is in the MBCA and is the analogue of the effect of a change or amendment of underlying law provided in Section 104. Concerning subsection (b): Do cooperatives sometimes have marketing contract provisions in by-laws? If so, is subsection (b) a problem? It doesn't seem to cause a problem in corporate law even though there may be financial contract rights set forth therein (*e.g.*, preferred dividends). The Committee has yet to address whether this is a default or mandatory provision. This issue is an important one because under the corporate law of most states the directors alone may amend the by-laws. This draft more closely follows LLC law. It is also consistent with the Oregon Cooperative Act (§ 62.135).

SECTION 1402. NOTICE AND ACTION ON AMENDMENT OF ARTICLES OF ORGANIZATION OR BYLAWS.

To amend its organic rules:

(1) either

(A) a majority of the association's board of directors, or a greater percentage if required by the association's organic rules, must approve the proposed amendment; or

(B) the board of directors must have received a petition in a record that:

(i) proposes an amendment; and

(ii) authenticated by at least 20 percent of the patron participants or 20 percent of the investor participants; and

(2) the board of directors shall mail or otherwise transmit or deliver in a record to each participant:

(A) the proposed amendment;

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

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

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

Reporters' Note

This section is consistent with the article on conversion, merger or consolidation. Subsection (2)(D) has been revised because, the annual meeting does not require detailed notice of what is to be considered.

SECTION 1403. METHOD OF VOTING ON AMENDMENT OF ORGANIC RULES. Participants may vote on a proposed amendment to the organic rules of a cooperative association as provided in Section 415.

Reporters' Note

This section is derived from Colorado section 7-55-110. The known inconsistency concerning proxies in a prior draft, the Reporters believe, has been fixed in the February 2006

draft. Under this draft proxies are not allowed. That is a major policy decision that the Committee has only tentatively made. The Committee needs to reach resolution of this policy issue.

SECTION 1404. CHANGE TO AMENDMENT OF ORGANIC RULES AT MEETING.

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

(b) Any change in the amendment to the organic rules of a cooperative association at a meeting permitted by subsection (a) need not be separately voted upon by the board of directors.

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

Reporters' Note

At the November 2004 meeting the term "germane" was suggested instead of "substantive" in subsection (a). Is subsection (b) clear? This Section received comment from the floor at the 2005 Annual Meeting. A commissioner stated that Robert's Rules of Order should take care of this and queried about "substitute amendments." In response to the latter comment the February 2006 draft broadens the language slightly from "amendment to amendment" to "change."

SECTION 1405. VOTING BY GROUP, CLASS, OR DISTRICT OF PARTICIPANTS.

(a) If a proposed amendment to the organic rules of a cooperative association affects a group, class, or district of participants in one or more of the ways described in Section 1406(b), those participants shall vote as a separate group.

(b) Unless the organic rules otherwise provide, if a proposed amendment to the organic

rules of a cooperative association affects more than one group, class, or district of participants in the same or a substantially similar way, the participants of those groups, classes, or districts shall vote on the proposed amendment as a single group.

(c) A group, class, or district of participants in a cooperative association has the rights provided in this section even if those participants are not otherwise entitled to vote under the organic rules.

Reporters' Note

Query whether (b) is/should be limited to patron participants. This is part of the balancing issue discussed in the previous note and elsewhere and needs Committee direction.

Subsection (c) entitles "nonvoting" participants the right to vote concerning fundamental changes to the terms of their participation. The interrelationship between subsection (c) and the rights of creditors and transferees of economic rights needs to be explored.

This section should not be interpreted to extend voting rights to transferees. That is, "participants" as used herein means "participants." Other law, like the Uniform Fraudulent Transactions Act, should apply in some circumstances. Dissolution for oppression (elsewhere in this draft) might also apply in given circumstances.

SECTION 1406. APPROVAL OF AMENDMENT.

(a) Subject to Section 1405, an amendment to the articles of organization of a cooperative association must be approved by at least a two-thirds vote of all participants voting at the meeting and at least one-half of the votes cast must be cast in the affirmative by patron participants.

(b) Subject to Section 1405, an amendment to the bylaws of a cooperative association must be approved by at least a majority vote of all participants voting at the meeting and by at least a majority of patron participants voting at the meeting, but a two-thirds vote of participants

voting at the meeting and at least one-half the votes cast by patron members at the meeting must be cast in the affirmative by patron participants is required for any amendment modifying:

(1) the capital structure of the cooperative association, including the relative rights, preferences, and restrictions granted or imposed upon any group or class of participants, and the rights of the cooperative association's participants to share in profits or distributions;

(2) the terms for admission of new participants;

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

(4) the transferability of participants' interests; or

(5) the manner or method of allocation of profits or losses among participants.

Reporters' Note

This section has changed markedly since the 2005 Annual Meeting and now departs from the Minnesota statute and its progeny.

Many cooperative acts allow the board of directors to amend the bylaws, some do not. It is the tentative general sense of the committee to be protective of members and this draft is consistent with that sense. It would be possible to make (b) a default rule rather than mandatory (*See* Colorado Rev. Stat. § 7-56-208).

The allocation of provisions between the articles of organization and bylaws, even given the foregoing, is a unique feature of cooperatives. In many ways it seems that the bylaws of some cooperative serve an analogous role of the operating agreement under LLC law, albeit far easier to amend. In order to address the real function of the bylaws in a cooperative association this Section sets forth several actions that require a higher vote quantum no matter whether they are in the bylaws or articles of organization. Whether the effect of changing of district boundaries is included in subsection (b) as drafted needs to be considered (and the effects of gerrymandering in this context are similar to those in other contexts).

SECTION 1407. EMERGENCY BYLAWS.

(a) Unless the articles of organization otherwise provide, a cooperative association's board of directors may adopt emergency bylaws that are effective only if a quorum of the board

of directors cannot readily be assembled because of a catastrophic event. The emergency bylaws may be amended or repealed by the participants and may make all provisions necessary for managing the cooperative association during the emergency, including:

(1) procedures for calling a meeting of the board of directors;

(2) quorum requirements for the meeting; and

(3) designation of additional or substitute directors.

(b) The bylaws of a cooperative association that are consistent with the emergency bylaws adopted pursuant to subsection (a) remain effective during the emergency. The emergency bylaws are not effective after the emergency ends.

(c) Action taken by a cooperative association in good faith in accordance with the emergency bylaws:

(1) binds the association; and

(2) may not be used to impose liability on a director, officer, employee, or agent of the association.

Reporters' Note

This Section was formerly numbered Section 206.

Emergency bylaw provisions are common in cooperative law. Similar provisions are not typically found in unincorporated entity law. Corporate law, however, frequently contains such provisions. Indeed, according to the annotated version of the MBCA the corporation law of approximately 40 states contains some provision for emergency bylaws.

The Committee thought it important, therefore, to mirror existing cooperative law. Subsection (d) needs to be revisited by the Committee as there is some variety in its expression in corporate law.

SECTION 1408. RESTATED ARTICLES. A cooperative association, by the

affirmative vote of a majority of all the participants taken at a meeting for which the purpose is stated in the notice of the meeting, may adopt restated articles that contain the original articles as currently amended. Upon filing, restated articles supersede the existing articles and all amendments.

Reporters' Note

This Section provides for a restatement of the Articles of Organization without amendments. For this reason a lower voting requirement is provided. Section 1410 provides for a restatement with amendments. The Reporters need to rework this section before the Fall 2006 Drafting Committee Meeting.

SECTION 1409. AMENDMENT OR RESTATEMENT OF ARTICLES OF ORGANIZATION.

(a) To amend its articles of organization, a cooperative association must deliver to the [Secretary of State] for filing an amendment of the articles of organization, or restated articles of organization or articles of conversion, merger, or consolidation pursuant to [Article 15] that contain one or more amendments of the articles of organization, stating:

(1) the name of the cooperative association;

(2) the date of filing of its initial articles of organization; and

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

(b) A cooperative association shall promptly deliver to the [Secretary of State] for filing an amendment to the articles of organization to reflect the appointment of a person to wind up the association's activities under subsection 1106(c).

(c) Before the commencement of the initial meeting of the board of directors of a

cooperative association, an organizer of the association that knows that any information in the filed articles of organization of the association was false when the articles were filed or has become false due to changed circumstances shall promptly:

(1) cause the articles to be amended; or

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

(d) Articles of organization may be amended at any time for any other proper purpose as determined by the cooperative association.

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

(f) Subject to Section 203, an amendment of the articles of organization or other record containing an amendment of the articles of organization that has been properly adopted by the participants is effective when filed by the [Secretary of State].

Reporters' Note

In addition to an amendment to the articles of organization itself, this Section permits amendments to the articles of organization to be reflected by a record of action taken by the participants that contains an amendment.

Query whether amendments should be effective inter se even before being filed under subsection (f). Such a revision would be more consistent with other unincorporated law whose filings, admittedly, are usually for notice only.

[ARTICLE] 15

CONVERSION, MERGER, AND CONSOLIDATION

SECTION 1501. DEFINITIONS. In this [article]:

(1) "Constituent cooperative association" means a cooperative association that is a party to a consolidation or merger.

(2) "Constituent organization" means an organization that is party to a consolidation or merger.

(3) "Converted organization" means the organization into which a converting organization converts pursuant to Sections 1502 through 1505.

(4) "Converting cooperative association" means a converting organization that is a cooperative association.

(5) "Converting organization" means an organization that converts into another organization pursuant to Sections 1502 through 1505.

(6) "Governing statute" of an organization means the statute that governs the organization's internal affairs.

(7) "Organization" means an entity.

(8) "Personal liability" means personal liability for a debt, liability, or other obligation of an organization that is imposed by operation of law or otherwise on or is assumed by a person that co-owns or has an interest in the organization:

(A) by the organization's governing statute solely by reason of co-owning or having an interest in the organization; or

(B) by the organization's organizational documents under a provision of the organization's governing statute authorizing those documents to make one or more specified persons liable for all or specified debts, liabilities, and other obligations of the organization solely by reason of co-owning or having an interest in the organization.

(9) "Surviving organization" means an organization into which one or more other organizations are merged. A surviving organization may exist before the merger or be created by the merger.

Reporters' Note

Perhaps the best way to deal with the Model Entity Transactions Act (META) would be to provide a legislative note to accompany this act setting forth the necessary revisions to this act if META is in place. Such a note would also provide rough guidance for states that have a non-model "junction box" type of statutes. In the latter regard the final section in this article ("nonexclusivity") may also be helpful.

Legislative notes accompany META for suggested amendments to plug into other acts (a.k.a. "trailing amendments") when META is adopted in a state. The basic idea of META is that it will replace the existing transactions dispersed throughout the entities as they relate to trans-entity transactions and provide default rules for those entities that do not contemplate a transaction allowed by META (*e.g.* divisions) in their own governing law. Nonetheless, the individual laws (*e.g.* this act) will govern the cooperative association side of any transaction to the extent it addresses it (*e.g.*, the vote quantum for merging a cooperative association will trump any META default rules for the voting provision in META).

After Committee discussion of this article, perhaps it would want to direct the Reporters to draft the "META" legislative note for review at the next Committee meeting.

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 (8) needs work.

SECTION 1502. CONVERSION.

(a) An organization that is not a cooperative association may convert to a cooperative association and a cooperative association may convert to an organization that is not a cooperative association 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;

(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.

Reporters' Note

Source: ULPA (2001) § 1102. This Article cannot govern or change the provisions of another statute that governs an entity into which a cooperative association would be converted or that would be a party to a merger or a consolidation.

SECTION 1503. ACTION ON PLAN OF CONVERSION BY CONVERTING COOPERATIVE ASSOCIATION.

(a) Unless the organic rules otherwise provide, in order for an association to convert to another organization:

(1) a majority of the board of directors, or a greater percentage if required by the association's organic rules, must approve a plan of conversion;

(2) the board of directors must call a special meeting of participants to consider the plan of conversion to be held within ninety days following approval of the proposed plan by the board and must mail or otherwise transmit or deliver in a record to each participant:

(A) the proposed amendment;

(B) a recommendation that the participants approve the plan of conversion, or if the board determines, because of conflicts of interest or other special circumstances, that it should not make a favorable recommendation, the basis for that decision;

(C) a statement of any condition of its submission of the plan of conversion to the participants; and

(D) notice of the meeting at which the proposed plan of conversion will be considered in the same manner as a special participants' meeting;

(3) subject to Sections 411, 414 and 1504, a plan of conversion of an association must be approved by at least a two-thirds vote of all participants voting at the meeting and at least one-half of the affirmative votes cast must be cast by patron participants; and

(4) if as a result of the conversion any participant of the association has personal liability, consent in a record of that participant must be delivered to the association prior to

delivery of articles of conversion for filing pursuant to Section 1505.

(b) Subject to Section 1503(a)(4) and any contractual rights, after a conversion is approved, and at any time before a filing is made under Section 1505, a converting cooperative association may amend the plan or abandon the planned conversion:

(1) as provided in the plan; and

(2) except as prohibited by the plan, by the same consent as required to approve the plan.

(c) Participants may vote on a proposed plan of conversion of a cooperative association as provided in Section 415.

Reporters' Note

The special "consent" by those being burdened by personal liability is drafted differently in ULPA (2001). It is pulled out into a separate section (§1110) and that section makes clear that the special consent provisions trump any general provisions in the organic rules regarding their amendment. The Committee should discuss this matter.

SECTION 1504. VOTING BY GROUP, CLASS, OR DISTRICT PARTICIPANTS.

(a) A group, class, or district of participants must vote as a separate group, class, or district if the plan effects the participants of the group, class, or district:

(1) the capital structure of the cooperative association, including the relative rights, preferences, and restrictions granted or imposed upon any group or class of participants, and the rights of the association's participants to share in the profits, surplus, or distributions;

(2) the terms for admission of new participants;

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

(4) the transferability of participants' interests; or

(5) the manner or method of allocation of profits and losses among participants;

(b) Unless otherwise provided in the organic rules, if a proposed amendment to the organic rules of a cooperative association affects more than one group, class, or district of participants in the same or a substantially similar way, the participants of those groups, classes, or districts shall vote on the proposed plan of conversion as a single group.

(c) A group, class, or district of participants in a cooperative association has the rights provided in this section even if those participants are not otherwise entitled to vote under the organic rules.

SECTION 1505. FILINGS REQUIRED FOR CONVERSION; EFFECTIVE DATE.

(a) After a plan of conversion is approved:

(1) a converting cooperative association shall deliver to the [Secretary of State] for filing articles of conversion, which must include:

(A) a statement that the association has been converted into another organization;

(B) the name and form of the converted organization and the jurisdiction of its governing statute;

(C) the date the conversion is effective under the governing statute of the converted organization;

(D) a statement that the conversion was approved as required by this [act];

(E) a statement that the conversion was approved as required by the governing statute of the converted organization; and

(F) if the converted organization is a foreign organization not authorized to transact business in this state, the street and mailing address of an office which the [Secretary of State] may use for the purposes of Section 1506(c); and

(2) if the converting organization is not a converting cooperative association, the converting organization shall deliver to the [Secretary of State] for filing articles of organization, which must include, in addition to the information required by Section 302:

(A) a statement that the association was converted from another organization;

(B) the name and form of the converting organization and the jurisdiction of its governing statute; and

(C) a statement that the conversion was approved in a manner that complied with the converting organization's governing statute.

(b) A conversion becomes effective:

(1) if the converted organization is a cooperative association, when the articles of conversion take effect; or

(2) if the converted organization is not a cooperative association, as provided by the governing statute of the converted organization.

Reporters' Note

Source: ULPA (2001) §1104.

SECTION 1506. EFFECT OF CONVERSION.

(a) An organization that has been converted pursuant to this [article] is for all purposes

the same entity that existed before the conversion.

(b) When a conversion takes effect:

(1) all property owned by the converting organization remains vested in the converted organization;

(2) all debts, liabilities, and other obligations of the converting organization continue as obligations of the converted organization;

(3) an action or proceeding pending by or against the converting organization may be continued as if the conversion had not occurred;

(4) except as prohibited by other law, all of the rights, privileges, immunities, powers, and purposes of the converting organization remain vested in the converted organization;

(5) except as otherwise provided in the plan of conversion, the terms and conditions of the plan of conversion take effect; and

(6) except as otherwise agreed, the conversion does not dissolve a converting cooperative association for the purposes of [Article] 11.

(c) A converted organization that is a foreign organization consents to the jurisdiction of the courts of this state to enforce any obligation owed by the converting cooperative association if before the conversion the converting cooperative association was subject to suit in this state on the obligation. A converted organization that is a foreign organization and not authorized to transact business in this state appoints the [Secretary of State] as its agent for service of process for purposes of enforcing an obligation under this subsection. Service on the [Secretary of State] under this subsection is made in the same manner and with the same consequences as in Section 119(c) and (d).

(d) This [act] does not authorize an act prohibited by, and does not affect the application or requirements of, law other than this [act].

Reporters' Note

Source: ULPA (2001) § 1105. Subsection (d) is from META § 103(b).

At the February 2006 Committee meeting, questions were raised about the wording of subsection (a), especially the phrase "for all purposes the same entity that existed before the conversion." This language is consistent with other NCCUSL products. META, however, approaches the effect of a conversion in a different way that is reproduced here as an alternative approach to this Section for the Committee's consideration.

SECTION 406. EFFECT OF CONVERSION.
(a) When a conversion becomes effective:
(1) the converted entity is:
(A) organized under and subject to the organic law of the converted entity; and
(B) the same entity without interruption as the converting entity;
(2) all property of the converting entity continues to be vested in the entity without assignment, reversion, or impairment;
(3) all liabilities of the converting entity continue as liabilities of the entity;
(4) except as provided by law other than this [Act] or the plan of conversion, all of the rights, privileges, immunities, powers, and purposes of the converting entity remain in the converted entity;
(5) the name of the converted entity may be substituted for the name of the converting entity in any pending action or proceeding;
(6) unless otherwise provided by the organic law of the converting entity, the conversion does not cause the dissolution of the converting entity;
(7) if a converted entity is a filing entity, its public organic document is effective and is binding on its interest holders;
(8) if the converted entity is a limited liability partnership, its [statement of qualification] is effective simultaneously;
(9) the private organic rules of the converted entity that are to be in a record, if any, approved as part of the plan of conversion are effective and are binding on its interest holders; and
(10) the interests in the converting entity are converted, and the interest holders of the converting entity are entitled only to the rights provided to them under the plan of conversion [and to any appraisal

rights they have under Section 109].

(b) Except as otherwise provided in the organic law or organic rules of the converting entity, the conversion does not give rise to any rights that an interest holder, governor, or third party would otherwise have upon a dissolution, liquidation, or winding-up of the converting entity.

(c) When a conversion becomes effective, a person that did not have interest holder liability with respect to the converting entity and that becomes subject to interest holder liability with respect to a domestic entity as a result of a conversion has interest holder liability only to the extent provided by the organic law of the entity and only for those liabilities that arise after the conversion becomes effective.

(d) When a conversion becomes effective:

(1) the conversion does not discharge any interest holder liability under the organic law of a domestic converting entity to the extent the interest holder liability arose before the conversion became effective;

(2) a person does not have interest holder liability under the organic law of a domestic converting entity for any liability that arises after the conversion becomes effective;

(3) the organic law of a domestic converting entity continues to apply to the release, collection or discharge of any interest holder liability preserved under paragraph (1) as if the conversion had not occurred; and

(4) a person has whatever rights of contribution from any other person as are provided by the organic law or organic rules of domestic converting entity with respect to any interest holder liability preserved under paragraph (1) as if the conversion had not occurred.

(e) When a conversion becomes effective, a foreign entity that is the converted entity:

(1) may be served with process in this state for the collection and enforcement of any of its liabilities; and

(2) appoints the [Secretary of State] as its agent for service of process for collecting or enforcing those liabilities.

(f) If the converting entity is a qualified foreign entity, the certificate of authority or other foreign qualification of the converting entity is canceled when the conversion becomes effective.

SECTION 1507. MERGER.

(a) One or more cooperative associations may merge with one or more other organizations pursuant to this [article] and a plan of merger if:

(1) the governing statute of each of the other organizations authorizes the merger;

(2) the merger is not prohibited by the law of a jurisdiction that enacted any of those governing statutes; and

(3) each of the other organizations complies with its governing statute in effecting the merger.

(b) A plan of merger must be in a record and must include:

(1) the name and form of each constituent organization;

(2) the name and form of the surviving organization and, if the surviving organization is to be created by the merger, a statement to that effect;

(3) the terms and conditions of the merger, including the manner and basis for converting the interests in each constituent organization into any combination of money, interests in the surviving organization, and other consideration;

(4) if the surviving organization is to be created by the merger, the surviving organization's organizational documents;

(5) if the surviving organization is not to be created by the merger, any amendments to be made by the merger to the surviving organization's organizational documents; and

(6) if a participant of a constituent cooperative association will have personal liability with respect to a surviving organization, the identity of the participant by descriptive class or other reasonable manner.

SECTION 1508. NOTICE AND ACTION ON PLAN OF MERGER BY CONSTITUENT COOPERATIVE ASSOCIATION.

(a) A plan of merger must be approved by a majority vote of the board of directors of a cooperative association or a greater percentage if required by the association's organic rules.

(b) The board of directors must call a special meeting of participants to consider the plan of conversion to be held within ninety days following approval of the proposed plan by the board and must mail or otherwise transmit or deliver in a record to each participant:

(1) the plan of merger;

(2) a recommendation that the participants approve the plan of merger, or if the board determines, because of conflicts of interest or other special circumstances that it should not make a favorable recommendation, the basis for that decision;

(3) a statement of any condition of its submission of the plan of merger to the participants; and

(4) notice of the meeting at which the plan of merger will be considered in the same manner as special participants' meeting.

SECTION 1509. APPROVAL AND ABANDONMENT OF MERGER BY PARTICIPANTS OF CONSTITUENT COOPERATIVE ASSOCIATION.

(a) Subject to Sections 411 and 413, an amendment to a plan of merger of a cooperative association must be approved by at least a two-thirds vote of all participants voting at the meeting and at least one-half of the affirmative votes must be cast by patron participants. If as a result of the merger any participant of the association has personal liability as a result of the merger, consent in a record of that participant must be delivered to the association prior to

delivery of articles of merger for filing pursuant to Section 1510.

(b) Subject to any contractual rights, after a merger is approved, and at any time before articles of merger are delivered for filing pursuant Section 1510, a constituent cooperative association that is a party to the merger may amend the plan of merger or abandon the planned merger:

(1) as provided in the plan; and

(2) except as prohibited by the plan, with the same consent as was required to approve the plan.

(c) Participants may vote on a proposed merger of a cooperative association as provided in Section 415.

Reporters' Note

Is "filing" the appropriate measuring date in subsection (b)?

This Section does not permit a cooperative association to vary the voting requirements in its organic rules. It provides the same approach to voting as in the sections dealing with amendments to its organic rules, conversions and sales of assets. Some cooperatives desire to reduce the member voting requirement to make mergers easier. Non-profit corporate statutes tend to permit any voting requirement the corporation desires. Partnership statutes generally require unanimous approval. If the merger provisions permit a lower voting requirement than is required for amending articles of organization, a cooperative association could avoid the higher requirements for amendments by creating a new company with the desired amendment provisions in its governing documents and merging the association into the new company. The Committee should consider the possible ramifications of the possible different approaches.

This draft does not permit voting by districts, classes or other groups as is provided for other actions. Should it do so?

[Prior Section 1509 entitled Merger of Subsidiary has been deleted at the direction of the Committee. This Section provided for the "short form" merger of a wholly owned subsidiary into a parent.]

SECTION 1510. FILINGS REQUIRED FOR MERGER; EFFECTIVE DATE.

(a) After each constituent organization has approved a merger, articles of merger must be signed on behalf of each constituent organization, by an authorized representative.

(b) The articles of merger must include:

(1) the name and form of each constituent organization and the jurisdiction of its governing statute;

(2) the name and form of the surviving organization, the jurisdiction of its governing statute, and, if the surviving organization is created by the merger, a statement to that effect;

(3) the date the merger is effective under the governing statute of the surviving organization;

(4) if the surviving organization is to be created by the merger:

(A) if it will be a cooperative association, the association's articles of organization; or

(B) if it will be an organization other than a cooperative association, the organizational document that creates the organization;

(5) if the surviving organization preexists the merger, any amendments provided for in the plan of merger for the organizational document that created the organization;

(6) a statement as to each constituent organization that the merger was approved as required by the organization's governing statute;

(7) if the surviving organization is a foreign organization not authorized to transact business in this state, the street and mailing addresses of an office which the [Secretary

of State] may use for the purposes of Section [service of process]; and

(8) any additional information required by the governing statute of any constituent organization.

(c) Each constituent cooperative association shall deliver the articles of merger for filing in the [office of the Secretary of State].

(d) A merger becomes effective under this [article]:

(1) if the surviving organization is a cooperative association, upon the later of:

(A) compliance with subsection (c); or

(B) subject to Section [203(c)], as specified in the articles of merger; or

(2) if the surviving organization is not a cooperative association, as provided by the governing statute of the surviving organization.

SECTION 1511. EFFECT OF MERGER.

(a) When a merger becomes effective:

(1) the surviving organization continues or comes into existence;

(2) each constituent organization that merges into the surviving organization ceases to exist as a separate entity;

(3) all property owned by each constituent organization that ceases to exist vests in the surviving organization;

(4) all debts, liabilities, and other obligations of each constituent organization that ceases to exist continue as obligations of the surviving organization;

(5) an action or proceeding pending by or against any constituent organization that ceases to exist may be continued as if the merger had not occurred;

(6) except as prohibited by other law, all rights, privileges, immunities, powers, and purposes of each constituent organization that ceases to exist vest in the surviving organization;

(7) except as otherwise provided in the plan of merger, the terms and conditions of the plan take effect;

(8) except as otherwise provided in the plan of merger, if a constituent cooperative association ceases to exist, the merger does not dissolve the cooperative association for purposes of [Article] 11;

(9) if the surviving organization is created by the merger:

(A) if it is a cooperative association, the articles of organization become effective; or

(B) if it is an organization other than a cooperative association, the organizational document that creates the organization becomes effective; and

(10) if the surviving organization exists before the merger, any amendments provided for in the articles of merger for the organizational document that created the organization become effective.

Reporters' Note

Source: ULPA (2001). The plan will by necessity address the pre-merger terms of the directors and board officers.

SECTION 1512. CONSOLIDATION.

(a) One or more cooperative associations may agree to substitute the word "consolidation" for the term "merger" under this [article] if:

(1) each organization is a cooperative association or the governing statute of the constituent organization expressly provides for consolidation; and

(2) the surviving organization is a cooperative association or the governing statute of the surviving organization expressly provides for consolidation.

(b) All provisions governing mergers or using the term merger in this [act] apply equally to mergers that the constituent organizations choose to name consolidations under subsection (a).

Reporters' Note

This is the Reporter's second attempt to draft "consolidations" into the draft at the direction of the Committee. The first attempt simply defined "consolidation" in Section 1501. Unfortunately that attempt was, at best, confusing. This attempt still stops short of segregating and repeating all of the sections governing merger.

One reason to avoid the repetition is length.

The most important reason, however, is to avoid creating inconsistencies between this act and the overwhelming majority of both corporate and unincorporated statutes which no longer distinguish between "mergers" and "consolidations" and which use the term "mergers" to encompass all combinations. This is more than a mere drafting issue because: (a) if "consolidation" is not deemed to be a merger under this act many constituent organizations will be unable to combine in the precise form of "consolidation" as provided herein because the statutory authorization in their statute will not authorize it; and (b) it is assumed many secretaries of state will having filing issues for articles of consolidation if the constituents or survivor is anything but a cooperative association formed under this act or the other law expressly provides for a filing with a "consolidation" caption.

For the foregoing reasons, this Section requires all organizations involved in a "consolidation" to be cooperative association have express authority to use the term "consolidation" under their governing law. It should be reported that there was a question generally consistent with this note from the floor of the 2005 Annual Meeting asserting the draft used archaic language.

The Reporters intend to present an alternative approach for consideration by the Committee at its Fall 2006 meeting.

[Prior Section 1513 entitled Method of Voting has been relocated to subsection 1509(c) at the direction of the Committee.]

SECTION 1513. [ARTICLE] NOT EXCLUSIVE. This [article] does not preclude a cooperative association from being converted, consolidated, or merged under law other than this [act].

Reporters' Note

Drafts prior to the February 2006 draft did not provide for conversions. They are not included. The merger portions of this Article are based on the merger provisions found in Article 11, ULPA (2001). It may be important to discuss the conversion processes here 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.

[ARTICLE] 16

DISPOSITION OF ASSETS

SECTION 1601. DISPOSITION OF ASSETS NOT REQUIRING PARTICIPANT APPROVAL.

Unless the articles of organization provide otherwise, if conducted in the usual and regular course of business of a cooperative association, no participant approval under Section 1602 is required for the association to:

(1) sell, lease, exchange, license, or otherwise dispose of all or any part of the assets of the association; or

(2) mortgage, pledge, dedicate to the repayment of indebtedness, or encumber in any way all or any part of the assets of the association.

Reporters' Note

This Section is new to the February 2006 draft and is similar to the MBCA formulation except the term "ordinary" has replaced "usual and regular" to conform to the language used in other conference products. The Model Business Corporation Act contains two additional subsections which were not included in the text of this draft. They are:

> (3) to transfer any or all of the corporation's assets to one or more corporations or other entities all of the shares or interests which are owned by the corporation; or
> (4) to distribute assets pro rata to the holders of one or more classes or series of the corporation's shares.

Subsection (3) of the MBCA allows the transfer of all the assets to wholly owned subsidiaries. The Comments for subsection (4) state that it applies to traditional spin-offs but not split-offs ("non pro rata distribution of shares of a sub to some or all shareholders in exchange for some of their shares") or split-ups (which would be governed by the dissolution provisions rather than the disposition section.

SECTION 1602. PARTICIPANT APPROVAL OF OTHER DISPOSITION OF ASSETS. Subject to Section 1601, a sale, lease, exchange, license, or other disposition of assets requires approval of the cooperative association's participants under Sections 1603 through 1605 if the disposition leaves the association without significant continuing business activity.

Reporters' Note

Source: MBCA Section 12.02.

The MBCA provides greater textual detail as follows:

> If a corporation retains a business activity that represented at least 25 percent of total assets at the end of the most recently completed fiscal year, and 25 percent of either income from continuing operations before taxes or revenues from continuing operations for that fiscal year, in each case of the corporation and its subsidiaries on a consolidated basis, the corporation will conclusively be deemed to have retained a significant continuing business activity.

Another alternative is to replace Sections 1601 and 1602 with language similar to older corporate statutes, something like:

> The sale, lease, exchange, mortgage, pledge, dedication of indebtedness or other encumbrance of substantially all of the assets of the cooperative association not in the ordinary course of business must be approved by the participants under Sections _____ through _____.

SECTION 1603. NOTICE AND ACTION ON DISPOSITION OF ASSETS. In order for a cooperative association to dispose of assets under Section 1602:

(1) a majority of the board of directors of the association, or a greater percentage, if required by the association's organic rules, must approve the proposed disposition;

(2) the board of directors must call a special meeting of participants to consider the proposed disposition to be held within ninety days following approval of the proposed

disposition by the board and must mail or otherwise transmit or deliver in a record to each participant:

(A) the terms of the proposed disposition;

(B) a recommendation that the participants approve the disposition, or if the board determines, because of conflict of interest or other special circumstances, that it should not make a favorable recommendation, the basis for that decision;

(C) a statement of any condition of its submission of the proposed disposition to the participants; and,

(D) give notice of the meeting at which the proposed disposition will be considered in the same manner as a special participants' meeting.

Reporters' Note

This Section is consistent with the provisions governing amendment of the organic rules.

Should the next draft provide that the vote shall take place at a special participant meeting?

SECTION 1604. METHOD OF VOTING. Participants may vote on a proposed disposition of assets as provided in Section 415.

SECTION 1605. ACTION ON DISPOSITION OF ASSETS. The proposed disposition of assets must be consented to by at least a two-thirds vote of all participants voting at the meeting, and at least one-half of the affirmative votes must be cast by patron participants.

Reporters' Note

This is substantively consistent with mergers, consolidations, and conversions though in a slightly different format. *See, e.g.,* Section 1503(a). Note that it does not include any of the abandonment machinery that is included in Article 15. *See, e.g.,* Section 1503(b).

[ARTICLE] 17

MISCELLANEOUS PROVISIONS

SECTION 1701. EXEMPTION FROM SECURITIES LAWS.

(a) In addition to any other exemptions that may be applicable to the offer or sale of participant interests in a cooperative association, patron participant interests offered or sold by an association are exempt from the securities laws of this state to the extent membership interests or shares of stock qualifying a person to be a member of other types that are offered or sold by cooperatives are exempt under [citation to the provision applicable to other existing forms of cooperatives].

(b) This [Act] may not be construed to cause a participant interest in a cooperative association to be a security if it would not be a security under the securities laws of this state.

Reporters' Note

The language of the statutes vary greatly by state. Many state laws contain exemptions from securities regulation either in the law governing cooperatives or in their securities acts. To avoid the necessity of each state renegotiating both the policy and nonuniform statutory language during the adoption of this Act this draft simply applies those existing exemptions by reference. *See generally*, Reporters' Note to Section 909 of this draft.

The language has been modified from prior drafts in response to concerns expressed on the floor at the 2005 annual meeting that the former language could have broader implications than intended.

The Uniform Securities Act (2002) contains a limited exemption at USA § 201(8). It is limited to "nonprofit membership cooperatives" and, even there, does *not* apply to "a member's or owner's interest, retention certificate, or like security sold to persons other than bona fide members of the cooperative." Comment 8 to Section 201 states:

> "The 1956 Act... had instead provided: 'insert any desired exemption for cooperatives'. The Reporter for the 1956 Act had

> found such sharp variation among the 18 states that then had adopted a cooperative exemption that 'no common pattern can be found.' Louis Loss, Commentary on the Uniform Securities Act 118 (1976).

The Committee suggests it unlikely to achieve further uniformity than that proposed by the USA (2002) and that states have already made policy decisions that are unlikely to change based upon anything stated in this limited purpose unincorporated cooperative act. A strong legislative not should be drafted.

An ambiguity under the USA is created by this draft: An investor participant's "bona fide" members? It seems that is a matter more appropriately addressed by securities law (other than co-op association law).

SECTION 1702. EXEMPTION FROM RESTRAINT OF TRADE AND ANTITRUST LAWS. A cooperative association has the same immunities, rights, and privileges provided cooperatives formed under [other law of this state], is governed by [citation to the applicable restraint of trade and antitrust provisions], and is exempt from [those laws] to the extent, but only to the extent, cooperatives organized under [other law of this state] are exempt.

Reporters' Note

It is most certainly *not* the intent of this Section to expand any such exemptions beyond the purposes provided in those other laws. The addition is intended to clarify that, but more consideration may need to be given to the wording as was suggested from the floor at the 2005 annual meeting. See the last paragraph of this Note. A question of both interpretation and policy is raised, however, by a slippery-slope hypothetical. Assume the referenced statute states "controlled by agricultural producers" versus "exclusively owned and controlled by agricultural producers."

In any event, these sections will require a strong legislative note. One of the issues that needs to be addressed by the legislative note is how to conform the provision to apply to this Act if it is not completely self-executing. *E.g.*, if it simply states that "cooperatives complying with...".

[This Article has been renumbered from 18 to 17. Prior Section 1803 entitled Inducing

Breach of Marketing or Purchase Contracts has been relocated to Section 605 at the direction of the Committee.]

SECTION 1703. 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 1704. 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. [as amended], but this [act] does not modify, limit, or supersede Section 101(c) of that act (15 U.S.C. Section 7001(c) as amended) or authorize electronic delivery of any of the notices described in Section 103(b) of that act (15 U.S.C. Section 7003(b) as amended).

SECTION 1705. EFFECTIVE DATE. This [act] takes effect [effective date].

SECTION 1706. SAVINGS CLAUSE. This [act] does not affect an action or proceeding commenced, or right accrued before [this [act] takes effect].