UNIFORM LIMITED COOPERATIVE ASSOCIATION ACT (2007)

(Last Amended 2013)

Drafted by the

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ON UNIFORM STATE LAWS

and by it

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WITH PREFATORY NOTE AND COMMENTS

August 19, 2015

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UNIFORM LIMITED COOPERATIVE ASSOCIATION ACT (2007)
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PREFATORY NOTE TO 2007 ACT

Introduction to ULCAA

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

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

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

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

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

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

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

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

Cooperative Principles

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

> Instead of a direct approach as to whether a particular rule, in the light of the reason for the rule, should be applied to cooperatives, courts in the past tended to create the preliminary hurdle of determining whether cooperatives are to be treated as corporations, partnerships, or other joint ventures. [He later discussed *Moore v. Hillsdale County Tel. Co.*, 137 N.W. 241 (Mich. 1912)

> (categorizing an unincorporated telephone cooperative as a joint venture).]
>
> The uselessness of such an analysis becomes even more apparent when it leads to a statement that cooperatives "are somewhat of a hybrid, partaking both of the nature of a corporation and a partnership" [*citing Philadelphia School Dist. v. Frankford Grocery Co.*, 103 A.2d 738 (Penn. 1954)].

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

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

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

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

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

The Rochdale Society of Equitable Pioneers, Ltd., however, is recognized as having "singular impact" on the cooperative movement. *Id.* at 109. It was a consumer cooperative

formed in Rochdale, England, in 1844. The "Rochdale Principles" grew out of the experience of the Rochdale Society and probably "evolved from 'rules of conduct and points of organization'" published by the Society in 1860. The number of "Rochdale Principles" varies depending on source probably "because the rules enumerated by the Rochdale Society continued to evolve from its founding... up to its publication in 1860 and thereafter." DAVID BARTON, PRINCIPLES IN COOPERATIVES IN AGRICULTURES p. 22 (1989).

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

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

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

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

Justice Brandeis further stated:

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

Id.

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

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

One of the fulcrums in this act regarding cooperative values is Section 103 ("Nature of Limited Cooperative Association"). It addresses the values of member economic participation, autonomy, and independence. Autonomy, however, must be placed within the practical context of long-term debt, equity, and the use of combination entities. Voluntary membership remains voluntary in the sense that this act requires the "consent" of both the person seeking to become a member and the association. *See* Section 109(a). Open membership has been compromised under existing law establishing entities similar to limited cooperative associations and remains so in ULCAA to allow (but not require) the formation of "closed" cooperatives. Closed cooperative structure assists patron members to share the increased value of the entity they helped build and provides member liquidity.

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

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

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

Selected Features

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

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

Structure and Interpretation of ULCAA

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

Sections 106 ("Governing Law"), 114 ("Supplemental Principles of Law") and 109 ("Effect of Organic Rules") relate to the application and interpretation of the act. The first two sections are common with other uniform acts.

Section 109 underpins the contractual unincorporated nature of ULCAA. In the first instance the fluidness (or ambiguity) caused by the strong influence of contract law on the organic rules may seem troublesome. This fluidness, however, is generally consistent with member based entities and is fundamental to unincorporated entities. Indeed, whatever ambiguity exists concerning the boundary of the interpretation of the organic rules and contract in ULCAA should provide no more practical consternation than does the definition of "operating agreement" in ULLCA (2006) which states, in relevant part, that "operating agreement":

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

ULLCA (2006) § 102 (13).

By way of overview Section 109(a) provides that the organic rules govern relationships internal to the association. The balance of Section 109 performs two functions. The first function is that it indirectly establishes the interpretive primacy of the organic rules both within Section 113(a) and other sections elsewhere in the act that restrict, limit, qualify, or emphasize that primacy. Subsections (b) and (c) identify sections which limit the flexibility of the organic rules. Subsection (b) identifies provisions by section number that may be modified only in the articles of organization. Subsection (c), like subsection (b), identifies provisions by section number in which limitations exist; but, which may be modified in either the articles of organization or bylaws within those limitations. Thus, subsections (b) and (c) provide the necessary background rule for those sections that expressly limit the broad flexibility recognized in subsection (a). In addition to providing this negative definition to subsection (a), subsections (b) through (d) provide practical guidance for those drafting organic rules similar to the way provisions in ULLCA (2006), ULPA (2001), UPA (1997) and MBCA provide the same guidance.

On the other hand, many provisions that would clearly be interpreted as "flexible" under the application of the general rule of Section 109(a) contain an express statement that the organic rules may "otherwise provide." When used in this manner the quoted phrase is for emphasis and for the convenience of those using the act, for example, opinion givers. The use of the phrase should not be interpreted as a negative implication about the flexibility of provisions that govern the internal affairs of the association but which do not contain the phrase. Nonetheless, like other organizational acts, this act contains administrative provisions. For example, Section 111

("Name") deals with the name of a limited cooperative association. Also, similar to other acts, these administrative provisions are mandatory even though they do not expressly so state.

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

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

Organic Rules

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

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

Certain items must be contained in the articles of organization; some may be in the articles or bylaws. There is no penalty or adverse consequence under the act if a limited cooperative association does not adopt bylaws even though the act could be interpreted as requiring bylaws.

See Comment to Section 303 ("Bylaws").

Investor Members

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

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

Voting Control

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

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

A strong measure of control is vested in patron members by the provisions addressing election and composition of the board of directors. The act requires that a specified number of directors be patron members relative to the size of the board. For example, if the board has nine or more members at least one-third of the members must be patron members. Further, and at least as important as the number of patron members on the board, a majority of the board of directors must be *elected* by patron members. *See* Section 804. Patron member "control" provided by the election of a majority of directors is leveraged by the default rule that directors may be removed without cause. *See* Section 807. ULCAA (2006), however, allows more flexibility than in other law for the election of independent directors whose use is becoming more popular in traditional

cooperatives. In summary, the director election provisions assure patron members have a significant place at the board table and "control" over the composition of the board while at the same time providing investor members the minimum electoral voice believed necessary as a matter of policy to encourage their equity investment.

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

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

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

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

See Comment to Section 405.

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

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

Board of Directors: "Fiduciary" Duty

The application of corporate based concepts such as the business judgment rule is controversial within unincorporated entities. *See* Elizabeth S. Miller and Thomas E. Rutledge,

The Duty of Finest Loyalty and Reasonable Decisions: The Business Judgment Rule in Unincorporated Business Organizations? 30 DEL. J. CORP. L. 343 (2005). There is no necessity for this act to fuel or even enter this policy debate because the limited cooperative association, though intended to be an unincorporated association, also draws upon the long tradition and customary law applicable to cooperatives which for the past five decades has borrowed duties and standards from business and not-for-profit corporation law to identify the appropriate duties and measuring standards for its non-agent directors. These sources provide the context and flexibility necessary for judicial review in the broad range of entities that may be formed as limited cooperative associations under this act.

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

This act, however, contains an important modification concerning the matters that may be appropriately considered by the board of directors. Unless the articles of organization otherwise provide, directors may consider other constituencies, the community, and cooperative principles and values, without breaching their duties. *See* Section 820 ("Other Considerations of Directors"). It is only a default rule, but this modification is intended to reflect the traditional notion that cooperatives serve interests beyond narrowly defined constituencies. It provides a touch stone to the concern for public good as historically reflected by special treatment afforded cooperatives under some regulatory statutes and, more generally, helps explain the influence of not-for-profit law on traditional cooperatives.

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

Formation of a Limited Cooperative Association

The formation of a limited cooperative association is more formal than some other unincorporated associations though it shares with other statutes the requirement of a public filing. The required filing under this act is the articles of organization. *See* Section 301 ("Formation of Limited Cooperative Association; Articles of Organization").

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

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

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

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

Financial Rights

A member's interest in a limited cooperative association consists of three clearly delineated rights: (1) governance rights; (2) financial rights; and, (3) the right or obligation, if any, to do business with the association. *See* Section 601. Of the three rights only financial rights are transferable as a matter of default under the act. Financial rights serve the same function as "transferable interests" under other unincorporated law. *See, e.g.*, ULPA (2001) Art. 7. As a result of this functional equivalency, ULCAA addresses the same issues concerning financial rights as other unincorporated law addresses under the rubric of "transferable interests." *See, e.g.*, Section 605 ("Charging Orders for Judgment Creditor of Member or Transferee").

ULCAA, unlike unincorporated acts since the original UPA (1914), delineates and identifies non-transferable rights. The identification is a practical necessity because patron members in a cooperative also use the cooperative. That is, cooperative organizations *contract* with their patron members for the purchase or sale of goods or services and this contract may be the primary reason a patron member becomes a member. Under other unincorporated law such contracts are analyzed either as third party contracts or, conceivable as subsumed under the concept of "transferable interest." This act must address these contracts apart from financial rights because of the central role they play in cooperatives.

Allocations and Distributions

The general trend among statutes governing unincorporated entities is to address distributions but to allow allocation of profits and losses to follow the agreement between the owners subject to the law of taxation and generally accepted accounting principles. State statutes relating to the formation and operation of traditional cooperatives have taken a minimalist

approach to this matter focusing on the identity of those owning equity capital and by limiting return and voting rights for "non-patron" owners consistent with federal regulatory law. Illustratively, some traditional state cooperative statutes simply require cooperatives to operate in accordance with a "cooperative plan" without much further statutory definition or delineation.

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

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

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

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

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

Marketing Contracts

A key feature of some types of traditional cooperatives is the right or obligation of a

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

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

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

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

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

Interrelationship with Other Law

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

Four other sections, however, directly address the relationship between ULCAA and specific provisions of other law because those provisions are included, at least in some states, within traditional cooperative statutes. These four sections (or portions of sections) are bracketed

in the text of the act meaning an adopting jurisdiction needs to be aware of the law governing traditional cooperatives in that jurisdiction.

One of these sections, Section 115(b), provides that the required use of the word "cooperative" within the context of "limited cooperative association" does not violate a specific law restricting the use of the word "cooperative" found in the traditional cooperative statutes of many states. This provision, like the rest of the provisions discussed here, should be adopted only by jurisdictions whose other law contains such a restriction. Another section that addresses the relationship of entities formed under this act with other law involves exemptions to state restraint of trade and antitrust law for "cooperatives". *See* Section 108 ("Relation of Trade and Antitrust Laws").

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

A final section expressly addresses other law, but it is different in kind and approach from the sections previously discussed. It provides detail about the coordination between security interests in members' interests under ULCAA and the Uniform Commercial Code. *See* Section 604 ("Security Interest and Setoff").

PREFATORY NOTE TO THE 2011 AND 2013 AMENDMENTS

From 2009 to 2013, the Uniform Law Conference undertook an intensive effort to harmonize, to the extent possible, all uniform acts pertaining to unincorporated organizations. As part of that effort, ULCAA underwent three types of changes: substantive; major improvements in language for the sake of harmonization; and relocation within this particular "spoke" of provisions that are part of the "HUB" in the new Uniform Business Organizations Code. Amendments to ULCAA as part of the Harmonization project were adopted in 2011 and some additional harmonization amendments were adopted in 2013.

Substantive Changes

The most significant substantive changes are:

Changing the definition of "foreign cooperative" in Section 102(10) to make it clear that only foreign cooperatives that are organized under a limited cooperative association statute similar to this act can register to do business in this state under this act.

Adding a new subsection to Section 1007 excluding reasonable compensation and retirement and other benefits from being considered as part of a distribution to members of a limited cooperative association.

Authorizing a limited cooperative association (LCA) to advance expenses as well as indemnify an individual who is a party or is threatened to be made a party to litigation because of the performance of duties on behalf of the cooperative. See Section 901(a).

Adding a new Section 1301 outlining the conditions under which a member of a LCA may bring a direct action (as opposed to a derivative action) against a limited cooperative association.

Authorizing a special litigation committee in derivative actions in new Section 1306.

Adding a new Section 1207 setting out the requirements for rescinding the dissolution of a limited cooperative association.

Expanding Article 16 to include the ability of a LCA to participate in interest exchange and domestication transactions as well as mergers and conversions. See also Section 518, which consolidates the approval requirements for all Article 16 transactions into one section.

Adding a new subsection (f) to Section 605 authorizing a court to foreclose a charging order against a single member limited cooperative association and the purchaser at the foreclosure sale not only obtains the member's financial rights but also the member's entire interest in the cooperative.

Harmonization-Based Language Changes

Changes in language for the sake of harmonization appear throughout the act. For example, Section 407(a) is revised as follows:

> (b) To amend its articles of organization, a limited cooperative association must deliver to the [Secretary of State] for filing an amendment … stating:
>
> (1) the name of the association;
>
> (2) the date of filing of the association's initial articles of organization; and
>
> (3) ~~the changes~~ the text of the amendment ~~makes to the certificate as most recently amended or restated~~.

Relocation and Renumbering of HUB-Based Provisions

The Harmonization project included both the harmonization of various stand-alone acts and the compilation of a Uniform Business Code. The Code comprises a "HUB" (somewhat analogous to Article 1 of the Uniform Commercial) and various spokes. Each spoke pertains to a different type of organization (e.g., limited liability company, statutory trust entity). Naturally, spokes in the Code do not repeat the provisions from the HUB. In contrast, each stand-alone act includes provisions that appear in the HUB in the Code.

So that the section numbers this "spoke", which is Article 6 of the Code, correspond with the spoke provisions in the Code, "HUB"-based provisions of this act have been renumbered to appear at the end of articles. *See, e.g.*, Sections 113 through 122 and 202-211, which deal

primarily with documents filed in the state's filing office and registered agents. Many of these sections were renumbered as part of the 2011 and 2013 amendments to make it easier to integrate this act into the Code.

If a state enacts this act and at a later time enacts the Code, this act should be repealed as of the effective date of the Code.

The Drafting Committee on Harmonization of Business Entity acts was greatly assisted in its work by the very substantial and knowledgeable contributions of the following Observers who diligently attended and actively participated in its meetings:

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EXPLANATORY NOTE ON THE REVISED COMMENTS

As part of the Harmonization project, the Conference substantially revised the comments to the Uniform Limited Cooperative Company Act.

To distinguish among the current and prior versions of uniform and model business organization acts, the Harmonization comments use the following references.

> The phrase "this act" refers to this Harmonized act – i.e., the Uniform Limited Cooperative Association Act as last amended in 2013.
>
> "ULLCA (2006) (Last Amended 2013) refers to the harmonized Uniform Limited Liability Company Act.
>
> "ULLCA (2006)" refers to the Revised Uniform Limited Liability Act.
>
> "ULLCA (1996)" refers to the original Uniform Limited Liability Company Act.
>
> "UPA (1997) (Last Amended 2013)" refers to the Uniform Partnership Act as harmonized.
>
> "UPA (1997)" refers to the version of the Uniform Partnership Act current before the Harmonization project.
>
> "UPA (1914)" refers to the original Uniform Partnership Act.

"ULPA (2001)" refers to the version of the Uniform Limited Partnership Act (2001) current before the Harmonization project.

"ULPA (2001) (Last Amended 2013)" refers to the 2001 version of Uniform Limited Partnership Act as harmonized.

"RULPA (1975/1986)" refers to the Revised Uniform Limited Partnership Act as adopted in 1976 and substantially revised in 1985.

"MBCA" refers to the Model Business Cooperation Act.

The entity formed under this act is a "limited cooperative association." It is frequently referred to in the comments by its acronym "LCA."

UNIFORM LIMITED COOPERATIVE ASSOCIATION ACT (2007)
(Last Amended 2013)

[ARTICLE] 1

GENERAL PROVISIONS

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

Comment

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

SECTION 102. DEFINITIONS. In this [act]:

(1) "Articles of organization" means the articles of organization of a limited cooperative association required by Section 301. The term includes the articles as amended or restated.

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

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

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

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

(6) "Director" means a director of a limited cooperative association.

(7) "Distribution," except as used in Section 1007(a), means a transfer of money or other property from a limited cooperative association to a member because of the member's financial

rights or to a transferee of a member's financial rights.

(8) "Entity" means a person other than an individual.

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

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

(11) "Governance rights" means the right to participate in governance of a limited cooperative association.

(12) "Investor member" means a member that has made a contribution to a limited cooperative association and

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

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

(13) "Jurisdiction", used to refer to a political entity, means the United States, a state, a foreign country, or a political subdivision of a foreign country.

(14) "Jurisdiction of formation" means the jurisdiction whose law governs the internal affairs of an entity.

(15) "Limited cooperative association" means an association formed under this [act] or that becomes subject to this [act] under [Article] 16.

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

dissociated as a member.

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

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

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

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

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

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

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

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

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

(24) "Person" means an individual, business corporation, nonprofit corporation, partnership, limited partnership, limited liability company, [general cooperative association,] limited cooperative association, unincorporated nonprofit association, statutory trust, business trust, common-law business trust, estate, trust, association, joint venture, public corporation,

government or governmental subdivision, agency, or instrumentality, or any other legal or commercial entity.

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

(26) “Property” means all property, whether real, personal, or mixed or tangible or intangible, or any right or interest therein.

(27) “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.

(28) “Registered agent” means an agent of an entity which is authorized to receive service of any process, notice, or demand required or permitted by law to be served on the entity.

(29) “Required information” means the information a limited cooperative association is required to maintain under Section 110.

(30) “Registered foreign cooperative” means a foreign cooperative that is registered to do business in this state pursuant to a statement of registration filed by the [Secretary of State].

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

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

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

(32) “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.

(33) “Transfer” includes:

(A) an assignment;

(B) a conveyance;

(C) a sale;

(D) a lease;

(E) an encumbrance, including a mortgage or security interest;

(F) a gift; and

(G) a transfer by operation of law.

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

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

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

Comment

This Section contains definitions for terms used throughout the act. Section 1601 contains definitions specific to provisions of [Article] 16 which authorizes mergers, interest exchanges, conversions, and domestications involving limited cooperative associations.

"Articles of organization" [(1)] – This act purposely uses the term "articles of organization" instead of "certificate of organization" or "articles of incorporation." The articles of organization may state substantive rules that together with the bylaws, govern the association and its members. For example, throughout this act there are references to "unless the organic rules otherwise provide." Persons forming an association under this act may find it advisable in some circumstances to place provisions varying the default rules under the act in articles of organization. Therefore, the articles of organization filed under this act may be more detailed in practice than a certificate of organization of a limited liability company filed under ULLCA (2006) (Last Amended 2013). Items required to be placed in the articles are listed in Section 301. In addition, other sections of this act require items to be included in the articles of organization to be effective. *See* Section 109(b). Because an association under this act is not an incorporated entity, it would be inappropriate to call the "articles" articles of incorporation. Articles of organization are included in the definition of "organic rules." *See also* Prefatory Note to 2007 Act

("Organic Rules").

"Bylaws" [(3)] – This definition must be read in conjunction with Section 303 of the act and the various provisions permitting default rules to be varied by the organic rules. The definition is very broad when examined in light of Section 303(b) that permits the bylaws to contain any provision for managing and regulating the affairs of the association, unless prohibited by the act or the articles of organization.

Section 303(a) states bylaws must be in a record.

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

"Contribution" [(4)] – This definition helps to distinguish capital contributions from other benefits which a member or other person provides to a limited cooperative association in a different capacity under Section 111. For example, if an individual provides services to the association in exchange for a membership in the association, the value of the services are a capital contribution. If the association hires the individual as an employee, the value of the services rendered to the association as an employee are not contributions.

The term "contribution" plays an important role in the sections of this act relating to financial rights and governance rights.

"Cooperative" [(5)] – In this act the term "cooperative" includes limited cooperative associations and all other types of cooperatives organized under any other cooperative law whether or not formed in this state. It includes entities formed under organic laws commonly considered cooperative laws. It does not include entities formed under other organic laws but operating on a cooperative basis as permitted, for example, under Subchapter T of the Internal Revenue Code.

"Distribution" [(7)] – The term includes a transfer of money or other property by a limited cooperative association to a member or transferee in the form of a payment or other transfer of profits previously allocated to the member, dividends, cash portions of patronage dividends or refunds, repurchase redemption of retained allocated amounts not previously distributed, or any other form of payment or transfer with respect to the member's or transferee's financial rights. A distribution is different from an allocation. An allocation is a bookkeeping and accounting concept under this act. "Allocation" may have important implications under income tax law. The term "distribution" does not typically include money or other property paid to a member for goods or services.

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

EXAMPLE: Wages paid to a worker in a worker owned limited cooperative association are not distributions.

EXAMPLE: A farmer sells oranges to an association for a fixed price. Payment of the price by the association is not a distribution.

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

"Financial rights" [(9)] – "Financial rights" include rights to participate in the financial results of the operations of a limited cooperative association. For example, the term includes the right to be allocated profits and losses, to receive a proportionate share of distributions made to members, to receive dividends if dividends are a method used to distribute funds, to receive patronage allocations and dividends, to receive rebates, to have retained patronage allocations and per unit retains credited to the member's capital account, to receive an allocated share of losses, to receive payments for redemptions of retained patronage allocations or per unit retains, to receive a return of capital however described, to receive distributions upon dissolution and winding-up, as well as to receive any other allocations or distributions from the association that are a result of membership in the association.

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

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

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

"Governance rights" [(11)] – "Governance rights" include, but are not limited to, the right of a member to vote on matters affecting a limited cooperative association to the extent the act or the organic rules provide voting power to the member, the right to receive notices of members meetings and the right to participate in members meetings. "Governance rights" also include the right to petition the association or the board of directors and may be a required

qualification, director or member of a committee of an association to the extent.

"Investor member" [(12)] – An "investor member" is a member who contributes capital to a limited cooperative association, may be provided governance rights, and is not required to conduct business with the association. The existence of investor members and patron members in a single entity is unusual, but not entirely novel, in traditional cooperatives whose organic law generally allows for preferred stockholders without governance rights. Allowing investor members to possess governance rights is an identifying feature of this act.

"Jurisdiction of formation" [(14)] – The term "jurisdiction of formation" is not limited to United States jurisdictions. See Paragraph (13) [Jurisdiction]

"Member" [(16)] – "Member" means both patron members and investor members. The definition recognizes a person can hold interests in a limited cooperative association either as a patron member or as an investor member. If a person holds both types of membership interests, each interest is governed by the provisions of the act and the organic rules related to the particular type of membership. *See* Section 112.

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

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

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

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

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

"Required information" [(29)] – Information required to be maintained under Section 114 is significant in relation to the ability for members to access information from a limited cooperative association under Section 505.

"Transfer" [(33)] – The term "transfer" is broadly defined to include all types of conveyances of property. The reference to "transfer by operation of law" is significant in connection with Section 603 (Transferability of Member Interest). That Section severely restricts a transferee's rights (absent consent of the members or provisions in the organic rules), and this definition makes those restrictions applicable, for example, to transfers ordered by a family court as part of a divorce proceeding and transfers resulting from the death of a member. The restrictions also apply to transfers in the context of a member's bankruptcy, except to the extent that bankruptcy law supersedes the act. Section 603(a), however, references certain limitations on transfer restrictions under the Uniform Commercial Code.

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

"Voting group" [(34)] – Sections 511 and 517 of the act permit patron members to be divided into geographic districts and for patron members and investor members to be divided into classes. If the members in a district or class have voting rights under the organic rules, the members in a district or class, or a combination of them, are a voting group whose voting procedures may be governed by the organic rules pursuant to Section 517. Similarly situated members are required to vote as a voting group where their rights are potentially affected adversely by the vote. *See e.g.*, Sections 404 and 518(d).

"Voting member" [(35)] – The act requires that every patron member be entitled to vote. The organic rules could create classes of investor members that do not have voting rights.

"Voting power" [(36)] – "Voting power" encompasses all votes that may be cast by members as provided by this act or the organic rules on a particular matter.

SECTION 103. NATURE OF LIMITED COOPERATIVE ASSOCIATION.

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

(1) ownership, financing, and receipt of benefits by the members for whose

interests the association is formed; and

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

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

Comment

Section 103 is descriptive of an entity that is organized in conformity with this act and, as such, there are no consequences if the limited cooperative association fails to conform to the description in this Section. Cooperative values and principles are distributed throughout the act, though some are varied as a result of permitting investor members with limited governance rights.

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

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

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

Section 103 addresses the values of voluntary membership, member economic participation, and autonomy and independence. Voluntary membership is reflected by the term "persons united" in this Section and relationships that are "consensual" in Section 109(a). Open membership has been compromised under this act and similar existing law in order to allow (but not require) the formation of "closed" cooperatives. Closed cooperative structure is necessary where an association desires for patron members to share fully in any increased value of their equity and to provide member liquidity.

A limited cooperative association is a self-help organization controlled by its members and is a separate entity from its members under Section 104. This principle of autonomy must, however, be placed within the practical context of long-term debt, equity, and contractual

relationships both in this act and in traditional cooperatives.

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

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

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

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

SECTION 104. PURPOSE AND DURATION OF LIMITED COOPERATIVE ASSOCIATION.

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

(b) A limited cooperative association may be organized for any lawful purpose, regardless of whether for profit [except designated prohibited purposes].

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

Legislative Note: *This act does not preclude a limited cooperative association organized under this act from pursuing any lawful purpose. If an adopting jurisdiction desires to prevent an association under this act from being used for a particular purpose, this can be accomplished as follows. First, an exception for the particular purpose can be specified in subsection (b). Second, if there is another statute in the adopting jurisdiction that governs the particular purpose and that*

statute by its own terms does not already apply, the other statute could be amended to ensure that no entity organized under this act may pursue the purpose identified in the other statute or that any entity organized under this act will comply with the other statute. Third, Section 107 may identify a particular purpose or statute with which this act should be coordinated; as is done in optional Section 107(c).

Comment

Subsection (a) – This Section, together with Section 103, identifies the "separate entity" concept of a limited cooperative association. *See* Comment to Section 103.

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

The subsection does not prevent a limited cooperative association from being organized to carry on charitable activities, but with the exception of Section 1603(b), this act does not include any specific protective provisions pertaining to charitable purposes. Those protections must be (and typically are) found in other law, although sometimes that "other law" appears within a state's non-profit corporation statute. *See, e.g.*, MINN. STAT. ANNOT. § 317A.811 (2006) (providing restrictions on charitable organizations that seek to "dissolve, merge, or consolidate, or to transfer all or substantially all of their assets" but imposing those restrictions only on "corporations" which are elsewhere defined as corporations incorporated under the non-profit corporation act). Of course, tax law significantly effects charities and contains strict parameters beyond the scope of this act.

Section 107 emphasizes that protective and other regulatory provisions outside this act remain applicable to limited cooperative associations. Those laws and regulations are not supplanted by this act or the organic rules of an association organized under this act. *See* Section 109.

Subsection (c) – In this context, the word "perpetual" states the default rule consistent with statutes governing other entities. As in many current limited liability company statutes, this act provides several methods that could be used to override perpetuity: a term specified in the articles of organization and occurrences specified in Sections 1202, 1203, 1205, and 1214. In this act, "perpetuity" means that the act does not require a definite term and creates no nexus between the dissociation of a member and the dissolution of the association beyond, in most cases, the requirement that a limited cooperative association have two members. *See* Section 501. (The dissociation of an association's last remaining member does threaten dissolution under the compulsory provisions of Section 1202(3).)

SECTION 105. POWERS. A limited cooperative association has the capacity to sue and be sued in its own name and has the power to do all things necessary or convenient to carry on

its activities and affairs. An association may maintain an action against a member for harm caused to the association by the member's violation of a duty to the association or of the organic law or organic rules.

Comment

As is the case with all the other uniform unincorporated entity acts,, this act omits as unnecessary any detailed list of specific powers.

The capacity to sue and be sued is mentioned specifically. It cannot be varied by the organic rules. *See* Section 109. The Section affirms the right of a limited cooperative association to maintain an action against a member in the circumstances described.

The omission of any reference to non-members in connection with a limited cooperative association maintaining an action against a member does not imply that an association may not sue non-members or restrict the association from engaging in business or other transactions with non-members. *See* Section 114. It is intended to broaden the rights of the association rather than narrow them.

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

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

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

Comment

This Section may not be varied by the organic rules. *See* Section 109. This act is part of the law of this state. *See generally*, Section 109(a) (addressing the flexibility of this act).

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

In some types of cooperatives marketing contracts are an integral part of an association's business. Article 7 ("Marketing Contracts") of this act, like most traditional marketing cooperative statutes, allows all or part of a marketing contract to be included in the organic rules.

The placement of the terms of the marketing contract in the organic rules or in a separate agreement is not necessarily determinative of whether those terms are part of the internal affairs of the association. *See* Comments to Section 601 and Section 701.

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

SECTION 107. REQUIREMENTS OF OTHER LAWS.

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

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

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

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

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

Comment

Section 107 may appear to be surplusage because it restates the application of known legal interpretive principles outside this act. Nonetheless it attempts to make clear that this act is limited to its terms; that it does not supersede other law, either directly or by implication, including regulatory law; and that a limited cooperative association organized under this act is not exempt from separately qualifying as a "cooperative" under other law. Thus, it serves a similar purpose for domestic associations as does Section 1501(c) for foreign cooperatives which provides that a "certificate of authority does not authorize the cooperative to exercise any power not given a limited cooperative association in this state". To an extent, this is related to the policy that the use of the term "limited" is included in the name of the association to distinguish it from cooperatives formed under other law.

The following examples illustrate the application of this Section.

EXAMPLE: Ten construction workers desire to form a worker's cooperative as a limited cooperative association. Organizing as a limited cooperative association will not excuse the limited cooperative from any contractor bonding requirements in other law. Further, the limited cooperative association will be required to comply with applicable wage and hour law.

EXAMPLE: Same scenario as in previous example except the jurisdiction in which the workers desire to form a limited cooperative association has a specific workers' cooperative statute that expressly states all workers cooperatives must be organized under the workers cooperative statute. Workers cannot lawfully organize a workers cooperative under this act in that jurisdiction.

EXAMPLE: A group of consumers desires to form a limited cooperative association to conduct business as a natural foods cooperative. The association must comply with the health regulations applicable to grocery businesses as well as laws relating to distribution of natural foods.

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

The number and types of regulatory laws are too numerous to list in the text of this act and any exclusive list of laws or activities raises the risk of inadvertent omission. For example, the application for, the qualification of, and the licensing and examination of the following business professions would appear in a comprehensive statutory list: legal, medical, dental, optometry,

engineers, architects, surveyors, public accountancy, opticians, psychologists, veterinary medicine, speech pathologists, audiologists, financial institutions, contractors, fumigators, pest control operators, real estate brokers and sales persons, electricians, plumbers, real estate appraisers, photographers, pharmacists, physical therapy, podiatry, barbering, nursing, social workers, embalmers and funeral directors, motor vehicle dealers, boxing contests, cable television, and degree granting institutions.

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

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

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

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

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

Subsection (c) – This subsection recognizes that the state's housing cooperative law contains a comprehensive and integrated regulatory scheme that extends to a substantial number of aspects of a housing cooperative. As a result, it might be argued that limited cooperative

associations should not be able to be formed for that purpose. Exclusions described in terms of broad activities or purposes, however, are likely to be difficult to interpret and apply and run the risk of being either over or under exclusive. Expressly referencing a specific act mitigates these difficulties while clearly emphasizing the desired regulatory result which would probably otherwise apply because of subsections (a) and (b). This is consistent with the policy of permitting limited cooperative associations to be available for a broad range of endeavors.

[SECTION 108. RELATION TO RESTRAINT OF TRADE AND ANTITRUST LAWS. To the extent a limited cooperative association or activities conducted by the association in this state meet the material requirements for other cooperatives entitled to an exemption from or immunity under any provision of [the restraint of trade or antitrust laws of this state], the association and its activities are entitled to the exemption or immunity. This section does not create any new exemption or immunity for an association or affect any exemption or immunity provided to a cooperative organized under any other [law].]

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

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

Comment

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

SECTION 109. EFFECT OF ORGANIC RULES.

(a) The relations between a limited cooperative association and its members are

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

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

(1) state a term of existence for the association under Section 104(c);

(2) limit or eliminate the acceptance of new or additional members by the initial board of directors under Section 302(b);

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

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

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

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

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

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

(9) provide for member approval of asset dispositions under Section 1401; [and]

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

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

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

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

(1) require more information to be maintained under Section 110 or provided to members under Section 505(j);

(2) provide restrictions on transactions between a member and an association under Section 111;

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

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

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

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

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

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

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

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

Sections 511 through 517;

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

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

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

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

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

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

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

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

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

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

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

(22) specify when a member's dissociation is wrongful and the liability incurred by

the dissociating member for damage to the association under Section 1101(b) and (c);

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

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

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

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

(C) transaction under [Article] 16 as required under Section 518; and

(D) a proposed disposition of assets under Section 1403(1); and

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

(A) a resolution to dissolve under Section 1205;

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

(C) a transaction under [Article] 16 as required under Section 518; and

(D) a disposition of assets under Section 1404.

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

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

Comment

The act contains default rules which may be varied by the organic rules. This Section identifies specific provisions in the act that may be altered, eliminated, revised or otherwise modified by the organic rules. Subsection (b) identifies those provisions that may be modified only in the articles of organization. Subsection (c) identifies those provisions that may be modified in either the articles or the bylaws (the "organic rules"). The provisions identified in subsections (b) and (c) are substantive only to the extent they provide guidance on the interpretation of phrases like "unless otherwise provided in the organic rules." They serve the additional function of collecting references to provisions where variance from statutory default rules must be in the organic rules.

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

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

Other techniques are used to signal that sections are not mandatory. In some sections of the act, there are specific prohibitions on how the act may be varied or on how negation of a default result, such as a default delegation of authority to the board of directors, must be made. *See, e.g.*, Sections 812(a) and 1004(d). Other provisions in the act use the phrase "may provide" to emphasize the flexibility of the act and to provide further guidance with respect to a particular subject. The phrase does not necessarily grant additional authority beyond what is already available. By way of illustration, where "may provide" is used, the organic rules may state specific rules, instructions or results or may state a procedure by which the subject matter will be decided, such as delegating authority to the board of directors. *See, e.g.*, Sections 515(c) and (d) and 1004(a). For a more comprehensive discussion see the Prefatory Note to 2007 Act ("Organic Rules").

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

SECTION 110. REQUIRED INFORMATION.

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

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

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

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

(4) all filed articles of merger, interest exchange, conversion, and domestication;

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

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

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

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

(9) a list containing:

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

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

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

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

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

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

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

(15) a description and statement of the agreed value of contributions or benefits

other than money made or provided and agreed to be made or provided by each member;

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

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

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

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

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

Comment

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

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

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

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

The association's principal office under the act is the principal executive office of the association or a foreign cooperative wherever located. Section 102(16).

The form of the record in which the information must be maintained is any form included in the definition of "record" in Section 102(18).

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

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

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

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

Subsection (a) (18) – The emphasis in this subsection is on "all members." The subsection does not require communications to an individual member; only communications directed to all members of a limited cooperative association or to all members in a district or class must be maintained.

Subsection (c) – This subsection is a good example of the operation of Section 109(c) because requiring greater information would be the rule even without this subsection. *See* Comment to Section 109 ("Subsections (b) and (c)").

SECTION 111. BUSINESS TRANSACTIONS OF MEMBER WITH LIMITED COOPERATIVE ASSOCIATION. Subject to Sections 818 and 819 and except as otherwise provided in the organic rules or a specific contract relating to a transaction, a member may lend

money to and transact other business with a limited cooperative association in the same manner as a person that is not a member.

Comment

This section is derived from Section 112 of the ULPA (2001) (Last Amended 2013). Basically what this section means is that this act does not discriminate against a creditor of a limited cooperative association that also happens to be a member of the LCA. Other law, such as fraudulent transfer or conveyance acts, will be applicable to these creditor-member transactions. *See* Section 114.

SECTION 112. DUAL CAPACITY. A person may have a patron member's interest and an investor member's interest. When such person acts as a patron member, the person is subject to this [act] and the organic rules governing patron members. When such person acts as an investor member, the person is subject to this [act] and the organic rules governing investor members.

Comment

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

SECTION 113. PERMITTED NAMES.

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

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

use of the term "cooperative" [insert cross-reference to other laws of this state].]]

[(b)][(c)] Except as otherwise provided in subsection (d), the name of a limited cooperative association, and the name under which a foreign cooperative may register to do business in this state, must be distinguishable on the records of the [Secretary of State] from any:

(1) name of an existing person whose formation required the filing of a record by the [Secretary of State] and which is not at the time administratively dissolved;

(2) name of a limited liability partnership whose statement of qualification is in effect;

(3) name under which a person is registered to do business in this state by the filing of a record by the [Secretary of State];

(4) name reserved under Section 116 or other law of this state providing for the reservation of a name by the filing of a record by the [Secretary of State];

(5) name registered under Section 117 or other law of this state providing for the registration of a name by the filing of a record by the [Secretary of State]; and

(6) name registered under [this state's assumed or fictitious name statute].

[(c)][(d)] If a person consents in a record to the use of its name and submits an undertaking in a form satisfactory to the [Secretary of State] to change its name to a name that is distinguishable on the records of the [Secretary of State] from any name in any category of names in subsection [(b)][(c)], the name of the consenting person may be used by the person to which the consent was given.

[(d)][(e)] Except as otherwise provided in subsection [(e)][(f)], in determining whether a name is the same as or not distinguishable on the records of the [Secretary of State] from the name of another person, words, phrases, or abbreviations indicating a type of entity, such as

"corporation", "corp.", "incorporated", "Inc.", "professional corporation", "P.C.", "PC", "professional association", "P.A.", "PA", "Limited", "Ltd.", "limited partnership", "L.P.", "LP", "limited liability partnership", "L.L.P.", "LLP", "registered limited liability partnership", "R.L.L.P.", "RLLP", "limited liability limited partnership", "L.L.L.P.", "LLLP", "registered limited liability limited partnership", "R.L.L.L.P." "RLLLP", "limited liability company", "L.L.C.", or "LLC", "limited cooperative association", "limited cooperative", "L.C.A.", or "LCA" may not be taken into account.

[(e)][(f)] A person may consent in a record to the use of a name that is not distinguishable on the records of the [Secretary of State] from its name except for the addition of a word, phrase, or abbreviation indicating the type of entity as provided in subsection [(d)][(e)]. In such a case, the person need not change its name pursuant to subsection [(b)][(c)].

[(f)][(g)] A limited cooperative association or foreign cooperative may use a name that is not distinguishable from a name described in subsection [(b)][(c)](1) through (6) if the association or foreign cooperative delivers to the [Secretary of State] a certified copy of a final judgment of a court of competent jurisdiction establishing the right of the association or foreign cooperative to use the name in this state.

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

Many cooperative statutes include name protection provisions unique among organizational laws. If the adopting jurisdiction has a prohibition of the use of the word "cooperative" or a permitted abbreviation by any entity other than a cooperative organized under a statute providing for the formation of cooperative entities, this act will not violate that statute if this Section is adopted with a reference to that statute in subsection (a). Moreover, if this Section is adopted with a reference to the other statute in subsection (b), restrictions on the use of the word "cooperative" or a permitted abbreviation under that statute may be enforced by

a limited cooperative association or a member of an association organized under this act. Alternatively, the adopting jurisdiction could amend the other statute to permit an association organized under this act to use the word "cooperative" or a permitted abbreviation without violating that statute and to enforce the restrictions on the use of the word or abbreviations under that statute.

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

Comment

This section adopts the "distinguishable on the records" test for name availability and rejects the "deceptively similar" test widely used in the past in business entity statutes.

This section does not supersede or preempt fictitious or assumed name statutes. A foreign cooperative must comply with those statutes in the adopting jurisdiction. *See* Sections 116 and 1506.

Subsection (a) – Some states have provisions in their existing cooperative statutes restricting the use of the term "cooperative" to entities formed under those statutes. This subsection states that those provisions do not apply to a limited cooperative association formed under this act.

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

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

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

SECTION 114. RESERVATION OF POWER TO AMEND OR REPEAL. The

[legislature of this state] has the power to amend or repeal all or part of this [act] at any time, and

all limited cooperative associations and foreign cooperatives subject to this [act] are governed by the amendment or repeal of this [act].

Comment

Provisions similar to this section have their genesis in *Trustees of Dartmouth College v. Woodward*, 17 U.S. (4 Wheat) 518 (1819), which held that the United States Constitution prohibited the application of newly enacted statutes to existing corporations while suggesting the efficacy of a reservation of power similar to this section. This section is a generalized form of the type of provision found in many entity organic laws, the purpose of which is to avoid any possible argument that an entity has contractual or vested rights in any specific statutory provision of its organic law and to ensure that the state may in the future modify its entity statutes as it deems appropriate and require existing entities to comply with the statutes as modified.

SECTION 115. SUPPLEMENTAL PRINCIPLES OF LAW. Unless displaced by particular provisions of this [act], the principles of law and equity supplement this [act].

Comment

The supplement principles of law encompass not only the law of agency and estoppel and the law merchant, but all of the other principles listed in UCC Section 1-103: the law relative to capacity to contract, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, and other common law validating or invalidating causes, such as unconscionability.

SECTION 116. RESERVATION OF NAME.

(a) A person may reserve the exclusive use of a name that complies with Section 115 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 to be reserved. If the [Secretary of State] finds that the name is available, the [Secretary of State] shall reserve the name for the applicant's exclusive use for a period of 120 days.

(b) The owner of a reserved name may transfer the reservation to another person by delivering to the [Secretary of State] a signed notice in a record of the transfer which states the name and address of the person to which the reservation is being transferred.

Comment

This section does not provide for the renewal of a name reservation for successive 120-day periods. A new reservation may be filed upon the expiration of a reservation, but by requiring a new filing this section creates the possibility that another party may timely submit a reservation for the same name. It was considered appropriate to allow for that possibility so that the procedure in this section cannot be used to block a name indefinitely. Compare Section 117 which authorizes a renewable registration of certain names.

SECTION 117. REGISTRATION OF NAME.

(a) A foreign cooperative not registered to do business in this state under [Article] 15 may register its name, or an alternate name adopted pursuant to Section 1506, if the name is distinguishable upon on the records of the [Secretary of State] from the names that are not available under Section 115.

(b) To register its name or an alternate name adopted pursuant to Section 1506, a foreign cooperative must deliver to the [Secretary of State] for filing an application stating the cooperative's name, the jurisdiction and date of its formation, and any alternate name adopted pursuant to Section 1506. If the [Secretary of State] finds that the name applied for is available, the [Secretary of State] shall register the name for the applicant's exclusive use.

(c) The registration of a name under this section is effective for [one year] after the date of registration.

(d) A foreign cooperative whose name registration is effective may renew the registration for successive [one-year] periods by delivering, not earlier than [three months] before the expiration of the registration, to the [Secretary of State] for filing a renewal application that complies with this section. When filed, the renewal application renews the registration for a succeeding [one-year] period.

(e) A foreign cooperative whose name registration is effective may register as a foreign

cooperative under the registered name or consent in a signed record to the use of that name by another person that is not an individual.

Comment

Unlike the reservation of a name under Section 117, a registration of a name under this section may be renewed for successive periods thus permitting a name to be protected for a period longer than the initial registration period. Use of the procedure in this section is limited, however, to the names of foreign cooperatives (Section 102(10)). The purpose of this section is to permit a foreign entity to make sure its name will be available in the event it should choose to register in the state at some time in the future.

SECTION 118. REGISTERED AGENT.

(a) Each limited cooperative association and each registered foreign cooperative shall designate and maintain a registered agent in this state. The designation of a registered agent is an affirmation of fact by the association or foreign cooperative that the agent has consented to serve.

(b) A registered agent for a limited cooperative association or registered foreign cooperative must have a place of business in this state.

(c) The only duties under this [act] of a registered agent that has complied with this [act] are:

(1) to forward to the limited cooperative association or registered foreign cooperative at the address most recently supplied to the agent by the association or foreign cooperative any process, notice, or demand pertaining to the association or foreign cooperative which is served on or received by the agent;

(2) If the registered agent resigns, to provide the notice required by Section 120(c) to the limited cooperative association or foreign cooperative at the address most recently supplied to the agent by the association or foreign cooperative; and

(3) to keep current the information with respect to the agent in the articles of

organization or foreign registration statement.

Comment

This section is limited to prescribing the duties of a registered agent under this act. An agent may undertake other responsibilities to a represented limited cooperative association, such as by contract or course of dealing, but those duties will be determined under other law.

Section 203 imposes liability on persons filing known inaccurate information that causes harm to those relying on the information.

SECTION 119. CHANGE OF REGISTERED AGENT OR ADDRESS FOR REGISTERED AGENT BY LIMITED COOPERATIVE ASSOCIATION.

(a) A limited cooperative association or registered foreign cooperative may change its registered agent or the address of its registered agent by delivering to the [Secretary of State] for filing a statement of change that states:

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

(2) the information that is to be in effect as a result of the filing of the statement of change.

(b) The members or directors of a limited cooperative association need not approve the filing of:

(1) a statement of change under this section; or

(2) a similar filing changing the registered agent or registered office, if any, of the association in any other jurisdiction.

(c) A statement of change under this section designating a new registered agent is an affirmation of fact by the limited cooperative association or registered foreign cooperative that the agent has consented to serve.

(d) As an alternative to using the procedure in this section, a limited cooperative

association may amend its articles of organization.

Comment

A change in the identity of the registered agent of a LCA or foreign LCA or a change of the office address of a LCA's registered agent are usually routine matters that do not affect the rights of the members of the represented LCA. This section permits those changes to be made without: (i) amendment of an LCA's articles of formation; or (ii) formal approval by an LCA's members or directors. For the registered agent's power to resign, see Section 120. For the registered agent's power to change its name, address, or both, see Section 121.

Subsection (c) avoids the need to file with a statement of change consent of the new registered agent being designated.

Subsection (d) makes clear that the procedures in this section are not exclusive. A common way in which a limited liability company changes its registered agent is to include the change in an amendment of its certificate of organization or in its annual/biennial report. See Section 210(e).

For liability for filing inaccurate information see Section 203.

SECTION 120. RESIGNATION OF REGISTERED AGENT.

(a) A registered agent may resign as agent for a limited cooperative association or registered foreign cooperative by delivering to the [Secretary of State] for filing a statement of resignation that states:

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

(2) the name of the agent;

(3) that the agent resigns from serving as registered agent for the association or foreign cooperative; and

(4) the address of the association or foreign cooperative to which the agent will send the notice required by subsection (c).

(b) A statement of resignation takes effect on the earlier of:

(1) the 31st day after the day on which it is filed by the [Secretary of State]; or

(2) the designation of a new registered agent for the limited cooperative association

or registered foreign cooperative.

(c) A registered agent promptly shall furnish to the limited cooperative association or registered foreign cooperative notice in a record of the date on which a statement of resignation was filed.

(d) When a statement of resignation takes effect, the registered agent ceases to have responsibility under this [act] for any matter thereafter tendered to it as agent for the limited cooperative association or registered foreign cooperative. The resignation does not affect any contractual rights the association or foreign cooperative has against the agent or that the agent has against the association or foreign cooperative.

(e) A registered agent may resign with respect to a limited cooperative association or registered foreign cooperative whether or not the association or foreign cooperative is in good standing.

Comment

Resignation under this section may be accomplished solely by action of the registered agent and does not require the cooperation or consent of the represented entity. Whether a resignation violates a contract between the registered agent and the represented entity is beyond the scope of this part and subsection (d) preserves whatever claims a represented entity may have against its registered agent for a wrongful termination. Even if a resignation were to violate such a contract, the resignation would still be effective if the provisions of this section are followed.

Subsection (b) delays the effectiveness of a statement of resignation for 31 days to allow the notice of the resignation that must be sent under subsection (c) to reach the represented entity and to allow the represented entity to arrange for a substitute registered agent.

Subsection (e) makes clear that a registered agent may resign with respect to a limited cooperative association that is not in good standing and supersedes the contrary administrative practice in some states of refusing to accept any filings with respect to an entity that is not in good standing until the problem with the entity's standing is cured.

SECTION 121. CHANGE OF NAME OR ADDRESS BY REGISTERED AGENT.

(a) If a registered agent changes its name or address, the agent may deliver to the

[Secretary of State] for filing a statement of change that states:

(1) the name of the limited cooperative association or registered foreign cooperative represented by the registered agent;

(2) the name of the agent as currently shown in the records of the [Secretary of State] for the association or foreign cooperative;

(3) if the name of the agent has changed, its new name; and

(4) if the address of the agent has changed, its new address.

(b) A registered agent promptly shall furnish notice to the represented limited cooperative association or registered foreign cooperative of the filing by the [Secretary of State] of the statement of change and the changes made by the statement.

Legislative Note: *Many registered agents act in that capacity for many entities, and the Model Registered Agents Act (2006) (Last Amended 2013) provides a streamlined method through which a commercial registered agent can make a single filing to change its information for all represented entities. The single filing does not prevent an enacting state from assessing filing fees on the basis of the number of entity records affected. Alternatively the fees can be set on an incremental sliding fee or capitated amount based upon potential economies of costs for a bulk filing.*

Comment

This section permits a registered agent to change the name and address of the agent that appears in the registered agent filing of an LCA or foreign LCA represented by the agent. This act does not provide for commercial registered agents, *compare* Uniform Business Organizations Code (2011) (Last Amended 2013), §§ 1-405, 1-406, and 1-409, As a result, a registered agent will need to make a separate filing under this section for each LLC represented by the agent.

SECTION 122. SERVICE OF PROCESS, NOTICE, OR DEMAND.

(a) A limited cooperative association or registered foreign cooperative may be served with any process, notice, or demand required or permitted by law by serving its registered agent.

(b) If a limited cooperative association or registered foreign cooperative ceases to have a registered agent, or if its registered agent cannot with reasonable diligence be served, the

association or foreign cooperative may be served by registered or certified mail, return receipt requested, or by similar commercial delivery service, addressed to the association or foreign cooperative at its principal office. The address of the principal office must be as shown on the association's or cooperative's most recent [annual] [biennial] report filed by the [Secretary of State]. Service is effected under this subsection on the earliest of:

(1) the date the association or foreign cooperative receives the mail or delivery by the commercial delivery service;

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

(3) five days after its deposit with the United States Postal Service or with the commercial delivery service, if correctly addressed and with sufficient postage or payment.

(c) If process, notice, or demand cannot be served on a limited cooperative association or registered foreign cooperative pursuant to subsection (a) or (b), service may be made by handing a copy to the individual in charge of any regular place of business or activity of the association or foreign cooperative if the individual served is not a plaintiff in the action.

(d) Service of process, notice, or demand on a registered agent must be in a written record.

(e) Service of process, notice, or demand may be made by other means under law other than this [act].

Comment

Subsection (b) – This subsection offers three alternative methods for establishing the date service is effected, a date important for determining the time frame in which an LCA or foreign LCA must respond to the process, notice, or demand served. Under subsection (b)(1), service is effected on the date of receipt by the company of the mail or commercial delivery. Under subsection (b)(2), service is effected on the date shown on the return receipt, if signed on behalf of the company. Under subsection (b)(3), service is effected five days after it is deposited with the Postal Service or with a similar commercial delivery service, if correctly addressed and with

correct postage or payment. Service is effective at the earliest of the three listed circumstances.

However, for the party effecting service there are difficulties of proof under the first two circumstances. Under subsection (b)(1) the exact date of the receipt by the LCA or foreign LCA of mail or commercial delivery is peculiarly within the knowledge of the company. Under subsection (b)(2) the return receipt must be signed on behalf of the company. That requirement is designed to assure that the service is actually received by the company, but the signature on the return receipt may not always show unambiguously that the signer was acting for the company and was authorized to do so. As a practical matter, therefore, parties effecting service under subsection (b) may find it most convenient to rely on subsection (3) and to maintain their own records so that the date of deposit in the mails or with a commercial delivery service can easily be established.

Subsection (c) – This subsection provides a means for serving process on a limited cooperative association or foreign cooperative that cannot be served under subsection (a) or (b). Some statutes require or permit service of process in that circumstance be made on the filing office

Subsection (e) – *See e.g.* Fed. R. Civ. P. 4(h)(1)(B) (authorizing service on "a domestic or foreign corporation, or a partnership or other unincorporated association that is subject to suit under a common name" to be made on "an officer, a managing or general agent, or any other agent authorized by appointment or by law to receive service of process").

[ARTICLE] 2

FILING AND OTHER REPORTS

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

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

(1) A limited cooperative association's initial articles of organization must be signed by at least one person acting as an organizer.

(2) A statement of withdrawal under Section 206 must be signed as provided in that section.

(3) Except as otherwise provided in paragraph (4), a record signed by an existing

association must be signed by an officer.

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

(5) Any other record delivered on behalf of a person to the [Secretary of State] for filing must be signed by that person.

(b) A record delivered for filing under this [act] may be signed by an agent. Whenever this [act] requires a particular individual to sign a record and the individual is deceased or incompetent, the record may be signed by a legal representative of the individual.

(c) A person that signs a record as an agent or legal representative affirms as a fact that the person is authorized to sign the record.

Comment

Subsection (a) – As provided in Section 102(31), "sign" includes any manual, facsimile, conformed, or electronic signature.

Subsection (a) – From the perspective of the filing office, it is not necessary that a record delivered for filing on behalf of a limited cooperative association be filed by a member, officer or director. The bylaws can impose such a requirement as an *inter se* matter, but the requirement would not affect this provision.

The filing office will not check whether a person who purports to be authorized to sign a record on behalf of an LCA actually has that authority, even if a statement of authority pertaining to the matter is in effect. The filing officer's duties are ministerial and the official's assessment of fa record delivered for filing is limited to determining if the record contains the information required by this act and is accompanied by the required filing fee. *See* Section 210(a) and the comment to Section 204.

Subsection (b) – The filing office will not check the bona fides of a person purporting to have signed a record in a representative capacity.

Subsection (c) – As a matter of agency law, a person who signs in a representative capacity gives a "warranty of authority." RESTATEMENT (THIRD) OF AGENCY § 6.10 (2006). Under Section 203(b)., "[a]n individual who signs a record authorized or required to be filed

under this [act] affirms under penalty of perjury that the information stated in the record is accurate."

SECTION 202. SIGNING AND FILING 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 under this [act] does not do so, any other person that is aggrieved may petition [the appropriate court] to order:

(1) the person to sign the record;

(2) the person to deliver the record to the [Secretary of State] for filing; or

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

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

(c) A record filed under subsection (a)(3) is effective without being signed.

Comment

This section gives the court the flexibility to order either that a record be signed or that the record be filed by the filing office unsigned. The later circumstance may arise, for example, in a situation where the person who should sign the record is not subject to the jurisdiction of the court. This section also makes clear that the court may order a person with control over a record that has been signed to deliver the record to the filing office for filing.

SECTION 203. LIABILITY FOR INACCURATE INFORMATION IN FILED RECORD.

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

information was inaccurate.

(b) An individual who signs a record authorized or required to be filed under this [act] affirms under penalty of perjury that the information stated in the record is accurate.

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

Comment

Subsection (a) – This subsection relates to liability to third parties for inaccurate information in a filed record.

Subsection (b) – This subsection provides criminal liability. The elements of perjury are a matter for the criminal law of the jurisdiction.

SECTION 204. FILING REQUIREMENTS.

(a) To be filed by the [Secretary of State] pursuant to this [act], a record must be received by the [Secretary of State], comply with this [act], and satisfy the following:

(1) The filing of the record must be required or permitted by this [act].

(2) The record must be physically delivered in written form unless and to the extent the [Secretary of State] permits electronic delivery of records.

(3) The words in the record must be in English, and numbers must be in Arabic or Roman numerals, but the name of an entity need not be in English if written in English letters or Arabic or Roman numerals.

(4) The record must be signed by a person authorized or required under this [act] to sign the record.

(5) The record must state the name and capacity, if any, of each individual who signed it, either on behalf of the individual or the person authorized or required to sign the record,

but need not contain a seal, attestation, acknowledgment, or verification.

(b) If law other than this [act] prohibits the disclosure by the [Secretary of State] of information contained in a record delivered to the [Secretary of State] for filing, the [Secretary of State] shall file the record if the record otherwise complies with this [act] but may redact the information.

(c) When a record is delivered to the [Secretary of State] for filing, any fee required under this [act] and any fee, tax, interest, or penalty required to be paid under this [act] or law other than this [act] must be paid in a manner permitted by the [Secretary of State] or by that law.

(d) The [Secretary of State] may require that a record delivered in written form be accompanied by an identical or conformed copy.

(e) The [Secretary of State] may provide forms for entity filings required or permitted to be made by this [act], but, except as otherwise provided in subsection (f), their use is not required.

(f) The [Secretary of State] may require that a cover sheet for a filing be on a form prescribed by the [Secretary of State].

Comment

The filing office's duty under this section is ministerial, Section 210(a), and the office's assessment of a record delivered for filing is limited to conformity with this section. The filing office *must* file a record delivered for filing if the record contains the information required by this act and is accompanied by the required filing fee. The filing office is authorized to provide forms but not require their use, and, as a result, may not reject records delivered for filing on the basis of form (except to the very limited extent permitted by Subsections (d) and (f)).

In view of the very limited discretion granted to the filing office under this section and Section 208(a), "[t]he filing of … a record does not create a presumption that the information contained in the record is correct… ." Section 208(e).

Subsection (a) – The first requisite for having a record filed is to cause the record actually to be received by the filing office. Section 108(b) reiterates this point.

Subsection (a)(2) – A record delivered for filing must be in typewritten or printed form

unless the filing office permits delivery by electronic transmission. The types of electronic transmission that may be used will be determined by the filing office and is intended to include the evolving methods of electronic delivery, including facsimile transmissions, electronic transmissions between computers, and filings through delivery of storage media.

Subsection (a)(3) – The text of an entity filing must be in the English language, except to the limited extent permitted by this paragraph.

Subsection (a)(4) – To be filed a record must be signed by the appropriate person. See the definition of "sign" in Section 102(31) for a description of the manner in which a record may be "signed." Who is an appropriate person is determined under Section 201, but the filing office will not check to determine whether a person purportedly authorized to sign is in fact authorized. See Section 201(a)-(c), comment.

The requirement in some state statutes that records delivered for filing on behalf of an entity must be acknowledged or verified as a condition for filing has been rejected. These requirements serve little purpose in connection with entity filings. On the other hand, many organizations, like lenders or title companies, may desire that specific records include acknowledgements, verifications, or seals; Subsection (a)(4) does not prohibit the addition of these forms of execution and their use does not affect the eligibility of the record for filing.

Subsection (b) – Under this subsection, a confidentiality obligation does not affect the filing office's duty to file, and the filing office is authorized but not required to redact. This act does not affect any confidentiality-related obligations the filing office may have under other law.

SECTION 205. EFFECTIVE DATE AND TIME. Except as otherwise provided in Section 206 and subject to Section 207(d), a record filed under this [act] is effective:

(1) on the date and at the time of its filing by the [Secretary of State], as provided in Section 208;

(2) on the date of filing and at the time specified in the record as its effective time, if later than the time under paragraph (1);

(3) at a specified delayed effective time and date, which may not be more than 90 days after the date of filing; or

(4) if a delayed effective date is specified, but no time is specified, at 12:01 a.m. on the date specified, which may not be more than 90 days after the date of filing.

Comment

Records accepted for filing become effective at the date and time of filing, or at another specified time on that date, unless a delayed effective date is stated in the record.

Section 208(b) requires the filing office to maintain some means of recording the date and time of delivery of a record, and requires the office to record that date and time as the date and time of filing. That provision gives express statutory authority to the common practice of most filing offices of ignoring processing time and treating a record as filed as of the date and time it is delivered for filing even though it may not be reviewed and accepted for filing until several days after delivery. That section contemplates that time of delivery, as well as the date, will be routinely recorded.

Under paragraph (1) of this section, in the absence of provision for a delayed effective date, an entity filing becomes effective on the date and time of filing by the Secretary of State. Since under 208(b) the date and time of filing is the recorded date and time of delivery of the entity filing, together these provisions eliminate any doubt about situations involving same-day transactions in which a record, for example, a statement of merger, is delivered for filing on the morning of the day the merger is to become effective.

Paragraph (3) does not authorize or contemplate the retroactive establishment of an effective date before the date of filing.

Under Paragraphs (3) and (4) a record that states an effective date beyond the 90-day limit is not a record that "satisfies this [act]" (Section 208(a)) and will properly be rejected by the filing office.

SECTION 206. WITHDRAWAL OF FILED RECORD BEFORE EFFECTIVENESS.

(a) Except as otherwise provided in Sections 1624, 1634, 1644, and 1654, a record delivered to the [Secretary of State] for filing may be withdrawn before it takes effect by delivering to the [Secretary of State] for filing a statement of withdrawal.

(b) A statement of withdrawal must:

(1) be signed by each person that signed the record being withdrawn, except as otherwise agreed by those persons;

(2) identify the record to be withdrawn; and

(3) if signed by fewer than all the persons that signed the record being withdrawn, state that the record is withdrawn in accordance with the agreement of all the persons that signed the record.

(c) On filing by the [Secretary of State] of a statement of withdrawal, the action or transaction evidenced by the original record does not take effect.

Comment

Only records that have not yet taken effect may be withdrawn under this section. If a record has taken effect, it may be corrected under Section 207 if the requirements of that section are satisfied. Otherwise, the record must be amended in accordance with the applicable provisions of this act or, if the record relates to the formation of an entity, the existence of the entity may be dissolved and terminated in accordance with Article 12.

Subsection (b)(1) – This provision is subject to Section 201 (b) ("Whenever this [act] requires a particular individual to sign a record and the individual is deceased or incompetent, the record may be signed by a legal representative of the individual.").

SECTION 207. CORRECTING FILED RECORD.

(a) A person on whose behalf a filed record was delivered to the [Secretary of State] for filing may correct the record if:

(1) the record at the time of filing was inaccurate;

(2) the record was defectively signed; or

(3) the electronic transmission of the record to the [Secretary of State] was defective.

(b) To correct a filed record, a person on whose behalf the record was delivered to the [Secretary of State] must deliver to the [Secretary of State] for filing a statement of correction.

(c) A statement of correction:

(1) may not state a delayed effective date;

(2) must be signed by the person correcting the filed record;

(3) must identify the filed record to be corrected;

(4) must specify the inaccuracy or defect to be corrected; and

(5) must correct the inaccuracy or defect.

(d) A statement of correction is effective as of the effective date of the filed record that it corrects except as to persons relying on the uncorrected filed record and adversely affected by the correction. For those purposes and as to those persons, the statement of correction is effective when filed.

Comment

This section permits making corrections in entity filings without re-filing the entire record. Under subsection (d), the correction relates back to the original effective date of the entity filing being corrected, except as to persons relying on the original entity filing and adversely affected by the correction. As to these persons, the effective date of the statement of correction is the date the statement is filed.

An entity filing may be corrected either because it contains an inaccuracy or because it was defectively executed (including defects in optional forms of execution that do not affect the eligibility of the original record for filing). In addition, an entity filing may be corrected if its electronic transmission was defective. This is intended to cover the situation where an electronic filing is made but, due to a defect in transmission, the filed record is later discovered to be inconsistent with the record intended to be filed. If no filing is made because of a defect in transmission, a statement of correction may not be used to make a retroactive filing. Therefore, a limited cooperative association making an electronic filing should take steps to confirm that the filing was received by the filing office

A provision in an entity filing setting an effective date may be corrected under this section, but the corrected effective date must comply with the requirements of Section 205 limiting delayed effective dates to within 90 days after filing. A corrected effective date is thus measured from the date of the original filing of the record being corrected, i.e., it cannot be before the date of filing of the record or more than 90 days thereafter.

SECTION 208. DUTY OF [SECRETARY OF STATE] TO FILE; REVIEW OF REFUSAL TO FILE; DELIVERY OF RECORD BY [SECRETARY OF STATE] .

(a) The [Secretary of State] shall file a record delivered to the [Secretary of State] for filing which satisfies this [act]. The duty of the [Secretary of State] under this section is ministerial.

(b) When the [Secretary of State] files a record, the [Secretary of State] shall record it as filed on the date and at the time of its delivery. After filing a record, the [Secretary of State] shall deliver to the person that submitted the record a copy of the record with an acknowledgment of the date and time of filing and, in the case of a statement of denial, also to the limited cooperative association to which the statement pertains.

(c) If the [Secretary of State] refuses to file a record, the [Secretary of State] shall, not later than [15] business days after the record is delivered:

(1) return the record or notify the person that submitted the record of the refusal; and

(2) provide a brief explanation in a record of the reason for the refusal.

(d) If the [Secretary of State] refuses to file a record, the person that submitted the record may petition the [appropriate court] to compel filing of the record. The record and the explanation of the [Secretary of State] of the refusal to file must be attached to the petition. The court may decide the matter in a summary proceeding.

(e) The filing of or refusal to file a record does not:

(1) affect the validity or invalidity of the record in whole or in part; or

(2) create a presumption that the information contained in the record is correct or incorrect.

(f) Except as provided by Section 122 or by law other than this [act], the [Secretary of State] may deliver any record to a person by delivering it:

(1) in person to the person that submitted it;

(2) to the address of the person's registered agent;

(3) to the principal office of the person; or

(4) to another address the person provides to the [Secretary of State] for delivery.

Comment

Subsection (a) – Under this subsection the filing office is required to file a record if it "satisfies this [act]." The purpose of this language is to limit the discretion of the filing office to a ministerial role in reviewing the contents of records. If the record submitted is in the form prescribed, contains the information required by this act, and the appropriate filing fee is tendered, the filing office must file the record. Consistent with this approach, this subsection states explicitly that the filing duty of the filing office is ministerial. See also subsection (e)(pertaining to presumptions not created).

Subsection (b) – This subsection provides that when the filing office files a record, the filing office records it as filed on the date and time of delivery to the filing office, retains the original record for the office's records, and delivers a copy of the record to the person who delivered the record for filing with an acknowledgement of the date and time of filing.

In the case of a record transmitted electronically to the filing office, that office may make delivery by electronic transmission. The copy returned will be the exact or conformed copy if one has been required by the filing office, or will be a copy made by the filing office if an exact or conformed copy was not required.

Under this subsection the acceptance of a filing is evidenced merely by the filing office's delivery of a copy of the record with an acknowledgment of the date and time of filing. The act does not provide for the filing office to issue a formal certificate of filing. A copy of the filed record together with an acknowledgment of the date and time of filing should sufficiently indicate that the filing has been accepted for filing and been filed.

Subsection (c) – Because of the simplification of formal filing requirements and the limited discretion granted to the filing office by this act, it is probable that rejection of records delivered to the filing office for filing will occur only rarely. This subsection provides that if the filing office does reject a record delivered for filing, the filing office must return the record to the person that submitted the filing within 15 days together with a brief written explanation of the reason for rejection. In the case of a record delivered by electronic transmission, rejection of the record may be made electronically by the filing office or by a mailing to the person that submitted the record.

Subsection (e) – This subsection provides that the filing of a record by the filing office does not affect the validity or invalidity of any provision contained in the record and does not create any presumption with respect to any information in the record. Likewise, the refusal of the filing office to file a record creates no presumption that any of the information in the record is incorrect. Persons adversely affected by a statement in a filed record may contest the statement in a proceeding appropriate for that purpose, including a damage action under Section 203 (a).

SECTION 209. CERTIFICATE OF GOOD STANDING OR REGISTRATION.

(a) On request of any person, the [Secretary of State] shall issue a certificate of good standing for a limited cooperative association or a certificate of registration for a registered foreign cooperative.

(b) A certificate under subsection (a) must state:

(1) the limited cooperative association's name or the registered foreign cooperative's name used in this state;

(2) in the case of a limited cooperative association:

(A) that articles of organization have been filed and have taken effect;

(B) the date the articles became effective;

(C) the period of the association's duration if the records of the [Secretary of State] reflect that its period of duration is less than perpetual; and

(D) that:

(i) no statement of dissolution, statement of administrative dissolution, or statement of termination has been filed;

(ii) the records of the [Secretary to State] do not otherwise reflect that the association has been dissolved or terminated; and

(iii) a proceeding is not pending under Section 1214;

(3) in the case of a registered foreign cooperative, that it is registered to do business in this state;

(4) that all fees, taxes, interest, and penalties owed to this state by the limited cooperative association or foreign cooperative and collected through the [Secretary of State] have been paid, if:

(A) payment is reflected in the records of the [Secretary of State]; and

(B) nonpayment affects the good standing or registration of the association or foreign cooperative;

(5) that the most recent [annual] [biennial] report required by Section 210 has been delivered to the [Secretary of State] for filing; and

(6) other facts reflected in the records of the [Secretary of State] pertaining to the limited cooperative association or foreign cooperative which the person requesting the certificate reasonably requests.

(c) Subject to any qualification stated in the certificate, a certificate issued by the [Secretary of State] may be relied on as conclusive evidence of the facts stated in the certificate.

Comment

This section establishes a procedure by which anyone may obtain a conclusive certificate from the filing office that the records of the filing office either (i) do not indicate that a particular domestic limited cooperative association has ceased to exist or (ii) indicate that a particular foreign cooperative is registered to do business in the state. The certificate will probably be a standardized form. The filing office is to make those determinations from public records only and is not expected to make a more extensive investigation.

This section refers only to fees, taxes, interest, and penalties collected by the filing office. In some states other agencies may report to the filing office that franchise or other taxes have been paid; in those state, this information may be included in the certificate. In states where this procedure does not unduly delay the issuance of certificates, this section may be revised appropriately. Subsection (b)(4)(B) limits the scope of the statement in the certificate that all fees, taxes, interest, and penalties have been paid to those where nonpayment affects the existence or authorization to do business of the entity.

SECTION 210. [ANNUAL] [BIENNIAL] REPORT FOR [SECRETARY OF STATE].

(a) A limited cooperative association or registered foreign cooperative shall deliver to the [Secretary of State] for filing [an annual] [a biennial] report that states:

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

(2) the name and street and mailing addresses of its registered agent in this state;

(3) the street and mailing addresses of its principal office;

(4) the name of at least one director; and

(5) in the case of a foreign cooperative, its jurisdiction of formation and any alternative name adopted under Section 1506.

(b) Information the [annual] [biennial] report must be current as of the date the report is signed by the limited cooperative association or registered foreign cooperative.

(c) The first [annual] [biennial] report must be delivered to the [Secretary of State] for filing after [January 1] and before [April 1] of the year following the calendar year in which the limited cooperative association's articles of organization became effective or the registered foreign cooperative registered to do business in this state. Subsequent [annual] [biennial] reports must be delivered to the [Secretary of State] for filing after [January 1] and before [April 1] of each [second] calendar year thereafter.

(d) If [an annual] [a biennial] report does not contain the information required by this section, the [Secretary of State] promptly shall notify the reporting limited cooperative association or registered foreign cooperative in a record and return the report for correction.

(e) If [an annual] [a biennial] report under this section contains the name or address of a registered agent which differs from the information shown in the records of the [Secretary of State] immediately before the report becomes effective, the differing information is considered a statement of change under Section 119.

Comment

The requirement that the report include the name of at least one director of the limited

cooperative association will be a new requirement for some entities in some states. There has been increasing pressure from law enforcement for access to more information about the ownership and control of legal entities. The identification of a director for each association will give law enforcement the ability to contact a person with some knowledge about the affairs of the association.

SECTION 211. FILING FEES. The filing fee for records filed under this [Article] by the [Secretary of State] is [insert appropriate fee or citation to fee provision under other state law].

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

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

[ARTICLE] 3

ORGANIZATION OF LIMITED

COOPERATIVE ASSOCIATION

SECTION 301. FORMATION OF LIMITED COOPERATIVE ASSOCIATION; ARTICLES OF ORGANIZATION.

(a) One or more persons may act as organizers to form a limited cooperative association by delivering to the [Secretary of State] for filing articles of organization.

(b) The articles of organization must state:

(1) the name of the limited cooperative association, which must comply with Section 115;

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

(3) the street and mailing addresses in this state of the initial registered agent;

(4) the street and mailing addresses of the initial principal office;

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

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

(c) Subject to Section 109, articles of organization may contain any other provisions in addition to those required by subsection (a).

(d) A limited cooperative association is formed after articles of organization that substantially comply with subsection (a) are delivered to the [Secretary of State], are filed, and become effective under Section 205.

Comment

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

This act permits the organizing of limited cooperative associations without members at the time of organization. Section 501, however, requires the existence of at least two patron members before a limited cooperative association may begin business (unless the sole member is a cooperative). It may seem somewhat paradoxical that an unincorporated entity may exist, even if largely for filing convenience, without members. Some limited liability company statutes, however, provide for such "shelf" organizations. .

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

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

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

This section governs how a limited cooperative association comes into existence. An association is formed only if (i) articles of organization are prepared, signed and delivered to the specified public official for filing, (ii) the public official files the articles, (iii) the articles are in substantial compliance with this Section, and (iv) the articles become effective under Section 205(c). To commence business an association must have patron members. *See* Section 501.

Despite its foundational importance, the articles of organization of a limited cooperative

association are not required to contain significant amounts of information. Under this act bylaws must contain certain provisions that are fundamental to the organizational structure of a limited cooperative association if those matters are not contained in the articles or which override specific default rules hereunder. *See* Sections 109, 303(a) and 405(e). The bylaws of an association play a more powerful role than is typical in corporate law. Together the articles and bylaws are similar to the operating agreement of a limited liability company or the partnership agreement of a partnership. The relationship between the articles and bylaws of limited cooperative associations, therefore, places great weight on any planning decision to delegate authority to the board of directors to amend the bylaws.

The bylaws are, however, subject to the articles. *See* Section 303(a). Some matters must be addressed, if at all, in the articles to effectively vary the default rules of this act. *See* Section 109(b).

Subsection (a)(1) – Section 115 contains name requirements. To be acceptable for filing, articles of organization must state a name for a limited cooperative association that complies with that section.

Subsection (a)(2) – For "the purposes for which the association is formed," the articles of organization may state "any lawful purpose." *See* Section 104(b).

SECTION 302. ORGANIZATION OF LIMITED COOPERATIVE ASSOCIATION.

(a) After a limited cooperative association is formed:

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

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

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

association to begin business.

(c) Initial directors need not be members.

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

Comment

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

Subsection (a) – This subsection contemplates adoption of initial bylaws by the initial directors. There are circumstances, however, under which bylaws might not be required such as where all provisions required to be in the bylaws or articles of organization are in the articles of organization. *See* Section 303(a).

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

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

SECTION 303. BYLAWS.

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

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

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

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

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

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

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

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

(6) a statement concerning:

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

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

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

(b) Subject to Section 109(c) and the articles of organization, bylaws may contain any other provision for managing and regulating the affairs of the association.

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

Comment

The initial directors adopt the original bylaws. Section 302.

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

This act provides default rules for many items that can be covered in bylaws and permits the bylaws to vary many of those default rules. This act does not, however, address or provide for all matters that are permitted in an association's bylaws. *See* Section 109(c) and Section 303(b). Best practices might dictate that bylaws contain comprehensive provisions for the governance and financial structure of the association.

Bylaws have played a particularly central role in traditional cooperatives. Traditional cooperative statutes sometimes place power in the members to determine specific matters in the bylaws, such as the allocations of the profits or savings of the association. In practice bylaws have been a source for the cooperative principle of democratic control by members. *See* comment to Section 103. Membership qualification and eligibility frequently appear in the bylaws. In the agricultural marketing cooperative, even the marketing contract sometimes appears in the bylaws. Under this act, members are specifically required to address and vote on various matters unless the bylaws, or the articles of organization, otherwise provide.

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

Subsection (a) – This subsection states the minimum requirements for bylaws of a limited cooperative association if those required provisions are not contained in the articles of organization. It draws upon the statutory requirements for bylaws of traditional cooperatives. The primary focus of the required provisions is on governance and financial rights.

Oral bylaws are not permitted by this act, however, not all policies or procedures adopted by the board of directors pursuant to Section 801(b) need be contained in the bylaws. *Compare* Section 303(b) *with* Section 801(b).

Subsection (a)(1) – This subsection, together with Section 1001, requires the organic rules (articles of organization and bylaws –See Section 102 (20)) to set forth the financial rights and obligations between the members and the limited cooperative association. The items contained in subsection (a)(1)(A) broadly include both financial benefits and burdens. Therefore, for example, provisions for additional capital contribution requirements must be made in the organic rules under Section 1001.

[ARTICLE] 4

AMENDMENT OF ORGANIC RULES OF LIMITED COOPERATIVE ASSOCIATION

SECTION 401. AUTHORITY TO AMEND ORGANIC RULES.

(a) A limited cooperative association may amend its organic rules under this [article] for any lawful purpose. In addition, the initial board of directors may amend the bylaws of an association under Section 303.

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

Comment

This section is important because it introduces the manner and method of amending the organic rules (Section 102(20)) and provides background concerning the unique relationship and distinction between the articles of organization and bylaws of a limited cooperative association. *See* Sections 109 and 405(e). It is important because it contains a clear statement of authority to amend the organic rules.

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

The default rule for all bylaw amendments require member voting. These provisions are consistent with the nature of the limited cooperative association and underscore its unique management structure with centralized management, but democratic control. The organic rules may provide for greater voting percentages than the default rules, including unanimity. The act provides mechanisms in this article and elsewhere which balance and protect the interests of patron members and investor members when investor members are introduced into the association. *See, e.g.*, Sections 405 ("Approval of Amendment"), 1004 ("Allocations of Profits and Losses"), and 1203 ("Judicial Dissolution").

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

Subsection (b) – Without this subsection, it is possible that all amendments would require unanimity based on contract principles because the contractual nature of an association might give rise to vested property rights. *See* Prefatory Note to 2007 Act. The subject of this section also appears in corporate law for slightly different historical reasons. Much of the common law for traditional cooperatives has arisen under a corporate structure and, therefore, may be helpful here. This subsection does not directly address contracts between an association and its members or between members that are independent from the organic rules.

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

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

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

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

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

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

(2) a recommendation that the members approve the amendment, or if the board

determines that because of conflict of interest or other special circumstances it should not make a favorable recommendation, the basis for that determination;

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

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

Comment

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

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

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

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

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

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

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

Comment

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

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

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

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

Comment

Section 405 provides the fundamental voting structure for the members in a limited cooperative association. This structure is repeated throughout the act although the percentage votes are different in various areas. The rules of that section apply whether there are only patron members of an association or a combination of patron members and investor members voting together as the entire membership. This section provides an alternative voting structure if the organic rules provide for members to be divided into districts or classes as authorized in Section 517. Where the members are to vote on the amendments to the organic rules by district or class, the rules of Section 405 apply in determining whether a proposed amendment is passed in each district or class.

The same alternative structure applies to other identifiable voting groups that would be affected differently from other members with respect to the items listed in Section 405(e)(1) through (5). "Voting group" is a defined term. *See* Section 102(34). The concept of voting group is protective. It gives a group of similarly situated members who share a specific burden under a

fundamental change a right to vote separately in order to protect their interests. Voting groups are not provided in the organic rules. Rather only districts and classes are provided for in the organic rules. Voting groups for purposes of voting on a proposed amendment to the organic rules would be determined based upon the scope of the amendment and the members it would affect.

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

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

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

SECTION 405. APPROVAL OF AMENDMENT.

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

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

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

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

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

and

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Comment

Voting structure is one of the key balancing points between patron members and investor members necessary to fulfill the purposes of the act. The voting structure in this section is also contained in correlative voting provisions concerning dissolution (Section 1205), merger, interest exchange, conversion, and domestication transactions (Section 518), and disposition of assets (Section 1604). Another important balancing provision is Section 514(1) that requires the majority of voting power be held by patron members.

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

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

Subsection (a) – The default vote to amend the articles of organization is two-thirds of the

voting power present at the meeting.

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

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

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

The bifurcated voting structure also provides investor members significant voting influence. The two-thirds majority under subsection (a)(1) would not be reached in the Example even if all the patron member votes were cast for the amendment unless a sufficient number of investor members vote to achieve the required two-thirds. In addition, using the flexibility afforded under Section 404, blocking power could be provided to investor members by establishing strict class voting for them in the organic rules. The same could be done for patron members.

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

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

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

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

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

Comment

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

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

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

(1) the name of the association;

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

(3) the text of the amendment.

(b) Before the beginning of the initial meeting of the board of directors, an organizer who

knows that information in the filed articles of organization was inaccurate when the articles were filed or has become inaccurate due to changed circumstances shall promptly:

(1) cause the articles to be amended; or

(2) if appropriate, deliver an amendment to the [Secretary of State] for filing pursuant to Section 204.

(c) To restate its articles of organization, a limited cooperative association must deliver to the [Secretary of State] for filing a restatement designated as such in its heading.

(d) Upon filing, an amendment of the articles of organization or other record containing an amendment of the articles which has been properly adopted by the members is effective as provided in Section 205.

Comment

If a restatement of the articles of organization contains amendments, it must be filed. If a restatement does not contain amendments, this section permits it to be filed. Amendments to the articles may also be included in statements of merger, interest exchange, conversion, and domestication that are filed.

[ARTICLE] 5

MEMBERS

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

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

Comment

One person may organize a limited cooperative association under Section 301 but this section adds an additional requirement that the association have at least two *patron* members to begin business unless the sole member is a cooperative. More than one member is required

consistent with the general meaning of "cooperation." The requirement of multiple members to begin business is, thus, somewhat analogous to partnership law that requires two members to form a partnership. *See* Section 202 (a) of the UPA (1997) (last Amended 2013). *See also* comment to Section 301. The reason a cooperative is allowed to be a sole member is because its "organic" law will provide the necessary "cooperation" among members.

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

SECTION 502. BECOMING MEMBER.

(a) If a limited cooperative association is to have only one cooperative member upon formation, the cooperative becomes a member as agreed by that cooperative and the organizer of the association. That cooperative and the organizer may be, but need not be, different persons. If different, the organizer acts on behalf of the initial cooperative member.

(b) If a limited cooperative association is to have more than one member upon formation, those persons become members as agreed by the persons before the formation of the association. The organizer acts on behalf of the persons in forming the association and may be, but need not be, one of the persons.

(c) After formation of a limited cooperative association, a person becomes a member:

(1) as provided in the organic rules;

(2) as the result of a transaction effective under [Article] 16;

(3) with the affirmative vote or consent of all the members; or

(4) as provided in Section 1202(3).

Comment

This section combines concepts from traditional cooperatives, limited liability companies and partnerships in determining how persons become members. Traditional cooperatives usually provide for the qualifications and the process for admitting members in their bylaws. Limited liability companies and partnerships usually provide for these matters in their operating agreements or partnership agreements, respectively, and frequently require member consent for admission as a member or partner in the entity.

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

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

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

Subsection (c)(2) – Subsection (c)(2) recognizes that memberships may be continued or new memberships may be created in a merger, interest exchange, conversion, or domestication.

SECTION 503. NO AGENCY POWER OF MEMBER AS MEMBER.

(a) A member is not an agent of a limited cooperative association solely by reason of being a member.

(b) A person's status as a member does not prevent or restrict law other than this [act] from imposing liability on a limited cooperative association because of the person's conduct.

Comment

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

of the association, for example, by an act of the board of directors, with power to bind the association under the law of agency as otherwise applicable.

SECTION 504. LIABILITY OF MEMBERS AND DIRECTORS.

(a) A debt, obligation, or other liability of a limited cooperative association is solely the debt, obligation, or other liability of the association. A member or director is not personally liable, directly or indirectly, by way of contribution or otherwise, for a debt, obligation, or other liability of the association solely by reason of being or acting as a member or director of the association. This subsection applies regardless of the dissolution of the association.

(b) The failure of a limited cooperative association to observe formalities relating to the exercise of its powers or management of its activities and affairs is not a ground for imposing liability on any member or director for a debt, obligation, or other liability of the association.

Comment

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

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

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

This section has no application to directors whose liability is addressed in Sections 802

and 818 through 820.

This act does not address the equitable doctrine of "piercing the veil" which is well-established with respect to corporations, Because certain formalities are required in the operation of a limited cooperative association organized under this act, corporate law regarding "piercing the corporate veil" (including the factor of "disregard of corporate formalities") could properly be applied to associations organized under this act under some circumstances even though they are unincorporated associations. *See* comment to ULLCA (2006) (Last Amended 2013) § 304 (b). Of course, disregard of formalities is but one factor of the multifactor analysis applied in cases of equitable piercing. Finally, some provision of regulatory law outside this act may impose liability on members and this section does not affect the operation of those regulations. *See* Section 107.

SECTION 505. RIGHT OF MEMBERS AND DISSOCIATED MEMBERS TO INFORMATION.

(a) On reasonable notice, a member may inspect and copy during regular business hours, at the principal office or a reasonable location specified by the limited cooperative association, required information listed in Sections 110(a)(1) through (8). A member need not have any particular purpose for seeking the information. The association is not required to provide the same information listed in Section 110(a)(1) through (8) to the same member more than once during a six-month period.

(b) On reasonable notice, a member may inspect and copy during regular business hours, at the principal office or a reasonable location specified by the limited cooperative association, required information listed in Section 110(a)(9), (10), (12), (13), (16), and (18), if:

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

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

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

(4) the demand is reasonable.

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

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

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

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

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

(d) On 10 days' demand made in a record received by a limited cooperative association, a dissociated member may have access to information to which the person was entitled while a member if the information pertains to the period during which the person was a member, the person seeks the information in good faith, and the person satisfies the requirements imposed on a member by subsection (b)(2). The association shall respond to a demand made pursuant to this subsection in the manner provided in subsection (b)(3).

(e) Not later than 10 business days after receipt by a limited cooperative association of a demand made by a member in a record, but not more often than once in a six-month period, the association shall deliver to the member a record stating the information with respect to the member required by Section 110(a)(17).

(f) In addition to any restriction or condition stated in its organic rules, a limited cooperative association, as a matter within the ordinary course of its activities and affairs, may impose reasonable restrictions and conditions on access to and use of information to be furnished

under this section, including designating information confidential and imposing nondisclosure and safeguarding obligations on the recipient. In a dispute concerning the reasonableness of a restriction under this subsection, the association has the burden of proving reasonableness.

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

(h) A member or dissociated member may exercise rights under this section through an agent or, in the case of an individual under legal disability, a legal representative. Any restriction or condition imposed by the organic rules or under subsection (g) applies both to the agent or legal representative and the member or dissociated member.

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

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

Comment

This section provides to members of a limited cooperative association rights of inspection of records of the association that must be maintained by it under Section 110, but the section does not require an association to maintain any records that are not specifically required to be maintained under Section 110. These rights may not be reduced by the organic rules although subsection (f) does permit an association to impose reasonable restrictions on the use of information obtained by a member under this section.

Cooperative associations present a conundrum with respect to information about the association. Cooperatives are owned and controlled by their members. Members need information for that purpose. Most cooperatives are, however, representative democracies governed by a board of directors or similar body elected by the members. This may reduce the need for information on the part of members and permit a cooperative to withhold confidential information from the members. The "proper purpose" provision of subsection (b) allows an evaluation of the need for the information demanded by the member making the demand to be measured against the needs of the association. If there is a change in information obtained by a member under this section, the changed information is new information for purposes of this section. The section anticipates that both a member and the limited cooperative association will

act in good faith with respect to the rights and obligations of each under this section.

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

Records listed in subsections 110(a)(11), (14) and (15) regarding accounting records and contributions are not covered by the inspection rights of this subsection because of concerns over confidentiality and privacy.

Subsection (a) – The subsection permits a member to request, inspect and copy records specified in Section 110(a)(1) through (8) that are records that should be generally available and relate to the organization, general financial condition and membership actions of the association. No particular purpose is required for the inspection and copying of these records.

Subsection (b) – The subsection permits a member to request, inspect and copy records specified in Section 110(a)(9), (10), (12), (13), (16) and (18) that may be records more likely to contain confidential information or information that may be more difficult to understand or harder for an association to produce than the records referenced in subsection (a). To obtain access to these records a member must act in good faith and state a "proper purpose" for seeking the records that must be directly connected to the member's purpose. "Proper purpose" is a well-recognized term. This subsection closely follows corporate provisions. *See* MBCA § 16.02.

The six-month time period in subsection (a) and "proper purpose" under subsection (b) serve an analogous function to the phrase, "except to the extent the demand or information demanded is unreasonable or otherwise improper under the circumstances" in ULLCA (2006) (Last Amended 2013) § 410(a)(2)(B).

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

Subsection (d) – A person dissociated as a member may obtain any of the information referenced in subsections (a) or (b) but in either case must follow the procedures for a member seeking to obtain information under subsection (b). The right to inspect and copy records under this section does not extend to a transferee of a member who has not been admitted as a member in the limited cooperative association. *See* subsection (i). If a member dies or is adjudged incompetent Section 1103 applies.

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

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

SECTION 506. ANNUAL MEETING OF MEMBERS.

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

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

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

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

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

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

Comment

Section 506(a) requires every limited cooperative association to hold an annual meeting of members each year. Rather than having an annual meeting, the members may take action by written consent under Section 516. Unlike corporate statutes, this section does not specifically require an election of directors to the board of directors at the annual meeting, but this is implied from subsection 805(a) that provides a director's term expires at the annual meeting following the

director's election or appointment unless the organic rules otherwise provide. The purpose of an annual meeting is not limited and provides an appropriate forum for a member to raise any relevant question about the association's operations unless inconsistent with notices of annual meetings where fundamental changes such as amendments to the limited cooperative association's organic rules are to be considered. *See* Sections 402, 508(b).

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

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

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

The default rule in subsection (c) provides great flexibility by allowing conduct of meetings and member attendance through means of modern communication (e.g., telephone and the internet) while protecting the deliberative function of the meeting. The use of the words "attend" and "conduct" encompass the ability to vote and, therefore, voting under subsection (c) is not "voting by other means" for purposes of Section 515(d). *See also* Section 507 (e) (similar flexibility for special meetings of members).

SECTION 507. SPECIAL MEETING OF MEMBERS.

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

(1) as provided in the organic rules;

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

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

purpose of the meeting stated in the demand; or

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

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

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

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

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

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

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

Comment

This section provides the means for calling and holding special members meetings of the limited cooperative association. Any meeting of members other than an annual meeting is a special meeting. The primary difference between an annual meeting and a special meeting under this act is that any issue relevant to the association may be discussed at an annual meeting subject only to special notice requirements for certain matters under this act, for example, voting on

amendments to the organic rules, sales of assets, and Article 16 transactions. Only issues provided in the call and notice of a special meeting may be discussed at a special meeting. *See* Section 508(c). If an annual meeting is not held, members could demand that a special meeting be held to consider specific items that would ordinarily be considered at an annual meeting.

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

Members may suggest a place for a special meeting, but the ultimate authority for determining the place is the organic rules or the board of directors under Subsection (d). The act does not specifically state who sets the time and date of a special meeting. Generally the board of directors acting for the limited cooperative association would set the time and date under its management authority in Section 801 and the notice provisions of Section 508(a).

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

SECTION 508. NOTICE OF MEMBERS MEETING.

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

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

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

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

Comment

This act requires that notice of meetings be given to all members of a limited cooperative association whether they are entitled to vote at the meeting or not. This seems more consistent

with cooperative principles than corporate statutes under which, generally, only shareholders who are entitled to vote at a meeting are entitled to notice. *See* MBCA § 7.05(a).

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

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

SECTION 509. WAIVER OF MEMBERS MEETING NOTICE.

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

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

Comment

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

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

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

Comment

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

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

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

Comment

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

Section 513 governs voting by investor members.

SECTION 512. ALLOCATION OF VOTING POWER OF PATRON MEMBER.

(a) The organic rules may allocate voting power among patron members on the basis of

one or a combination of the following:

(1) one member, one vote;

(2) use or patronage;

(3) equity; or

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

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

Comment

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

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

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

EXAMPLE: A member sells and delivers wheat to the association. The member is paid $60,000 for the wheat sold and delivered. Over a one year period, the association paid $2,000,000 for all the wheat it purchased from all of its members. The association's organic rules base voting power on patronage measured by the purchase price paid to each member for wheat purchased from each member during the year. The member that was paid $60,000 would be entitled to 3% of the voting power of all of the voting members in the association.

If the association in this example had ten members, and each had only one vote, each member would have 10% of the voting power. If voting in this example is based on patronage percentages, the fact that the member did not have ten percent of the voting power does not violate Section 511 because the member is entitled to vote the member's percentage of total member patronage as determined under the organic rules of the

association. *period*.

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

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

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

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

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

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

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

EXAMPLE: An association has 20 individual members and a cooperative entity as a member that itself has 15 members. The organic rules could provide for adding all the individual members of the association and the 20 members of the cooperative together for a total of 35 votes of which 15 would be cast by the cooperative member.

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

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

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

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

Comment

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

If there are to be investor members the organic rules must provide for them. If they do not do so, all of the members must be patron members by default. *See* Section 502(a). If the organic rules provide for investor members, they may provide for any means of allocating voting power among them including the use of classes and combinations of classes. If the organic rules do not provide another means of allocating voting power, each investor member will have one vote following the cooperative "one person, one vote" principle. *See* Comment to Section 511.

However, unlike patron member voting under Section 511, this section permits the organic rules to provide for nonvoting investor members. No matter of the quantum of votes a member votes, the voting provisions of an association must meet the requirements of Section 514.

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

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

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

(A) all members voting at the meeting unless more than a majority is required by [Article] 4, 12, 14, or 16 or the organic rules; and

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

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

Comment

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

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

Paragraph (2) – If there are investor members this section mandates two tests that must be met for members to take action: (1) a majority of all members voting must be in the affirmative; and, (2) a majority of patron members voting must be in the affirmative. The two test approach is used for voting by members throughout the act. The organic rules may require a larger affirmative vote for all members voting or may increase the affirmative vote required by

patron members. By mandating patron member votes to be counted separately, this act gives the patron members blocking power in all votes but does not necessarily give them the ability to dictate affirmative action.

Voluntary dissolution, amendments to the organic rules, Article 16 transactions and certain dispositions of assets have special minimum voting requirements under Sections 405, 518, 1205, and 1404.

EXAMPLE: A limited cooperative association has 30 members of which 20 are patron members and 10 are investor members all of whom attend and vote at a meeting of members. The bylaws provide for voting on a "one member, one vote" basis. The association has a majority of the total voting power in patron members. On a particular proposition, 12 of the patron members vote "yes" and eight vote "no." Four investor members vote "yes" and six vote "no." A majority of all members (16 of 30) voted "yes" and a majority of the patron members (12 of 20) voted "yes." The proposition passes.

EXAMPLE: In the preceding example, eight of the patron members vote "yes" and 12 vote "no." All of the investor members vote "yes." Clearly a majority of all the members (18 of 30) voted "yes" but the proposition does not pass because a majority of the patron members did not vote "yes."

EXAMPLE: In the first example, 18 patron members vote "yes" and two vote "no." All of the investor members vote "no." The proposition passes because a majority of the members (18 of 30) voted "yes" and a majority of the patron members (18 of 20) voted "yes" even though the proposition received no votes from the investor members. *But see* Comment to paragraph (3).

Paragraph (3) – In addition to the requirement for separately counting patron member votes, the organic rules may provide for a percentage of affirmative votes of the investor members necessary for a matter to be approved. That percentage does not necessarily need to be a majority and, unlike patron member voting percentage under paragraph (2), may be below a majority. A separate affirmative vote by investor members as permitted by this paragraph may result in giving investor members blocking power. This paragraph is for emphasis because it would be allowed under the general flexibility of the act if the act were silent. *See* Section 109.

SECTION 515. MANNER OF VOTING.

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

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

another investor member as a proxy.

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

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

Comment

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

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

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

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

Subsection (d) – The subsection gives broad power for the organic rules to provide for membership voting to be conducted in ways other than by being in attendance at a meeting or by authorizing a vote to be cast by a proxy. The power can be extended to all or less than all matters brought before the members at a meeting. The power can be utilized to prohibit other means of voting. Secret ballots could be required. Voting by mail could be authorized.

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

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

SECTION 516. ACTION WITHOUT A MEETING.

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

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

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

Comment

Most state business corporation statutes allow for less than unanimous consent in writing for action by shareholders and the consents are generally effective if signed and delivered by the number of shareholders necessary to pass a matter if it were voted on at a meeting. Unincorporated law rarely, if ever, requires meetings but does contemplate written consents. *See e.g.*, ULLCA (2006) (Last Amended 2013 § 407(d). This act retains the historical and more prevalent requirement that written consent to action without a meeting must be unanimous. The unanimity requirement provides that each member has the ability to force a meeting for purposes of voting and discussion of the matter to be voted upon. This is consistent with the deliberative function of meetings and cooperative principles.

SECTION 517. DISTRICTS AND DELEGATES; CLASSES OF MEMBERS.

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

(1) for the conduct of patron member meetings by districts and the election of

directors at the meetings; or

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

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

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

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

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

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

Comment

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

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

Subsections (a) and (b) – The geographic locations of patron members in a limited cooperative association may cause them to reflect different perspectives with respect to the association. For this reason, many traditional cooperatives, especially in agriculture, have permitted the division of members into geographic districts within which the members can

address localized concerns, have representatives or delegates represent those interests in association wide meetings, and otherwise benefit from more localized structures within larger organizations. These subsections permit the organic rules to provide for formation of geographic districts of patron members, the conduct of district meetings, the election of directors from districts, and provides a default rule for voting by a delegate elected by a district to represent the district in a full membership meeting. The subsections do not provide details for the structure or operation of a district leaving that to the organic rules and, under its general management authority, the board of directors.

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

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

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

SECTION 518. APPROVAL OF TRANSACTION UNDER [ARTICLE] 16.

(a) For a limited cooperative association to approve a plan for a transaction under [Article] 16, the plan must be approved by a majority of the board of directors, or a greater vote if required by the organic rules, and the board shall call a members meeting to consider the plan, hold the meeting not later than 90 days after approval of the plan by the board, and mail or otherwise transmit or deliver in a record to each member:

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

(2) a recommendation that the members approve the plan, or if the board

determines that because of a conflict of interest or other circumstances it should not make a favorable recommendation, the basis for that determination;

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

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

(b) Subject to subsections (c) and (d), a plan must be approved by:

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

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

(c) The organic rules may provide that the required vote under subsection (b)(1) be:

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

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

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

(d) The vote required under subsections (b) and (c) to approve a plan may not be less than the vote required for the members of the limited cooperative association to amend the articles of organization.

(e) A member's consent in a record to a plan must be delivered to the limited cooperative association before delivery to the [Secretary of State] for filing of articles of merger, interest exchange, conversion, or domestication if, as a result of the merger, interest exchange,

conversion, or domestication, the member will have interest holder liability for debts, obligations, or other liabilities that are incurred after the transaction becomes effective.

(f) The voting requirements for districts, classes, or voting groups under Section 404 apply to approval of a transaction under this [article].

Comment

Article 16 authorizes mergers, interest exchange, conversion, and domestication transactions involving limited cooperative associations. This section, which was added to this act in the Harmonization project, consolidates in one section the voting requirements for approval of these transactions. These voting requirements were formerly part of the approval section for each type of transaction in what is now Article 16. The approval sections (Sections 1623, 1633, 1643, and 1653) contain additional provisions and refer to Section 5i8 for the voting requirements.

Subsection (e) – This provision deals with the situation where an interest holder (defined in Section 1601 (18) of an entity that is a party to an Article 16 transaction will have vicarious liability for the liabilities of the surviving entity that are incurred after the Article 16 transaction is effective. *See also* Sections 1626 (c), 1636 (c), 1646 (c), and 1656 (c).

[ARTICLE] 6

MEMBER'S INTEREST IN LIMITED COOPERATIVE ASSOCIATION

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

(1) is personal property;

(2) consists of:

(A) governance rights;

(B) financial rights; and

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

(3) may be in certificated or uncertificated form.

Comment

This act has its genesis in cooperative principles and laws. Its structure combines

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

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

Nonetheless, this act provides for the fundamental governance rights and financial rights within a limited cooperative association and between the association and its members as well as the governance and financial relationships among all the members. The act permits the organic rules of an association to vary, with certain limitations (for example, Section 514 that requires certain voting power for patron members), many of the rules provided by the act function as default rules so that the governance and financial relationships within the association can be designed to fit the objectives and needs of the association and its members. *See* Section 109.

Paragraph (1) – Like ULLCA (2006) (Last Amended 2013) and ULPA (2001) (Last Amended 2013), a member's interest in a limited cooperative association is personal property. Section 603(a) deals with transferability and the results of transfers or attempted transfers, either voluntary or involuntary.

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

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

a membership agreement or the organic rules may affect whether those provisions are interpreted solely as a matter of third party contract. Such a determination will depend on all the facts and circumstances of the particular scenario.

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

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

Some traditional cooperatives provide in their organic rules and operating policies that simply engaging in business with the cooperative constitutes an application for membership in the cooperative or automatically constitutes a person as a member of the cooperative. For example, rural telephone cooperatives almost always provide that a request for service also constitutes an application for membership and, in some cases, require a person to be a member to obtain telephone service. This act does not prohibit this type of provision in the organic rules.

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

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

SECTION 602. PATRON AND INVESTOR MEMBERS' INTERESTS.

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

(b) Unless the organic rules otherwise provide, if a limited cooperative association has

investor members, while a person is a member of the association, the person:

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

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

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

Comment

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

Subsection (b) – If a limited cooperative association has investor members, persons who become a member as either a patron member or as an investor member will remain that type of member so long as the person remains a member of the association. A person may hold memberships in both capacities. *See* Section 112. The organic rules could provide that a patron member is converted to an investor member upon the occurrence of specified events, such as ceasing to qualify as a patron member under the organic rules. If a person holds memberships in both capacities, the member could dissociate in one capacity but not in the other or, subject to the act and the organic rules of the association, could transfer one type of membership interest but not the other.

SECTION 603. TRANSFERABILITY OF MEMBER'S INTEREST.

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

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

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

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

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

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

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

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

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

(h) A transfer of a member's financial rights in violation of a restriction on transfer contained in the organic rules is ineffective if the intended transferee has notice of the restriction at the time of transfer.

Comment

Generally – Unincorporated entity law restricts transferability of interests because of the personal and contractual nature of the entities. Members choose to form unincorporated entities in reliance on their knowledge of, and comfort with, the persons with whom they will be associated. The governing law generally distinguishes between the governance (or management) rights of members and their financial rights. *See, e.g.*, ULLCA (2006) (Last Amended 2013) § 501 (transferable interest is personal property); § 502(a)(3)(A) (transfer does not entitle transferee to participate in management or conduct of company's activities); § 502(a)(3)(B) (transferee has right to receive distributions to which transferor would otherwise be entitled).

This act draws the same basic distinction. Thus, subsections (b) and (c) provide the default rule that only financial rights may be transferred, and subsection (f) states that a transferee of financial rights does not thereby become a member. Subsection (e) provides that a transferee of financial rights receives only the right to share in the allocation of profits and losses and the right to receive the distributions to which the transferring member would otherwise have been entitled. A member who transfers financial rights retains governance rights. *See* comment to Section 102(9).

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

is especially true in a small, closely held entity.

In secured transactions involving a member's interest in a limited cooperative association as collateral, Uniform Commercial Code Sections 9-406 and 9-408 must be consulted to determine whether any restrictions on the transferability of the member's interest are effective with respect to the secured party.

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

Subsection (c) – To be effective, a restriction or prohibition on the transfer of financial rights in a limited cooperative association must be set forth in the organic rules. The default rule that financial rights are transferable is based on laws governing other unincorporated entities, where such rights are considered to be personal property that is not subject to transfer restrictions except to the extent a restriction is set forth in the entity's organic document.

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

Subsection (f) – A transferee of the financial rights of a member of a limited cooperative association does not automatically become a member of the association because of the transfer. For a transferee to become a member (with all the rights of a member including governance rights) requires an act of the association to admit the transferee as a member of the association. See Section 502 (c). A mere transfer of financial rights does not alone dissociate the transferor member. *See* Section 1101. Therefore, under the default rules, the transferor retains all other rights including the right to vote as a member. If the transferor is dissociated pursuant to Section 1101, the voting rights associated with the membership vanish. The organic rules could vary this result, however, by admitting the transferee as a member. If the organic rules admit the transferee, they should address the case of a transfer to a transferee who is an existing member; especially if the association uses the one member - one vote manner of voting.

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

in the organic rules.

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

SECTION 604. SECURITY INTEREST AND SET-OFF.

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

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

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

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

Comment

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

Subsection (c) – This subsection permits the organic rules of a limited cooperative association to create an enforceable UCC Article 9 security interest in the financial rights of a member to secure the indebtedness or the performance of obligations of a member to the association with the organic rules themselves constituting the security agreement. In other words, the organic rules will have the same legal effect as a UCC Article 9 security agreement

authenticated by the debtor (member) and describing the collateral as the member's financial rights. If the organic rules provide for such a security interest, issues of perfection, priority, and the manner of enforcement are governed by the relevant provisions of the UCC.

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

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

Subsection (d) – Under the default rule of this subsection, no member of a limited cooperative association may require the association to offset amounts due to the member from the association against amounts due to the association from the member. An association may, however, offset against amounts due a member in accordance with other law.

SECTION 605. CHARGING ORDER.

(a) On application by a judgment creditor of a member or transferee, a court may enter a charging order against the financial rights of the judgment debtor for the unsatisfied amount of the judgment. Except as otherwise provided in subsection (f), a charging order constitutes a lien on the judgment debtor's financial rights and requires the limited cooperative association to pay over to the person to which the charging order was issued any distribution that otherwise would be paid to the judgment debtor.

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

(1) appoint a receiver of the 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 necessary to give effect to the charging order.

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

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

(e) At any time before foreclosure under subsection (c), the limited cooperative association or one or more members whose financial rights are not subject to the charging order may pay to the judgment creditor the full amount due under the judgment and thereby succeed to the rights of the judgment creditor, including the charging order. Unless the organic rules otherwise provide, the association may act under this subsection only with the consent of all members whose financial rights are not subject to the charging order.

(f) If a court forecloses a charging order lien against the sole member of a limited cooperative association:

(1) the court shall confirm the sale;

(2) the purchaser at the sale obtains the member's entire interest, not only the member's financial rights;

(3) the purchaser thereby becomes a member; and

(4) the person whose interest was subject to the foreclosed charging order is dissociated as a member.

(g) This [act] does not deprive any member or transferee of the benefit of any exemption law applicable to the member's or transferee's financial rights.

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

Comment

This section balances the needs of a judgment creditor of a member or transferee with the needs of the limited cooperative association and its members. The section achieves that balance by allowing the judgment creditor of a member to collect on the judgment from distributions with respect to financial rights of the judgment debtor in the association while prohibiting interference in the management and activities of the association by the judgment creditor or a court. If the organic rules permit the entire interest of a member in an association to be transferred, this section only permits a charging order to reach the member's or transferee's financial rights (defined in Section 102(9). *See also Section 603 ("Transferability of Member's Interest").* It does not permit a charging order to reach governance rights except in the circumstance described in subsection (f),

Under this section, the judgment creditor of a member or transferee is entitled to a charging order against the relevant financial rights. While the order is in effect, it entitles the judgment creditor to whatever distributions (defined in 102(15) would otherwise be due to the member or transferee whose interest is subject to the order. However, the judgment creditor has no voice in determining the timing or amount of those distributions. The charging order does not entitle the judgment creditor to accelerate any distributions or to otherwise interfere with the management and activities of the limited cooperative association.

"Distributions" may be made in a variety of ways under Section 1005 including the distribution of property. The charging order would apply to those distributions, but this would not compel the association to accelerate the time at which the property would be distributed or converted to money by the association in its ordinary course of operations.

This section may not be varied by the organic rules.

Subsection (a) – The phrase "judgment debtor" encompasses both members and transferees. As a matter of civil procedure and due process, an application for a charging order must be served both on the limited cooperative association and the member or transferee whose financial rights are to be charged. The order itself must be served on the limited cooperative association. Whether the order must also be served on the judgment debtor is a matter for other law.

Subsection (b) – Paragraph (2) refers to "other orders" rather than "additional orders". Therefore, given appropriate circumstances, a court may invoke either paragraph (1) or (2), or both.

Subsection (b)(1) – The receiver contemplated here is not a receiver for the limited cooperative association, but rather a receiver for the distributions. The principal advantage provided by this paragraph is a probable expanded right to information. However, that right goes no further than "the extent necessary to effectuate the collections of distributions pursuant to a charging order".

Subsection (b)(2) – This paragraph must be understood in the context of the balance described in the general comment to this section. In particular, the court's power to make orders "that the circumstances of the case may require" is limited to "giv[ing] effect to the charging order."

> EXAMPLE: A judgment creditor with a charging order believes that the limited cooperative association should invest less of its surplus in operations, leaving more funds for distributions. The creditor moves the court for an order directing the association to restrict re-investment. Subsection (b)(2) does not authorize the court to grant the motion.

> EXAMPLE: A judgment creditor with a judgment for $10,000 against a member obtains a charging order against the member's financial rights. Having been properly served with the order, the limited cooperative association nonetheless fails to comply and makes a $3,000 distribution to the member. The court has the power to order the association to pay $3,000 to the judgment creditor to "give effect to the charging order."

Under subsection (b)(2), the court also has the power to decide whether a particular payment is a distribution, because that decision determines whether the payment is part of the financial rights subject to the charging order. To the extent a payment is not a distribution, it may not be part of the financial rights and, if not, would not be subject to a charging order. In that connection, Section 1007(a) of this act excludes "reasonable compensation" from being a distribution.

> EXAMPLE: A member of ABC LCA has for several years received distributions from the LCA. However, when a judgment creditor of A obtains a charging order against A's transferable interest, the LCA ceases to make distributions to A and instead provides a

salary to A equivalent to A's former distributions. Under subsection (b)(2), a court might deem this salary a disguised distribution.(In any event, however, the salary will be subject to garnishment.)

This act has no specific rules for determining the fate or effect of a charging order when the limited cooperative association undergoes a merger, interest exchange, conversion, or domestication under Article 16.

Subsections (c)-(f) – These subsections set forth the procedure and effect of a foreclosure action on the charging order. As is pointed out in subsection(c), except as provided in subsection (f) (see below), the purchaser at a foreclosure sale only obtains the financial rights that are subject to the charging order.

The phrase "that distributions under the charging order will not pay the judgment debt within a reasonable period of time" comes from case law. *See, e.g., Nigri v. Lotz*, 453 S.E.2d 780, 783 (Ga. Ct. App. 1995).

Subsection (e) – The definition of "distribution" in Subsection 102(9) is broad enough to include payments in redemption of a membership interest in a limited cooperative association under Section 1006 making those payments a part of a member's financial rights. A charging order could reach distributions to redeem the interest. The procedure provided in ULLCA (2006) (Last Amended 2013) and followed in this act is appropriate for limited cooperative associations.

At the same time, when possible, buying the judgment remains superior to the mechanism provided by this subsection, because this subsection requires full satisfaction of the underlying judgment, while the limited cooperative association or the other members might be able to buy the judgment for less than face value. On the other hand, this subsection operates without need for the judgment creditor's consent, so it remains a valuable protection in the event a judgment creditor seeks to do mischief to the association.

A unanimous vote of members is required for an association to pay a member's judgment creditor under this subsection unless otherwise provided in the organic rules.

Subsection (f) – The charging order remedy – and more particularly, the exclusiveness of the remedy – protect the "pick your partner" principle in this and other uniform unincorporated entity acts as well as in traditional cooperative statutes. *See* Sections 502 ("Becoming a Member") and 603(f) ("A transferee of a member's financial rights does not become a member upon transfer of those rights unless the transferee is admitted as a member of the limited cooperative association"). That principle is inapposite when a limited cooperative association has only one member. The exclusivity of the charging order was never intended to protect a judgment debtor, but rather only to protect the interests of the judgment debtor's co-owners.

Put another way, the charging order was never intended as an "asset protection" device for judgments. *See Olmstead v. F.T.C.,* 44 So. 3d 76, 83 (Fla. 2010) and *Inre Aalbright*, 391 B.R. 538, 540 (Bankr. D. Colo. 2003), both of which involved single member limited liability

companies. Accordingly, when a charging order against the sole member of a limited cooperative association is foreclosed, the member's entire interest is sold and the buyer replaces the judgment debtor as the sole member.

This subsection was added to this act during the Harmonization project. It is parallel to Section 503(g) of ULLCA (2006) (Last Amended 2013). These are the only two unincorporated entity acts that have single member authorization. For example, a partnership must, by definition, have two or more partners.

Subsection (g) – This subsection preserves otherwise applicable exemptions but does not create any. *See*. *In Re Foos*, 405 B.R. 604, 609 (Bankr. N.D. 2009).

Subsection (h) – This subsection does not override Article 9 of the Uniform Commercial Code ("UCC"), which may provide different remedies for a secured creditor acting in that capacity. A secured creditor with a judgment might decide to proceed under UCC Article 9 alone, under this Section alone, or under both UCC Article 9 and this section. In the last-mentioned circumstance, the constraints of this section would apply to the charging order but not to the UCC Article 9 remedies. The effect of Section 604 with respect to the creation of security interests in membership interests in a limited cooperative association needs to be considered in connection with UCC Article 9 security interests and related remedies if a creditor seeks a security interest in a membership interest in an association in which the creditor's debtor is a member.

See the comments to Section 503 of ULLCA (2006) (Last Amended2013) for additional background information on the history and use of the charging order remedy in unincorporated entities.

[ARTICLE] 7

MARKETING CONTRACTS

Preliminary Comment

Agricultural cooperatives that market or process members' agricultural commodities have benefitted from special statutory marketing contract provisions that are unique to agricultural cooperatives under many traditional cooperative statutes. These statutes authorize the cooperative to enter into agricultural marketing contracts that specifically authorize sums for, or methods to establish, liquidated damages for a breach of the contract by a member selling and delivering or consigning commodities to the cooperative. In the early 1900s absent these statutory authorizations, marketing contracts were held to be void as against public policy. The damages provided in the contracts were treated as unenforceable penalties. *E.g.*, *Burns v. Wray Farmers' Grain Co.*, 65 Colo. 425, 176 P. 487 (1918) (agreement void); *Rifle Potato Growers' Coop. Ass'n v. Smith*, 78 Colo. 171, 240 P. 937 (1925) (agreement upheld and is not invalid because it permits injunctive relief or specific performance); *Mountain States Beet Growers' Mkt. Ass'n v. Monroe*, 84 Colo. 300, 269 P. 886 (1928) (discuss history of marketing contracts). Section 704 contains but a vestige of these statutory provisions addressing the enforcement of remedies that may be in

the contract.

The act broadens the application of marketing contracts from solely for agricultural commodities to the sale of products processed from any type of product, commodity, or goods furnished by a member; and, to commodities, products, and goods of any kind that are marketed through the association. Oregon, for example, has provided for a similar breadth in its traditional cooperative statute. OR. REV. STAT. § 62.355 (2003).

This article has no application to contracts for the purchase of any item by a limited cooperative association for its members in the role of a purchasing entity for the members or to contracts between an association and its members under which members of the association market their services to others. Likewise, it does not have any application to any other type of contractual relationship between the association and a member other than a marketing contract. It neither authorizes nor prevents the enforcement of remedies, including liquidated damages and injunctive relief, under other types of contracts. Those contracts are governed under the general law of contracts and other law.

"Goods" is used in the definitional sense of the Uniform Commercial Code (Section 2-105 (1)) but is supplemented by "products" and "commodities" to emphasize the breadth of authorization for an association's use of marketing contracts governed by this article.

Marketing contract provisions are sometimes distributed across a number of agreements or documents and do not necessarily appear within the four corners of a single instrument. *See* Comment to Section 601(2)(C); *cf.* JAMES R. BAARDA, STATE INCORPORATION STATUTES FOR FARMER COOPERATIVES, AGRICULTURAL COOPERATIVES SERVICE, UNITED STATES DEPARTMENT OF AGRICULTURE, Info. Rep. 30, § 14.04.12, p. 102 (1982). Provisions are sometimes placed in the organic rules, even though this can create difficulties if the provisions require amendment. Provisions are also sometimes placed in separate membership agreements.

Whether rights and obligations under a marketing contract are subject to assignment may be addressed in the organic rules or the terms of the contract itself as supplemented by the law of contracts. In the absence of express provisions concerning assignment in the organic rules or the contract itself, general contract law will govern. The contract or the provisions governing membership, wherever located, frequently require a person to be a member of a cooperative as a prerequisite to entering into a marketing contract. Such provisions may affect the assignability of a marketing contract.

If a limited cooperative association is not prevented by its organic rules from engaging in business with persons who are not members, frequently called "non-member patrons," the association may enter into marketing contracts with the non-member patrons. *See* Comment to Section 601(2)(C). Those contracts are authorized by Section 701(1) of the act and could contain provisions authorized by this article including the remedies provided in Section 704. If, however, provisions of the marketing contract are contained in the organic rules and those provisions are amended by an amendment to the organic rules, the amendments to the organic rules might not be binding on a non-member patron in the absence of the non-member patron's specific consent.

The provisions of this act regarding marketing contracts do not affect the application of statutes, such as the Packers and Stockyards act, 7 U.S.C.A. Section 181 *et seq.*, that provide protections for payments to agricultural producers who deliver their livestock or commodities to a buyer or processor *See* Sections 107 and 114.

This article has no effect on contracts, other than marketing contracts.

SECTION 701. AUTHORITY. In this [article], "marketing contract" means a contract between a limited cooperative association and another person,that need not be a patron member:

(1) requiring the other person to sell, or deliver for sale or marketing on the person's behalf, a specified part of the person's products, commodities, or goods exclusively to or through the association or any facilities furnished by the association; or

(2) authorizing the association to act for the person in any manner with respect to the products, commodities, or goods.

Comment

Paragraph (1) – A marketing contract may cover a portion or all of a member's products, commodities, or goods. It need not be a total output contract to be subject to this article.

Paragraph (2) – This paragraph permits a limited cooperative association to be a buyer, a sales agent, a consignee, or act in any other capacity in connection with marketing products, commodities, or goods under a marketing contract.

SECTION 702. MARKETING CONTRACTS.

(a) If a marketing contract provides for the sale of products, commodities, or goods to a limited cooperative association, the sale transfers title to the association upon delivery or at any other specific time expressly provided by the contract.

(b) A marketing contract may:

(1) authorize a limited cooperative association to create an enforceable security interest in the products, commodities, or goods delivered; and

(2) allow the association to sell the products, commodities, or goods delivered and

pay the sales price on a pooled or other basis after deducting selling costs, processing costs, overhead, expenses, and other charges.

(c) Some or all of the provisions of a marketing contract between a patron member and a limited cooperative association may be contained in the organic rules.

Comment

Subsection (a) – This subsection addresses the question of when title passes to products, commodities, or goods delivered and sold to a limited cooperative association under a marketing contract. The question often has no clear answer under other law if the contract does not provide one. This subsection provides the date of delivery as a default rule but recognizes the contract may provide a different time.

Subsection (b)(1) – This subsection recognizes that it may be necessary for business reasons for a limited cooperative association to borrow money to carry on its operations, including for purposes of making payments to its member patron suppliers, before it has sold the products, commodities, or goods delivered to it under the contract. A marketing contract may permit the association to grant a security interest in the products, commodities, or goods delivered to it even if title has not passed to the association. Perfection, priority and other matters related to the security interest are governed by other law such as Article 9 of the Uniform Commercial Code.

Subsection (b)(2) – This subsection permits a marketing contract to provide one of a variety of ways to determine the price or amount to be paid for products, commodities, or goods delivered to the association. It expressly includes pooling of products, commodities, or goods from all or several producers for marketing, sale, and payment based on the results of marketing the entire pool. The act does not provide default rules. The marketing contract must provide those terms.

SECTION 703. DURATION OF MARKETING CONTRACT. The initial duration of a marketing contract may not exceed 10 years, but the contract may be self-renewing for additional periods not exceeding five years each. Unless the contract provides for another manner or time for termination, either party may terminate the contract by giving notice in a record at least 90 days before the end of the current term.

Comment

This section limits the primary term of a marketing contract to a maximum of 10 years which is in accord with similar provisions concerning marketing contracts in traditional

cooperative statutes.

SECTION 704. REMEDIES FOR BREACH OF CONTRACT.

(a) Damages to be paid to a limited cooperative association for breach or anticipatory repudiation of a marketing contract may be liquidated, but only at an amount or under a formula that is reasonable in light of the actual or anticipated harm caused by the breach or repudiation. A provision that so provides is not a penalty.

(b) Upon a breach of a marketing contract, whether by anticipatory repudiation or otherwise, a limited cooperative association may seek:

(1) an injunction to prevent further breach; and

(2) specific performance.

(c) The remedies in this section are in addition to any other remedies available to an association under law other than this [act].

Comment

Subsections (a) and (b) – Many traditional cooperative statutes addressing marketing contracts in agriculture have detailed provisions regarding the enforcement and remedies. This Section identifies three primary remedies which a marketing contract may provide and authorizes their enforcement as provided in the contract. The remedies are expressed somewhat differently in this act as compared to their expression in many traditional cooperative statutes that include similar provisions.

[ARTICLE] 8

DIRECTORS AND OFFICERS

Preliminary Comment

This act draws its substance from limited liability company and partnership concepts and limited cooperative associations formed under it are unincorporated entities under state law. *See* Section 103. Traditional cooperatives, however, use a board of director management structure similar to corporate law (whether for-profit or not-for-profit). Therefore, this article dealing with boards of directors draws primarily from traditional cooperative and for-profit corporation statutes. This act requires an elected board of directors for general governance of a limited

cooperative association. *See* Section 801. Although not statutorily required by limited liability company law, some LLCs choose to organize their internal management to provide for a board management structure. Members have a more participatory role in cooperatives than in typical business corporations and any analogy to corporate management, therefore, is by its nature somewhat limited. Nonetheless, some of the meeting and notice provisions borrow heavily from corporate law because that content is where those provisions have the longest history and experience. This article does not generally contain the level of detail that is present in business corporation law leaving many of the details to be developed by the parties in the organic rules in a manner similar to other unincorporated or alternative entities like limited liability companies.

A substantial number of the provisions of this article, as in other articles, may be modified by the organic rules, but in the absence of modification, the article provides sufficient default rules that a board of directors can be elected and function.

SECTION 801. BOARD OF DIRECTORS.

(a) A limited cooperative association must have a board of directors of at least three individuals, unless the association has fewer than three members. If the association has fewer than three members, the number of directors may not be fewer than the number of members.

(b) The affairs of a limited cooperative association must be managed by, or under the direction of, the board of directors. The board may adopt policies and procedures that do not conflict with the organic rules or this [act].

(c) An individual is not an agent for a limited cooperative association solely by being a director.

Comment

Subsection (a) – This subsection is similar to Section 62.280(2) of the Oregon Cooperative Corporation Act. The subsection does not limit the number of directors to the number of members where there are fewer than three members but it does require there be at least the number of directors equal to the number of members in that case. The flexibility to deviate below three directors when there are fewer than three members allows an industry practice of having wholly-owned cooperative subsidiaries of a cooperative. It seems *unnecessary* as a matter of law to require three directors if there are only one or two members. Section 803(c)(1) permits an association to have one director who is a non-member if so provided in the organic rules if there is at least one director that is a member. Section 801(a) provides the members great, but not unfettered, flexibility in organizing their board governance structure.

Subsection (b) – This act follows statutes for most entities which have a governing body or other individuals authorized by statute or the entity's organic rules to manage or provide for the direction of the entity. This is consistent with a representative democracy approach followed in most traditional cooperative statutes and by most cooperatives. The general management authority of the board of directors is mandatory.

Subsection (c) – Simply being a director does not make the director an agent nor does it confer agency authority on a person to act on behalf of a limited cooperative association. The association could delegate agency authority to a director in the same manner as it delegates agency authority to other persons. *See* Section 503.

SECTION 802. NO LIABILITY AS DIRECTOR FOR LIMITED COOPERATIVE ASSOCIATION'S OBLIGATIONS. A debt, obligation, or other liability of a limited cooperative association is solely that of the association and is not a debt, obligation, or liability of a director solely by reason of being a director. An individual is not personally liable, directly or indirectly, for an obligation of an association solely by reason of being a director.

Comment

This section is "new" to the law of cooperatives as a codified statement and is arguably necessary because limited cooperative associations are unincorporated entities and distinguishes directors under this act with general partners of limited partnerships to whom they may be compared. It does not change the result under existing traditional cooperative law. The liability shield for directors is not different in-kind from the shield for members under Section 504. *See* Comment to Section 504. It does not shield the director from liability on account of the director's own conduct, for improper distributions under Section 1008(a), or for a breach of the duties under Sections 818 or 819.

SECTION 803. QUALIFICATIONS OF DIRECTORS.

(a) Unless the organic rules otherwise provide, and subject to subsection (c), each director of a limited cooperative association must be an individual who is a member of the association or an individual who is designated by a member that is not an individual for purposes of qualifying and serving as a director. Initial directors need not be members.

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

(c) If the organic rules provide for nonmember directors, the number of nonmember directors may not exceed:

(1) one, if there are two through four directors;

(2) two, if there are five through eight directors; or

(3) one-third of the total number of directors if there are at least nine directors.

(d) The organic rules may provide qualifications for directors in addition to those in this Section.

Comment

This section follows traditional cooperative approaches for the qualifications of directors in that, generally the directors must be individuals and must be a member of the limited cooperative association or a designee of a member that is not an individual even though a limited number of non-members may be directors.

The director qualification requirements of this act limiting the number of nonmember directors, as in cooperatives generally, may conflict with the concept of an "independent board." The conflict may be important in specific regulatory contexts. *See* Comment to subsection (c).

This section needs to be coordinated with Section 804 in practical application.

Subsection (b) – An officer or employee of the association may be a director, but would be required to be a member, a designee of a member that is not an individual, or a non-member director if non-member directors are authorized by the organic rules within the limitations of subsection (c), and meet any other qualifications for eligibility to be a director established in the organic rules under subsection (d).

Subsection (c) – In keeping with traditional cooperative governance structures which require directors to be members, the directors must be predominantly members or designees of members who are not individuals. This is a traditional cooperative policy that is different from corporate policy and against the general thrust of federal securities laws for publicly traded corporations. Traditional cooperative policy requires the governance of the cooperative to be in the hands of the members who are its owners and users and who provide the primary financial support of the cooperative. This act follows that policy but provides some flexibility in recognition of the possibility of having investor members in a limited cooperative association and in recognition of the potential usefulness of having a limited number of nonmember directors to provide outside advice and counsel in the affairs of the association.

Subsection (d) – Consistent with Section 109, the organic rules may provide additional

qualifications for eligibility to be a director. Those qualifications may not conflict with the requirements of this section.

SECTION 804. ELECTION OF DIRECTORS AND COMPOSITION OF BOARD.

(a) Unless the organic rules require a greater number:

(1) the number of directors that must be patron members may not be fewer than:

(A) one, if there are two or three directors;

(B) two, if there are four or five directors;

(C) three, if there are six through eight directors; or

(D) one-third of the directors if there are at least nine directors; and

(2) a majority of the board of directors must be elected exclusively by patron members.

(b) Unless the organic rules otherwise provide, if a limited cooperative association has investor members, the directors who are not elected exclusively by patron members are elected by the investor members.

(c) Subject to subsection (a), the organic rules may provide for the election of all or a specified number of directors by one or more districts or classes of members.

(d) Subject to subsection (a), the organic rules may provide for the nomination or election of directors by districts or classes, directly or by district delegates.

(e) If a class of members consists of a single member, the organic rules may provide for the member to appoint a director or directors.

(f) Unless the organic rules otherwise provide, cumulative voting for directors is prohibited.

(g) Except as otherwise provided by the organic rules, subsection (e), or Sections 302, 516,

517, and 809, member directors must be elected at an annual members meeting.

Comment

This section reflects one of the major policy decisions in the act concerning the cooperative principle of "user control" and the flexibility for an equity structure that includes "non-user" investor members. It resolves the matter by bifurcating the issue as follows: (1) director qualification requirements assuring a significant percentage of the board will be composed of patron members; and (2) requiring a majority of the board will be elected by patron members.

> EXAMPLE: Assume a limited cooperative association has 20 members (14 patron members, six investor members), six directors, and one vote for each member. Under the default rules, (1) two of the directors (one-third of the total number) must be patron members by whomever elected, and (2) only the patron members elect four (a majority) of the directors. The investor members may elect the other two directors.

The act's resolution of composition assures patron members have significant "control" over choosing board members. The extent of patron member "control," however, hinges on the terms of the organic rules and the interplay between the qualification, nomination and election provisions in them. This act does not address the nomination process. The protection of patron member control by the default and mandatory rules, however, is neither perfect nor designed to be complete and does not guarantee that patron members will always be able to dictate results.

Subsection (a)(1) – This subsection provides for the minimum number of directors who must be patron members. The organic rules may require that there be a greater number of directors who are patron members.

Subsection (a)(2) – In addition to the requirements of subsection (a)(1), the majority of the directors must be elected by the patron members, whether the directors are patron members, investor members, designees of members who are not individuals, or nonmembers. *See* Section 803.

Subsection (b) – Although a majority of the directors must be elected by patron members, this subsection permits a limited cooperative association through its organic rules to have great flexibility in the manner of electing the remaining directors.

Subsection (c) – Subject to the requirements of subsection (a) regarding the number of directors who must be patron members, the organic rules may provide for some or all of the directors of a limited cooperative association to be elected by districts or classes of members that may be established pursuant to Section 517. An association could have some directors elected by districts or classes and some elected at large. In the context of this act, the term "classes" of members is broader than the distinction between patron members and investor members. Election by classes, in particular, can significantly vary the results of elections when compared to the results under the default rules.

Subsection (d) – If provided by the organic rules, directors may be nominated or elected directly by members in districts or classes without a vote of the entire membership or the districts or classes may elect delegates to nominate or vote for directors at the annual meeting of a cooperative association without nominations from, or votes by, the entire membership. Of course, under the general flexibility of this act the organic rules may provide for other methods of nomination.

Subsection (e) – If a class of members consists of only one member, for example where there is only one investor member, the single member of the class may appoint a director rather than requiring the director to stand for election if such an appointment process is provided by the organic rules.

Subsection (f) – Cumulative voting for directors is not permitted in most traditional cooperatives. This subsection permits the organic rules to provide for cumulative voting. Corporate statutes typically no longer define "cumulative voting." This subsection follows that approach. Best practices would provide a definition in the organic rules if cumulative voting is to be permitted. The organic rules should fully cover how cumulative voting is intended to apply because of its complexity where classes or districts may exist.

Subsection (g) – This subsection provides a default rule that directors are elected at an annual meeting of the members. It may be varied by the organic rules within parameters. Other exceptions to this default rule reference other provisions of the act that apply in the context of specific circumstances. They are the appointment or naming of the initial board of directors (Section 302(a)), by action taken without a meeting (Section 516) and filling a vacancy on the board (Section 809). The other exceptions to the default rule stated in this subsection occur when the organic rules (1) provide for districts and classes (Section 517) including single member classes (subsection (e)), or (2) provide for nonmember directors (Section 803(c)). The method or manner of selecting directors under the last two exceptions is left to the organic rules because the exceptions themselves are creatures of the organic rules.

SECTION 805. TERM OF DIRECTOR.

(a) Unless the organic rules otherwise provide, and subject to subsections (c) and (d) and Section 302(d), the term of a director expires at the annual members meeting following the director's election or appointment. The term of a director may not exceed three years.

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

(c) Except as otherwise provided in subsection (d), a director continues to serve until a successor director is elected or appointed and qualifies or the director is removed, resigns, is adjudged incompetent, or dies.

(d) Unless the organic rules otherwise provide, a director does not serve the remainder of the director's term if the director ceases to qualify to be a director.

Comment

This section coordinates with Section 809 relating to filling a vacancy on the board of directors of a limited cooperative association.

Subsection (a) – This subsection provides for one-year terms for directors but the organic rules may provide for longer terms not to exceed three years. Exceptions to the term are provided for initial directors whose terms are governed by Section 302(d), for holdover directors under subsection (c), and for directors who cease to qualify to be a director under subsection (d).

Requiring reelection at least every three years is conceptually important because this act, like cooperatives generally, contemplates meaningful participation by members coupled with centralized management control by the board of directors. This is true in any event, but especially if the board may amend the bylaws.

Nothing in this act prohibits staggered terms for directors and it expressly provides that the organic rules may establish terms longer than one year which are necessary for staggered terms. *See* Section 109(a).

Subsection (b) – This subsection permits directors to serve unlimited numbers of terms but the organic rules could obviously provide term limitations for directors. *See* Section 109(c)(13).

Subsection (c) – This subsection provides for "holdover" directors so that director positions do not automatically become vacant at the expiration of their terms. Rather, the same directors continue in office until successors qualify for office. This allows the board of directors to act continuously and without interruption even if an election is not held or the members are deadlocked and unable to elect directors. *See generally* Section 1203 ("Judicial Dissolution").

SECTION 806. RESIGNATION OF DIRECTOR. A director may resign at any time by giving notice in a record to the limited cooperative association. Unless the notice states a later effective date, a resignation is effective when the notice is received by the association.

Comment

The resignation of a director is effective when a notice in a record is received by a limited cooperative association unless the notice provides a later effective date. If the notice provides a later effective date, since the person giving the notice is still a member of the board, the person may participate in all decisions until the specified date. The participation of the resigning director

in the decision of the successor may be particularly important where political balances within the board may be affected by the resignation. Relatedly, Section 809 places limitations on the persons who may be appointed as replacements with respect to classes who elected the resigning director.

SECTION 807. REMOVAL OF DIRECTOR. Unless the organic rules otherwise provide, the following rules apply:

(1) Members may remove a director with or without cause.

(2) A member or members holding at least 10 percent of the total voting power entitled to be voted in the election of a director may demand removal of the director by one or more signed petitions submitted to the officer of the limited cooperative association charged with keeping its records.

(3) Upon receipt of a petition for removal of a director, an officer of the association or the board of directors shall:

(A) call a special meeting of members to be held not later than 90 days after receipt of the petition by the association; and

(B) mail or otherwise transmit or deliver in a record to the members entitled to vote on the removal, and to the director to be removed, notice of the meeting which complies with Section 508.

(4) A director is removed if the votes in favor of removal are equal to or greater than the votes required to elect the director.

Comment

All provisions of this section may be varied by the organic rules providing maximum latitude for a limited cooperative association to fashion the standard, manner and procedure for removal of directors. This act does not provide for removal of a director by the board of directors but this could be provided in the organic rules. *See* Section 109(c)(13). The board may suspend a director, however, under Section 808. In the absence of variation of the act's provisions by the organic rules, this section provides the rules regarding the removal of directors.

Paragraph (1) – This Section reflects the policy that the members are the owners of a limited cooperative association and should be entitled to change the directors if they desire to do so. It is consistent with the notion of member control. This differs from corporate common law that a director may only be removed "for cause" such as fraud, criminal conduct, gross abuse of office or similar conduct.

Paragraph (2) – The process of removing a director by the members is commenced by a demand made in a signed record (essentially a petition process) by members holding 10 percent of the *total* voting power of the membership group who could vote on the election of the director. The record must be delivered to the officer of the limited cooperative association who is charged with keeping its records.

The organic rules may provide that a director may only be removed for cause. "Cause" can be defined in the organic rules.

Paragraph (3) – Once the signed record of the demand is received by the limited cooperative association, an officer or the board of directors must call a special members meeting that is to be held within 90 days and provide proper notice to the members of the meeting stating that the removal will be considered at the meeting.

Paragraph (4) – The vote on the removal of a director by the members must be the same as the vote that would be necessary to have elected the director. This means, consistently with subsection (2): a director elected solely by patron members can be removed only by patron members; a director elected solely by investor members can be removed only by investor members; directors elected by a district or class can be removed only by members of that district or class. If cumulative voting is permitted by the organic rules, cumulative voting would be applicable in a removal vote. *See* comment to MBCA § 8.08 (describing how cumulative voting operates in connection with a vote on removal).

SECTION 808. SUSPENSION OF DIRECTOR BY BOARD.

(a) A board of directors may suspend a director if, considering the director's course of conduct and the inadequacy of other available remedies, immediate suspension is necessary for the best interests of the association and the director is engaging, or has engaged, in:

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

(2) gross abuse of the position of director;

(3) intentional or reckless infliction of harm on the association; or

(4) any other behavior, act, or omission as provided by the organic rules.

(b) A suspension under subsection (a) is effective for 30 days unless the board of directors calls and gives notice of a special meeting of members for removal of the director before the end of the 30-day period in which case the suspension is effective until adjournment of the meeting or the director is removed.

Comment

Although the board of directors may not remove a director, it may suspend a director for 30 days for cause as defined in subsection (a). Within the 30 day period the board may call and give notice of a special meeting of members to consider removing the suspended director in the same manner as if the board received a demand for removal from members under Section 807. In that case, the suspension continues until the removal is determined at the members meeting. If members do not vote to remove the director, the director continues in office.

SECTION 809. VACANCY ON BOARD.

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

(1) within a reasonable time by majority vote of the remaining directors until the next annual members meeting or a special meeting of members called to fill the vacancy; and

(2) for the unexpired term by members at the next annual members meeting or a special meeting of members called to fill the vacancy.

(b) Unless the organic rules otherwise provide, if a vacating director was elected or appointed by a class of members or a district:

(1) the new director must be of that class or district; and

(2) the selection of the director for the unexpired term must be conducted in the same manner as would the selection for that position without a vacancy.

(c) If a member appointed a vacating director, the organic rules may provide for that member to appoint a director to fill the vacancy.

Comment

Subsection (a) – This subsection provides that the remaining directors (without regard to quorum requirements) are to fill a vacancy on the board within a reasonable time. The replacement director is to serve until the next annual members meeting or until a special meeting is called by the remaining directors to fill the vacancy. If the term of the director whose position is vacant would have extended beyond the next annual meeting of members, the members are to vote on a person to fill the vacancy until the end of the term. The special members meeting could be the same meeting at which members were asked to vote on the removal of a director if the appropriate notice was given.

Subsection (b) – This subsection provides that if a voting group of members is entitled to elect a director, only that voting group is entitled to fill a vacant office which was held by a director elected by that voting group. This section is part of the consistent treatment of directors elected by a voting group of members. *See* Section 804(c) and (d).

Subsection (c) – This subsection permits the organic rules to provide that a member, who alone constitutes a class of members entitled to appoint a director under Section 804(e), may appoint a director to replace a director previously appointed by the member if that director's position becomes vacant. Unless the organic rules provide for this, the vacancy would be filled in the same manner as other vacancies under subsections (a) and (b).

SECTION 810. REMUNERATION OF DIRECTORS. Unless the organic rules otherwise provide, the board of directors may set the remuneration of directors and of nondirector committee members appointed under Section 817(a).

Comment

Although the act permits the organic rules to provide other means for establishing the compensation of directors, the default rule is for the board of directors to fix the remuneration of directors and nondirector committee members appointed by the board pursuant to subsection 817(a).

SECTION 811. MEETINGS.

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

(b) Unless the organic rules otherwise provide, a board of directors may permit directors to attend or conduct board meetings through the use of any means of communication, if all directors

attending the meeting can communicate with each other during the meeting.

Comment

This section provides maximum flexibility for directors meetings requiring only that the directors meet at least once a year.

In the traditions of many types of cooperatives, non-director members of the cooperative are permitted to observe board meetings. These traditions may have emerged from the member governance concepts in cooperatives especially those in the non-profit sector or where cooperatives operate within a regulatory sphere which makes them quasi-public entities. The act does not address this matter. Best practices may suggest this matter be addressed in the organic rules. This act implicitly allows the board to close its meetings. In some areas, such as employment law, legal requirements and best business practices may make it advisable or necessary to close meetings of the directors.

SECTION 812. ACTION WITHOUT MEETING.

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

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

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

Comment

Formal board meetings are not the most efficient manner in which to take board action. Often board action is not controversial but needs to be memorialized in a record of unanimous consent. For example, where a limited cooperative association is a wholly-owned subsidiary of another cooperative entity and there is only one director of the association, a record of action by the sole director is an efficient and practical way to make a record of the action. Consent may be given in one or more records as defined in Section 102(27), which includes the use of electronic media.

A director who believes discussion or further consideration is necessary or helpful may force a meeting by withholding consent.

SECTION 813. MEETINGS AND NOTICE.

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

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

Comment

Regular meetings of the board of directors may be held at designated times without further notice of time, date, place or purpose. Special meetings require three days' notice and must state the time, date, place and purpose. At special meetings, only the matters specified in the notice may be subject to action at the meeting. The latter differs from typical provisions in business corporation law. This act does not require the notice of a special meeting to be in writing.

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

The organic rules may provide for different requirements regarding notices of meetings.

SECTION 814. WAIVER OF NOTICE OF MEETING.

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

(b) Unless the organic rules otherwise provide, a director's participation in a meeting is a waiver of notice of that meeting unless:

(1) the director objects to the meeting at the beginning of the meeting or promptly upon the director's arrival at the meeting and does not thereafter vote in favor of or otherwise

assent to the action taken at the meeting; or

(2) the director promptly objects upon the introduction of any matter for which notice under Section 813 has not been given and does not thereafter vote in favor of or otherwise assent to the action taken on the matter.

Comment

Subsection (a) – This subsection follows modern corporate practice in viewing notice as a technical requirement with waivers being favored at the level of the board of directors. Generally, subsection (a) applies where a director desires to waive notice so that action taken will be valid.

Subsection (b) – This subsection addresses the effect of a director's attendance at a meeting as related to waiver of notice. The subsection governs circumstances clearly distinguishable from voluntary waivers under subsection (a). Absent modification by the organic rules, this subsection requires a director to object to the holding of a meeting for lack of notice at the beginning of the meeting or upon the director's arrival. If there is no objection to the notice of a meeting, but a matter is presented at a meeting that was not included in the notice, a director may object at the time the matter is presented.

A director who stays during a meeting to which the director has objected is not presumed to have waived notice of the meeting unless the director votes for or assents to action taken at the meeting in which case the director would be considered to have waived objection to the meeting for lack of notice.

SECTION 815. QUORUM.

(a) Unless the articles of organization provide for a greater number, a majority of the total number of directors specified by the organic rules constitutes a quorum for a meeting of the directors.

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

(c) A director present at a meeting but objecting to notice under Section 814(b)(1) or (2) does not count toward a quorum.

Comment

Subsection (a) – The default rule under this act, which may be varied by the organic rules, requires the number of directors to be fixed either in the organic rules or by a resolution of the board within parameters established by the organic rules. Thus, this subsection establishes a quorum as a majority of the fixed number of directors. If a higher number is to be required for a quorum, it must be provided in the articles of organization and not in the bylaws.

Subsection (b) – This subsection permits a meeting to continue once a quorum is established even if a sufficient number of directors leave the meeting to reduce the number in attendance to less than a quorum. This means no director may block the board from acting simply by leaving the meeting.

Subsection (c) – For purposes of establishing a quorum, a director who is present but only to object to the meeting because of lack of notice is not counted in determining the presence of a quorum.

SECTION 816. VOTING.

(a) Each director shall have one vote for purposes of decisions made by the board of directors.

(b) Unless the organic rules otherwise provide, the affirmative vote of a majority of directors present at a meeting is required for action by the board of directors.

Comment

A limited cooperative association may not provide for any director to have more, or less, than one vote in connection with action by the board of directors. A majority of directors present may take action as a board, but the organic rules may establish a different voting standard, including unanimity, on some or all matters that come before the board.

SECTION 817. COMMITTEES.

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

(b) Unless the organic rules otherwise provide, an individual appointed to serve on a committee of a limited cooperative association need not be a director or member.

(c) An individual who is not a director and is serving on a committee has the same rights,

duties, and obligations as a director serving on the committee.

(d) Unless the organic rules otherwise provide each committee of a limited cooperative association may exercise the powers delegated to it by the board of directors, but a committee may not:

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

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

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

Comment

Many types of committees have become common in organizations, *e.g.*, executive committees, audit committees, litigation committees, legislative committees, membership committees. Those committees, however, are subject to the oversight responsibility of the board.

This section provides substantial flexibility in the board of directors to establish committees. The flexibility may be expanded or contracted by the organic rules. The act does not provide for creation of committees to which the board may delegate its power by any means other than by board action or in the organic rules.

Subsection (a) – Under this subsection a committee can consist of only one individual. This can facilitate rapid decision making when circumstances require it.

Subsections (b) and (c) – The directors may appoint persons who are not directors or members of the limited cooperative association to a committee, but if persons are appointed who are not directors, they have all the rights, duties, and obligations of a director appointed to serve on a committee. This is broader than, for example, MBCA Section 8.25 which authorizes the board of directors of a corporation to create committees that consist only of board members. This act provides for the board to have greater flexibility in the creation of committees to which the board may delegate its power. It does not limit other ways in which a committee may be created and its members designated. *But see* Comment to Section 901 (indemnification and insurance considerations). In any event, however, the board has oversight responsibility. Those willing to serve on such committees need to be aware of their statutory obligations. Consulting arrangements, may in many circumstances, be an alternative to the official delegation of board authority.

Subsection (d) – The board of directors can delegate substantial powers to a committee but may not do so with respect to the three subjects listed in paragraphs (1), (2) or (3).

SECTION 818. STANDARDS OF CONDUCT AND LIABILITY. Except as otherwise provided in Section 820:

(1) the discharge of the duties of a director or member of a committee of the board of directors is governed by the law applicable to directors of entities organized under [reference to this state's cooperative corporation act or the general business corporation act]; and

(2) the liability of a director or member of a committee of the board of directors is governed by the law applicable to directors of entities organized under [insert reference to this state's cooperative corporation act or to the general business corporation act].

Legislative Note: *Adopting jurisdictions should choose only one of the bracketed alternative statutes to govern what has traditionally been called the "fiduciary duties" of directors. While the listed laws are generally similar in most jurisdictions, they do not contain the same formulation either between the laws in a given jurisdiction or between laws governing even the same type of entity among various jurisdictions. Thus the choice of the bracketed law, including any power to modify the law as referenced in optional Sections 109(b)(10) and (11), has policy implications for limited cooperative associations organized under this act.*

Adopting jurisdictions should carefully coordinate the choices under this Section and Sections 819 and 901.

Comment

The approach taken to Sections 818 and 819 recognizes that (1) states take fundamentally different approaches to the duties of managers or governors within unincorporated organizations of the same kind; (2) there is variety among the states in their approach to duties within corporate statutes; and (3) there is variety among the states in their approach in cooperative laws. The existing cooperative statutes appear to most closely follow corporate duty formulations.

This act establishes a limited cooperative association as an unincorporated entity.. Although an unincorporated entity, the board of directors of a limited cooperative association under this act functions more analogously to a corporate board than to the typical managers in a manager-managed limited liability company or general partners in a limited partnership. Nonetheless, the duties in almost all entities use the same labels of care and loyalty. Thus adopting corporate standards in this act, while unusual for unincorporated entities (but not cooperatives), is unusual only to a matter of degree even apart from the distinctive features of the standards.

If a statute to which reference is made in this act permits the equivalent of its organic rules

to vary the standards of conduct and liability of directors, drafters of the organic rules of a limited cooperative association should take care to provide for the levels of conduct and potential liability to be imposed on directors consistent with those statutory provisions. *See* Legislative Note to this Section.

SECTION 819. CONFLICT OF INTEREST.

(a) The law applicable to conflicts of interest between a director of an entity organized under [reference to this state's cooperative corporation act or the general business corporation act] governs conflicts of interest between a limited cooperative association and a director or member of a committee of the board of directors.

(b) A director does not have a conflict of interest under this [act] or the organic rules solely because the director's conduct relating to the duties of the director may further the director's own interest.

Legislative Note: *See the Legislative Note to Section 818.*

Comment

See comment to Section 818.

Subsection (b) – This subsection recognizes that the members of a cooperative entity, including a limited cooperative association, both own and patronize the cooperative and that directors are commonly required to be members of the cooperative. Thus there will be technical conflicts of interest even where a director properly performs a director's functions because the director may receive contractual benefits shared by other members. This subsection makes it clear that a director will not be held to have a conflict of interest simply by performing the required duties of a director even if the director is benefitted as a member.

SECTION 820. OTHER CONSIDERATIONS OF DIRECTORS. Unless the articles of organization otherwise provide, in considering the best interests of a limited cooperative association, a director of the association in discharging the duties of director, in conjunction with considering the long and short term interest of the association and its patron members, may consider:

(1) the interest of employees, customers, and suppliers of the association;

(2) the interest of the community in which the association operates; and

(3) other cooperative principles and values that may be applied in the context of the decision.

Comment

In keeping with traditional cooperative values and principles, *e.g.*, community interests, interests of persons related to the cooperative, and other appropriate cooperative principles such as education regarding cooperative organizations, this section clearly permits the board of directors of a limited cooperative association to consider matters which may be improper for consideration in connection with other entities. The additional factors identified in this section modify the statutes referenced in Sections 818 and 819 in application. Such application will be highly contextual.

SECTION 821. RIGHT OF DIRECTOR OR COMMITTEE MEMBER TO INFORMATION. A director or a member of a committee appointed under Section 817 may obtain, inspect, and copy all information regarding the state of activities and financial condition of the limited cooperative association and other information regarding the activities of the association if the information is reasonably related to the performance of the director's duties as director or the committee member's duties as a member of the committee. Information obtained in accordance with this section may not be used in any manner that would violate any duty of or to the association.

Comment

This section gives a director or a member of a committee created and appointed by the board of directors a right to access to all information regarding a limited cooperative association that is necessary for the individual to perform the functions of a director or a member of a committee. A director's or committee member's use of the information is, however, limited to its use in performing the functions for which the information was obtained and not in any way that would violate the individual's duty to the association or any duty of the association to others.

SECTION 822. APPOINTMENT AND AUTHORITY OF OFFICERS.

(a) A limited cooperative association has the officers:

(1) provided in the organic rules; or

(2) established by the board of directors in a manner not inconsistent with the organic rules.

(b) The organic rules may designate or, if the rules do not designate, the board of directors shall designate, one of the association's officers for preparing all records required by Section 110 and for the authentication of records.

(c) Unless the organic rules otherwise provide, the board of directors shall appoint the officers of the limited cooperative association.

(d) Officers of a limited cooperative association shall perform the duties the organic rules prescribe or as authorized by the board of directors not in a manner inconsistent with the organic rules.

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

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

Comment

This section provides substantial flexibility for a limited cooperative association to structure its internal affairs with respect to officers. Only an officer to prepare and maintain records required by Section 110 and to authenticate records is required. Practically, most limited cooperative associations will need additional officers. The offices may be established through the organic rules or by the board of directors in a manner not inconsistent with the organic rules. The duties, authority and obligations of officers are to be provided in the organic rules and by the board of directors in accordance with the organic rules. If the organic rules are silent the board has broad authority. The act contemplates the board will appoint officers but this can be modified by the organic rules. See Section 109 (c)(18).

SECTION 823. RESIGNATION AND REMOVAL OF OFFICERS.

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

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

Comment

If an officer is removed or resigns, this in and of itself will have no effect on contractual rights of an officer under an employment or other contract with the association which will govern the rights and obligations of the officer and the association following the removal or resignation. *See* Section 822(e).

This act contains no provision directly addressing the standard of conduct of officers. This is, at the least, not unusual in the world of general cooperative statutes. This act leaves much of the law governing officers to contract and agency principles.

There is a distinction between the power to remove an officer and the right to do so. This section is intended to give complete discretion to the board of directors to remove officers (the power). The exercise of that power, however, may lead to a damage claim by the officer if, for example, the officer has a separate employment contract. The exercise of the power could also violate other law (*e.g.*, Title VII of the Civil Rights Act).

Subsection (a) – Authority for removal of an officer resides in the board of directors under its general management authority and is necessary in order to match board liability with board authority. *See* Section 801(b). Removal need not be for cause.

Subsection (b) – Subsection (b) follows current corporate law permitting an officer to resign immediately or through a resignation that becomes effective at a later date. Notice of the resignation must be given to the limited cooperative association. This subsection does not require any action by the association with respect to a resignation.

[ARTICLE] 9

INDEMNIFICATION

Legislative Note: *See the Legislative Note to Section 818. Adopting jurisdictions should coordinate the selection of the bracketed references with the selections made in conjunction with Sections 818 and 819. As with standards of conduct and liability and conflicts of interest, the matter of indemnification of directors and officers of an entity can be among the most complex and important in a statute governing an entity. Because most, if not all, adopting jurisdictions*

will have addressed this issue in statutes relating to corporations or in other cooperative statutes, an adopting jurisdiction should consistently reference one of the bracketed statutes to provide a workable and comprehensive policy with respect to indemnification and the right of a limited cooperative association to provide insurance.

SECTION 901. INDEMNIFICATION AND ADVANCEMENT OF EXPENSES; INSURANCE.

(a) Indemnification and advancement of expenses of an individual who has incurred liability or is a party, or is threatened to be made a party, to litigation because of the performance of a duty to, or activity on behalf of, a limited cooperative association is governed by [reference to this state's cooperative corporation act or this state's general business corporation act].

(b) A limited cooperative association may purchase and maintain insurance on behalf of any individual against liability asserted against or incurred by the individual to the same extent and subject to the same conditions as provided by [reference to this state's cooperative corporation act or this state's general business corporation act].

Comment

This section takes the same approach to indemnification and related insurance as Sections 818 and 819 take to "Standards of Conduct and Liability" and "Conflict of Interest." The identity of the individuals referred to in this section is limited to those identified in the referenced statutes as being entitled to indemnification or the benefit of insurance under those statutes.

The referenced statutes govern the ability and the extent of that ability to expand or limit indemnification for specified actions and standards for indemnification and the provision of insurance by a limited cooperative association. If the referenced statute requires such matters to be addressed in the articles or bylaws those requirements apply to an association under this act.

The association should consider the scope of sections referenced in this section and Sections 818 and 819 in anticipation of appointing non-directors to committees under Section 817.

[ARTICLE] 10

CONTRIBUTIONS, ALLOCATIONS, AND DISTRIBUTIONS

Preliminary Comment

The development and management of the capital structure and handling of profits and losses in a cooperative entity help to define the uniqueness of the cooperative. There are strong similarities in these areas, however, between cooperatives and other types of entities. This article contains the provisions relating to contributions (Sections 1001 through 1003), allocations (Section 1004), distributions (Sections 1005, 1007 and 1008) and redemptions of capital (Section 1006).

The contribution and distribution provisions in this article address issues that are dealt with in ways similar across many entities but with recognition of cooperative principles peculiarly applicable to limited cooperative associations organized under this act. While redemptions are treated in this act as a kind of distribution in a manner similar, for example, to state partnership law, this article reflects the slightly different business role and function of redemption plays under traditional cooperative law where it functions rather like a nonguaranteed buy-out for dissociating members.

The manner in which profits and losses are allocated among members is a defining element of a cooperative. Allocations are central to this act and limited cooperative associations organized under it. For this reason, Section 1004 is a pivotal provision. The addition of investor members to limited cooperative associations made possible by this act requires a more detailed definition of what it means to be a "cooperative" than is necessary under other kinds of cooperative statutes and this article, particularly Section 1004, serves that definitional and regulatory purpose. Thus Section 1004 contains more detail than is frequently found in the statutes under which other types of entities are organized. Emphatically, however, this article governs allocations for state law purposes only. Financial reporting and income taxation are clearly beyond the scope of this act.

This article reflects cooperative principles related to "operation at cost" and ownership of profits based on the use of the cooperative by its members. *See* Comment to Section 1004. Partnership based accounting mechanisms provide an appropriate and efficient means to achieve a cooperative result and are the basis of that section.

SECTION 1001. MEMBERS' CONTRIBUTIONS. The organic rules must establish the amount, manner, or method of determining any contribution requirements for members or must authorize the board of directors to establish the amount, manner, or other method of determining any contribution requirements for members.

Comment

This section requires the organic rules to contain provisions governing contribution requirements for new members and additional capital contributions from existing members. *See also* Section 109(d). It allows the organic rules to provide for a structure like that of limited partnerships where "capital call" provisions are often part of the partnership agreement but which may, by terms of the provision, be subject to rather broad authority in the general partner.

An amendment of the organic rules pursuant to Section 405 is necessary to require existing members to contribute additional capital if the organic rules are silent regarding additional contributions by members. Under that section consent in a record by each member that the amendment proposes to require to make additional contributions is necessary. The consent requirement, therefore, is consistent with the merger, interest exchange, conversion, and domestication provisions in Article 16 of this act. *See* Section 518.

The limited cooperative association also has information requirements concerning contributions. *See* Section 110(a)(14).

It is certainly permissible, given the flexibility of the act, for the organic rules to provide for pre-emptive rights for existing members or to fashion other anti-dilution provisions but no such matters are addressed by the act. Further, tailored redemption and buy-sell agreements are appropriately addressed in planning under the act. *See also* Section 1006.

SECTION 1002. CONTRIBUTION AND VALUATION.

(a) Unless the organic rules otherwise provide, the contributions of a member to a limited cooperative association may consist of property transferred to, services performed for, or another benefit provided to the association or an agreement to transfer property to, perform services for, or provide another benefit to the association.

(b) The receipt and acceptance of contributions and the valuation of contributions must be reflected in a limited cooperative association's records.

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

Legislative Note: *The type of property that is permitted to be contributed to organizations and entities is sometimes, though increasingly rarely, the subject of state constitutions. Adopting jurisdictions should review their constitutions for the existence of inconsistent provisions and revise this section accordingly.*

Comment

Subsection (a) – This subsection is derived from Section 402 of ULLCA (2006) (last Amended 2013) and provides wide latitude for the form of contribution.

Subsection (c) – The board of directors, subject to modification by the organic rules, has the authority and obligation to determine the value of a member's contribution and reflects the central role performed by the board of directors under traditional cooperative statutes. Valuation of different forms of contributions raises the specter of unfairness or abuse if, for example, services are valued optimistically. A modicum of protection from such abuse is provided by director standards of conduct and liability under Section 818 and by provisions related to conflicts of interest under Section 819. As a result this act's approach differs from Section 502(c) of ULPA (2001) (Last Amended 2013) and Section 403(c) of ULLCA (2006) (Last Amended 2013) in that it does not give creditors who have granted credit to a member without notice or knowledge of a compromise an express direct right to enforce the contribution obligation of a member. Any such rights, by design, are left to the common law.

SECTION 1003. CONTRIBUTION AGREEMENTS.

(a) Except as otherwise provided in the agreement, the following rules apply to an agreement made by a person before formation of a limited cooperative association to make a contribution to the association:

(1) The agreement is irrevocable for six months after the agreement is signed by the person unless all parties to the agreement consent to the revocation.

(2) If a person does not make a required contribution:

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

(B) the association, once formed, may rescind the agreement if the debt remains unpaid more than 20 days after the association demands payment from the person, and

upon rescission the person has no further rights or obligations with respect to the association.

(b) Unless the organic rules or an agreement to make a contribution other than money to a limited cooperative association otherwise provide, if a person does not make a required contribution to an association, the person or the person's estate is obligated, at the option of the association, to contribute money equal to the value of the part of the contribution which has not been made.

Comment

Pre-formation agreements to contribute to a limited cooperative association are addressed in subsection (a). It states default terms variable by the terms of the agreement itself.

Post-formation agreements are addressed in subsection (b) and are subject to the terms of the agreement and the applicable provisions of the organic rules. *See also* Section 1001.

Section 110(a)(14) and (15) require the association to maintain a record of the amount of money or value of contributions other than money agreed to be contributed by each member.

SECTION 1004. ALLOCATIONS OF PROFITS AND LOSSES.

(a) The organic rules may provide for allocating profits of a limited cooperative association among members, among persons that are not members but conduct business with the association, to an unallocated account, or to any combination thereof. Unless the organic rules otherwise provide, losses of the association must be allocated in the same proportion as profits.

(b) Unless the organic rules otherwise provide, all profits and losses of a limited cooperative association must be allocated to patron members.

(c) If a limited cooperative association has investor members, the organic rules may not reduce the allocation to patron members to less than 50 percent of profits. For purposes of this subsection, the following rules apply:

(1) amounts paid or due on contracts for the delivery to the association by patron

members of products, goods, or services are not considered amounts allocated to patron members.

(2) amounts paid, due, or allocated to investor members as a stated fixed return on equity are not considered amounts allocated to investor members.

(d) Unless prohibited by the organic rules, in determining the profits for allocation under subsections (a), (b), and (c), the board of directors may first deduct and set aside a part of the profits to create or accumulate:

(1) an unallocated capital reserve; and

(2) reasonable unallocated reserves for specific purposes, including expansion and replacement of capital assets; education, training, cooperative development; creation and distribution of information concerning principles of cooperation; and community responsibility.

(e) Subject to subsections (b) and (f) and the organic rules, the board of directors shall allocate the amount remaining after any deduction or setting aside of profits for unallocated reserves under subsection (d):

(1) to patron members in the ratio of each member's patronage to the total patronage of all patron members during the period for which allocations are to be made; and

(2) to investor members, if any, in the ratio of each investor member's contributions to the total contributions of all investor members.

(f) For purposes of allocation of profits and losses or specific items of profits or losses of a limited cooperative association to members, the organic rules may establish allocation units or methods based on separate classes of members or, for patron members, on class, function, division, district, department, allocation units, pooling arrangements, members' contributions, or other equitable methods.

Comment

The first part of this comment explains the importance of this section and places it within the context of the act and cooperative law. It identifies the policy behind the section. The second part of the comment briefly explains the mechanical operation of the section and then discusses each subsection.

Generally – Allocation of profits and losses is typically not a matter of detailed statutory treatment in general unincorporated or general corporate statutes. The modern trend of organizational law is to expressly govern distributions but not detail the manner or method of the internal allocation of profits and losses between and among the owners. Rather, allocations are left to organic rule, for example, the operating agreement in limited liability companies. Moreover, accounting conventions for financial accounting or reporting, and state and federal income tax law for purposes of taxation will, in any event, apply largely independent of any state law allocation provisions. For example unallocated reserves will raise federal income taxation for unincorporated entities but are contemplated by the law of taxation in the context of cooperatives.

For general business entities there seems to be little purpose for intervention in allocations by a state organizational statute. Indeed, general business corporation law has abandoned much of the corporate legal capital machinery required by older corporate statutes. One of the primary purposes of that machinery was creditor protection. A leading treatise observed, concerning changes in that machinery, "It is conceivable, even, that the proposed changes may lead some persons for the first time to examine the degree of protection afforded to creditors by the present legal capital system and discover that it is a Swiss Cheese made up mainly of holes ... ." BAYLESS MANNING AND JAMES J. HANKS, LEGAL CAPITAL, 194 (3rd ed. 1990).

It is for good reason, therefore, that there is a trend away from including statutory provisions concerning allocations of profit and loss. Nonetheless, regulatory law sometimes uses balance sheet accounting for regulatory purposes, for example, in the regulation of financial institutions. There are, however, good reasons for including such provisions in cooperative law. *See generally* Preliminary Comment to Article 10.

One reason "allocations" are important in cooperative law is as an analogue to regulatory law. Allocation of profit and loss to members is a key component to determine whether an entity is operating in accordance with a "cooperative plan" which is a term used in some traditional cooperative statutes or on a "cooperative basis" which is a term of art for defining "cooperative" for some purposes of federal income taxation. This act takes the approach that the mere use of terms of art from other substantive bodies of law is too ambiguous for purposes of defining a limited cooperative association for state law purposes. And that such importation represents a trap to the unwary, and would inhibit the use of this act that contemplates voting investor members.

A second reason, related to the first, is both historical and a matter of cooperative principles. One of the fundamental principles of cooperative organizations is that they operate "at cost." This is a different concept from operating "for profit" or "not for profit." This principle

has caused much confusion for persons dealing with cooperatives, including regulators, who seek to compartmentalize cooperatives as either "for profit" or "not for profit" entities. Cooperatives are unique in having a principle that, in operation, results in a cooperative having "no profit" and "no loss" at the end of an annual accounting period. Business methods have been developed to reach the "at cost" result while at the same time providing necessary capital to the cooperative.

Profits are usually allocated among members (and in some cooperatives among non-member patrons) through some method that returns annual profits to the members on the books of the cooperative, in cash payments, or a combination of both. Traditional midwestern agricultural cooperatives have usually used patronage dividends (called by various names such as "patronage allocations" and "allocations of net margins") as the means to allocate net profits at the end of an accounting year among the members. This approach is similar to the allocation of profits among partners in a partnership or among members in a limited liability company. It is derived in a cooperative, however, from a different philosophical basis.

Another method utilized by certain marketing cooperatives is a "per unit retain" under which the cooperative withholds a portion of the purchase price to be paid to a member for goods or commodities marketed by or through the cooperative as a capital contribution to the cooperative.

Traditional cooperatives may permit assessments of members if there is a loss at the end of an annual accounting period. Among other techniques, losses may also be charged against reserves or surplus accounts or be carried over to be offset against future profits. The method of allocation of losses is usually the same as allocations of profits. This is reflected in Section 1004, notably Section 1004(a).

Although more detailed with respect to allocations than statutes governing other entities, this act does not address any *particular allocation* method to be used by an association. Section 1004 does not prohibit any method to be authorized in the organic rules. While based on partnership accounting, Section 1004 overlays partnership accounting with allocation methods based on patronage for patron members developed in traditional cooperatives. *See* Section 1004(e)(1). The organic rules can authorize methods of allocation and, further, can designate the Board of Directors to apply the methods. *See also* Section 817(d)(1).

Investor members are not patron members. *But see* Section 112 ("Dual Capacity"). The organic rules may provide methods unburdened by patronage considerations for allocating net profits and losses among investor members.

A third reason this act provides rather detailed allocation provisions is because "profit" is a key concept in Section 1004(c) which tests and constrains the division of profits between patrons and investor members under this act. Here Section 1004 operates in a regulatory manner.

Section 1004 – Section 1004 addresses the allocation of profit and loss among members of a limited cooperative association. As an important policy matter, it establishes that patron members must be allocated at least 50 percent of the profit of the association as determined under

customary accounting procedures and as augmented, amplified, and defined by this Section.

Section 1004 is a part of state organizational law governing limited cooperative associations. Accounting standards, tax law, and exceptions and qualifications found in other state and federal laws and regulations independently apply to associations governed by this act. These other laws and regulations may require careful drafting of organic rules to take advantage of, or comply with, those laws. This Section has no application to distributions. Distributions are governed by Sections 1005 through 1008.

The distinct concepts of "profit" and "allocation" animate the operation of this Section. Simply stated, Section 1004 provides a framework that in application results in a number of dollars representing profit (or loss) of the association being allocated to the members of the limited cooperative association to provide some assurance that patron members receive "their share" of profit.

The basic mechanical operation of the Section is:

- take the profit of the association (subsection (a)), as determined in accordance with the accounting method of the association, and deduct amounts placed in reserves (subsection (d));
- apportion it between groups entitled to receive an allocation of profit and loss (subsections (a), (b) and (c)); and
- allocate the apportioned amounts within the groups' members (subsections (e) and (f)).

Subsection (a) – The organic rules may provide that profit and loss be allocated only among members (patron members and investor members), and others who utilize the cooperative but are not members, to an unallocated account (such as a reserve), or in some combination of the foregoing.

Losses are to be allocated in the same manner as profits unless the organic rules establish a different means for allocating losses.

Some traditional cooperatives permit the cooperative to engage in business with non-members and permit those non-members (sometimes called "participating patrons" or "non-member patrons") to share in allocations of profit and loss. Allocations to non-members who do business with the association create complexities and may affect matters outside this act such as financial reporting and taxation.

Subsection (b) – The general default rule under Section 1004 is that profit and loss are to be allocated among patron members. Therefore if there are investor members to whom profit is to be allocated, the organic rules must provide for making those allocations.

Subsection (c) – While Section 1004 provides significant flexibility in how allocations of profit are to be determined, this subsection places parameters on those allocations. It is central to the act. Patron members must be allocated at least 50 percent of profit that is allocated in

accordance with this section. A larger percentage, but not a lower one, could be provided by the organic rules.

The provisions in this subsection are mandatory and may not be varied by the organic rules for purposes of measuring the minimum 50 percent allocation to patron members. The determination of the percentage required to be allocated to patron members is a difficult policy decision *for an association*. On one hand, the percentage goes to the heart of what it means to be a cooperative in which the patron members are to share in any profit of the entity resulting from their use and the "investment" of their allocated retained earnings. On the other hand, one of the purposes of the act is to encourage greater equity capital formation by allowing investor members to receive a return on their capital investments in the association. To that end, the act seeks to provide enough flexibility to allow financial participation by investor members while protecting the economic interests of patron members.

Subsections (c)(1) and (2) modify "profits" for purposes of applying the 50 percent minimum standard to be allocated to patrons. They contain mandatory rules regarding the treatment of amounts paid to patron members for products, goods or services delivered to a limited cooperative association for marketing; and, for specifically identified categories of amounts paid, due or allocated to investor members on the equity (capital) account established for them in the association. These amounts are not treated as allocations to the recipients *for purposes of determining whether the patron members have been allocated 50 percent* of profit (or a higher amount provided in the organic rules).

> EXAMPLE: A limited cooperative association has investor members and allocates 50 percent of the profits to them under its organic rules. It contracts to purchase 500 units of goods from its patron members for $10 for each unit. The association resells the goods for a total of $11,000. The only expense for the association is the total price paid to its patron members. It has revenues of $11,000 (resale). Its expense is $5000 (500 units at $10 per unit). Therefore, its "profit" is $6,000. ($11,000 minus $5,000). Under its 50 percent allocation rule the patron members are allocated $3,000 profit and the investor members are allocated $3,000 profit. Under subsection (c)(1), the $5,000 paid as a purchase price to patron members for the goods is not counted as an allocation to the patron members *for purposes of the 50 percent test* because it is characterized at the association level as cost of goods sold (an expense).
>
> EXAMPLE: Same facts as in the previous Example except the investor members receive a stated fixed return on their contributions (equity). The stated fixed return is 10 percent of the value of their contributions and their total contributions are $12,000. Therefore, they are paid $1,200 as a return on contributions. The profit from the above Example is $6,000 and remains $6,000 in this Example because a stated fixed return on equity contributions is not an expense under general accounting practices. As a result, as in the previous Example, the patron members would be allocated $3,000 profit (and also receive the price paid for their goods) and the investor members would be allocated $3,000 profit. Under subsection (c)(2), the $1,200 paid to investor members for the stated fixed return on contributions is not treated as an allocation to the investor members for purposes of the 50

percent test. Note that money allocated is not the same as money paid-out. While seemingly complex this difference is present and material in the drafting and planning of unincorporated "deals". That is, the source of the $1,200 paid to the investor members is "cash" not profit.

There is a relevant, but subtle, distinction between the *probable* accounting treatment of the two Examples. In the first Example, the purchase price for the goods paid to the patron members represents an expense in determining profit which is the starting point in applying the 50 percent test under subsection (c). In the second Example, the stated fixed return paid to investor members on their equity capital (contributions) is not an expense in determining profit under general accounting practices. Although the distinction is worth noting, it does not directly affect the mechanical operation of subsection (c).

In traditional cooperatives various ways exist to compensate members for products, goods or services. For example, cooperatives may pay a market or otherwise fixed price for the products, goods or services. There are, however, a variety of other arrangements under which products, goods or services may be sold through the cooperative. These other arrangements include several commonly used, but vastly different, methods for determining the amount to be paid to the patron member. Some of these methods are net proceeds contracts, agency contracts, and marketing pool arrangements. In some of them a proportionate part of the total gross amount received by the cooperative from its sale of the products, goods and services after deducting the operating costs of the cooperative is paid to the member. Under these circumstances, the "price" for the products, goods and services marketed through the cooperative by the member is the amount received by the member. Any of these approaches may be provided by contract but the method used will greatly affect the allocation calculations under this section.

EXAMPLE: Same facts as in the first Example except the arrangement between the patron member and the association is different. It is a net proceeds contract under which the revenues from resale ($11,000) less the association's expenses are paid to the patron members as the price of the goods. Just as in the first example there are no expenses other than the purchase price of the goods. Therefore, the purchase price is $11,000 ($11,000 revenues minus $0 other association expenses). There is no profit to be allocated to the members.

Subsection (d) – In determining the amount of profit to be allocated, a limited cooperative association's board of directors may first set aside a portion of profit for reserves of the types specified in subsections (d)(1) and (2). The portion set aside under subsection (d) is subtracted from the association's profit to determine the "profit" to be allocated.

The phrase "unless the organic rules prohibit" is used to make clear that, if the organic rules are silent, the board of directors may set aside a portion of the profit for reserves in determining "profit" as the term is used in the rest of the Section. Over time it is conceivable that these reserves could be the source of funds to pay investor members a fixed stated return on their contributions.

Subsection (e) – Once the provisions of subsections (c) and (d) have been applied in determining profit or loss of a limited cooperative association, profit or loss is first apportioned between patron members as a categorical group and investor members as a categorical group as provided in the organic rules pursuant to subsection (b). Then the apportioned amounts are further allocated to the members in each group. The default method for patron member allocation is based on patronage (subsection (e)(1)). The default method for investor member allocation is based on contributions (subsection (e)(2)). Of course, the organic rules may change the default rules provided in this Section. *See also* subsections (a), (b), and (f).

Subsection (f) – Subsection (f) is intended to provide the association great latitude in the ways it may establish allocated profit and loss among patron members.

SECTION 1005. DISTRIBUTIONS.

(a) Unless the organic rules otherwise provide and subject to Section 1007, the board of directors may authorize, and the limited cooperative association may make, distributions to members.

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

Comment

Subsection (a) – This subsection is consistent with unincorporated entity law in that members are not entitled to distributions. It is also consistent with cooperative and corporate law where dividends or other distributions are at the discretion of the board of directors. In the context of the law of other business organizations, distributions under this section might be termed "interim distributions" to distinguish them from distributions under Section 1208 ("Distributions of Assets in Winding Up").

"Interim" distributions to members are related to the allocation provisions in Section 1004 but not determined by them and the calculations and limitations in Section 1004 do not apply directly to distributions.

The reference to Section 1007 is because Section 1007 limits distributions under certain circumstances based on the financial position of the association.

Subsection (b) – Cooperative statutes typically contain this or a similar provision consistent with cooperative business practices. This subsection contains terms that are common in the context of cooperatives but which are not defined for purposes of the act. They are used for purposes of illustrating the variety of forms of distributions and as a common point of reference

between this act and other cooperative statutes.

SECTION 1006. REDEMPTION OR REPURCHASE. Property distributed to a member by a limited cooperative association, other than money, may be redeemed or repurchased as provided in the organic rules but a redemption or repurchase may not be made without authorization by the board of directors. The board may withhold authorization for any reason in its sole discretion. A redemption or repurchase is treated as a distribution for purposes of Section 1007.

Comment

This section coordinates "redemption" as used practically in traditional cooperatives with the operation of unincorporated entities. This section, together with Section 1005(b), addresses features that are ubiquitous in cooperative businesses. "Redemption" has a special role in cooperatives and is one way, if not the only way, members receive their share of accumulated capital when "retiring" or terminating their membership. In the business policy of some types of traditional marketing cooperatives "redemption" serves as a kind of functional equivalent to buy-out rights of a dissociated partner in general partnerships. *See* UPA (1997) (last Amended 2013) § 701. The legal rules in the two situations are, however, markedly different and the similarity is in function only. A Department of Agriculture publication stated:

> Although equity accumulation is one of the biggest challenges facing cooperatives, each year many associations redeem part of their patronage-based capital. Equity redemption frequently focuses on the oldest allocations in the cooperative. Redeeming the oldest equities, particularly those of persons no longer patronizing the cooperative, implements the cooperative principle that financing should come from persons currently benefitting from the cooperative's services.

DONALD A. FREDERICK, INCOME TAX TREATMENT OF COOPERATIVES, DISTRIBUTIONS, RETAINS, REDEMPTIONS AND PATRONS' TAXATION, Info. Rep. 44, Part 3, p. 4 (2005).

This act affords flexibility for planning different "buy-out" and "redemption" arrangements. One disadvantage of using traditional cooperatives is that members infrequently receive a portion of the increase of value of the entity due in part to their "investment" and use of the entity. This was one of the important financial reasons for the advent of "new generation" cooperatives which were frequently "closed-end." *See* Prefatory Note to 2007 Act ("Introduction to ULCAA"). It is also an important reason for the flexibility afforded under this act which allows the organic rules to provide for a plethora of plans and arrangements including the

reflection of appreciated value.

Redemption or repurchase must be in the discretion of the board of directors because of its duty to manage the association. *See* Section 801(b). The necessity of this authority is illustrated, for example, in the application of Section 1007.

SECTION 1007. LIMITATIONS ON DISTRIBUTIONS.

(a) In this section, "distribution" does not include reasonable compensation for present or past services or other payments made in the ordinary course of business for commodities or goods or under a bona fide retirement or other bona fide benefits program.

(b) A limited cooperative association may not make a distribution, including a distribution under Section 1208, 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 and affairs; or

(2) the association's total assets would be less than the sum of its total liabilities plus the amount that would be needed, if the association were to be dissolved and wound up at the time of the distribution, to satisfy the preferential rights upon dissolution and winding up of members whose preferential rights are superior to the rights of persons receiving the distribution.

(c) A limited cooperative association may base a determination that a distribution is not prohibited under subsection (b) on:

(1) financial statements prepared on the basis of accounting practices and principles that are reasonable under the circumstances; or

(2) a fair valuation or other method that is reasonable under the circumstances.

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

(1) in the case of a distribution by purchase, redemption, or other acquisition of

financial rights in the limited cooperative association, as of the earlier of:

(A) the date money or other property is transferred or debt is incurred by the association; or

(B) the date the person entitled to the distribution ceases to own the financial rights being acquired by the association in return for the distribution;

(2) in the case of any other distribution of indebtedness, as of the date the indebtedness is distributed; and

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

(A) the distribution is authorized, if the payment occurs not later than 120 days after that date; or

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

(e) A limited cooperative association's indebtedness incurred by reason of a distribution made in accordance with this section is at parity with the association's indebtedness to its general, unsecured creditors except to the extent subordinated by agreement.

(f) A limited cooperative association's indebtedness, including indebtedness issued as a distribution, is not a liability for purposes of subsection (b) if the terms of the indebtedness provide that payment of principal and interest is made only if and to the extent that payment of a distribution could then be made under this section. If the indebtedness is issued as a distribution, each payment of principal or interest is treated as a distribution, the effect of which is measured on the date the payment is made.

(g) In measuring the effect of a distribution under Section 1208, the liabilities of a dissolved limited cooperative association do not include any claim that has been disposed of

under Section 1209, 1210, or 1211.

Comment

Both this section and Section 1008 were derived essentially from the Model Business Corporation Act § 6.40. Both this sections are necessary and appropriate because a limited cooperative association provides its members and directors a corporate-like liability shield.

Subsection (a) – Whether compensation and payments made under a retirement or benefits program to a member are considered "distributions" has been the subject of litigation in cases involving unincorporated business entities. Subsection (a), added to this act as part of the Harmonization project, codifies the majority rule that these payments are not distributions.

Subsection (b) – This subsection provides two tests of insolvency, which are disjunctive. A distribution violates this section if, after the distribution, the LCA fails either of the tests. The subsection applies to both interim and liquidating distributions.

Subsection (c)(2) – This alternative valuation provision is likely to be both useful and fair when a LCA has appreciated assets but for accounting purposes these assets are valued at book value less depreciation.

Subsection (e) – This exception is directly derived from ULLCA (2006) (Last Amended 2013) § 405(e). It emphasizes that protection from the operation of this section extends to some contracts between members and the association. It applies only for purposes of this ection.

See ULLCA (2006) (Last Amended 2013) § 405, comments for additional information on how the limitations in this section are applied.

SECTION 1008. LIABILITY FOR IMPROPER DISTRIBUTIONS; LIMITATION OF ACTION.

(a) If a director of a limited cooperative association consents to a distribution made in violation of Section 1007 and in consenting to the distribution fails to comply with Section 818, the director is personally liable to the association for the amount of the distribution that exceeds the amount that could have been distributed without the violation of Section 1007.

(b) A person that receives a distribution knowing that the distribution violated Section 1007 is personally liable to the limited cooperative association but only to the extent that the distribution received by the person exceeded the amount that could have been properly paid under

Section 1007.

(c) A director against whom an action is commenced because the director is liable under subsection (a) may:

(1) implead any other director that is liable under subsection (a) and seek to enforce a right of contribution from the director; and

(2) implead any person that received a distribution in violation of subsection (b) and seek to enforce a right of contribution from the person in the amount the person received in violation of subsection (b).

(d) An action under this section is barred unless commenced not later than two years after the distribution.

Comment

This section, and Section 1007) are derived from MBCA § 6.40. They are mandatory and may not be changed by the organic rules. In substance and effect these sections protect the interests of creditors of the limited cooperative association.

There are two types of liability in this section: Subsection (a) imposes liability on the directors who approve an improper distribution; and subsection (b) imposes liability on the members who receive the improper distribution.

Subsection (a) – This subsection refers both to Section 1007 which includes in its subsection (c)(2) a standard of ordinary care ("reasonable in the circumstances"), and to Section 818 and Section 819 (concerning standards of conduct and liability of directors). Section 818 adopts the standards of other law in this state by reference.

A limited cooperative association's failure to meet the standard of Section 1007(b) cannot by itself cause a director to be liable under Section 1008(a). *Both* of the following would have to occur before a failure to satisfy Section 1007(b) could occasion personal liability for a director under Section 1008(a):

(1) the association "base[s] a determination that a distribution is not prohibited ... on financial statements prepared on the basis of accounting practices and principles that are [not] reasonable in the circumstances or on a valuation [that is not fair] or other method that is [not] reasonable in the circumstances"[Section 1007(c)].

and

(2) the director's decision to rely on the improper methodology in consenting to the distribution constitutes a breach of the standard imported into [this act] by Section 818 or Section 819.

[SECTION 1009. RELATION TO STATE SECURITIES LAW. A patron member's interest in a limited cooperative association has the same exemption as provided for substantially similar interests in cooperatives under [reference to appropriate provision of this state's laws].]

Legislative Note: *Section 1009 is bracketed because it represents a unique policy decision that concerns both limited cooperative associations and state securities law. If the adopting jurisdiction has a securities exemption for general cooperatives located in cooperative statutes, it should determine whether the jurisdiction is best served by including limited cooperative associations within the existing exemption by referencing the statutory provision here. If the adopting jurisdiction's free standing securities law has a specific exemption or definitional exclusion for cooperatives this optional section need not be included but the adopting jurisdiction might consider whether limited cooperative associations should be treated similarly by that statutory provision.*

Comment

There is a great variation among the states concerning exemptions for cooperatives from state securities laws and this act does not attempt to change the settled policy of any state. Section 1009 is further limited, however, to apply the law of this state to patron member interests because those interests are most similar to membership interests in traditional cooperatives. Securities exemptions may be particularly important where the limited cooperative association distributes interests which might be deemed to be securities in lieu of money on a regular basis. *See, e.g.*, Section 1005(b). Federal securities law will, obviously, apply independently of this act and any securities law exemptions, if any, available under federal law must be obtained in accordance with that law.

[SECTION 1010. ALTERNATIVE DISTRIBUTION OF UNCLAIMED PROPERTY, DISTRIBUTIONS, REDEMPTIONS, OR PAYMENTS. A limited cooperative association may distribute unclaimed property, distributions, redemptions, or payments under [reference to the appropriate provision in the law governing cooperatives not formed under this [act] in this state].]

Legislative Note: *The general cooperative law of some, but not all, states contains a provision*

unique to cooperatives concerning the disposition of unclaimed property. Some of these provisions allow unclaimed property to revert to the cooperative if, after reasonable search, the member cannot be found; others may allow the cooperative to donate unclaimed property to a charity. See, e.g., OREGON REV. STAT. § 62.425 (2003). In states having such a provision the legislature should consider as a matter of policy whether the same provision should be applicable to limited cooperative associations. This is the appropriate place in this act for referencing the provision contained in other law of the adopting jurisdiction and thereby incorporating it by reference. If the referenced statute in a given state requires the cooperative's articles or bylaws to authorize the use of the statutory provision, the authorization requirement should be added in the appropriate subsection of Section 109.

Comment

This section is intended to provide an exception to this state's general unclaimed property statute.

The probable reasons that some state traditional cooperative statutes contain unique provisions concerning unclaimed property is two-fold. First, many cooperatives have revolving membership and, in the regular course of business, have occasional small sales that are patronage; for example, a consumer food cooperative. In these cases it can be reasonably anticipated that there will be numerous accounts with small balances that will not be claimed. Second, cooperative principles and values emphasize community and operation on a cost basis. While operation at cost is not synonymous with either not-for-profit or charity, it may be appropriate to distinguish cooperatives from general for-profit entities for purposes of treatment of unclaimed property.

[ARTICLE] 11

DISSOCIATION

SECTION 1101. MEMBER'S DISSOCIATION.

(a) A person has the power to dissociate as a member at any time.

(b) Unless the organic rules otherwise provide, a member's dissociation from a limited cooperative association is wrongful only if:

(1) it is in breach of an express provision of the organic rules; or

(2) it occurs before the termination of the limited cooperative association and:

(A) the person is expelled as a member under subsection (d)(3) or (4); or

(B) in the case of a person that is not an individual, trust other than a

business trust, or estate, the person is expelled or otherwise dissociated as a member because it dissolved or terminated in bad faith.

(c) Unless the organic rules otherwise provide, a person that wrongfully dissociates as a member is liable to the limited cooperative association and to the other members for damages caused by the dissociation. The liability is in addition to any other debt, obligation, or liability of the person to the association.

(d) A member is dissociated as a member when:

(1) the limited cooperative association receives notice in a record of the member's express will to dissociate as a member, or if the member specifies in the notice an effective date later than the date the association received notice, on that later date;

(2) an event stated in the organic rules as causing the person's dissociation occurs;

(3) the person's entire interest is transferred in a foreclosure sale under Section 605(f);

(4) the person is expelled as a member under the organic rules;

(5) the person is expelled as a member by the board of directors if:

(A) it is unlawful to carry on the limited cooperative association's activities and affairs with the person as a member;

(B) there has been a transfer of all the member's financial rights in the association, other than:

(i) a transfer for security purposes; or

(ii) a charging order in effect under Section 605 which has not been foreclosed;

(C) the person is an unincorporated entity that has been dissolved and its

activities and affairs are being wound up; or

(D) the person is a corporation or cooperative and:

(i) the person filed a certificate of dissolution or the equivalent, or the jurisdiction of formation revoked the person's charter or right to conduct business;

(ii) the association sends a notice to the person that it will be expelled as a member for a reason described in clause (i); and

(iii) not later than 90 days after the notice was sent under clause (ii), the person did not revoke its certificate of dissolution or the equivalent, or the jurisdiction of formation did not reinstate the person's charter or right to conduct business; or

(E) the member is an individual and is adjudged incompetent;

(6) in the case of an individual, the individual dies;

(7) in the case of a member that is a testamentary or inter vivos trust or is acting as a member by virtue of being a trustee of a trust, the trust's entire financial rights in the limited cooperative association are distributed;

(8) in the case of a person that is an estate or is acting as a member by virtue of being a personal representative of an estate, the estate's entire financial interest in the association is distributed;

(9) in the case of a person that is not an individual, partnership, limited liability company, cooperative, corporation, trust, or estate, the existence of the person terminates; or

(10) the association's participation in a transaction under [Article] 16 that causes the person to cease to be a member.

Comment

This act follows current unincorporated law terminology in using "dissociation" as the

term used to mean a person ceasing to be affiliated with an organization as a member or partner.

This section, together with Sections 1102 and 1103, addresses a member's dissociation from a limited cooperative association. Many provisions of these subsections may be varied by the organic rules. Drafters of organic rules should consider the different dynamics in associations with many members versus those with a small number of members and recognize those differences in the organic rules. For example, associations with few members may need to be designed with more restrictions on dissociation than would be appropriate for associations with many members. This act does not provide different rules for associations with a large number of members versus associations with a small number but the organic rules could be drafted to be appropriate under the circumstances. This is consistent with ULLCA (2006) (Last Amended 2013) and ULPA (2001) (Last Amended 2013) where dissociation of members or partners is treated generally without regard to the numbers of members in the entity. Consideration should also be given to the dichotomy between patron members and investor members where investor members are authorized.

After a person has been dissociated as a member, the rights of the person as a member cease, but debts, obligations, or liabilities of the person to the association that arose prior to the dissociation continue and are enforceable as debts, obligations, or liabilities of the person to the association without regard to membership status. *See* Section 1102 (b). A person who is both a patron member and an investor member could be dissociated in one capacity but not the other. *See* Section 112.

As in other provisions of this act, what constitutes proper notice in connection with a dissociation is governed by other law.

Subsection (a) – This subsection recognizes the power of a person to dissociate as a member of a limited cooperative association. The "power" to dissociate is different from the "right" to dissociate. While a member may have the power to dissociate from an association, the dissociation may be "wrongful" as a violation of the organic rules because, for example, a specific prohibition on the right to dissociate, or for other reasons described in subsection (b). A prohibition against dissociation in the organic rules cannot stop a member from dissociating from the association (the power to dissociate) but, on the other hand, the dissociation could be a clear violation of the rules (there being no right to dissociate).

The organic rules may not eliminate the power to dissociate.

Subsection (b) – This subsection provides a limited number of situations when a dissociation is wrongful. The situations could be expanded or contracted by the organic rules.

Subsection (c) – This confirms that a wrongful dissociation may result in the dissociating member being liable to the limited cooperative association if the dissociation causes harm to the association. The amount of damages would need to be proven. These damages are in addition to any other obligation the member owes to the association.

Subsection (d) – This subsection details the various means through which different types of members are dissociated from a limited cooperative association, whether voluntarily or involuntarily.

Subsection (d)(5) – None of the events described in paragraphs (A) through (E) of this subsection cause a dissociation of a member without action of the board of directors to expel the member. Stated another way, these events do not cause an automatic dissociation of the member.

Subsection (d)(5)(E) – A member who has been adjudged incompetent may be dissociated by the board of directors. This could be addressed in the organic rules. Section 1103 provides for the representative of an expelled incompetent member to have certain rights which are less than the rights of the personal representative settling the estate of a deceased member. Being adjudged incompetent, however, does not automatically dissociate the member. If the member is not expelled they would continue to have the rights of a member.

Subsection (d)(6) – An individual is dissociated upon death under this provision. The decedent's estate has the powers conferred by Section 1103. An estate that is carrying on business could become a member by admission.

> EXAMPLE: An individual farmer who was a member of the limited cooperative association dies. The decedent's estate anticipates farming for three years before the estate closes. The estate could become a member of the association pursuant to the organic rules of the association for admission of a member.

Subsection (d)(10) – A plan of merger, interest exchange, conversion, or domestication under Article 16 could provide for dissociation of members in a limited cooperative association.

SECTION 1102. EFFECT OF DISSOCIATION.

(a) When a person is dissociated as a member:

(1) the person's right to participate as a member in the management and conduct of the limited cooperative association's activities and affairs terminates; and

(2) subject to Section 1103 and [Article] 16, any financial rights owned by the person in the person's capacity as a member immediately before dissociation are owned by the person as a transferee.

(b) A person's dissociation as a member does not of itself discharge the person from any debt, obligation, or other liability to the limited cooperative association or the other members

which the person incurred while a member.

Comment

Subsection (a) – In general, when a person dissociates as a member, the person's rights as a member disappear and, subject to Section 112 ("Dual Capacity"), the person's status degrades to that of a mere transferee of financial rights. However, Section 1103, provides some special rights when dissociation is caused by an individual's death or a member has been adjudged incompetent.

SECTION 1103. POWER OF LEGAL REPRESENTATIVE OF DECEASED MEMBER. If a member dies, the deceased member's legal representative may exercise for the purposes of settling the estate, the rights the deceased member had under Section 505.

Comment

The estate of a deceased member and those claiming through the estate are transferees, and as such they have very limited rights to information. This section provides temporary additional information rights to the legal representative of the estate.

[ARTICLE] 12

DISSOLUTION

SECTION 1201. DISSOLUTION AND WINDING UP. A limited cooperative association is dissolved only as provided in [this article] and upon dissolution winds up in accordance with [this article].

Comment

There are only three basic ways in which a limited cooperative association is dissolved: non-judicially, judicially and administratively. In subsequent sections the act identifies these ways in detail and provides how each of the three ways is applied.

After dissolution, no matter how the dissolution occurred, Sections 1206 through 1213 govern the winding up process including the handling of claims and final distributions. In that regard, Section 1010, an optional provision, may provide an alternative to the general unclaimed property statute of this State.

Sections 1212 and 1213 provide for voluntary filings that may prove helpful to the limited cooperative association under certain circumstances.

SECTION 1202. NONJUDICIAL DISSOLUTION. Except as otherwise provided in Sections 1203 and 1215, a limited cooperative association is dissolved and its activities must be wound up:

(1) upon the occurrence of an event or at a time specified in the articles of organization;

(2) upon the action of the association's organizers, board of directors, or members under Section 1204 or 1205; or

(3) 90 days after the dissociation of a member, which results in the association having one patron member and no other members, unless the association:

(A) has a sole member that is a cooperative; or

(B) not later than the end of the 90-day period, admits at least one member in accordance with the organic rules and has at least two members, at least one of which is a patron member.

Comment

The exception for Sections 1203 relating to judicial dissolution and 1215 relating to administrative dissolution is to make it clear those sections provide the only other ways that a limited cooperative association may be dissolved.

Paragraph (1) – The articles of organization may, but are not required to, state events or times when a limited cooperative association is dissolved. To be effective, the provision must be in the articles of organization (not in the bylaws). For example, the articles could provide for dissolution to be required if the association has only five remaining members. This does not contradict the provision in paragraph (3) because it would provide a higher standard. The articles could also provide for a term of years for the association consistent with subsection 301(b)(6). That subsection requires the term be stated in the articles if the association is not to have perpetual existence.

Paragraph (3) – This paragraph and Section 501 (requiring at least two members for a limited cooperative association to commence business unless the sole member is a cooperative) together state a requirement that there be at least two members except where an association is wholly-owned by a cooperative.

SECTION 1203. JUDICIAL DISSOLUTION. The [appropriate court] may dissolve a limited cooperative association or order any action that under the circumstances is appropriate and equitable:

(1) in a proceeding initiated by the [Attorney General], if:

(A) the association obtained its articles of organization through fraud; or

(B) the association has continued to exceed or abuse the authority conferred upon it by law; or

(2) in a proceeding initiated by a member, if:

(A) the directors are deadlocked in the management of the association's affairs, the members are unable to break the deadlock, and irreparable injury to the association is occurring or is threatened because of the deadlock;

(B) the directors or those in control of the association have acted, are acting, or will act in a manner that is illegal, oppressive, or fraudulent;

(C) the members are deadlocked in voting power and have failed to elect successors to directors whose terms have expired for two consecutive periods during which annual members meetings were held or were to be held; or

(D) the assets of the association are being misapplied or wasted.

Comment

Section 1203 permits a court to fashion remedies other than dissolution if an application to dissolve is made to the court. Illustratively, a court could refuse to dissolve a limited cooperative association and instead appoint provisional directors or force a buy-out of membership interests. This follows what appears to be a trend in both statutory and case law of corporations. The language expressly providing for such remedies is "or order any action that under the circumstances is appropriate and equitable." This provision is not subject to change by the organic rules.

Neither a creditor of a limited cooperative association nor a transferee may initiate an

action to dissolve a limited cooperative association. In the case of a creditor with a claim or judgment against the association, the creditor's remedies are left to other law, such as bankruptcy or fraudulent transfer law. Flatly, a transferee may not seek dissolution. This is consistent with other unincorporated entity law.

Paragraph (1) – A proceeding may be initiated by the attorney general to dissolve a limited cooperative association only if its articles of organization were obtained through fraud or the association continues to exceed or abuse its legal authority. "Continued" in this context implies that the behavior is temporal in nature and has not ceased. It is somewhat similar to "acting" as used in paragraph (2)(B).

A policy reason for the attorney general having authority to bring an action to dissolve the limited cooperative association is rooted in the history of cooperatives as a unique type of entity formed for the mutual benefit of its members and in recognition that some cooperatives receive special statutory treatment under particular laws. Traditional cooperative laws typically contain a similar provision.

Paragraph (2) – A member may seek dissolution of a limited cooperative association if the member can demonstrate one of the four conditions stated as grounds for a court to dissolve the association. The burden of proof is on the member who initiates the proceeding.

Paragraphs (2)(A)-(D) – The language in these paragraphs is similar to that commonly found in corporate law (*see* MBCA § 14.30) invites the courts to apply the deadlock and "oppression" doctrines from closely-held corporation law to limited cooperative associations as they have begun to do in the context of limited liability companies. *See* ULLCA (2006) (Last Amended 2013 § 701, subsection (a)(4)(C) comment. These subsections permit inquiry into the management and operations of a limited cooperative association within the stated parameters of the litigation if dissolution is sought by a member.

SECTION 1204. VOLUNTARY DISSOLUTION BEFORE COMMENCEMENT OF ACTIVITY. A majority of the organizers or initial directors of a limited cooperative association that has not yet begun business activity or the conduct of its affairs may dissolve the association.

Comment

This section reflects the practical reality that the organizers or initial directors need to be able to dissolve a limited cooperative association before it begins business. Corporate law recognizes that both organizers and the initial board of directors owe duties to the entity.

SECTION 1205. VOLUNTARY DISSOLUTION BY THE BOARD AND MEMBERS.

(a) Except as otherwise provided in Section 1204, for a limited cooperative association to voluntarily dissolve:

(1) a resolution to dissolve must be approved by a majority vote of the board of directors unless a greater percentage is required by the organic rules;

(2) the board of directors must call a members meeting to consider the resolution, to be held not later than 90 days after adoption of the resolution; and

(3) the board of directors must mail or otherwise transmit or deliver to each member in a record that complies with Section 508:

(A) the resolution required by paragraph (1);

(B) a recommendation that the members vote in favor of the resolution or, if the board determines that because of conflict of interest or other special circumstances it should not make a favorable recommendation, the basis of that determination; and

(C) notice of the members meeting, which must be given in the same manner as notice of a special meeting of members.

(b) Subject to subsection (c), a resolution to dissolve must be approved by:

(1) at least two-thirds of the voting power of members present at a members meeting called under subsection (a)(2); and

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

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

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

meeting; or

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

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

Comment

Subsections (a) and (b) – These subsections follow the notice, action, and voting procedures in other parts of the act for amendments to the organic rules, Article 16 transactions, and disposition of assets. *See* Sections 402, 405, 518, and 1402 through 1404.

Subsection (c) – The articles of organization or the bylaws may provide for a voting percentage to approve dissolution that ranges from a majority of the voting power of the members present at a meeting of the members to unanimity of all members. If there are investor members, at least one-half of the votes cast by patron members must be affirmative unless the organic rules require a larger percentage. *See* Section 514.

SECTION 1206. WINDING UP.

(a) A dissolved limited cooperative association shall wind up its activities and affairs, and except as provided in Section 1207, the association continues after dissolution only for the purpose of winding up.

(b) In winding up its activities and affairs, the board of directors:

(1) shall discharge the association's debts, obligations, or other liabilities, settle and close the association's activities, and marshal and distribute the assets of the association; and

(2) may:

(A) deliver to the [Secretary of State] for filing a statement of dissolution stating the name of the association and that the association is dissolved;

(B) preserve the association's activities, affairs and property as a going concern for a reasonable time;

(C) prosecute and defend actions and proceedings, whether civil, criminal, or administrative;

(D) transfer the association's property;

(E) settle disputes by mediation or arbitration;

(F) deliver to the [Secretary of State] for filing a statement of termination stating the name of the company and that the company is terminated; and

(G) perform other acts necessary or appropriate to the winding up.

(c) After dissolution and upon application of a limited cooperative association, a member, or a holder of financial rights, [the appropriate court] may order judicial supervision of the winding up of the association, including the appointment of a person to wind up the association's activities, if:

(1) after a reasonable time, the association has not wound up its activities; or

(2) the applicant establishes other good cause.

(d) If a person is appointed pursuant to subsection (c) to wind up the activities of a limited cooperative association, the association shall promptly deliver to the [Secretary of State] for filing an amendment to the articles of organization to reflect the appointment.

Comment

Sections 1206 through 1213 govern the process of winding-up including the handling of claims and final distributions no matter how the dissolution occurred. Sections 1214-1216 govern administrative dissolution. *See also* Section 1010 ("Alternative Distribution of Unclaimed Property, Distributions, Redemptions or Payments").

Sections 1212 and 1213 permit a limited cooperative association to deliver for filing a statement of dissolution and a statement of termination. For the effect of filing the statements see Comment to Section 1214. The purpose of the filings is to provide public notice relevant to the post-dissolution activities of the association.

Subsection (a) – Dissolution changes the scope of activities in which a limited cooperative association may engage. Following dissolution, the association may only engage in activities consistent with winding up its affairs.

Subsection (b) – The subsection places the primary obligations in the winding up process

on the board of directors consistent with its general management authority under this act. Despite the limitation on the scope of business of a limited cooperative association following dissolution, this subsection provides broad authority in the board of directors to undertake activities in connection with winding up the affairs of the association. The subsection is expansive to enable the board of directors to conduct the winding up process. The board has authority to designate agents and others to conduct winding up activities. Whether the agent has the authority to bind the association in any given transaction during the winding-up process is a matter of agency law.

The board of directors is given broad authority to take necessary action to wind-up its affairs under subsection (b). For example, if any of the limited cooperative's assets are insubstantial in value and cannot be readily converted to cash, those assets may be abandoned or donated to a charitable organization without violating the obligations of the person conducting the winding up of the association.

Subsection (c) – If the board of directors of a limited cooperative association fails to carry out its obligations under subsection (b), either the association, a member or a holder of financial rights (a transferee) may apply to a court for supervision of the winding up process. This subsection is a safety net for members and holders of financial rights if winding up is unreasonably delayed or other good cause for judicial supervision can be shown.

Subsection (d) – This subsection requires an amendment to the articles of organization to be delivered to the Secretary of State for filing only when a person is appointed by a court to wind up the association's activities. This requirement is not applicable if the board of directors manages the winding up.

SECTION 1207. RESCINDING DISSOLUTION.

(a) A limited cooperative association may rescind its dissolution, unless a statement of termination applicable to the association is effective, [the appropriate court] has entered an order under Section 1203 dissolving the association, or the [Secretary of State] has dissolved the association under Section 1214.

(b) Rescinding dissolution under this section requires:

(1) the affirmative vote or consent of each member;

(2) if a statement of dissolution applicable to the limited cooperative association has been filed by the [Secretary of State] but has not become effective, the delivery to the [Secretary of State] for filing of a statement of withdrawal applicable to the statement of

dissolution; and

(3) if a statement of dissolution applicable to the limited cooperative association is effective, the delivery to the [Secretary of State] for filing of a statement of recission stating the name of the association and that dissolution has been rescinded under this section.

(c) If a limited cooperative association rescinds its dissolution:

(1) the association resumes carrying on its activities and affairs as if dissolution had never occurred;

(2) subject to paragraph (3), and any liability incurred by the association after the dissolution and before the rescission is effective is determined as if dissolution had never occurred; and

(3) the rights of a third party arising out of conduct in reliance on the dissolution before the third party knew or had notice of the rescission may not be adversely affected.

Comment

The Harmonization project added this section, which is based on UPA (1997) (Last Amended 2013) § 802(b)(1) permitting the partners to "waive the right to have the partnership's business wound up and the partnership terminated" after which "the partnership resumes carrying on its business as if dissolution had never occurred").

Subsection (a) – The first exclusion results inevitably from the effect of a statement of termination – i.e., the limited cooperative association ceases to exist. A "dead" entity lacks both the capacity and power to bring itself back from the dead.

The second and third exclusions pertain to dissolutions effected by outsiders – i.e., the court and the filing office.

Subsections (b)(1) – The requirement of unanimous consent protects any vested rights or reliance by members. However, the organic rules may vary this provision.

Subsection (c)(3) – This paragraph protects third parties. *E.g.*, *Neurobehavorial Associates, P.A. v. Cypress Creek Hosp., Inc.*, 995 S.W.2d 326, 331 (Tex. App. 1999) ("If the Hospital had the right to terminate the Agreement when it did because the Association was then dissolved, then even though the Association can revoke articles of dissolution and have that relate

back to the date of dissolution, it would be grossly unfair to let the Association assert its ex post facto change as a defense. Surely the Association would be estopped from doing so, having created the very conditions that gave the Hospital the correct impression that it was then dissolved."). The rule is subject to constructive notice by filing. *See* Section 1212.

SECTION 1208. DISTRIBUTION OF ASSETS IN WINDING UP.

(a) In winding up its activities and affairs, the limited cooperative association shall apply its assets to discharge its obligations to creditors, including members that are creditors. The association shall apply any remaining assets to pay in money the net amount distributable to members in accordance with their right to distributions under subsection (b).

(b) Unless the organic rules otherwise provide, in this subsection "financial interests" means the amounts recorded in the names of members in the records of a limited cooperative association at the time a distribution is made, including amounts paid to become a member, amounts allocated but not distributed to members, and amounts of distributions authorized but not yet paid to members. Unless the organic rules otherwise provide, each member is entitled to a distribution from the association of any remaining assets in the proportion of the member's financial interests to the total financial interests of the members after all other obligations are satisfied.

Comment

Subsection (a) – This subsection follows a traditional approach to the distribution of assets in winding up an entity. It leaves priorities among creditors to other law, such as the Uniform Commercial Code and real property mortgage law.

Subsection (b) – This subsection provides for a distribution to all members of assets available for distribution to members after all other obligations of the limited cooperative association are satisfied. The distribution is based on a proportional comparison of the financial interests of the members. "Financial interests" is a specially defined term for purposes of the subsection.

In some cooperatives, such as rural electric associations, other law or custom may provide for a "look back" period of a designated amount of time to determine members entitled to receive

a distribution in the winding up process. This could be addressed in the organic rules. If members or holders of financial rights cannot be located, Section 1010 ("Alternative Distributions of Unclaimed Property, Distributions, Redemptions or Payments") of this act and other law governing unclaimed property apply.

The organic rules may establish rules to determine the financial interests and manage the distributions under this section but only as a matter of the internal relationship between and among the members and the entity. The existence of nonmember patrons that may have what appears to be equity accounts may raise difficult interpretive issues that turn on the unique facts under the circumstances.

SECTION 1209. KNOWN CLAIMS AGAINST DISSOLVED LIMITED COOPERATIVE ASSOCIATION.

(a) Except as otherwise provided in subsection (d), a dissolved limited cooperative association may give notice of a known claim under subsection (b), which has the effect provided in subsection (c).

(b) A dissolved limited cooperative association in a record may notify its known claimants of the dissolution. The notice must:

(1) specify the information required to be included in a claim;

(2) state that a claim must be in writing and provide a mailing address to which the claim is to be sent;

(3) state the deadline for receipt of a 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 limited cooperative association is barred if the requirements of subsection (b) are met, and:

(1) the claim is not received by the specified deadline; or

(2) if the claim is timely received but rejected by the association:

(A) the association causes the claimant to receive a notice in a record stating that the claim is rejected and will be barred unless the claimant commences an action against the association to enforce the claim not later than 90 days after the claimant receives the notice; and

(B) the claimant does not commence the required action not later than 90 days after the claimant receives the notice.

(d) This section does not apply to a claim based on an event occurring after the date of dissolution or a liability that on that date is contingent.

Comment

Sections 1209-1211 provide rules under which a dissolved limited cooperative association may achieve finality with regard to creditor claims.

This section, which is derived almost verbatim from MBCA § 14.02, provides a means for a dissolved limited cooperative association to address known claims against it and to bar those claims if the claimant does not act in a timely manner or meet other requirements for making a claim to the association. The section also provides the procedures to be followed by a claimant in seeking to enforce a claim against a dissolved association.

SECTION 1210. OTHER CLAIMS AGAINST DISSOLVED LIMITED COOPERATIVE ASSOCIATION.

(a) A dissolved limited cooperative association may publish notice of its dissolution and request persons having claims against the association to present them in accordance with the notice.

(b) A notice authorized under subsection (a) must:

(1) be published at least once in a newspaper of general circulation in the [county] in this state in which the dissolved limited cooperative association's principal office is located or, if the principal office is not located in this state, in the [county] in which the office of the

association's registered agent is or was last located;

(2) describe the information required to be contained in a claim, state that the claim must be in writing, 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 not later than three years after publication of the notice.

(c) If a dissolved limited cooperative association publishes a notice in accordance with subsection (b), the claim of each of the following claimants is barred unless the claimant commences an action to enforce the claim against the association not later than three years after the publication date of the notice:

(1) a claimant that did not receive notice in a record under Section 1209;

(2) a claimant whose claim was timely sent to the company but not acted on; and

(3) a claimant whose claim is contingent at, or based on an event occurring after, the effective date of dissolution.

(d) A claim not barred under this section or Section 1209 may be enforced:

(1) against a dissolved limited cooperative association, to the extent of its undistributed assets; and

(2) except as provided in Section 1211, if the assets of the association have been distributed after dissolution, against a member or holder of financial rights to the extent of that person's proportionate share of the claim or the assets distributed to the person after dissolution, whichever is less, but a person's total liability for all claims under this paragraph may not exceed the total amount of assets distributed to the person after dissolution.

Comment

This section, which is derived almost verbatim from MBCA § 14.07, provides a means

for a dissolved limited cooperative association to address unknown claims against it and to bar those specific types of claims. Those claims are barred three years after completion of publication by the association of a notice to submit claims if a claim is not presented to the association within that period.

Subsection (c) – This subsection identifies the specific types of claims which may be barred under this section. They include known claimants who did not receive notice under Section 1210. They also include claimants with contingent claims and claimants whose claims are based on an event occurring after the date of dissolution.

Subsection (d)(2) – Liability under this paragraph would extend to anyone who has received distributions as a member or as a holder of financial rights (transferee, assignee) and under a charging order attaching to financial rights. This paragraph contains no "knowledge" element.

SECTION 1211. COURT PROCEEDINGS.

(a) A dissolved limited cooperative association that has published a notice under Section 1210 may file an application with [the appropriate court] in the [county] where the association's principal office is located or, if the principal office is not located in this state, where the office of its registered agent is or was last located, for a determination of the amount and form of security to be provided for payment of claims that are reasonably expected to arise after the date of dissolution based on facts known to the association and:

(1) at the time of the application:

(A) are contingent; or

(B) have not been made known to the association; or

(2) are based on an event occurring after the date of dissolution.

(b) Security is not required for a claim that is or is reasonably anticipated to be barred under Section 1210.

(c) Not later than 10 days after filing an application under subsection (a), the dissolved limited cooperative association shall give notice of the proceeding to each claimant holding a

contingent claim known to the association.

(d) In a proceeding under this section, the court may appoint a guardian ad litem to represent all claimants whose identities are unknown. The reasonable fees and expenses of the guardian, including all reasonable expert witness fees, must be paid by the dissolved limited cooperative association.

(e) A dissolved limited cooperative association that provides security in the amount and form ordered by the court under subsection (a) satisfies the association's obligations with respect to claims that are contingent, have not been made known to the association, or are based on an event occurring after the effective date of dissolution. Such claims may not be enforced against a member or holder of financial rights on account of assets received in liquidation.

Comment

This section is similar to MBCA § 14.08. It provides a procedure under which a dissolved limited cooperative association that has followed the procedures under Section 1210 to seek judicial assistance for providing security for contingent and unknown claims and claims based on events occurring after dissolution. Its purpose is to provide greater certainty for distributions made in liquidation. If satisfactory security is provided, the association can confidently distribute the remaining assets. Subsection (d) provides protection to the recipients of the distributions from recovery by claimants of the association.

It is expected a court would use its discretion and deny the protections of Section 1210 to a dissolved association where it is determined that the association is dissolving for purposes of avoiding anticipated claims of future tort claimants. *See, e.g.*, Uniform Fraudulent Transfer act.

SECTION 1212. STATEMENT OF DISSOLUTION.

(a) A limited cooperative association that has dissolved or is about to dissolve may deliver to the [Secretary of State] for filing a statement of dissolution that states:

(1) the name of the association;

(2) the date the association dissolved or will dissolve; and

(3) any other information the association considers relevant.

(b) A person has notice of a limited cooperative association's dissolution on the later of:

(1) 90 days after a statement of dissolution is filed; or

(2) the effective date stated in the statement of dissolution.

Comment

This section provides for the voluntary filing of a statement of dissolution with the filing office. The effect of filing the statement is to give notice that a limited cooperative association has dissolved or will soon dissolve and is winding up. It provides constructive notice of dissolution under subsection (b). If a person is appointed by a court to wind up the activities of a dissolved association under subsection 1206(c), an amendment to the articles of organization reflecting the appointment must be filed with the filing office under subsection 1206(d).

SECTION 1213. STATEMENT OF TERMINATION.

(a) A dissolved limited cooperative association that has completed winding up may deliver to the [Secretary of State] for filing a statement of termination that states:

(1) the name of the association;

(2) the date of filing of its initial articles of organization; and

(3) that the association is terminated.

(b) The filing of a statement of termination does not itself terminate the limited cooperative association.

Comment

This section provides for the voluntary filing of a statement of termination with the filing office. The effect of filing the statement is to give notice that a limited cooperative association has terminated its existence. As with the statement of dissolution under Section 1212, the effect of this notice is left to other law, including the law of agency.

Filing of a notice of termination does not eliminate the obligations of the association and those handling its winding up to complete the winding up of the association's affairs and distributing its assets as required by this act.

If a statement of dissolution or a statement of termination is not filed, and no further annual reports are filed with the filing office, the filing office will eventually administratively dissolve the limited cooperative association under Section 1214.

SECTION 1214. ADMINISTRATIVE DISSOLUTION.

(a) The [Secretary of State] may commence a proceeding under subsection (b) to dissolve a limited cooperative association administratively if the association does not:

(1) pay any fee, tax, interest, or penalty required to be paid to the [Secretary of State] not later than [six months] after it is due;

(2) deliver [an annual] [a biennial] report to the [Secretary of State] not later than [six months] after it is due; or

(3) have a registered agent in this state for [60] consecutive days.

(b) If the [Secretary of State] determines that one or more grounds exist for administratively dissolving a limited cooperative association, the [Secretary of State] shall serve the association with notice in a record of the [Secretary of State's] determination.

(c) If a limited cooperative association, not later than [60] days after service of the notice under subsection (b), does not cure or demonstrate to the satisfaction of the [Secretary of State] the nonexistence of each ground determined by the [Secretary of State], the [Secretary of State] shall administratively dissolve the association by signing a statement of administrative dissolution that recites the grounds for dissolution and the effective date of dissolution. The [Secretary of State] shall file the statement and serve a copy on the association pursuant to Section 122.

(d) A limited cooperative association that is administratively dissolved continues in existence as an entity but may not carry on any activities except as necessary to wind up its activities and affairs and liquidate its assets under Sections 1206 and 1208 through 1213, or to apply for reinstatement under Section 1215.

(e) The administrative dissolution of a limited cooperative association does not terminate the authority of its registered agent.

Comment

Many failures to comply with statutory requirements that may give rise to administrative dissolution occur because of oversight or inadvertence and are usually corrected promptly when brought to the entity's attention. Subsections (a) and (b) therefore provide a mandatory notice by the filing office to each entity subject to administrative dissolution and a grace period following the notice before the statement of administrative dissolution may be filed.

In most instances, the issue whether the entity is subject to administrative dissolution will not be controverted. If an entity is administratively dissolved, it may petition the filing office for reinstatement under Section 1215 and, if this is denied, it may appeal to the courts under Section 1216.

SECTION 1215. REINSTATEMENT.

(a) A limited cooperative association that is administratively dissolved under Section 1214 may apply to the [Secretary of State] for reinstatement [not later than two years after the effective date of dissolution]. The application must state:

(1) the name of the association at the time of its administrative dissolution and, if needed, a different name that satisfies Section 115;

(2) the address of the principal office of the association and the name and street and mailing addresses of its registered agent;

(3) the effective date of the association's administrative dissolution; and

(4) that the grounds for dissolution did not exist or have been cured.

(b) To be reinstated, a limited cooperative association must pay all fees, taxes, interest, and penalties that were due to the [Secretary of State] at the time of the association's administrative dissolution and all fees, taxes, interest, and penalties that would have been due to the [Secretary of State] while the association was administratively dissolved.

(c) If the [Secretary of State] determines that an application under subsection (a) contains the required information, is satisfied that the information is correct, and determines that all

payments required to be made to the [Secretary of State] by subsection (b) have been made, the [Secretary of State] shall

(1) cancel the statement of administrative dissolution and prepare a statement of reinstatement that states the [Secretary of State's] determination and the effective date of reinstatement; and

(2) file the statement of reinstatement and serve a copy on the limited cooperative association.

(d) When reinstatement under this section is effective the following rules apply:

(1) The restatement relates back to and takes effect as of the effective date of the administrative dissolution.

(2) The limited cooperative association resumes carrying on its activities and affairs as if the administrative dissolution had not occurred.

(3) The rights of a person arising out of an act or omission in reliance on the dissolution before the person knew or had notice of the reinstatement are not affected.

Comment

Some states require that reinstatement be sought within two years of administrative dissolution. Other states provide a longer time, or do not impose any time limit. The concern with not imposing any time limit is that the process of reinstatement may be abused by unscrupulous people seeking to reinstate a dormant entity that has been abandoned by its original interest holders and that they wish to appropriate for improper ends. On the other hand, the concern with imposing a time limit is that if those in charge of an entity have neglected to file an annual report or otherwise subjected the entity to administrative dissolution, they may also not realize that the two year period is running against them and thus do not learn of the administrative dissolution until after it is too late to correct.

Subsection (a)(1) – This provision will apply, if before the LCA is reinstated, another entity has taken the association's name. *See* Section 115.

SECTION 1216. JUDICIAL REVIEW OF DENIAL OF REINSTATEMENT.

(a) If the [Secretary of State] denies a limited liability cooperative association's application for reinstatement following administrative dissolution, the [Secretary of State] shall serve the association with a notice in a record that explains the reasons for the denial.

(b) A limited cooperative association may seek judicial review of denial of reinstatement in [the appropriate court] not later than [30] days after service of the notice of denial.

Comment

Because the grounds for administrative dissolution under Section 1214 are limited and straight-forward, it is unlikely there will be a dispute about whether a limited cooperative association has corrected the reasons for its administrative dissolution. But in the event a dissolved association disagrees with a determination by the filing office to deny the association's application for reinstatement, this section gives the association a limited right to seek judicial review of the denial of reinstatement.

[ARTICLE] 13

ACTIONS BY MEMBERS

Legislative Note: *This entire [Article] is bracketed to indicate its adoption is optional depending on whether an adopting jurisdiction places the substantive law regarding derivative actions in its statutes relating to entities or in its civil procedure law including its rules of civil procedure. If an adopting jurisdiction places derivative actions in its entity statutes, this [Article] should be adopted. If the adopting jurisdiction places provisions concerning derivative actions in its civil procedure law, this [article] should not be adopted although the adopting jurisdiction could place a reference to that law as the text of this [Article]. If the adopting jurisdiction's laws regarding derivative actions specifically reference particular types of entities to which derivative actions are to be applicable, this [act] should be referenced in those laws.*

SECTION 1301. DIRECT ACTION BY MEMBER.

(a) Subject to subsection (b), a member may maintain a direct action against another member, director, or the limited cooperative association to enforce the member's rights and protect the member's interests, including rights and interests under the organic rules or this [act] or arising independently of the membership relationship.

(b) A member maintaining a direct action under this section must plead and prove an actual or threatened injury that is not solely the result of an injury suffered or threatened to be suffered by the limited cooperative association.

Comment

This section was added as part of the Harmonization project. ULLCA (2006) (Last Amended 2013) and ULPA (2001) (Last Amended2013) have similar provisions. The distinction between direct and derivative actions (Sections 1302-1307) has been an issue that has frequently been litigated in the past.

Subsection (a) – A member's rights under this subsection are subject to the rule of standing stated in subsection (b). The phrase "otherwise protect the member's interests" pertains to remedies and creates no additional causes of action.

The last phrase of this subsection ("or arising independently ...") does not create any new rights, obligations, or remedies, and is included merely to emphasize that a person's membership in a limited cooperative association does not preclude the person from enforcing rights existing "independently of the membership relationship" – e.g., as a creditor.

Subsection (b) – This subsection codifies the rule of standing that predominates in law of limited liability companies as well as corporations. *See, e.g., Tooley v. Donaldson, Lufkin, & Jenrette, Inc.*, 845 A.2d 1031, 1035 (Del. 2004); *Jones v. H.F. Ahmanson & Co.*, 460 P.2d 464, 471 (Cal. 1969).

The distinction between direct and derivative claims protects the LCA's organic rules. If any member can sue directly over any management issue, the mere threat of suit can interfere with the members' agreed-upon arrangements. Although in ordinary contractual situations it is axiomatic that each party to a contract has standing to sue for breach of that contract, within a LCA different circumstances typically exist. A member does not have a direct claim against a director or another member merely because the director or other member has breached the operating agreement. Likewise a member's violation of this act does not automatically create a direct claim for every other member. To have standing in his, her, or its own right, a member plaintiff must be able to show a harm that occurs independently of the harm caused or threatened to be caused to the LCA.

> EXAMPLE: Through grossly negligent conduct, in violation of Section 818, the directors of a LCA reduce the net assets of an LCA by 50%, which in turns decreases the value of Member A's investment by $3,000,000. Member A has no standing to bring a direct claim. Member A's damage is merely derivative of the damage first suffered by the LCA. The member may, however, bring a derivative claim. Sections 1302--1307.

> EXAMPLE: Same facts, except in addition to violating Section 818, the directors'

conduct breaches an express provision of the organic rules to which Member A is a signatory. The analysis and the result are the same.

EXAMPLE: The organic rules of a LCA define "distributable cash" and requires the LCA to periodically distribute that cash among all members. The LCA's directors fail to distribute the cash. Each member has a direct claim against the directors and the LCA.

The reference to "threatened injury" is to encompass potential claims for preventative relief, such as a TRO or preliminary injunction.

Section 1203(2) gives a member the right to bring a direct action for dissolution against a LLC in circumstances involving deadlock, oppression and waste. This dissolution action is in addition to and independent of the direct action under this section.

SECTION 1302. DERIVATIVE ACTION. A member may maintain a derivative action to enforce a right of a limited cooperative association if:

(1) the member first makes a demand on the directors requesting that they cause the association to bring an action to enforce the right and the directors do not bring the action within a reasonable time; or

(2) a demand under paragraph (1) would be futile.

Comment

Paragraph (1) – The demand requirement recognizes that, presumptively at least, the decision to cause a limited liability company to bring suit is a business decision, to be made by those who manage the business. Deborah A. DeMott, SHAREHOLDER DERIVATIVE ACTIONS: LAW AND PRACTICE (Westlaw DB SDALP, retrieved November 4, 2012) § 5.9 (Demand on directors—Rationales for demand).

Paragraph (2) – Some jurisdictions have a "universal demand" requirement, but the approach stated here is by far the majority one. *Id.* § 5.12.

SECTION 1303. PROPER PLAINTIFF. A derivative action to enforce a right of a limited cooperative association may be maintained only by a person that is a member at the time the action is commenced and:

(1) was a member when the conduct giving rise to the action occurred; or

(2) whose status as a member devolved on the person by operation of law or pursuant to

the terms of the organic rules from a person that was a member at the time of the conduct.

Comment

The rule stated here is conventional in both the law of unincorporated entities and corporate law. Dissociated members and other transferees have no standing to bring a derivative action.

Paragraph (2) – This paragraph will be inapposite if the limited cooperative association has only two members, one of whom is the derivative plaintiff. In that limited circumstance, the plaintiff's death would cause the derivative action to abate.

This act takes no position on whether:

- the death of member abates a direct claim against the LCA or a fellow member; and
- bringing a direct claim precludes a person from being a proper plaintiff for a derivative claim.

As to the latter issue, s*ee e.g. Cordts-Auth v. Crunk, LLC*, 815 F. Supp. 2d 778, 793-94 (S.D.N.Y. 2011) (discussing the potential conflict of interest) aff'd, 479 F. App'x 375 (2d Cir. 2012).

SECTION 1304. PLEADING. In a derivative action to enforce a right of a limited cooperative association, the complaint must state with particularity:

(1) the date and content of plaintiff's demand and the response to the demand by the directors; or

(2) why demand should be excused as futile.

Comment

This section parallels Section 1302. The pleading requirement first appeared in a uniform act in 1976. Uniform Limited Partnership Act (1976) § 1003.

SECTION 1305. APPROVAL FOR DISCONTINUANCE OR SETTLEMENT. A derivative action on behalf of a limited cooperative association may not be voluntarily dismissed or settled without the court's approval.

Comment

Discontinuance or settlement of a derivative action must be approved by the court. This acts as a prophylactic against strike suits where a member-plaintiff brings an action with the

primary objective to obtain a private settlement.

The section does not address whether a court must provide notice to any members who might be affected by discontinuance of a derivative suit or a settlement. The court has discretion to determine what information should be provided to others in its judicial administration of the suit.

SECTION 1306. PROCEEDS AND EXPENSES.

(a) Except as otherwise provided in subsection (b):

(1) any proceeds or other benefits of a derivative action, whether by judgment, compromise, or settlement, belong to the limited cooperative association and not to the plaintiff; and

(2) if the plaintiff receives any proceeds, the plaintiff shall remit them immediately to the association.

(b) If a derivative action is successful in whole or in part, the court may award the plaintiff reasonable expenses, including reasonable attorney's fees and costs, from the recovery of the limited cooperative association.

Comment

Subsection (a) – The proceeds recovered in a derivative action belong to the LCA, not the members who brought the action. In a derivative action the plaintiffs are suing on behalf of the LCA. In contrast, any recovery in a direct action (Section 1301) belongs to the member or members who brought the action.

SECTION 1307. SPECIAL LITIGATION COMMITTEE.

(a) If a limited cooperative association is named as or made a party in a derivative proceeding, the association may appoint a special litigation committee to investigate the claims asserted in the proceeding and determine whether pursuing the action is in the best interests of the company. If the association appoints a special litigation committee, on motion by the committee made in the name of the association, except for good cause shown, the court shall stay discovery

for the time reasonably necessary to permit the committee to make its investigation. This subsection does not prevent the court from:

(1) enforcing a person's right to information under Section 505; or

(2) granting extraordinary relief in the form of a temporary restraining order or preliminary injunction.

(b) A special litigation committee must be composed of one or more disinterested and independent individuals, who may be members.

(c) A special litigation committee may be appointed:

(1) by a majority of the directors not named as parties in the proceeding; or

(2) if all directors are named as parties in the proceeding, by a majority of the directors named as defendants.

(d) After appropriate investigation, a special litigation committee may determine that it is in the best interests of the limited cooperative association that the proceeding:

(1) continue under the control of the plaintiff;

(2) continue under the control of the committee;

(3) be settled on terms approved by the committee; or

(4) be dismissed.

(e) After making a determination under subsection (d), a special litigation committee shall file with the court a statement of its determination and its report supporting its determination and shall serve each party with a copy of the determination and report. The court shall determine whether the members of the committee were disinterested and independent and whether the committee conducted its investigation and made its recommendation in good faith, independently, and with reasonable care, with the committee having the burden of proof. If the court finds that

the members of the committee were disinterested and independent and that the committee acted in good faith, independently, and with reasonable care, the court shall enforce the determination of the committee. Otherwise, the court shall dissolve the stay of discovery entered under subsection (a) and allow the action to continue under the control of the plaintiff.

Comment

Although special litigation committees are best known in the corporate field, they are no more inherently corporate than derivative litigation or the notion that an organization is a person distinct from its owners. An "SLC" can serve as an ADR mechanism, help protect an agreed upon arrangement from strike suits, protect the interests of members who are neither plaintiffs nor defendants (if any), and bring the benefits of a specially tailored business judgment to any judicial decision.

This section's approach corresponds to established law in most jurisdictions, modified to fit the typical governance structures of a limited cooperative association. Use of an SLC is optional.

Subsection (a)(1) – Section 505 pertains to information rights. On the availability of Section 505 remedies pending the SLC's investigation, *compare Kaufman v. Computer Assoc. Int'l., Inc.*, No. Civ.A. 699-N, 2005 WL 3470589 at *1 (Del.Ch. Dec. 21, 2005, as revised) (presenting "the question of whether to stay a books and records action under 8 Del. C. § 220 at the request of a special litigation committee when a derivative action encompassing substantially the same allegations of wrongdoing filed by different plaintiffs is pending in another jurisdiction;" concluding "[f]or reasons that have much to do with the light burden imposed by the plaintiff's demand in this case ... that the special litigation committee's motion to stay the books and records action should be denied").

Subsection (e) – The standard stated for judicial review of the SLC determination follows *Auerbach v. Bennett*, 47 N.Y.2d 619, 419 N.Y.S.2d 920 (N.Y. 1979) rather than *Zapata Corp. v. Maldonado*, 430 A.2d 779 (Del. 1981), because the latter's reference to a court's business judgment has generally not been followed in other states. In essence, an SLC is intended to function as a surrogate decision-maker, allowing the limited liability company to make what is fundamentally a business decision. If a court determines that "the members of the committee were disinterested and independent and whether the committee conducted its investigation and made its recommendation in good faith, independently, and with reasonable care, with the committee having the burden of proof," it makes no sense to substitute the court's legal judgment for the business judgment of the SLC.

Houle v. Low, 407 Mass. 810, 822, 556 N.E.2d 51, 58 (Mass. 1990) contains an excellent explanation of the court's role in reviewing an SLC decision:

> The value of a special litigation committee is coextensive with the extent to which that committee truly exercises business judgment. In order to ensure that special litigation committees do act for the [entity]'s best interest, a good deal of judicial oversight is necessary in each case. At the same time, however, courts must be careful not to usurp the committee's valuable role in exercising business judgment. ... . [A] special litigation committee must be independent, unbiased, and act in good faith. Moreover, such a committee must conduct a thorough and careful analysis regarding the plaintiff's derivative suit ... . The burden of proving that these procedural requirements have been met must rest, in all fairness, on the party capable of making that proof--the [entity].

For an extensive discussion of how a court should approach the question of independence, *see Einhorn v. Culea*, 612 N.W.2d 78, 91 (Wis. 2000).

[ARTICLE] 14

DISPOSITION OF ASSETS

SECTION 1401. DISPOSITION OF ASSETS NOT REQUIRING MEMBER

APPROVAL. Unless the articles of organization otherwise provide, member approval under Section 1402 is not required for a limited cooperative association to:

(1) sell, lease, exchange, license, or otherwise dispose of all or any part of the assets of the association in the usual and regular course of business; or

(2) mortgage, pledge, dedicate to the repayment of indebtedness, or encumber in any way all or any part of the assets of the association whether or not in the usual and regular course of business.

Comment

This section and article do not have express counterparts in ULLCA (2006) (Last Amended 2013), ULPA (2001) (Last Amended 2013), or UPA (1997) (Last Amended 2013), though in application those acts provide for similar heightened voting as matter of default in the context of a disposition of assets. For example, Section 401(j) of UPA (1997) (Last Amended 2013) provides that a majority of partners may decide matters arising "in the ordinary course of business" while an "act outside the ordinary course of business ... and an amendment to the partnership agreement may be undertaken only with the consent of all the partners." This act similarly requires, unless the articles otherwise provide, the same voting standard and mechanism for dispositions of assets as for amending the articles of organization if the disposition is outside

the usual and regular course of business. *See* Section 1402.

This section allows a limited cooperative association the flexibility to deal with its assets as required by modern business practices. No member approval is required for asset dispositions if they occur in the usual and regular course of business.

> EXAMPLE: A limited cooperative association of artisans purchases wares from its artisan members. It is organized in such a way that the artisans' ship wares from their personal studios located in twenty different states to a temporary market location in a different city every three months. The association leases market space in each city for one week and sells substantially all of the inventory of wares shipped to that location. The only other assets the association has are a small leased home office, leased telecommunication equipment and two personal computers. The sale of all the association's inventory of wares is in the usual and regular course of business and this article does not require member approval for its disposition even though the sale of the inventory represents substantially all of the assets of the association.

SECTION 1402. MEMBER APPROVAL OF OTHER DISPOSITION OF ASSETS. A sale, lease, exchange, license, or other disposition of assets of a limited cooperative association, other than a disposition described in Section 1401, requires approval of the association's members under Sections 1403 and 1404 if the disposition leaves the association without significant continuing business activity.

Comment

The test in determining whether member approval is necessary for the disposition of assets is not alone a matter of the nominal value of the assets to be disposed or the relative percentage of the value of assets disposed to the value of the assets owned by the limited cooperative association. This section, together with Section 1401, focuses the inquiry on whether the disposition is in the regular or usual course of business of the association and how the disposition effects the association's existence, purpose, and continued activity.

A primary reason for requiring member approval for the disposition of assets outside the usual and regular course of business is because such a sale may be used as a transactional substitute or a piece of a transactional substitute for a merger.

SECTION 1403. NOTICE AND ACTION BY BOARD OF DIRECTORS ON DISPOSITION OF ASSETS REQUIRING MEMBER APPROVAL. For a limited cooperative association to dispose of assets under Section 1402:

(1) a majority of the board of directors, or a greater percentage if required by the organic rules, must approve the proposed disposition; and

(2) the board of directors must call a members meeting to consider the proposed disposition, hold the meeting not later than 90 days after approval of the proposed disposition by the board, and mail or otherwise transmit or deliver in a record to each member:

(A) the terms of the proposed disposition;

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

(C) a statement of any condition of the board's submission of the proposed disposition to the members; and

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

Comment

This section and Section 1404 set forth the approval procedure by the directors and members of sales of assets that must be approved by the members under Section 1402

SECTION 1404. MEMBER ACTION ON DISPOSITION OF ASSETS.

(a) Subject to subsection (b), a disposition of assets under Section 1402 must be approved by:

(1) at least two-thirds of the voting power of members present at a members meeting called under Section 1403(2); and

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

patron members.

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

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

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

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

(c) Subject to any contractual obligations, after a disposition of assets is approved and at any time before the consummation of the disposition, a limited cooperative association may approve an amendment to the contract for disposition or the resolution authorizing the disposition or approve abandonment of the disposition:

(1) as provided in the contract or the resolution; and

(2) except as prohibited by the resolution, with the same affirmative vote of the board of directors and of the members as was required to approve the disposition.

(d) The voting requirements for districts, classes, or voting groups under Section 404 apply to approval of a disposition of assets under this [article].

Comment

Action on the proposed disposition of assets by members is coordinated with the voting on amendments to the articles of association. *See* Sections 405 and 518.

[ARTICLE] 15

FOREIGN COOPERATIVES

SECTION 1501. GOVERNING LAW.

(a) The law of the jurisdiction of formation of a foreign cooperative governs:

(1) the internal affairs of the cooperative; and

(2) the liability that a person has as a member or director for a debt, obligation, or liability of the cooperative.

(b) A foreign cooperative is not precluded from registering to do business in this state because of any difference between the law of its jurisdiction of formation and the law of this state.

(c) Registration of a foreign cooperative to do business in this state does not authorize ~~a~~ the foreign cooperative to engage in any activities and affairs or exercise any power that a limited cooperative association may not engage in or exercise in this state.

Comment

The definition of a "foreign cooperative" in Section 102(10) identifies a foreign cooperative as an entity organized under a law "similar" to this act. This contemplates a statute (in another jurisdiction) that provides for entities of the same general type as a limited cooperative association under this act, but does not require the other statute to contain provisions that are the same as provisions in this act.

Subsection (a) – This subsection provides that the laws of the jurisdiction of formation of a foreign LCA, rather than the laws of this State, govern both the internal affairs of the foreign LCA and the liability of its members and managers for the obligations of the LCA. This subdivision parallels Section 106 (pertaining to the governing law for domestic LCAs). See the comment to that section.

Subsections (b) and (c) – These sections together make clear that, although a foreign LCA may not be denied registration simply because of a difference between the laws of its jurisdiction of formation and the laws of this state, the foreign LCA may not engage in any activity or exercise any power in this state that a domestic LCA may not engage in or exercise.

SECTION 1502. REGISTRATION TO DO BUSINESS IN THIS STATE.

(a) A foreign cooperative may not do business in this state until it registers with the [Secretary of State] under this [article].

(b) A foreign cooperative doing business in this state may not maintain an action or proceeding in this state unless it is registered to do business in this state.

(c) The failure of a foreign cooperative to register to do business in this state does not

impair the validity of a contract or act of the foreign cooperative or preclude it from defending an action or proceeding in this state.

(d) A limitation on the liability of a member or director of a foreign cooperative is not waived solely because the foreign cooperative does business in this state without registering to do business in this state.

(e) Section 1501(a) and (b) applies even if a foreign cooperative fails to register under this [article].

Comment

Subsection (a) – Following a long-established tradition, this act does not state what constitutes "do[ing] business in this state." Instead, Section 1505 provides a non-exhaustive list of "[a]ctivities of a foreign limited liability company which do not constitute doing business in this state."

Subsection (b) – The purpose of this subsection is to induce foreign limited cooperatives to register without imposing harsh or erratic sanctions. Often the failure to register is a result of inadvertence or bona fide disagreement as to the scope of Section 1505, which is necessarily imprecise. Thus, the imposition of harsh sanctions in those situations is inappropriate. The sanction of closing the courts of the state to suits brought by foreign LCAs that should have registered is not a punitive one. If a foreign LCA should have registered and failed to do so, it may still enforce its contractual and other rights simply by registering. However, if a court dismisses a case under this subsection rather than staying the proceedings pending the foreign LCA's registration, a statute of limitations problem may occur. *Corco, Inc. v. Ledar Transport, Inc.* 24 Kan.App.2d 377, 379, 946 P.2d 1009, 1010 (1997) ("[T]he proper remedy was to dismiss [the unregistered entity's] counterclaim without prejudice rather than with prejudice. This would leave [the entity] the opportunity to comply with the statutes and then reassert its claim against [the defendant]. On the other hand, it would also leave the risk that the statute of limitations might run against [the entity].").

This subsection does not prevent a foreign LCA that has failed to register from "defending" an action or proceeding. The distinction between "maintaining" an action or proceeding under this subsection and "defending" an action or proceeding under Subsection (c) is determined on the basis of whether affirmative relief is sought. A nonregistered foreign LCA may interpose any defense or permissive or mandatory counterclaim to defeat a claimed recovery, but may not obtain an affirmative judgment based on the counterclaim without first registering.

Subsection (c) – In addition to permitting a non-registered foreign LCA doing business in this state to defend (but not maintain) an action or proceeding, this section makes clear that failure

to register does not impair the validity of a foreign LCA's acts.

Subsection (d) – This subsection preserves the effectiveness of a foreign LCA's liability shield applicable under the LCA's governing law. If a foreign LCA should have registered and failed to do so, it may still enforce its contracts simply by registering.

SECTION 1503. FOREIGN REGISTRATION STATEMENT. To register to do business in this state, a foreign cooperative must deliver a foreign registration statement to the [Secretary of State] for filing. The statement must state:

(1) the name of the cooperative and, if the name does not comply with Section 115, an alternate name adopted pursuant to Section 1506;

(2) that the cooperative is a foreign cooperative;

(3) the cooperative's jurisdiction of formation;

(4) the street and mailing addresses of the cooperative's principal office and, if the law of the cooperative's jurisdiction of formation requires the cooperative to maintain an office in that jurisdiction, the street and mailing addresses of the required office; and

(5) the name and street and mailing addresses of the cooperative's registered agent in this state.

Comment

The foreign registration statement provides certain basic information about the foreign entity to ensure that citizens of the state have access to that information in their dealings with the foreign entity. The statement also facilitates the subjection of the entity to the courts of the state.

Once registered, a foreign LCA must file an annual/biennial report. See Section 210.

SECTION 1504. AMENDMENT OF FOREIGN REGISTRATION STATEMENT. A registered foreign cooperative shall deliver to the [Secretary of State] for filing an amendment to its foreign registration statement if there is a change in:

(1) the name of the cooperative;

(2) the cooperative's jurisdiction of formation;

(3) an address required by Section 1503(4); or

(4) the information required by Section 1503(5).

Comment

This section works in tandem with the annual / biennial report required by Section 210 to keep up to date the information of record in the office of the filing office about a registered foreign limited cooperative association.

SECTION 1505. ACTIVITIES NOT CONSTITUTING DOING BUSINESS.

(a) activities of a foreign cooperative which do not constitute doing business in this state under this [article] include:

(1) maintaining, defending, mediating, arbitrating, or settling an action or proceeding;

(2) carrying on any activity concerning its internal affairs, including holding meetings of its members or directors;

(3) maintaining accounts in financial institutions;

(4) maintaining offices or agencies for the transfer, exchange, and registration of securities of the cooperative or maintaining trustees or depositories with respect to those securities;

(5) selling through independent contractors;

(6) soliciting or obtaining orders by any means if the orders require acceptance outside this state before they become contracts;

(7) creating or acquiring indebtedness, mortgages, or security interests in property;

(8) securing or collecting debts or enforcing mortgages or security interests in property securing the debts, and holding, protecting, or maintaining property;

(9) conducting an isolated transaction that is not in the course of similar transactions;

(10) owning, without more, property; and

(11) doing business in interstate commerce.

(b) A person does not do business in this state solely by being a member or director of a foreign cooperative that does business in this state.

(c) This section does not apply in determining the contacts or activities that may subject a foreign cooperative to service of process, taxation, or regulation under law of this state other than this [act].

Comment

This act does not attempt to formulate an inclusive definition of what constitutes doing business in a state. Rather, the concept is defined in a negative fashion by subsections (a) and (b), which state that certain activities do not constitute doing business.

In general terms, any conduct more regular, systematic, or extensive than that described in subsection (a) constitutes doing business and requires the foreign limited liability company to register to do business. Typical conduct requiring registration includes maintaining an office to conduct local intrastate business, selling personal property not in interstate commerce, entering into contracts relating to the local business or sales, and owning or using real estate for general purposes. But the passive owning of real estate for investment purposes does not constitute doing business. See subsection (a)(10).

The test of "doing business" defined in a negative way in subsections (a) and (b) applies only to the question whether a foreign limited cooperative association's contacts with the state are such that it must register under this section. The test is not applicable to other questions such as whether the foreign LCA is amenable to service of process under state "long-arm" statutes or liable for state or local taxes. A foreign LCA that has registered (or is required to register) will generally be subject to suit and state taxation in the state, while a foreign LCA that is subject to service of process or state taxation in a state will not necessarily be required to register.

Subsection (a) – The list of activities set forth in this subsection is not exhaustive.

Subsection (a)(1) – A foreign limited cooperative association is not "doing business" solely because it resorts to the courts of the state to recover an indebtedness, enforce an obligation, recover possession of personal property, obtain the appointment of a receiver,

intervene in a pending proceeding, bring a petition to compel arbitration, file an appeal bond, or pursue appellate remedies. Similarly, a foreign LCA is not required to register merely because it files a complaint with a governmental agency or participates in an administrative proceeding within the state.

Subsection (a)(2) – A foreign limited cooperative association does not "do business" within a state under this section merely because some of its internal affairs occur within a state. Thus, a foreign LCA may hold meetings of its managers or members within a state without first registering. A foreign LCA also may maintain offices or agencies within a state relating solely to the transfer, exchange or registration of its interests without registering. Other activities relating to the internal affairs of the foreign LCA that do not constitute doing business under this section include having officers or representatives who reside within or are physically present in the state; while there, the officers or representatives may make executive decisions relating to the internal affairs of the foreign LCA without imposing on the foreign LCA the requirement that it register, if these activities are not so regular and systematic as to cause the residence to be viewed as a business office.

Subsection (a)(5) – Under this paragraph, a foreign limited cooperative association need not register if it sells goods in the state through independent contractors. These transactions are viewed as transactions by the independent contractors, not by the foreign LCA itself even though the foreign LCA sets some limits or ground rules for its contractors. If these controls are sufficiently pervasive, however, the foreign LCA may be deemed to be selling for itself in intrastate commerce, and not through the independent contractors and therefore engaged in doing business in the state.

Subsection (a)(7) and (8) – The mere act of making a loan by a foreign limited liability company that is not in the business of making loans does not constitute doing business in the state in which the loan is made. On the same theory, a foreign LLC may obtain security for the repayment of a loan, and foreclose or enforce the lien or security interest to collect the loan, without being deemed to be doing business. Similarly, a refunding or "roll over" of a loan or its adjustment or compromise does not involve doing business.

Subsection (a)(9) – The concept of "doing business" involves regular, repeated, and continuing business contacts of a local nature. A single agreement or isolated transaction within a state does not constitute doing business if there is no intention to repeat the transaction or engage in similar transactions. This act does not impose the limitation found in some statutes, such as Section 15.01(b)(10) of the Model Business Corporation Act, that the isolated transaction be completed within 30 days. A foreign LCA should not be required to register simply because it engages in an isolated transaction that takes longer than 30 days to complete.

Subsection (a)(11) – A foreign limited cooperative association is not "doing business" within the meaning of this section if it is transacting business in interstate commerce. *See also* Subsection (a)(6) (stating that soliciting or obtaining orders that must be accepted outside the state before they become contracts is not "doing business" within the meaning of this section).

These exclusions reflect the provisions of the United States Constitution that grant to the United States Congress exclusive power over interstate commerce, and preclude states from imposing restrictions or conditions upon this commerce. This subsection should be construed in a manner consistent with judicial decisions under the United States Constitution. Under these decisions, a foreign entity is not required to register even though it sells goods within the state if they are shipped to the purchasers in interstate commerce. Thus a foreign LCA need not register even if it also does work and performs acts within the state incidental to the interstate business, e.g., if it takes or enforces a security interest incidental to these transactions. Nor is it required to register merely because it sends traveling salespeople or solicitors into a state so long as contracts are not made within the state. Similarly, an office may be maintained by a foreign LCA in this state without registering if the office's functions relate solely to interstate commerce. Purchases of goods may of course be in interstate commerce as readily as sales. Thus, the purchase of personal property in this state by a foreign limited liability company for shipment in interstate commerce out of the state does not require the entity to register.

SECTION 1506. NONCOMPLYING NAME OF FOREIGN COOPERATIVE.

(a) A foreign cooperative whose name does not comply with Section 111 may not register to do business in this state until it adopts, for the purpose of doing business in this state, an alternate name that complies with Section 115. A cooperative that registers under an alternate name under this subsection need not comply with [this state's assumed or fictitious name statute]. After registering to do business in this state with an alternate name, a cooperative shall do business in this state under:

(1) the alternate name;

(2) the cooperative's name, with the addition of its jurisdiction of formation; or

(3) a name the cooperative is authorized to use under [this state's assumed or fictitious name statute].

(b) If a registered foreign cooperative changes its name to one that does not comply with Section 115, it may not do business in this state until it complies with subsection (a) by amending its registration to adopt an alternate name that complies with Section 115.

Comment

A foreign limited cooperative association must register under its true name if that name satisfies the requirements of Section 115. If the true name is unavailable because it is not distinguishable upon the records of the filing office from a name already in use or reserved or registered, the foreign LCA may use an alternate name. *See also* Section 117, which authorizes a non-registered foreign cooperative to register its name in this state.

A foreign limited cooperative that registers to do business in the state may do business under a fictitious name to the same extent as a domestic entity.

SECTION 1507. WITHDRAWAL OF REGISTRATION OF REGISTERED FOREIGN COOPERATIVE.

(a) A registered foreign cooperative may withdraw its registration by delivering a statement of withdrawal to the [Secretary of State] for filing. The statement of withdrawal must state:

(1) the name of the cooperative and its jurisdiction of formation;

(2) that the cooperative is not doing business in this state and that it withdraws its registration to do business in this state;

(3) that the cooperative revokes the authority of its registered agent to accept service on its behalf in this state; and

(4) an address to which service of process may be made under subsection (b).

(b) After the withdrawal of the registration of a foreign cooperative, service of process in any action or proceeding based on a cause of action arising during the time the cooperative was registered to do business in this state may be made pursuant to Section 122.

Comment

The statement of withdrawal must set forth an address where service of process may be made on the entity pursuant to Section 122. There is no limit on how long the withdrawn entity must keep that address up to date.

SECTION 1508. WITHDRAWAL DEEMED ON CONVERSION TO DOMESTIC FILING ENTITY OR DOMESTIC LIMITED LIABILITY PARTNERSHIP. A registered foreign cooperative that converts to a domestic limited liability partnership or to a domestic entity whose formation requires delivery of a record to the [Secretary of State] for filing is deemed to have withdrawn its registration on the effective date of the conversion.

Comment

When a registered foreign limited cooperative association has converted to a domestic filing entity or domestic limited liability partnership, information about the entity in its capacity as a domestic entity will continue to be of record in the filing office. At that point, there is no further reason for it to be registered as the information applicable to it when it was a foreign LCA, and this section automatically treats its prior registration as withdrawn.

SECTION 1509. WITHDRAWAL ON DISSOLUTION OR CONVERSION TO NONFILING ENTITY OTHER THAN LIMITED LIABILITY PARTNERSHIP.

(a) A registered foreign cooperative that has dissolved and completed winding up or has converted to a domestic or foreign entity whose formation does not require the public filing of a record, other than a limited liability partnership, shall deliver a statement of withdrawal to the [Secretary of State] for filing. The statement must be signed by the dissolved or converted foreign cooperative and state:

(1) in the case of a cooperative that has completed winding up:

(A) its name and jurisdiction of formation; and

(B) that the cooperative surrenders its registration to do business in this state; and

(2) in the case of a cooperative that has converted:

(A) the name of the converting cooperative and its jurisdiction of formation;

(B) the type of entity to which the cooperative has converted and its jurisdiction of formation;

(C) that the converted entity surrenders the converting cooperative's registration to do business in this state and revokes the authority of the converting cooperative's registered agent to act as registered agent in this state on behalf of the cooperative or the converted entity; and

(D) a mailing address to which service of process may be made under subsection (b).

(b) After a withdrawal under this section is effective, service of process in any action or proceeding based on a cause of action arising during the time the foreign cooperative was registered to do business in this state may be made pursuant to Section 122.

Comment

When a registered foreign limited cooperative association has dissolved and completed winding up, or has converted to a nonfiling entity other than a limited liability partnership, there is no further reason for information about it to appear in the records of the filing office. This section thus requires delivery of a statement of withdrawal for the purpose of removing the entity from the rolls of active entities.

SECTION 1510. TRANSFER OF REGISTRATION.

(a) When a registered foreign cooperative has merged into a foreign entity that is not registered to do business in this state or has converted to a foreign entity required to register with the [Secretary of State] to do business in this state, the foreign entity shall deliver to the [Secretary of State] for filing an application for transfer of registration. The application must state:

(1) the name of the registered foreign cooperative before the merger or conversion;

(2) that before the merger or conversion the registration pertained to a foreign cooperative;

(3) the name of the applicant foreign entity into which the foreign cooperative has merged or to which it has been converted and, if the name does not comply with Section 115, an alternate name adopted pursuant to Section 1506;

(4) the type of entity of the applicant foreign entity and its jurisdiction of formation;

(5) the street and mailing addresses of the principal office of the applicant foreign entity and, if the law of the entity's jurisdiction of formation requires the entity to maintain an office in that jurisdiction, the street and mailing addresses of that office; and

(6) the name and street and mailing addresses of the foreign entity's registered agent in this state.

(b) When an application for transfer of registration takes effect, the registration of the foreign cooperative to do business in this state is transferred without interruption to the foreign entity into which the cooperative has merged or to which it has been converted.

Comment

The purpose of this section is to clarify the status of the foreign limited cooperative association in the public records of the state. A filing under this section has the two-fold effect of canceling the authority of the foreign LCA to do business in the state while at the same time reregistering it as the new type of foreign entity. If the reregistered foreign LCA subsequently wishes to cancel its registration to do business in the state, it may do so under Section 1511.

SECTION 1511. TERMINATION OF REGISTRATION.

(a) The [Secretary of State] may terminate the registration of a registered foreign cooperative in the manner provided in subsections (b) and (c) if the cooperative does not:

(1) pay, not later than [60 days] after the due date, any fee, tax, interest, or penalty required to be paid to the [Secretary of State] under this [act] or law other than this [act];

(2) deliver to the [Secretary of State] for filing, not later than [60 days] after the

due date, [an annual] [a biennial] report required under Section 210;

(3) have a registered agent as required by Section 118; or

(4) deliver to the [Secretary of State] for filing a statement of change under Section 119 not later than [30] days after a change has occurred in the name or address of the registered agent.

(b) The [Secretary of State] may terminate the registration of a registered foreign cooperative by:

(1) filing a notice of termination or noting the termination in the records of the [Secretary of State]; and

(2) delivering a copy of the notice or the information in the notation to the cooperative's registered agent or, if the cooperative does not have a registered agent, to the foreign cooperative's principal office.

(c) The notice must state or the information in the notation must include:

(1) the effective date of the termination, which must be at least [60 days] after the date the [Secretary of State] delivers the copy; and

(2) the grounds for termination under subsection (a).

(d) The authority of a registered foreign cooperative to do business in this state ceases on the effective date of the notice of termination or notation under subsection (b), unless before that date the foreign cooperative cures each ground for termination stated in the notice or notation. If the foreign cooperative cures each ground, the [Secretary of State] shall file a record so stating.

Comment

This section is analogous to the procedures for administrative dissolution under Section 1214.

SECTION 1512. ACTION BY [ATTORNEY GENERAL]. The [Attorney General] may maintain an action to enjoin a foreign cooperative from doing business in this state in violation of this [article].

Comment

The authority stated here has been part of corporate law for more than a century and has been carried over into the law of unincorporated business entities. Nowadays, the authority is rarely if ever invoked in either realm of entity law.

[ARTICLE] 16

MERGER, INTEREST EXCHANGE, CONVERSION AND DOMESTICATION

Introductory Comment

This article deals comprehensively with both same-type and cross-type mergers and interest exchanges and with conversions and domestications. For this article to apply, at least one participant organization must be a domestic limited cooperative association. For a foreign organization to be involved, its organic law must permit the organization's participation.

Part 1 contains definitions specific to this article as well as provisions applicable to all transactions authorized by this article.

Part 2 governs mergers and is an amalgamation of existing entity law, both unincorporated and incorporated.

Part 3 governs interest exchanges, previously a feature only of corporate law. Part 3 is derived from the share exchange provisions in Chapter 11 of the Model Business Corporation Act.

Part 4 governs conversions, a one-step procedure by which an entity changes from one type of entity to another type while nonetheless continuing in existence as the same legal entity.

Part 5 governs domestications, a procedure by a domestic LCA can become a foreign LCA or vice versa, in each instance with the company remaining the same legal entity.

Part 2 sets the paradigm for Parts 3, 4, and 5, because mergers are long-established and merger rules and concepts are familiar to business lawyers. Moreover, conversions and domestications could formerly be accomplished via mergers (with a new entity), and an interest exchange produces the same result as a triangular merger. The comments to Part 2 are thus relevant to understanding Parts 3, 4, and 5.

This article contemplates transactions in which the surviving entity is neither a filing entity nor otherwise of record in the filing office (e.g., the merger of an LCA into a non-LLP general partnership). As a result, a filing under this article may be the first time that a filing office takes cognizance of an entity's existence.

[PART] 1

GENERAL PROVISIONS

SECTION 1601. DEFINITIONS. In this [article]:

(1) "Acquired entity" means the entity, all of one or more classes or series of interests of which are acquired in an interest exchange.

(2) "Acquiring entity" means the entity that acquires all of one or more classes or series of interests of the acquired entity in an interest exchange.

(3) "Conversion" means a transaction authorized by [Part] 4.

(4) "Converted entity" means the converting entity as it continues in existence after a conversion.

(5) "Converting entity" means the domestic entity that approves a plan of conversion pursuant to Section 1643 or the foreign entity that approves a conversion pursuant to the law of its jurisdiction of formation.

(6) "Distributional interest" means the right under an unincorporated entity's organic law and organic rules to receive distributions from the entity.

(7) "Domestic", with respect to an entity, means governed as to its internal affairs by the law of this state.

(8) "Domesticated limited cooperative association" means the domesticating limited cooperative association as it continues in existence after a domestication.

(9) "Domesticating limited cooperative association" means the domestic limited

cooperative association that approves a plan of domestication pursuant to Section 1653 or the foreign limited cooperative association that approves a domestication pursuant to the law of its jurisdiction of formation.

(10) "Domestication" means a transaction authorized by [Part] 5.

(11) "Entity":

(A) means:

(i) a business corporation;

(ii) a nonprofit corporation;

(iii) a general partnership, including a limited liability partnership;

(iv) a limited partnership, including a limited liability limited partnership;

(v) a limited liability company;

[(vi) a general cooperative association;]

(vii) a limited cooperative association;

(viii) an unincorporated nonprofit association;

(ix) a statutory trust, business trust, or common-law business trust; or

(x) any other person that has:

(I) a legal existence separate from any interest holder of that person; or

(II) the power to acquire an interest in real property in its own name; and

(B) does not include:

(i) an individual;

(ii) a trust with a predominantly donative purpose or charitable trust;

(iii) an association or relationship that is not an entity listed in subparagraph (A) and is not a partnership under the rules stated in [Section 202(c) of the Uniform Partnership act (1997)(Last Amended 2011)] [Section 7 of the Uniform Partnership act (1914)] or a similar provision of the law of another jurisdiction;

(iv) a decedent's estate; or

(v) a government or a governmental subdivision, agency, or instrumentality.

(12) "Filing entity" means an entity whose formation requires the filing of a public organic record. The term does not include a limited liability partnership.

(13) "Foreign", with respect to an entity, means an entity governed as to its internal affairs by the law of a jurisdiction other than this state.

(14) "Governance interest" means a right under the organic law or organic rules of an unincorporated entity, other than as a governor, agent, assignee, or proxy, to:

(A) receive or demand access to information concerning, or the books and records of, the entity;

(B) vote for or consent to the election of the governors of the entity; or

(C) receive notice of or vote on or consent to an issue involving the internal affairs of the entity.

(15) "Governor" means:

(A) a director of a business corporation;

(B) a director or trustee of a nonprofit corporation;

(C) a general partner of a general partnership;

(D) a general partner of a limited partnership;

(E) a manager of a manager-managed limited liability company;

(F) a member of a member-managed limited liability company;

[(G) a director of a general cooperative association;]

(H) a director of a limited cooperative association;

(I) a manager of an unincorporated nonprofit association;

(J) a trustee of a statutory trust, business trust, or common-law business trust; or

(K) any other person under whose authority the powers of an entity are exercised and under whose direction the activities and affairs of the entity are managed pursuant to the organic law and organic rules of the entity.

(16) "Interest" means:

(A) a share in a business corporation;

(B) a membership in a nonprofit corporation;

(C) a partnership interest in a general partnership;

(D) a partnership interest in a limited partnership;

(E) a membership interest in a limited liability company;

[(F) a share in a general cooperative association;]

(G) a member's interest in a limited cooperative association;

(H) a membership in an unincorporated nonprofit association;

(I) a beneficial interest in a statutory trust, business trust, or common-law business trust; or

(J) a governance interest or distributional interest in any other type of unincorporated entity.

(17) "Interest exchange" means a transaction authorized by [Part] 3.

(18) “Interest holder” means:

(A) a shareholder of a business corporation;

(B) a member of a nonprofit corporation;

(C) a general partner of a general partnership;

(D) a general partner of a limited partnership;

(E) a limited partner of a limited partnership;

(F) a member of a limited liability company;

[(G) a shareholder of a general cooperative association;]

(H) a member of a limited cooperative association;

(I) a member of an unincorporated nonprofit association;

(J) a beneficiary or beneficial owner of a statutory trust, business trust, or common-law business trust; or

(K) any other direct holder of an interest.

(19) “Interest holder liability” means:

(A) personal liability for a liability of an entity which is imposed on a person:

(i) solely by reason of the status of the person as an interest holder; or

(ii) by the organic rules of the entity which make one or more specified interest holders or categories of interest holders liable in their capacity as interest holders for all or specified liabilities of the entity; or

(B) an obligation of an interest holder under the organic rules of an entity to contribute to the entity.

(20) “Merger” means a transaction authorized by [Part] 2.

(21) “Merging entity” means an entity that is a party to a merger and exists immediately

before the merger becomes effective.

(22) "Organic law" means the law of an entity's jurisdiction of formation governing the internal affairs of the entity.

(23) "Organic rules" means the public organic record and private organic rules of an entity.

(24) "Plan" means a plan of merger, plan of interest exchange, plan of conversion, or plan of domestication.

(25) "Plan of conversion" means a plan under Section 1642.

(26) "Plan of domestication" means a plan under Section 1652.

(27) "Plan of interest exchange" means a plan under Section 1632.

(28) "Plan of merger" means a plan under Section 1622.

(29) "Private organic rules" means the rules, whether or not in a record, that govern the internal affairs of an entity, are binding on all its interest holders, and are not part of its public organic record, if any. The term includes:

(A) the bylaws of a business corporation;

(B) the bylaws of a nonprofit corporation;

(C) the partnership agreement of a general partnership;

(D) the partnership agreement of a limited partnership;

(E) the operating agreement of a limited liability company;

[(F) the bylaws of a general cooperative association;]

(G) the bylaws of a limited cooperative association;

(H) the governing principles of an unincorporated nonprofit association; and

(I) the trust instrument of a statutory trust or similar rules of a business trust or

common-law business trust.

(30) "Protected agreement" means:

(A) a record evidencing indebtedness and any related agreement in effect on [the effective date of this [act]];

(B) an agreement that is binding on an entity on [the effective date of this [act]];

(C) the organic rules of an entity in effect on [the effective date of this [act]]; or

(D) an agreement that is binding on any of the governors or interest holders of an entity on [the effective date of this [act]].

(31) "Public organic record" means the record the filing of which by the [Secretary of State] is required to form an entity and any amendment to or restatement of that record. The term includes:

(A) the articles of incorporation of a business corporation;

(B) the articles of incorporation of a nonprofit corporation;

(C) the certificate of limited partnership of a limited partnership;

(D) the certificate of organization of a limited liability company;

[(E) the articles of incorporation of a general cooperative association;]

(F) the articles of organization of a limited cooperative association; and

(G) the certificate of trust of a statutory trust or similar record of a business trust.

(32) "Registered foreign entity" means a foreign entity that is registered to do business in this state pursuant to a record filed by the [Secretary of State].

(33) "Statement of conversion" means a statement under Section 1645.

(34) "Statement of domestication" means a statement under Section 1655.

(35) "Statement of interest exchange" means a statement under Section 1635.

(36) "Statement of merger" means a statement under Section 1625.

(37) "Surviving entity" means the entity that continues in existence after or is created by a merger.

(38) "Type of entity" means a generic form of entity:

(A) recognized at common law; or

(B) formed under an organic law, whether or not some entities formed under that organic law are subject to provisions of that law that create different categories of the form of entity.

Comment

This section defines the terms that are used in this article. Many of the definitions describe attributes that are significant in some forms of entity and not in others. For example, the concept of separate "distributional" and "governance" interests are inherent in unincorporated entities but have no counterpart in corporations. In addition, because some statutes use different terms to describe the same transaction, the definitions are intended to be broad enough to encompass those similar transactions, regardless of how described. *See*, for example, "domestication" below.

"Acquired entity" [(1)] – This definition recognizes that an interest exchange may involve only the acquisition of a particular "class" or "series" of interests in an entity. Model Business Corporation Act § 6.01 does not expressly define "classes" or "series." Because the interests of members in an unincorporated business organization often tend to be distinctive, it may be that each member's interest will comprise a separate class or series. For an explanation of a new and different meaning of the word "series," see the comment to Section 1631. The term "acquired entity" does not encompass series under that new meaning.

"Acquiring entity" [(2)] – An "acquiring entity" is an entity that acquires the interests of the acquired entity in an interest exchange governed by Part 3 of this article.

"Conversion" [(3)] – The term "conversion" means a transaction authorized by Part 4 pursuant to which an entity of one type is converted into an entity of another type. As used in this act, the term "conversion" does not include a transaction in which an entity changes the jurisdiction in which it is organized but does not change to a different form of entity; that type of transaction is referred to in this act as a "domestication" and is governed by Article 5.

"Converted entity" [(4)] – This term is used in Part 4 to refer to the entity that results from a conversion.

"Converting entity" [(5)] – A converting entity is the entity that becomes the converted entity under Part 4.

"Distributional interest" [(6)] – This term is similar to the concept of a transferable financial rights found in this act (*See* Section 603) and "transferable interest" in the organic laws of several other types of unincorporated entities, but has a broader meaning because the scope of this act includes entities in addition to those whose organic law uses these terms.

"Domestic" [(7)] – The term "domestic", when used in this Article with respect to an entity, refers to an entity whose internal affairs are governed by the organic laws of this state.

"Domesticated limited liability company" [(8)] – This term is used in Part 5 and means the entity that is domesticated pursuant to Part 5. By the nature of the transaction, the domesticated entity will be of the same type as the domesticating entity.

"Domesticating limited liability company" [(9)] – This term is used in Part 5 and means the entity that is domesticated pursuant to Part 5.

"Domestication" [(10)] – The term "domestication" means a transaction of the kind authorized by Part 5 pursuant to which an entity may change its *jurisdiction* of formation *but not its type* so long as the laws of the foreign jurisdiction permit the domestication. The legal effect of the domestication of an entity out of this state will be governed by the laws of both this state and the foreign jurisdiction. Some statutes include what is described in this act as "domestication" in their definition of a "conversion." *See, e.g.*, Colo. Rev. Stat § 7-90-201. It is intended that the domestication provisions of this act will apply to a transaction that may be characterized under another act as a "conversion" if the transaction meets the definition of "domestication" under this act.

"Entity" [(11)] – This definition determines the overall scope of the act because only an "entity" may participate in the transactions authorized by Parts 2 (mergers), 3 (interest exchanges), 4 (conversions), and 5 (domestications). *See* Sections 1621 (authorization of mergers), 1631(authorization of interest exchanges), 1641(authorization of conversions), and 1651(authorization of domestications).

Subparagraph (A)(x) is a "catch-all" provision that includes within the definition of "entity" any type of organization recognized under the law of this state which is not listed specifically in the preceding paragraphs of this definition. Subparagraph (A)(x) is intended to include all forms of private organizations, regardless of whether organized for profit, and artificial legal persons other than those excluded by Subparagraph (B). This definition does not exclude regulated entities such as public utilities, banks, and insurance companies. Should a state desire to exclude certain types of regulated entities or any of the entities listed in Subparagraph (A)(i)-(x) from participating in transactions permitted by the act for policy reasons, that may be done by listing those types of entities in Section 1007(a), or by permitting those type of entities to engage in transactions under this act generally but prohibiting certain types of transactions by listing those transactions in Section 1607(b).

Unincorporated nonprofit associations are treated as a type of entity in Subparagraph (A)(viii) because Section 5 of the Uniform Unincorporated Nonprofit Association Act (2008) (Last Amended 2013) specifically states that an unincorporated nonprofit association is an entity. In many states, the status of a nonprofit association may not be clear. Nevertheless, in most states a nonprofit association has the power to acquire an interest in real property in its own name and therefore would qualify as an "entity" under Subparagraph (A)(x). See Section 6 of the UUNAA which gives an unincorporated nonprofit association the power to acquire in its own name an interest in real property.

Subparagraph (B)(i) of this definition excludes a sole proprietorship from the concept of an "entity."

Trusts with a predominately donative purpose, such as inter vivos and testamentary trusts and charitable trusts, are treated in many states as having a separate legal existence, but they have been excluded from the definition of "entity" (and thus are not within the scope of this article) under Subparagraph (B)(ii) because they should not be able to engage in transactions under this act as a matter of public policy. Trusts that carry on a business, however, such as business and statutory entity trusts, are "entities." *See* Subparagraph (A)(ix).

Subparagraph (B)(iii) of this definition excludes from the concept of an "entity" any form of co-ownership of property or sharing of returns from property that is not listed in Subparagraph (A) and is not a partnership under the 1997 UPA. In that connection, Section 202(c) of UPA (1997) (Last Amended 2013) provides in part:

> In determining whether a partnership is formed, the following rules apply:
>
> (1) Joint tenancy, tenancy in common, tenancy by the entireties, joint property, common property, or part ownership does not by itself establish a partnership, even if the co-owners share profits made by the use of the property.
>
> (2) The sharing of gross returns does not by itself establish a partnership, even if the persons sharing them have a joint or common right or interest in property from which the returns are derived.

Limited liability partnerships and limited liability limited partnerships are "entities" because they are general partnerships and limited partnerships respectively that have made the additional required election claiming LLP or LLLP status. A limited liability partnership is not, therefore, a separate type of entity from the underlying general or limited partnership that has elected limited liability partnership status. Thus, for example, the election of a general partnership to become a limited liability partnership is not a conversion subject to Part 4.

Under Subparagraph (B)(iv), decedent's estates are excluded from the definition of an entity for the same policy reason as trusts with a predominately donative purpose and charitable trusts.

This same public policy rationale is the justification for the exclusion of governmental subdivisions, agencies, or instrumentalities in Subparagraph (B)(v).

"Filing entity" [(12)] – Whether an entity is a filing entity is determined by reference to whether its legal existence requires the filing of a document with the state filing officer. To fit within this definition, the filing must be necessary but need not be sufficient to form the entity. *See, e.g.*, Section 201(d) of ULLCA (2006) (Last Amended 2013) ("A limited liability company is formed when the company's certificate of organization becomes effective *and* at least one person becomes a member.) (Emphasis added).

While the statute refers to the "formation" of an entity, the term is intended to encompass corporations which are "incorporated," as well as other filing entities whose statutes refer to them as being "organized." Business trusts present a special problem. In some states a business trust is a filing entity or a common law relationship, while in other states business trusts are only recognized at common law. Under Section 201(a) of the Uniform Statutory Trust Entity Act (2009) (Last Amended 2013), a statutory trust entity formed under that act is formed by delivery of a certificate of trust to the appropriate filing officer, and is a filing entity.

The term "filing entity" does not include a limited liability partnership because an election filed by a general partnership claiming that status (*e.g.*, a statement of qualification under Uniform Partnership Act (1997) (Last Amended 2013) § 901 does not form the entity. A limited liability limited partnership, on the other hand, is a filing entity because the underlying limited partnership is formed by filing a certificate of limited partnership.

"Foreign" [(13)] – The term "foreign entity" includes any non-domestic entity of any type. Where a foreign entity is a filing entity, the entity is governed by the laws of the state of filing. A nonfiling foreign entity is governed by the laws governing its internal affairs. It is a factual question whether a general partnership whose internal affairs are governed by the Uniform Partnership Act (1914) ("1914 UPA") is a domestic or foreign partnership. A 1914 UPA partnership will likely be deemed to be a domestic entity where the greatest nexus of contacts are found. The domestic or foreign characterization of partnerships under the Uniform Partnership Act (1997) (Last Amended 2013) that have not registered as limited liability partnerships will be governed by Section 104(2) ("the law of the jurisdiction in which the partnership has its principal office").

"Governance interest" [(14)] – A governance interest is typically only part of the interest that a person will hold in an unincorporated entity and is usually coupled with a distributional interest (or economic rights). Memberships in some nonprofit corporations and unincorporated nonprofit associations consist solely of governance interests and memberships in other nonprofit entities may not include either governance interests or distributional interests. In some unincorporated business entities, including limited cooperative associations, there is a more limited right to transfer governance interests than there is to transfer distributional interests. *See* Section 603. An interest holder in such an unincorporated business entity who transfers only a distributional interest and retains the governance interest will also retain the status of an interest holder. Whether a transferee who acquires only a distributional interest will acquire the status of an interest holder is determined by the definition of "interest holder."

Governors of an entity have the kinds of rights listed in the definition of "governance

interest" by reason of their position with the entity. For a governor to have a "governance interest," however, requires that the governor also have those rights for a reason other than the governor's status as such. A manager who is not a member in a limited liability company, for example, will not have a governance interest, but a manager who is a member will have a governance interest arising from the ownership of a membership interest.

"Governor" [(15)] – This term has been chosen to provide a way of referring to a person who has the authority under an entity's organic law to make management decisions regarding the entity that is different from any of the existing terms used in connection with particular types of entities. Depending on the type of entity or its organic rules, the governors of an entity may have the power to act on their own authority, or they may be organized as a board or similar group and only have the power to act collectively, and then only through a designated agent. In other words, a person having only the power to bind the organization pursuant to the instruction of the governors is not a governor. Under the organic rules, particularly those of unincorporated entities, most or all of the management decisions may be reserved to the members or partners. Thus, if a manager of a limited liability company were limited to having authority to execute management decisions made by the members and did not have any authority to make independent management decisions, the manager would not be a governor under this definition.

"Interest" [(16)] – In the usual case, the interest held by an interest holder will include both a governance interest and a distributional interest. Members in nonprofit corporations or unincorporated nonprofit associations generally do not have any distributional interest because they do not receive distributions, but they nonetheless may hold a governance interest in which case they would have the status of interest holders under this act.

"Interest exchange" [(17)] – The term "interest exchange" means a transaction authorized by Part 3 pursuant to which an entity may acquire interests in another entity. The consideration that may be provided to the interest holders whose interests are being acquired in an exchange may consist in whole or part of interests in a third party that is not one of the two parties to the exchange itself. *See* Section 1631(a).

"Interest holder" [(18)] – This act does not refer to "equity" interests or "equity" owners or holders because the term "equity" could be confusing in the case of a nonprofit entity whose members do not have an interest in the assets or results of operations of the entity but only have a right to vote on its internal affairs.

"Interest holder liability" [(19)] – This term is used to describe the vicarious liability of an interest holder, by virtue of being an interest holder, for liabilities of the entity. The term includes only personal liability of an interest holder for a debt of the entity imposed on the interest holder either by statute or by the organic rules to the extent authorized pursuant to the organic law. Liabilities that an interest holder incurs in any other fashion are not interest holder liabilities for purposes of this act. Thus, for example, if a state's business corporation law makes shareholders personally liable for unpaid wages because of their status as shareholders, that liability would be an "interest holder liability." If, on the other hand, a shareholder were to guarantee payment of an obligation of a corporation, that liability would not be an "interest holder

liability" because it is a direct liability and not based on the status of being a shareholder. Similarly, the liability to return an improper distribution is not an interest holder liability because it is a direct liability of the interest holder based on receipt of the distribution.

"Merger" [(20)] – The term means a transaction in which two or more entities are combined into a single entity pursuant to a filing with the filing office. The term "merger" in this act includes the transaction known as a consolidation in which a new entity results from the combination of two or more pre-existing entities.

"Merging entity" [(21)] – The term "merging entity" refers to each entity that is in existence immediately before a merger and is a party to the merger. It will include the surviving entity if the surviving entity exists before the merger becomes effective. It does not include an entity that provides consideration to be received by interest holders if that entity is not a party to the merger.

"Organic law" [(22)] – Organic law means statutes that govern the internal affairs of an entity. For example, this act is the organic law of a limited cooperative association formed under this act.

Entity laws in a few states purport to require that some of their internal governance rules applicable to a domestic entity also apply to a foreign entity with significant ties to the state. See, e.g., CAL. CORP. CODE § 2115 (Foreign Corporations); N.Y. NOT-FOR-PROFIT-CORP. §§ 1318-1321 (Liabilities of Directors and Officers of Foreign Corporations); 15 PA.CONST. STAT. § 6145 (Applicability of Certain Safeguards to Foreign Corporations). Such a "sticky fingers" law is not included within the definition of "organic law" for purposes of this act because those laws are not part of the law of the entity's jurisdiction of formation.

"Organic rules" [(23)] – The term "organic rules" means an entity's public organic record and the private organic rules. The organic rules, together with this act, the organic law, and the common law, provide the rules governing the internal affairs of the entity. For example, the articles of organization and bylaws comprise the organic rules of a limited cooperative association formed under this act.

"Plan" [(24)] – The term "plan" is a short-hand way of referring to the plan of merger, interest exchange, conversion, or domestication, as the case may be, depending on which form of transaction is taking place. *See* Sections 1622 (plan of merger), 1632 (plan of interest exchange), 1642 (plan of conversion), and 1652 (plan of domestication).

"Private organic rules" [(29)] – The term private "organic rules" is intended to include all governing rules of an entity that are binding on all of its interest holders, whether or not in record form, except for the provisions of the entity's public organic record, if any. The term is intended to include agreements in "record" form such as corporate and cooperative bylaws as well as oral partnership agreements and oral operating agreements among LLC members.

"Protected agreement" [(30)] – The term "protected agreement" refers to evidences of

indebtedness and agreements binding on the entity or any of its governors or interest holders that are unpaid or executory in whole or in part on the effective date of the act. Thus a revolving line of credit from a bank to a corporation would constitute a protected agreement even if advances were not made until after the effective date of the act. Likewise, an operating agreement in effect under this act or a predecessor to this act is a "protected agreement."

If a protected agreement has provisions that apply if an entity merges, those provisions will apply if the entity enters into an interest exchange, conversion, or domestication even though the agreement does not mention those other types of transactions. *See* Sections 1631(c) (interest exchange), 1641(c) (conversion), and 1651(c) (domestication).

"Public organic record" [(31)] – A "public organic record" is a record that is filed publicly to form, organize, incorporate, or otherwise create an entity (e.g., articles of organization for a limited cooperative association –*See* Section 301). The term does not include a statement of authority filed under UPA (1997) (Last Amended 2013) § 303 or any of the other statements that may be filed under that act since those statements do not create a new entity.

For the same reason, a statement of qualification filed under UPA (1997) (Last Amended 2013) § 1001 is not a "public organic record." The limited liability partnership that results from the filing is the same entity as the partnership that delivered the statement to the filing office. Similarly, the term does not include a statement of authority filed under Section 7 of the Revised Uniform Unincorporated Nonprofit Association Act (2008) (Last Amended 2013) or a statement appointing a registered agent filed under Section 31 of that act.

In those states where a deed of trust or other instrument is publicly filed to create a business trust, that filing will constitute a public organic record. But in those states where a business trust is not created by a public filing, the deed of trust or similar record will be part of the private organic rules of the business trust.

Where a public organic document has been amended or restated, the term means the public organic document as last amended or restated.

"Registered foreign entity" [(32] – This term refers to a foreign entity that is registered to transact business in this state pursuant to a public filing.

"Surviving entity" [(37)] – The term "surviving entity" refers to either a merging entity that survives the merger or the new entity created by the merger.

"Type of entity" [(38] – The term "type of entity" has been developed in an attempt to distinguish different legal forms of entities. It is sometimes difficult to decide whether one is dealing with a different form of entity or a variation of the same form. For example, a limited partnership, although it has been defined as a partnership, is a different type of entity from a general partnership, while a limited liability partnership is not a different type of entity from a general partnership. In some states cooperatives are categories of business corporations or nonprofit corporations, while in other states cooperatives are a separate type of entity. A limited

cooperative formed under this act or a similar law in another jurisdiction is a separate type of entity.

SECTION 1602. RELATIONSHIP OF [ARTICLE] TO OTHER LAWS.

(a) This [article] does not authorize an act prohibited by, and does not affect the application or requirements of, law other than this [article].

(b) A transaction effected under this [article] may not create or impair a right, duty, or obligation of a person under the statutory law of this state relating to a change in control, takeover, business combination, control-share acquisition, or similar transaction involving a domestic merging, acquired, converting, or domesticating business corporation unless:

(1) if the corporation does not survive the transaction, the transaction satisfies any requirements of the law; or

(2) if the corporation survives the transaction, the approval of the plan is by a vote of the shareholders or directors which would be sufficient to create or impair the right, duty, or obligation directly under the law.

Comment

This section preserves existing regulatory law in an adopting state in general terms. Adopting states should consider more carefully integrating this act with their various regulatory laws. For example, in some states certain professions are limited in their use of limited liability entities. *See also* Section 1603.

Laws other than this act that will apply to transactions under the act include, for example, the various uniform fraudulent transfer and fraudulent conveyance acts; state insolvency statutes; federal bankruptcy law; and Articles 8 and 9 of the UCC.

Subsection (b) – Many states have enacted "antitakeover" statutes intended to make it more difficult to acquire control of a publicly-traded corporation. Those statutes often provide that their application to a particular corporation cannot be changed unless the corporation obtains certain specified approvals, such as a vote of disinterested directors or a supermajority vote by the shareholders. The purpose of the special requirements in this subsection on varying the application of an antitakeover statute is to protect against a hostile acquirer or group of shareholders seeking to use the act to avoid the application of the antitakeover statute.

This subsection protects the application of antitakeover statutes from being affected by a transaction under this act by requiring that the transaction be approved in a manner that would be sufficient to approve changing the application of the antitakeover statute. If a transaction is approved in that manner, there is no policy reason to prohibit the application of the antitakeover statute from being varied by a transaction under this act. If the application of an antitakeover statute cannot be varied by action of an entity subject to it, then a transaction under this act will be permissible only if the antitakeover provision continues to apply after the transaction or the transaction itself is permissible under the antitakeover statute.

SECTION 1603. REQUIRED NOTICE OR APPROVAL.

(a) A domestic or foreign entity that is required to give notice to, or obtain the approval of, a governmental agency or officer of this state to be a party to a merger must give the notice or obtain the approval to be a party to an interest exchange, conversion, or domestication.

(b) Property held for a charitable purpose under the law of this state by a domestic or foreign entity immediately before a transaction under this [article] becomes effective may not, as a result of the transaction, be diverted from the objects for which it was donated, granted, devised, or otherwise transferred unless, to the extent required by or pursuant to the law of this state concerning cy pres or other law dealing with nondiversion of charitable assets, the entity obtains an appropriate order of [the appropriate court] [the Attorney General] specifying the disposition of the property.

(c) A bequest, devise, gift, grant, or promise contained in a will or other instrument of donation, subscription, or conveyance which:

(1) is made to a merging entity that is not the surviving entity; and

(2) takes effect or remains payable after the merger inures to the surviving entity.

(d) A trust obligation that would govern property if transferred to a nonsurviving entity applies to property that is transferred to the surviving entity under this section.

Legislative Note: *As an alternative to enacting subsection (a), a state may identify each of its regulatory laws that requires prior approval for a merger of a regulated entity, decide whether*

regulatory approval should be required for an interest exchange, conversion, or domestication, and make amendments as appropriate to those laws.

As with subsection (a), an adopting state may choose to amend its various laws with respect to the nondiversion of charitable property to cover the various transactions authorized by this act as an alternative to enacting subsection (b).

Comment

Subsection (a) – Because at least some of the provisions of this act will be new in most states, it is likely that existing state laws that require regulatory approval of transactions by businesses such as banks, insurance companies, or public utilities may not be worded in a fashion that will include at least some of the transactions authorized by this act. The purpose of this subsection is to ensure that transactions under this act will be subject to the same regulatory approval as mergers. This subsection is based on whether a merger by a regulated entity requires prior approval because the transactions authorized by this act may be effectuated indirectly in many cases under existing law by establishing a wholly-owned subsidiary of the desired type and then merging into it.

The consequence of violating this subsection should be the same as in the case of a merger consummated without the required approval.

Subsection (b) – This act applies generally to nonprofit corporations and unincorporated nonprofit associations. As in the case of laws regulating particular industries, a state's laws governing the nondiversion of charitable property to other uses may not cover some of the transactions authorized by this act. To prevent the procedures in this act from being used to avoid restrictions on the use of such charitable property, this subsection requires approval of the effect of transactions under this act by the appropriate arm of government having supervision of nonprofit entities.

An approval or order obtained under this section may impose conditions or specify the disposition of assets or liabilities in a manner different than would otherwise be the case. In such an instance, the approval or order will control over the provisions of this act specifying the effects of a transaction. *See* Sections 1626 (effect of merger), 1636 (effect of interest exchange), 1646 (effect of conversion), and 1656 (effect of domestication).

Subsection (c) – This subsection clarifies the legal effect of a merger on bequests, etc. that were originally made to an entity that does not survive the merger. This issue does not arise in an interest exchange, conversion, or domestication transaction because the entity to which the bequest, etc. was made survives in some form after the transaction.

SECTION 1604. NONEXCLUSIVITY. The fact that a transaction under this [article]

produces a certain result does not preclude the same result from being accomplished in any other

manner permitted by law other than this [article].

Comment

This section allows a transaction that has the same end result as one of the transactions governed by this act, but that is accomplished in a manner not within the scope of this act, to be exempt from this act. For example, a sale of assets and transfer of liabilities by two entities to a third entity followed by the liquidation of the two transferring entities can be accomplished pursuant to sale of assets statutory provisions rather than under Part 2 of this article, even though the end result of the transaction is essentially the same as if the two entities had merged into a third entity.

SECTION 1605. REFERENCE TO EXTERNAL FACTS. A plan may refer to facts ascertainable outside the plan if the manner in which the facts will operate upon the plan is specified in the plan. The facts may include the occurrence of an event or a determination or action by a person, whether or not the event, determination, or action is within the control of a party to the transaction.

Comment

This section is based on, but more concise than, Section 1.20(k) of the Model Business Corporation Act.

SECTION 1606. APPRAISAL RIGHTS. An interest holder of a domestic merging, acquired, converting, or domesticating limited cooperative association is entitled to contractual appraisal rights in connection with a transaction under this [article] to the extent provided in the entity's organic rules or the plan.

Legislative Note: *Subsection (a) preserves appraisal rights (sometimes referred to as "dissenters' rights") granted by other laws. As an alternative to enacting subsection (a), a state may amend the appraisal rights provisions of its organic laws to specify which transactions under this act will give rise to appraisal rights. If that alternative approach is adopted, subsections (b) and (c) should be designated as subsections (a) and (b).*

Comment

In corporate law, appraisal rights developed when corporate statutes were amended to permit mergers with less than unanimous consent of the shareholders. This article provides no

appraisal rights, because as a default rule transactions under this article require the consent or affirmative vote of all the members. Where the operating agreement changes this default rule, parties may wish to consider contractual appraisal rights.

This subsection validates the grant of such contractual appraisal rights. *Cf.* 6 Del. Code §§ 15-120 (general partnerships), 17-212 (limited partnerships), and 18-210 (limited liability companies) which validate "contractual appraisal rights"; and Model Business Corporation Act § 13.02(5) which permits the articles of incorporation, bylaws, or a resolution of the board of directors to confer appraisal rights in contexts in which they would otherwise not be available. Legislative authorization in this subsection of the grant of contractual appraisal rights removes any question as to whether a court would have jurisdiction to hear a case in which the parties were attempting to create jurisdiction in the court by private agreement.

In this section, the term "appraisal rights" refers to any arrangement, either in the organic rules of a limited cooperative association that is a party to a transaction under this article or the plan, providing for the buy-out of members that object to a transaction under this article.

[SECTION 1607. EXCLUDED ENTITIES AND TRANSACTIONS.

(a) The following entities may not participate in a transaction under this [article]:

(1)

(2).

(b) This [article] may not be used to effect a transaction that:

(1)

(2).]

Legislative Note: *Subsection (a) may be used by states that have special statutes restricted to the organization of certain types of entities. A common example is banking statutes that prohibit banks from engaging in transactions other than pursuant to those statutes.*

Nonprofit entities may participate in transactions under this act with for-profit entities, subject to compliance with Section 1603 (b). If a state desires, however, to exclude entities with a charitable purpose or to exclude other types of entities from the scope of the act, that may be done by referring to those entities in subsection (a).

Subsection (b) may be used to exclude certain types of transactions governed by more specific statutes. A common example is the conversion of an insurance company from mutual to stock form. There may be other types of transactions that vary greatly among the states.

[PART] 2

MERGER

SECTION 1621. MERGER AUTHORIZED.

(a) By complying with this [part]:

(1) one or more domestic limited cooperative associations may merge with one or more domestic or foreign entities into a domestic or foreign surviving entity; and

(2) two or more foreign entities may merge into a domestic limited cooperative association.

(b) By complying with the provisions of this [part] applicable to foreign entities a foreign entity may be a party to a merger under this [part] or may be the surviving entity in such a merger if the merger is authorized by the law of the foreign entity's jurisdiction of formation.

Comment

The merger transaction authorized by this act involves the combination of one or more domestic limited cooperative associations with or into one or more other domestic or foreign entities. It also contemplates the consolidation of two or more foreign entities into a single domestic limited cooperative association. Upon the effective date of the merger, all the assets and liabilities of the constituent entities vest in the surviving entity as a matter of law. As such, mergers require the existence of at least two separate entities before the transaction and only one entity may survive the merger. If independent existence of the constituent entities is desired following the conclusion of the transaction, a restructuring transaction other than a merger must be used to accomplish the transfer of assets and liabilities.

This act authorizes a merger for state entity law purposes. Federal law and other state law will independently determine how a merger transaction will be taxed.

Subsection (a)(1) – This paragraph states the general rule that subject to subsection (b) one or more domestic LCAs may merge with or into a domestic or foreign surviving entity.

Subsection (a)(2) – This paragraph provides that two or more foreign entities may merge into a domestic surviving LCA so long as the requirements of subsection (b) are met.

Subsection (b) – This subsection provides that a foreign entity may be a party to a merger or may be the surviving entity in a merger only if the merger is authorized by the laws of the

foreign entity's jurisdiction of formation.

SECTION 1622. PLAN OF MERGER.

(a) A domestic limited cooperative association may become a party to a merger under this [part] by approving a plan of merger. The plan must be in a record and contain:

(1) as to each merging entity, its name, jurisdiction of formation, and type of entity;

(2) if the surviving entity is to be created in the merger, a statement to that effect and its name, jurisdiction of formation, and type of entity;

(3) the manner of converting the interests in each party to the merger into interests, securities, obligations, money, other property, rights to acquire interests or securities, or any combination of the foregoing;

(4) if the surviving entity exists before the merger, any proposed amendments to:

(A) its public organic record, if any; and

(B) its private organic rules that are, or are proposed to be, in a record;

(5) if the surviving entity is to be created in the merger:

(A) its proposed public organic record, if any; and

(B) the full text of its private organic rules that are proposed to be in a record;

(6) the other terms and conditions of the merger; and

(7) any other provision required by the law of a merging entity's jurisdiction of formation or the organic rules of a merging entity.

(b) In addition to the requirements of subsection (a), a plan of merger may contain any other provision not prohibited by law.

Comment

Subsection (a) – This subsection states the requirements for the plan of merger. They are similar to plan of merger provisions in corporation statutes. *See* Model Business Corporation Act § 11.02(c).

Subsection (a)(1) – This paragraph requires that the plan of merger identify the parties to the merger. The name of a merging entity as it appears in the plan of merger will be its name in its jurisdiction of formation.

Subsection (a)(3) – The language of this paragraph is similar to Model Business Corporation Act § 11.02(c)(3). What may be done under this paragraph with respect to providing for continuing interests in the surviving entity for some holders of interests of a class or series of a party to the merger while paying some other form of consideration to other holders of the same class or series of interests in that entity will vary depending on the type of entity involved and the extent to which its organic rules provide for non-uniform treatment of interest holders in a manner that is permissible under its organic law. Similarly the ability to use a merger to reorganize the capital structure of the surviving entity will vary depending on the type of entity involved and whether the entity has appropriately adopted relevant provisions in its organic rules.

If the organic law and organic rules of an unincorporated entity permit a non-uniform "equity shuffle" to be accomplished in a merger involving the unincorporated entity, the minority owners of the unincorporated entity will not necessarily be entitled to the statutory appraisal rights currently afforded to minority stockholders in merging corporate entities. Any perceived unfairness in the shuffle would be addressed either (i) under principles of fiduciary duties and the contractual obligations of good faith and fair dealing, assuming, of course, that such duties and obligations have not been contractually modified or eliminated to the extent permitted by the applicable organic law, or (ii) by the exercise of whatever rights the minority owners may have to veto the transaction or to withdraw or to dissociate and be paid the value of their interests.

The Model Business Corporation Act generally requires that shares of the same class or series be treated in the same manner in a merger unless the corporation has adopted an applicable provision of its articles of incorporation pursuant to Section 6.01(e) of that act providing for variations in the treatment of holders of the same class or series of shares. Thus a determination of what may be done by way of an equity shuffle in the case of a corporation will require reference to its organic law and organic rules.

The consideration paid to the interest holders of the merging parties may be supplied in whole or part by a person who is not a party to the merger.

Subsection (b) – This subsection provides the statutory authority for a merging party to include a provision in a plan of merger that is not specifically listed in subsection (a). One such possibility is contractual appraisal rights as provided in Section 1606(b).

SECTION 1623. APPROVAL OF MERGER.

(a) A plan of merger is not effective unless it has been approved by a domestic merging limited cooperative association as provided in Section 518.

(b) A merger involving a domestic merging entity that is not a limited cooperative association is not effective unless the merger is approved by that entity in accordance with its organic law.

(c) A merger involving a foreign merging entity is not effective unless the merger is approved by the foreign entity in accordance with the law of the foreign entity's jurisdiction of formation.

Comment

Subsection (a) – .Section 518 contains the approval requirements for a LCA that is a party to a merger under this article. Basically Section 518 requires approval by a majority of the LCA's board of directors and two-thirds of the voting power of the members and a majority of the investor members present at the meeting to approve the plan These approval requirements can be modified by the LCA' organic rules. *See* Section 518(c) and (d) and Section 109(c)(24) and (25) . In addition, a member that will have vicarious liability for obligations that are incurred after the merger must consent in a record to this potential liability,

Subsection (b) – Where a domestic entity other than a LCA is a party to a merger under this act, this subsection defers to that entity's organic law for the requirements for approval of the merger by that entity.

Subsection (c) – Where a foreign entity is a party to a merger under this act, this subsection defers to the laws of the foreign jurisdiction for the requirements for approval of the merger by the foreign entity. Those laws will include the organic law of the foreign entity and other applicable laws, such as this act if it has been adopted in the foreign jurisdiction. The laws of the foreign jurisdiction will also control the application of any special approval requirements found in the organic rules of the foreign entity.

SECTION 1624. AMENDMENT OR ABANDONMENT OF PLAN OF MERGER.

(a) A plan of merger may be amended only with the consent of each party to the plan except as otherwise provided in the plan.

(b) A domestic merging limited cooperative association may approve an amendment to a plan of merger:

(1) in the same manner as the plan was approved, if the plan does not provide for the manner in which it may be amended; or

(2) by its directors or members in the manner provided in the plan, but a member that was entitled to vote on or consent to approval of the merger is entitled to vote on or consent to any amendment of the plan that will change:

(A) the amount or kind of interests, securities, obligations, money, other property, rights to acquire interests or securities, or any combination of the foregoing, to be received by the members of any party to the plan;

(B) the public organic record, if any, or private organic rules of the surviving entity that will be in effect immediately after the merger becomes effective, except for changes that do not require approval of the interest holders of the surviving entity under its organic law or organic rules; or

(C) any other terms or conditions of the plan, if the change would adversely affect the member in any material respect.

(c) After a plan of merger has been approved and before a statement of merger becomes effective, the plan may be abandoned as provided in the plan. Unless prohibited by the plan, a domestic merging limited cooperative association may abandon the plan in the same manner as the plan was approved.

(d) If a plan of merger is abandoned after a statement of merger has been delivered to the [Secretary of State] for filing and before the statement becomes effective, a statement of abandonment, signed by a party to the plan, must be delivered to the [Secretary of State] for filing

before the statement of merger becomes effective. The statement of abandonment takes effect on filing, and the merger is abandoned and does not become effective. The statement of abandonment must contain:

(1) the name of each party to the plan of merger;

(2) the date on which the statement of merger was filed by the [Secretary of State]; and

(3) a statement that the merger has been abandoned in accordance with this section.

Comment

This section sets out the requirements for amending or abandoning the plan of merger. They are similar to provisions for amending or abandoning mergers found in existing corporation merger statutes. *See* Model Business Corporation Act §§ 11.02(e) and 11.08.

SECTION 1625. STATEMENT OF MERGER; EFFECTIVE DATE OF MERGER.

(a) A statement of merger must be signed by each merging entity and delivered to the [Secretary of State] for filing.

(b) A statement of merger must contain:

(1) the name, jurisdiction of formation, and type of entity of each merging entity that is not the surviving entity;

(2) the name, jurisdiction of formation, and type of entity of the surviving entity;

(3) a statement that the merger was approved by each domestic merging entity, if any, in accordance with this [part] and by each foreign merging entity, if any, in accordance with the law of its jurisdiction of formation;

(4) if the surviving entity exists before the merger and is a domestic filing entity, any amendment to its public organic record approved as part of the plan of merger;

(5) if the surviving entity is created by the merger and is a domestic filing entity, its

public organic record, as an attachment;

(6) if the surviving entity is created by the merger and is a domestic limited liability partnership, its statement of qualification, as an attachment; and

(7) if the surviving entity is a foreign entity that is not a registered foreign entity, a mailing address to which the [Secretary of State] may send any process served on the [Secretary of State] pursuant to Section 1626(e).

(c) In addition to the requirements of subsection (b), a statement of merger may contain any other provision not prohibited by law.

(d) If the surviving entity is a domestic entity, its public organic record, if any, must satisfy the requirements of the law of this state, except that the public organic record does not need to be signed.

(e) A plan of merger that is signed by all the merging entities and meets all the requirements of subsection (b) may be delivered to the [Secretary of State] for filing instead of a statement of merger and on filing has the same effect. If a plan of merger is filed as provided in this subsection, references in this [article] to a statement of merger refer to the plan of merger filed under this subsection.

(f) If the surviving entity is a domestic limited cooperative association, the merger becomes effective when the statement of merger is effective. In all other cases, the merger becomes effective on the later of:

(1) the date and provided by the organic law of the surviving entity; or

(2) when the statement is effective.

Comment

The filing of a statement of merger makes the transaction a matter of public record.

Subsection (a) – This subsection pertains to all merging entities involved in a merger, not merely any merging domestic limited cooperative association. Other filings may be required by the organic law of other entities participating in the merger.

Subsection (b)(1) and (2) – The names of foreign entities set forth in the statement of merger will generally be their names in their jurisdiction of formation, except that if a foreign entity has been required to adopt a different name in order to register to do business in this state, the foreign qualification statute will likely require that, when the entity does business in this state, the entity must use the name adopted for the purposes of registering to do business. Engaging in a merger under this act will be part of the business done by the entity in this state and the name of the entity set forth in the statement of merger will thus need to be the name under which the entity has registered to do business. Use of the name under which the entity has registered to do business will allow the records in the filing office to associate the registration of the entity to do business with the statement of merger.

Subsection (b)(3) – *See* the comment to subsection (f).

Subsection (b)(4) – The statement in this paragraph that the plan of merger was approved by each entity in accordance with this article necessarily presupposes that the plan was approved in accordance with any valid, special requirements in the organic rules of each merging entity.

Subsection (b)(5) and (6) – The public organic record of a domestic surviving entity created by the merger that is attached to the statement of merger becomes the original, officially filed text of the public organic record of the surviving entity when the statement of merger takes effect. It is not necessary, or appropriate, to make any other filing to create the surviving entity.

Similarly, a statement of qualification for a domestic limited liability partnership created by the merger that is attached to the statement of merger does not need to be filed separately.

Subsection (d) – Organic laws typically require that an initial filing that creates an entity be signed by the person serving as the incorporator or other organizer. This subsection, however, provides that the public organic record of the surviving entity does not need to be signed since the that record is attached to a signed record.

This subsection also permits the public organic record of the surviving entity to omit any provision that is not required to be included in a restatement of the public organic record. Pursuant to this provision, for example, the public organic record of a business corporation created as the surviving entity in the merger would not need to state the name and address of each incorporator even though that information would be required by Section 2.02(a)(4) of the Model Business Corporation Act if the corporation were being incorporated outside the context of the merger.

Subsection (e) – A plan of merger that contains all the information required in the statement of merger may be filed instead of the statement of merger. The plan must be in a record and signed by each merging party.

Subsection (f) – A merger in which the surviving entity is a domestic limited cooperative association takes effect when the statement of merger takes effect. A merger in which the surviving entity is a foreign entity will usually also take effect when the statement of merger takes effect because the practice is to coordinate the filings that need to be made when a merger involves both a domestic entity and also a foreign entity so that the filings in each jurisdiction take effect at the same time. Because of the possibility, however, that the filing in the foreign jurisdiction will take effect at a different time, subsection (f) provides that the merger transaction itself will take effect at the later of (i) when the statement of merger takes effect, and (ii) when the merger takes effect under the law of the foreign jurisdiction. That rule avoids the possibility that the merger will take effect in the domestic jurisdiction before it takes effect in the foreign jurisdiction, which would produce the undesirable result that the domestic entity would cease to exist before it has been merged into the foreign entity.

It is only necessary for the filing office to record the effective date of the statement of merger and the filing office does not need to be concerned with the effective date of the merger itself. Persons wishing to determine the effective date of a merger involving both a domestic and a foreign entity will be able to do so by consulting the records of the filing offices in each jurisdiction.

SECTION 1626. EFFECT OF MERGER.

(a) When a merger becomes effective:

(1) the surviving entity continues or comes into existence;

(2) each merging entity that is not the surviving entity ceases to exist;

(3) all property of each merging entity vests in the surviving entity without transfer, reversion, or impairment;

(4) all debts, obligations, and other liabilities of each merging entity are debts, obligations, and other liabilities of the surviving entity;

(5) except as otherwise provided by law or the plan of merger, all the rights, privileges, immunities, powers, and purposes of each merging entity vest in the surviving entity;

(6) if the surviving entity exists before the merger:

(A) all its property continues to be vested in it without transfer, reversion, or impairment;

(B) it remains subject to all its debts, obligations, and other liabilities; and

(C) all its rights, privileges, immunities, powers, and purposes continue to be vested in it;

(7) the name of the surviving entity may be substituted for the name of any merging entity that is a party to any pending action or proceeding;

(8) if the surviving entity exists before the merger:

(A) its public organic record, if any, is amended to the extent provided in the statement of merger; and

(B) its private organic rules that are to be in a record, if any, are amended to the extent provided in the plan of merger;

(9) if the surviving entity is created by the merger, its private organic rules are effective; and:

(A) if it is a filing entity, its public organic record is effective; and

(B) if it is a limited liability partnership, its statement of qualification is effective; and

(10) the interests in each merging entity which are to be converted in the merger are converted, and the interest holders of those interests are entitled only to the rights provided to them under the plan of merger and to any appraisal rights they have under Section 1608 and the merging entity's organic law.

(b) Except as otherwise provided in the organic law or organic rules of a merging entity, the merger does not give rise to any rights that an interest holder, governor, or third party would have upon a dissolution, liquidation, or winding up of the merging entity.

(c) When a merger becomes effective, a person that did not have interest holder liability

with respect to any of the merging entities and becomes subject to interest holder liability with respect to a domestic entity as a result of the merger has interest holder liability only to the extent provided by the organic law of that entity and only for those debts, obligations, and other liabilities that are incurred after the merger becomes effective.

(d) When a merger becomes effective, the interest holder liability of a person that ceases to hold an interest in a domestic merging limited cooperative association with respect to which the person had interest holder liability is subject to the following rules:

(1) The merger does not discharge any interest holder liability under this [act] to the extent the interest holder liability was incurred before the merger became effective.

(2) The person does not have interest holder liability under this [act] for any debt, obligation, or other liability that is incurred after the merger becomes effective.

(3) This act continues to apply to the release, collection, or discharge of any interest holder liability preserved under paragraph (1) as if the merger had not occurred.

(4) The person has whatever rights of contribution from any other person as are provided by this [act], law other than this [act], or the organic rules of the domestic merging limited cooperative association with respect to any interest holder liability preserved under paragraph (1) as if the merger had not occurred.

(e) When a merger becomes effective, a foreign entity that is the surviving entity may be served with process in this state for the collection and enforcement of any debts, obligations, or other liabilities of a domestic merging limited cooperative association as provided in Section 122.

(f) When a merger becomes effective, the registration to do business in this state of any foreign merging entity that is not the surviving entity is canceled.

Comment

With the exception of subsections (c) and (d), this section is similar to statutory provisions on the effect of a merger of a corporation with a corporation. *See* Model Business Corporation Act § 11.07.

Subsection (a) – This subsection states the general understanding that in a merger the assets and liabilities of the merging entities automatically vest in the surviving entity. The surviving entity becomes the owner of all real and personal property of the merged entities and is subject to all debts, obligations, and liabilities of the merging entities. A merger does not constitute a transfer, assignment, or conveyance of any property held by the merging entities prior to the merger. A merger also does not give rise to a claim that a contract with a merging entity is no longer in effect on the ground of nonassignability, unless the contract specifically provides that it does not survive a merger. The contract rights that are vested in the surviving entity include the right to enforce subscription agreements for interests and obligations to make capital contributions entered into or incurred before the merger. *See also* Section 1603(c) which deals with the surviving entity's rights in trust obligations to a nonsurviving party in a merger and transactions such as bequests made to a nonsurviving party to a merger that takes effect after the merger.

After a merger becomes effective, the law of the surviving entity's jurisdiction of formation governs the surviving entity.

See Sections 1003(a) and (b) which modify the provisions of this section with respect to the effects of a merger to the extent a regulatory law provides otherwise or any of the parties holds property committed to charitable purposes.

Subsection (a)(2) – A merger cannot have the effect of making an interest holder of a domestic merging entity subject to interest holder liability for the debts, obligations, or other liabilities of any other person or entity unless the interest holder has executed a separate written consent to become subject to such liability or previously agreed to the effectuation of a transaction having that effect without the interest holder's consent. .

Subsection (a)(7) – All pending proceedings involving either the survivor or a party whose separate existence ceased as a result of the merger are continued. Under this paragraph, the name of the survivor may be, but need not be, substituted in any pending proceeding for the name of a party to the merger whose separate existence ceased as a result of the merger. The substitution may be made whether the survivor is a complainant or a respondent, and may be made at the instance of either the survivor or an opposing party. Such a substitution has no substantive effect because, whether or not the survivor's name is substituted, the survivor succeeds to the claims, and is subject to the liabilities, of any party to the merger whose separate existence ceased as a result of the merger.

Subsection (a)(8)(B) – The private organic rules of an unincorporated entity typically may be either oral or written. The plan of merger is not required to set forth amendments to oral provisions of the private organic rules of the surviving entity, and thus this provision is limited in

scope just to amendments to the private organic rules that are to be in a record, if any.

Subsection (a)(10) – *See* Section 1606, comments.

Subsections (c) and (d) – These subsections set forth rules for two circumstances that typically do not exist in a merger where all the entities involved are corporations. Subsection (c) deals with the situation where an interest holder that does not have vicarious liability for the obligations of a merging entity before the merger has interest holder liability after the merger. An example would be a corporate shareholder who agrees to be the general partner in a limited partnership that is the surviving entity in a merger between a corporation and a limited partnership that is not a limited liability limited partnership. Subsection (d) deals with the situation where an interest holder has vicarious liability for the obligations of one of the merging parties before the merger but ceases to have any interest holder liability for the obligations of the surviving entity after the merger is effective. An example would be a general partner in a general partnership that merges into a corporation.

The effects of subsections (c) and (d) will depend on when a liability is incurred, which is determined by other law. When a contractual liability is incurred may depend on how the contractual obligation is worded. For example, a lease that provides that the entire rent is due when the lease is signed, but provides that rent may be paid in future installments, will be treated differently from a lease that does not provide that the entire rent is earned upon signing.

These subsections apply not only to merging domestic limited cooperative associations but also to any other domestic entity involved in the merger.

Subsection (c) – This subsection sets forth the general rule that an interest holder that was not liable for the liabilities of a merging entity before the merger but will have personal liability for the obligations of the surviving entity after the merger will be personally liable only for the liabilities of a domestic surviving entity that are incurred after the effective date of a merger. When a liability is incurred will be determined by other applicable law.

Subsection (d) – This subsection provides four rules with respect to a person who ceases to have interest holder liability after the effective date of the merger:

(1) the interest holder remains personally liable for any obligations that were incurred before the effective date of the merger;

(2) the interest holder does not have any personal liability for obligations of the surviving entity;

(3) the pre-existing personal liability of the interest holder is enforced against the interest holder on the same basis as if the merger had not taken place; and

(4) the interest holder has the same rights of contribution from other interest holders of the merging entity as the interest holder would have had if the merger had not

occurred.

See also Section 1646(d), comment.

Subsection (e) – When a merger becomes effective, this subsection provides that a foreign entity that is the surviving entity may be served with process in this state. The proceedings covered by this subsection include a proceeding to enforce the rights of any interest holders of each domestic merging entity who are entitled to and exercise appraisal rights. One of the liabilities that a foreign surviving entity succeeds to is the obligation of a merging entity to pay the amount, if any, to which its interest holders who assert appraisal rights are entitled.

[PART] 3

INTEREST EXCHANGE

SECTION 1631. INTEREST EXCHANGE AUTHORIZED.

(a) By complying with this [part]:

(1) a domestic limited cooperative association may acquire all of one or more classes or series of interests of another domestic entity or a foreign entity in exchange for interests, securities, obligations, money, other property, rights to acquire interests or securities, or any combination of the foregoing; or

(2) all of one or more classes or series of interests of a domestic limited cooperative association may be acquired by another domestic entity or a foreign entity in exchange for interests, securities, obligations, money, other property, rights to acquire interests or securities, or any combination of the foregoing.

(b) By complying with the provisions of this [part] applicable to foreign entities, a foreign entity may be the acquiring or acquired entity in an interest exchange under this [part] if the interest exchange is authorized by the law of the foreign entity's jurisdiction of formation.

(c) If a protected agreement contains a provision that applies to a merger of a domestic limited cooperative association but does not refer to an interest exchange, the provision applies to

an interest exchange in which the domestic limited cooperative association is the acquired entity as if the interest exchange were a merger until the provision is amended after [the effective date of this [act]].

Comment

An interest exchange is the same type of transaction as the share exchange provided for in Section 11.03 of the Model Business Corporation Act ("MBCA"). The effect of an interest exchange is that: (1) the separate existence of the acquired entity is not affected; and (2) the acquiring entity acquires all of the interests of one or more classes of the acquired entity. An interest exchange also allows an indirect acquisition through the use of consideration in the exchange that is not provided by the acquiring entity (*e.g.*, consideration from another or related entity).

Neither share exchanges nor interest exchanges are universally recognized in either corporation or unincorporated entity laws. The effect of an interest exchange can be achieved through a triangular merger in which the acquiring entity forms a new subsidiary and the acquired entity is then merged into the new subsidiary. Part 3 allows the interest exchange to be accomplished directly in a single step, rather than indirectly through the triangular merger route.

The "series" referenced in subsection (a) are not the series contemplated by the Uniform Statutory Entity Trust Act (2009) (Last Amended 2013) §§ 401-405 and some LLC statutes. *See, e.g.*, 805 ILCS 180/37-40 (2012); Del. Code Ann. tit. 6, § 18-215 (2012). Instead, in this context "series" refers to a subset of a class, which is a meaning commonly found in corporation law. *See, e.g.*, MBCA § 6.02. Specific provisions authorizing classes and series are less common in unincorporated entity law but do exist. *See, e.g.*, Minn.Stat. § 322B.155 (2012). In any event, the organic rules of a limited cooperative association can create classes and series as contemplated by this section. *See* Section 404.

Subsection (a) – For this section to apply, a domestic LCA must be either the acquiring or acquired entity.

The acquiring entity is not required to acquire all of the interests in the acquired entity. For example, assume that an LCA with three classes of membership interests enters into an interest exchange with an acquiring entity. The acquiring entity need only acquire all of the ownership interests of one or more classes of the LCA membership interests.

Subsection (b) – This subsection allows a foreign entity to effectuate an interest exchange with a domestic LCA if the interest exchange is authorized by the organic law of the foreign entity.

Subsection (c) – This subsection deals with rights of parties to protected agreements (defined in Section 1601(30)) when an interest exchange takes place. Because the concept of an

interest exchange is relatively new, a person contracting with a domestic LCA or loaning it money who drafted and negotiated special rights relating to the transaction before the enactment of this article should not be charged with the consequences of not having dealt with the concept of an interest exchange in the context of those special rights. Similarly, when the governance structure of an entity has been negotiated before the enactment of this act, the concept of an interest exchange may not have been reflected in any special governance arrangements; for example, special approval rights may have been provided for fundamental transactions, but those rights fail to include language that would make them applicable to an interest exchange. Subsection (c) accordingly provides a transitional rule that is intended to protect such special rights. If, for example, an entity is a party to a contract that provides that the entity cannot participate in a merger without the consent of the other party to the contract, the requirement to obtain the consent of the other party will also apply to an interest exchange in which the entity is the acquired entity. If the entity fails to obtain the consent, the result will be that the other party will have the same rights it would have had if the entity were to participate in a merger without the required consent.

The transitional rule in this subsection ceases to make sense at such time as the provisions of the agreement giving rise to the special rights is first amended after the effective date of this act because at that time the provision may be amended to address expressly an interest exchange. The transitional rule will continue to apply, however, if a provision other than the specific provisions giving rise to the special rights is amended.

SECTION 1632. PLAN OF INTEREST EXCHANGE.

(a) A domestic limited cooperative association may be the acquired entity in an interest exchange under this [part] by approving a plan of interest exchange. The plan must be in a record and contain:

(1) the name of the acquired entity;

(2) the name, jurisdiction of formation, and type of entity of the acquiring entity;

(3) the manner of converting the interests in the acquired entity into interests, securities, obligations, money, other property, rights to acquire interests or securities, or any combination of the foregoing;

(4) any proposed amendments to:

(A) the articles of organization of the acquired entity; and

(B) the organic rules of the acquired entity that are, or are proposed to be, in

a record;

(5) the other terms and conditions of the interest exchange; and

(6) any other provision required by the law of this state or the organic rules of the acquired entity.

(b) In addition to the requirements of subsection (a), a plan of interest exchange may contain any other provision not prohibited by law.

Comment

This section sets forth the requirements for the plan of interest exchange, which must be approved by the acquired entity in accordance with Section 1631. The content of the plan of interest exchange is similar to the content of a plan of merger. *See* Section 1622.

The plan of interest exchange may, but need not, be filed instead of the statement of interest exchange, Section 1635, so long as the plan contains all the information required to be in the statement and is delivered to the filing office for filing after the plan has been adopted and approved. *See* Section 1635(d).

Subsection (a)(3) – Under this paragraph, interest holders in the acquired entity may receive interests or securities of the acquiring entity or of a party other than the acquiring entity, obligations, rights to acquire interests or securities, cash, or other property. *See also* Section 1622(a)(3), comment.

Subsection (b) – This subsection authorizes the plan to contain any other provision the parties wish to include, unless the provision is prohibited by law.

SECTION 1633. APPROVAL OF INTEREST EXCHANGE.

(a) A plan of interest exchange is not effective unless it has been approved by a domestic converting limited cooperative association as provided in Section 518.

(b) An interest exchange involving a domestic acquired entity that is not a limited cooperative association is not effective unless it is approved by the domestic entity in accordance with its organic law.

(c) An interest exchange involving a foreign acquired entity is not effective unless it is

approved by the foreign entity in accordance with the law of the foreign entity's jurisdiction of formation.

(d) Except as otherwise provided in its organic law or organic rules, the interest holders of the acquiring entity are not required to approve the interest exchange.

Comment

This section and Section 518 sets forth the required approval of an interest exchange. *See* Section 1623, comment for an explanation of the approval requirements. An interest exchange transaction governed by this article only requires approval by the acquired entity, unless the applicable organic law or the organic rules of the acquiring entity otherwise provide, (subsection (d)), a condition that rarely exists.

SECTION 1634. AMENDMENT OR ABANDONMENT OF PLAN OF INTEREST EXCHANGE.

(a) A plan of interest exchange may be amended only with the consent of each party to the plan, except as otherwise provided in the plan.

(b) A domestic acquired limited cooperative association may approve an amendment to a plan of interest exchange:

(1) in the same manner as the plan was approved, if the plan does not provide for the manner in which it may be amended; or

(2) by its directors or members in the manner provided in the plan, but a member that was entitled to vote on or consent to approval of the interest exchange is entitled to vote on or consent to any amendment of the plan that will change:

(A) the amount or kind of interests, securities, obligations, money, other property, rights to acquire interests or securities, or any combination of the foregoing, to be received by any of the members under the plan;

(B) the organic rules of the acquired association that will be in effect

immediately after the interest exchange becomes effective, except for changes that do not require approval of the members of the acquired association under this [act] or the organic rules; or

(C) any other terms or conditions of the plan, if the change would adversely affect the member in any material respect.

(c) After a plan of interest exchange has been approved and before a statement of interest exchange becomes effective, the plan may be abandoned as provided in the plan. Unless prohibited by the plan, a domestic acquired limited cooperative association may abandon the plan in the same manner as the plan was approved.

(d) If a plan of interest exchange is abandoned after a statement of interest exchange has been delivered to the [Secretary of State] for filing and before the statement becomes effective, a statement of abandonment, signed by the acquired limited cooperative association, must be delivered to the [Secretary of State] for filing before the statement of interest exchange becomes effective. The statement of abandonment takes effect on filing, and the interest exchange is abandoned and does not become effective. The statement of abandonment must contain:

(1) the name of the association;

(2) the date on which the statement of interest exchange was filed by the [Secretary of State]; and

(3) a statement that the interest exchange has been abandoned in accordance with this section.

Comment

This section parallels analogous provisions in Parts 2 (mergers), 4 (conversions), and 5 (domestications). *See* Sections 1624 (mergers), 1644 (conversions), and 1654 (domestications).

SECTION 1635. STATEMENT OF INTEREST EXCHANGE; EFFECTIVE DATE OF INTEREST EXCHANGE.

(a) A statement of interest exchange must be signed by a domestic acquired limited cooperative association and delivered to the [Secretary of State] for filing.

(b) A statement of interest exchange must contain:

(1) the name of the acquired limited cooperative association;

(2) the name, jurisdiction of formation, and type of entity of the acquiring entity;

(3) if the statement of interest exchange is not to be effective upon filing, the later date and time on which it will become effective pursuant to Section 1636;

(4) a statement that the plan of interest exchange was approved by the acquired association in accordance with this [part]; and

(5) any amendments to the acquired association's articles of organization approved as part of the plan of interest exchange.

(c) In addition to the requirements of subsection (b), a statement of interest exchange may contain any other provision not prohibited by law.

(d) A plan of interest exchange that is signed by a domestic acquired limited cooperative association and meets all the requirements of subsection (b) may be delivered to the [Secretary of State] for filing instead of a statement of interest exchange and on filing has the same effect. If a plan of interest exchange is filed as provided in this subsection, references in this [article] to a statement of interest exchange refer to the plan of interest exchange filed under this subsection.

(e) An interest exchange becomes effective when the statement of interest exchange is effective.

Comment

This section applies only when the acquired entity is a domestic limited cooperative association. The filing makes the transaction a matter of public record.

This act has no filing requirement when the only domestic LCA involved is the acquired entity. For that situation, the organic law of the acquiring entity must be consulted.

Subsection (b) – This subsection states the requirements for a statement of interest exchange, which are essentially the same as the requirements for a statement of merger under Section 1625(b).

Subsection (d) – A plan of interest exchange can be used as a substitute for the statement of interest exchange so long as the plan satisfies the requirements in subsection (b).

Subsection (e) – This subsection applies when the acquiring entity is a domestic LCA, and Section 205 determines when a record delivered for filing under this act is effective. A statement of interest exchange may specify a delayed effective time and date, subject to the 90-day limit stated in subsection Section 205(3) and (4).

If the acquiring entity is not a domestic LCA, the effectiveness of the interest exchange will occur when provided by the law of the jurisdiction of formation of the acquiring entity.

SECTION 1636. EFFECT OF INTEREST EXCHANGE.

(a) When an interest exchange in which the acquired entity is a domestic limited cooperative association becomes effective:

(1) the interests in the acquired association which are the subject of the interest exchange are converted, and the members holding those interests are entitled only to the rights provided to them under the plan of interest exchange and to any appraisal rights they have under Section 1606;

(2) the acquiring entity becomes the interest holder of the interests in the acquired association stated in the plan of interest exchange to be acquired by the acquiring entity; and

(3) the organic rules of the acquired entity are amended to the extent provided in the statement of interest exchange.

(b) Except as otherwise provided in the organic rules of a domestic acquired limited cooperative association, the interest exchange does not give rise to any rights that a member, director, or third party would have upon a dissolution, liquidation, or winding up of the acquired association.

(c) When an interest exchange becomes effective, a person that did not have interest holder liability with respect to a domestic acquired limited cooperative association and becomes subject to interest holder liability with respect to a domestic entity as a result of the interest exchange has interest holder liability only to the extent provided by the organic law of the entity and only for those debts, obligations, and other liabilities that are incurred after the interest exchange becomes effective.

(d) When an interest exchange becomes effective, the interest holder liability of a person that ceases to hold an interest in a domestic acquired limited cooperative association with respect to which the person had interest holder liability is subject to the following rules:

(1) The interest exchange does not discharge any interest holder liability under this [act] to the extent the interest holder liability was incurred before the interest exchange became effective.

(2) The person does not have interest holder liability under this [act] for any debt, obligation, or other liability that is incurred after the interest exchange becomes effective.

(3) This [act] continues to apply to the release, collection, or discharge of any interest holder liability preserved under paragraph (1) as if the interest exchange had not occurred.

(4) The person has whatever rights of contribution from any other person as are provided by this [act], law other than this [act] or the organic rules of the acquired association with respect to any interest holder liability preserved under paragraph (1) as if the interest

exchange had not occurred.

Comment

This section applies only when the *acquired* entity is a domestic limited cooperative association, and this act states no rule for the effect of an interest exchange when the only domestic LCA involved is the *acquiring* entity. For that situation, the organic law of the acquiring entity must be consulted.

Subsection (a) – In contrast to a merger, an interest exchange does not in and of itself affect the separate existence of the parties, vest in the acquiring entity the assets of the acquired entity, or render the acquiring entity liable for the liabilities of the acquired entity. Thus, subsection (a) is significantly simpler than Section 1626(a) with respect to the effects of a merger.

When an interest exchange becomes effective: (1) the interests of the acquired domestic limited cooperative association are exchanged, converted or canceled as provided in the plan; (2) the only rights of the former members and transferees of the acquired LCA whose interests are affected by the interest exchange are those rights related to the exchange, conversion or cancellation; (3) the acquiring entity becomes the owner of the acquired LCA's interests as provided in the plan; (4) the certificate of organization of the acquired LCA is amended as provided in the statement of interest exchange, thus obviating the need for repetitive filings (*i.e.*, a filing as to the entity interest exchange and another filing to reflect amendments to certificate); and (5) the provisions of the operating agreement of the acquired LCA that are to be in a record, if any, are amended to the extent provided in the plan of interest exchange.

Subsection (c) – This subsection provides the rule for future interest holder liability pertaining to domestic entities and parallels analogous provisions in Parts 2 (mergers), 4 (conversions), and 5 (domestications). *See* Section 1626, comment.

Subsection (d) – This subsection provides the rule for past interest holder liability and parallels analogous provisions in Parts 2 (mergers), 4 (conversions), and 5 (domestications). *See* Section 1626(d), comment and Section 1646(d), comment.

[PART] 4

CONVERSION

SECTION 1641. CONVERSION AUTHORIZED.

(a) By complying with this [part], a domestic limited cooperative association may become:

(1) a domestic entity that is a different type of entity; or

(2) a foreign entity that is a different type of entity, if the conversion is authorized

by the law of the foreign entity's jurisdiction of formation.

(b) By complying with the provisions of this [part] applicable to foreign entities a foreign entity that is not a foreign limited cooperative association may become a domestic limited cooperative association if the conversion is authorized by the law of the foreign entity's jurisdiction of formation.

(c) If a protected agreement contains a provision that applies to a merger of a domestic limited cooperative association but does not refer to a conversion, the provision applies to a conversion of the association as if the conversion were a merger until the provision is amended after [the effective date of this [act]].

Comment

This part of Article 16 permits an entity to change to a different type of entity in its jurisdiction of formation or in a foreign jurisdiction. A transaction in which an entity changes its jurisdiction of organization but does not change its type is a domestication and is the subject of Part 5.

Subsection (a)(2) – For this provision to apply, this type of conversion must be authorized by the law of the foreign jurisdiction. If this is not the case, it may be possible to achieve the same result by forming an entity of the type desired in the foreign jurisdiction and then merging the domestic entity into the new foreign entity under Part 2 of Article 16.

Subsection (b) – This subsection allows a foreign entity to effectuate a conversion into a domestic limited cooperative association, but only if the conversion is permitted by the laws of the foreign entity's jurisdiction of formation. When a foreign entity becomes a domestic LCA pursuant to this part of Article 16, the effect of the conversion will be as provided in Section 1646. The procedures by which the conversion is approved, however, will be determined by the laws of the foreign entity's jurisdiction of formation. *See* Section 102(14) for the definition of "jurisdiction of formation."

Subsection (c) – *See* Section 1631(c), comment.

SECTION 1642. PLAN OF CONVERSION.

(a) A domestic limited cooperative association may convert to a different type of entity under this [part] by approving a plan of conversion. The plan must be in a record and contain:

(1) the name of the converting limited cooperative association;

(2) the name, jurisdiction of formation, and type of entity of the converted entity;

(3) the manner of converting the interests in the converting limited cooperative association into interests, securities, obligations, money, other property, rights to acquire interests or securities, or any combination of the foregoing;

(4) the proposed public organic record of the converted entity if it will be a filing entity;

(5) the full text of the private organic rules of the converted entity which are proposed to be in a record;

(6) the other terms and conditions of the conversion; and

(7) any other provision required by the law of this state or the organic rules of the converting limited cooperative association.

(b) In addition to the requirements of subsection (a), a plan of conversion may contain any other provision not prohibited by law.

Comment

This section sets forth the requirements for the plan of conversion, which must be approved by the converting entity in accordance with Sections 1643 and 518. The content of a plan of conversion is similar to the content of a plan of merger. *See* Section 1622.

Subsection (a)(3) – Interest holders in the converting entity may receive interests or other securities of the converted entity or of any other person, obligations, rights to acquire interests or other securities, cash, or other property. *See also* Sections 1622(a)(3) (mergers), 1632(a)(3) (interest exchanges), and 1652(a)(3) (domestications).

Subsection (b) – This subsection authorizes the plan to contain any other provision the parties wish to include, unless the provision is prohibited by law.

SECTION 1643. APPROVAL OF CONVERSION.

(a) A plan of conversion is not effective unless it has been approved by a domestic

converting limited cooperative association as provided in Section 518.

(b) A conversion involving a domestic converting entity that is not a limited cooperative association is not effective unless it is approved by the domestic converting entity in accordance with its organic law.

(c) A conversion of a foreign converting entity is not effective unless it is approved by the foreign entity in accordance with the law of the foreign entity's jurisdiction of formation.

Comment

This section and Section 518 set forth the approval requirements for a conversion. *See* Section 1623, comment for an explanation of the approval requirements for approval of a conversion of a domestic limited cooperative association.

SECTION 1644. AMENDMENT OR ABANDONMENT OF PLAN OF CONVERSION.

(a) A plan of conversion of a domestic converting limited cooperative association may be amended:

(1) in the same manner as the plan was approved, if the plan does not provide for the manner in which it may be amended; or

(2) by its directors or members in the manner provided in the plan, but an interest holder that was entitled to vote on or consent to approval of the conversion is entitled to vote on or consent to any amendment of the plan that will change:

(A) the amount or kind of interests, securities, obligations, money, other property, rights to acquire interests or securities, or any combination of the foregoing, to be received by any of the members of the converting association under the plan;

(B) the public organic record, if any, or private organic rules of the converted entity which will be in effect immediately after the conversion becomes effective,

except for changes that do not require approval of the interest holders of the converted entity under its organic law or organic rules; or

(C) any other terms or conditions of the plan, if the change would adversely affect the member in any material respect.

(b) After a plan of conversion has been approved by a domestic converting limited cooperative association and before a statement of conversion becomes effective, the plan may be abandoned as provided in the plan. Unless prohibited by the plan, a domestic converting limited cooperative association may abandon the plan in the same manner as the plan was approved.

(c) If a plan of conversion is abandoned after a statement of conversion has been delivered to the [Secretary of State] for filing and before the statement becomes effective, a statement of abandonment, signed by the entity, must be delivered to the [Secretary of State] for filing before the statement of conversion becomes effective. The statement of abandonment takes effect on filing, and the conversion is abandoned and does not become effective. The statement of abandonment must contain:

(1) the name of the converting limited cooperative association;

(2) the date on which the statement of conversion was filed by the [Secretary of State]; and

(3) a statement that the conversion has been abandoned in accordance with this section.

Comment

This section parallels analogous provisions in Parts 2 (mergers), 3 (interest exchanges), and 5 (domestications). *See* Sections 1624 (mergers), 1634 (interest exchanges), and 1654 (domestications).

SECTION 1645. STATEMENT OF CONVERSION; EFFECTIVE DATE OF CONVERSION.

(a) A statement of conversion must be signed by the converting entity and delivered to the [Secretary of State] for filing.

(b) A statement of conversion must contain:

(1) the name, jurisdiction of formation, and type of entity of the converting entity;

(2) the name, jurisdiction of formation, and type of entity of the converted entity;

(3) if the converting entity is a domestic limited cooperative association, a statement that the plan of conversion was approved in accordance with this [part] or, if the converting entity is a foreign entity, a statement that the conversion was approved by the foreign converting entity in accordance with the law of its jurisdiction of formation;

(4) if the converted entity is a domestic filing entity, its public organic record, as an attachment;

(5) if the converted entity is a domestic limited liability partnership, its [statement of qualification], as an attachment; and

(6) if the converted entity is a foreign entity, a mailing address to which the [Secretary of State] may send any process served on the [Secretary of State] pursuant to Section 1646(e).

(c) In addition to the requirements of subsection (b), a statement of conversion may contain any other provision not prohibited by law.

(d) If the converted entity is a domestic entity, its public organic record, if any, must satisfy the requirements of the law of this state, except that the public organic record does not need to be signed and may omit any provision that is not required to be included in a restatement

of the public organic record.

(e) A plan of conversion that is signed by a domestic converting limited cooperative association and meets all the requirements of subsection (b) may be delivered to the [Secretary of State] for filing instead of a statement of conversion and on filing has the same effect. If a plan of conversion is filed as provided in this subsection, references in this [article] to a statement of conversion refer to the plan of conversion filed under this subsection.

(f) If the converted entity is domestic limited cooperative association, the conversion becomes effective when the statement of conversion is effective. In all other cases, the conversion becomes effective on the later of:

(1) the date and time provided by the organic law of the converted entity; or

(2) when the statement is effective.

Comment

This section applies regardless of whether a domestic limited cooperative association is the converting or converted entity. A foreign entity seeking to convert to a domestic LCA must therefore comply with this section.

If either the converting or converted entity is a foreign entity, the organic law of the foreign entity's jurisdiction must also be consulted.

The filing of a statement of conversion makes the transaction a matter of public record.

Subsection (b) – This subsection sets forth the requirements for a statement of conversion. They are essentially the same as the requirements for a statement of merger in Section 1625.

Subsection (e) – A plan of conversion can be used as a substitute for the statement of conversion so long as the plan satisfies the requirements in subsection (b).

Subsection (f) – Section 205 determines when a record delivered for filing under this act is effective. A statement of conversion may specify a delayed effective time and date, subject to the 90-day limit stated in Section 205(3) and (4).

When the statement of conversion becomes effective under this subsection, the conversion transaction occurs if the converted entity is a domestic LCA. A conversion in which the

converted entity is a foreign entity will usually also take effect when the statement of conversion takes effect because the best practice will be to coordinate the filings that need to be made when a conversion involves both a domestic entity and also a foreign entity so that the filings in each jurisdiction take effect at the same time. Because of the possibility, however, that the filing in the foreign jurisdiction will take effect at a different time this subsection, provides that the conversion transaction itself will take effect at the later of (i) when the statement of conversion takes effect, and (ii) when the conversion takes effect under the law of the foreign jurisdiction. That rule avoids the possibility that the conversion will take effect in the domestic jurisdiction before it takes effect in the foreign jurisdiction, which would produce the undesirable result that the converting domestic entity would cease to exist before it has been converted into the foreign entity.

It is only necessary for the filing office to record the effective date of the statement of conversion and the filing office does not need to be concerned with the effective date of the conversion itself. Persons wishing to determine the effective date of a conversion involving both a domestic LCA and a foreign entity will be able to do so by consulting the records of the filing offices in each jurisdiction.

SECTION 1646. 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 converted entity without transfer, reversion, or impairment;

(3) all debts, obligations, and other liabilities of the converting entity continue as debts, obligations, and other liabilities of the converted entity;

(4) except as otherwise provided by law or the plan of conversion, all 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) the organic rules of the converted entity are effective; and

(7) 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 1606.

(b) Except as otherwise provided in the organic rules of a domestic converting limited cooperative association, the conversion does not give rise to any rights that a member, director, or third party would 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 becomes subject to interest holder liability with respect to a domestic entity as a result of the conversion has interest holder liability only to the extent provided by the organic law of the entity and only for those debts, obligations, and other liabilities that are incurred after the conversion becomes effective.

(d) When a conversion becomes effective, the interest holder liability of a person that ceases to hold an interest in a domestic converting limited cooperative association with respect to which the person had interest holder liability is subject to the following rules:

(1) The conversion does not discharge any interest holder liability under this [act] to the extent the interest holder liability was incurred before the conversion became effective.

(2) The person does not have interest holder liability under this [act] for any debt, obligation, or other liability that is incurred after the conversion becomes effective;

(3) This [act] 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.

(4) The person has whatever rights of contribution from any other person as are

provided by this [act], law other than this [act], or the organic rules of the domestic converting limited cooperative association 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 may be served with process in this state for the collection and enforcement of any of its debts, obligations, and other liabilities as provided in Section 122.

(f) If the converting entity is a registered foreign entity, its registration to do business in this state is canceled when the conversion becomes effective.

(g) A conversion does not require the entity to wind up its affairs and does not constitute or cause the dissolution of the entity.

Comment

A converted entity is the same entity as it was before the conversion; the entity just has a different legal form.

Subsection (a) – This subsection states the principal legal effects of a conversion. The converted entity remains the owner of all real and personal property and remains subject to all the liabilities, actual or contingent, of the converted entity. A conversion is not a conveyance, transfer, or assignment. A conversion does not give rise to: (i) claims of reverter or impairment of title based on a prohibited conveyance or transfer; or (ii) to a claim that a contract with the converting entity is no longer in effect on the ground of nonassignability, unless the contract specifically provides that it does not survive a conversion. The contract rights that remain in the converted entity include, without limitation, the right to enforce subscription agreements for interests and obligations to make capital contributions entered into or incurred before the conversion.

When a conversion becomes effective, the internal affairs of the converting entity are no longer governed by its former organic law but instead by the organic law of the converted entity. As a result, filings that may have been made under the organic law of the converting entity, such as the following, will no longer be effective.

Subsection (a)(5) – All pending proceedings involving the converting entity are continued. The name of the converted entity may be, but need not be, substituted in any pending proceeding for the name of the converting entity.

Subsection (c) – This subsection provides the rule for future interest holder liability and parallels provisions in Parts 2 (mergers), 3 (interest exchanges), and 5 (domestications). *See* Section 1626(c), comment.

Subsection (d) – Subsection (d) provides the rule for past interest holder liability and parallels analogous provisions in Parts 2 (mergers), 3 (interest exchanges), and 5 (domestications). *See* Section 1626(d), comment.

At first glance, this subsection might seem to apply to the null set; members of a limited cooperative association typically do not have interest holder liability. However, the definition of interest holder liability also includes "personal liability for a liability of an entity which is imposed on a person … by the organic rules of the entity which make one or more specified interest holders or categories of interest holders liable in their capacity as interest holders for all or specified liabilities of the entity." Section 1601(19)(A)(ii).

Subsection (e) – For this provision to apply, the converting entity must have been a domestic LCA. When a domestic LCA becomes a foreign entity as a result of a conversion, some mechanism is needed to facilitate the enforcement of claims by the creditors and interest holders of the converting LCA. This subsection, which parallels analogous provisions in Parts 2 (mergers) and 5 (domestications), authorizes service of process for all such claims in this state.

Subsection (g) – When a conversion takes effect, the entity continues to exist – simply in a different form. This subsection thus makes clear that the conversion does not require the entity to wind up its affairs and does not constitute or cause the dissolution of the entity.

[PART] 5

DOMESTICATION

SECTION 1651. DOMESTICATION AUTHORIZED.

(a) By complying with this [part], a domestic limited cooperative association may become a foreign limited cooperative association if the domestication is authorized by the law of the foreign jurisdiction.

(b) By complying with the provisions of this [part] applicable to foreign limited cooperative associations a foreign limited cooperative association may become a domestic limited cooperative association if the domestication is authorized by the law of the foreign limited cooperative association's jurisdiction of formation.

(c) If a protected agreement contains a provision that applies to a merger of a domestic limited cooperative association but does not refer to a domestication, the provision applies to a domestication of the limited cooperative association as if the domestication were a merger until the provision is amended after [the effective date of this [act]].

Comment

A domestication authorized by Part 5 of Article 16 differs from a conversion in that a domestication requires that the domesticating entity be the same type of entity as the domesticated entity. In a conversion, by contrast, the converting entity changes its type.

As with a conversion, all rights and privileges, debts, obligations and other liabilities, and actions or proceedings of a domesticating entity vest unimpaired in the domesticated entity. A domestication is not a sale, transfer, assignment, or conveyance and does not give rise to a claim of reverter or impairment of title.

Part 5 of Article 16 governs the legal effect of a foreign limited cooperative association domesticating in this state. On the other hand, the organic laws of the foreign jurisdiction, and not Part 5, will govern the legal effect of most aspects of a domestication of a domestic limited cooperative association in another jurisdiction. In the latter scenario, Part 5 authorizes the domestication of the domestic entity in the foreign jurisdiction, but Part 5 does not create a right in the domestic entity to be received in the foreign jurisdiction. Similarly, this section does not provide a right on the part of a foreign LCA to become a domestic LCA if the domestication is not authorized by the laws of the foreign jurisdiction. If the foreign jurisdiction does not authorize a domestication transaction, the same results can be accomplished by forming a new LCA in this state and merging the existing foreign LCA into the new domestic LCA.

Subsection (c) – *See* Section 1031(c).

SECTION 1652. PLAN OF DOMESTICATION.

(a) A domestic limited cooperative association may become a foreign limited cooperative association in a domestication by approving a plan of domestication. The plan must be in a record and contain:

(1) the name of the domesticating limited cooperative association;

(2) the name and jurisdiction of formation of the domesticated limited cooperative association;

(3) the manner of converting the interests in the domesticating limited cooperative association into interests, securities, obligations, money, other property, rights to acquire interests or securities, or any combination of the foregoing;

(4) the proposed organic rules of the domesticated limited cooperative association;

(5) the other terms and conditions of the domestication; and

(6) any other provision required by the law of this state or the organic rules of the domesticating limited cooperative association.

(b) In addition to the requirements of subsection (a), a plan of domestication may contain any other provision not prohibited by law.

Comment

This section sets forth the requirements for the plan of domestication for a domestic limited cooperative association seeking to become a limited cooperative association existing under the law of another jurisdiction. For a foreign LCA seeking to become a domestic LCA, the organic law of the foreign LCA governs the requirements for a plan of domestication. The content of a plan of domestication is similar to the content of a plan of merger. *See* Section 1622.

Subsection (a)(3) – Interest holders in the domesticating LCA may receive interests or other securities of the domesticated LCA or any other entity, obligations, rights to acquire interests or other securities, cash, or other property. *See also* Section 1622(a)(3), comment.

Subsection (b) – This subsection authorizes the plan to contain any other provision the parties wish to include, unless the provision is prohibited by law.

SECTION 1653. APPROVAL OF DOMESTICATION.

(a) A plan of domestication of a domestic domesticating limited cooperative association is not effective unless it has been approved as provided in Section 518.

(b) A domestication of a foreign domesticating limited cooperative association is not effective unless it is approved in accordance with the law of the foreign limited cooperative association's jurisdiction of formation.

Comment

Subsection (a) – *See* Section 1623, comment for an explanation of the approval requirements for a domesticating limited cooperative association.

Subsection (b) – In the case of a foreign limited cooperative association that is domesticating in this state, this subsection provides that the required approval is determined by the laws of the foreign LCA's jurisdiction of formation.

SECTION 1654. AMENDMENT OR ABANDONMENT OF PLAN OF DOMESTICATION.

(a) A plan of domestication of a domestic domesticating limited cooperative association may be amended:

(1) in the same manner as the plan was approved, if the plan does not provide for the manner in which it may be amended; or

(2) by its directors or members in the manner provided in the plan, but a member that was entitled to vote on or consent to approval of the domestication is entitled to vote on or consent to any amendment of the plan that will change:

(A) the amount or kind of interests, securities, obligations, money, other property, rights to acquire interests or securities, or any combination of the foregoing, to be received by any of the members of the domesticating limited cooperative association under the plan;

(B) the organic rules of the domesticated limited cooperative association that will be in effect immediately after the domestication becomes effective, except for changes that do not require approval of the members of the domesticated limited cooperative association under its organic rules; or

(C) any other terms or conditions of the plan, if the change would adversely

affect the member in any material respect.

(b) After a plan of domestication has been approved by a domestic domesticating limited cooperative association and before a statement of domestication becomes effective, the plan may be abandoned as provided in the plan. Unless prohibited by the plan, a domestic domesticating limited cooperative association may abandon the plan in the same manner as the plan was approved.

(c) If a plan of domestication is abandoned after a statement of domestication has been delivered to the [Secretary of State] for filing and before the statement becomes effective, a statement of abandonment, signed by the domesticating limited cooperative association, must be delivered to the [Secretary of State] for filing before the statement of domestication becomes effective. The statement of abandonment takes effect on filing, and the domestication is abandoned and does not become effective. The statement of abandonment must contain:

(1) the name of the domesticating limited cooperative association;

(2) the date on which the statement of domestication was filed by the [Secretary of State]; and

(3) a statement that the domestication has been abandoned in accordance with this section.

Comment

This section parallels provisions in Parts 2 (mergers), 3 (interest exchanges), and 4 (conversions). See Sections 1624 (mergers), 1634 (interest exchanges), and 1644 (conversions).

SECTION 1655. STATEMENT OF DOMESTICATION; EFFECTIVE DATE OF DOMESTICATION.

(a) A statement of domestication must be signed by the domesticating limited cooperative

association and delivered to the [Secretary of State] for filing.

(b) A statement of domestication must contain:

(1) the name and jurisdiction of formation of the domesticating limited cooperative association;

(2) the name and jurisdiction of formation of the domesticated limited cooperative association;

(3) if the domesticating limited cooperative association is a domestic limited cooperative association, a statement that the plan of domestication was approved in accordance with this [part] or, if the domesticating limited cooperative association is a foreign limited cooperative association, a statement that the domestication was approved in accordance with the law of its jurisdiction of formation;

(4) the articles of organization of the domesticated limited cooperative association, as an attachment; and

(5) if the domesticated entity is a foreign limited cooperative association, a mailing address to which the [Secretary of State] may send any process served on the [Secretary of State] pursuant to Section 1656(e).

(c) In addition to the requirements of subsection (b), a statement of domestication may contain any other provision not prohibited by law.

(d) The articles of organization of a domestic domesticated limited cooperative association must satisfy the requirements of this [act], but the articles do not need to be signed.

(e) A plan of domestication that is signed by a domestic domesticating limited cooperative association and meets all the requirements of subsection (b) may be delivered to the [Secretary of State] for filing instead of a statement of domestication and on filing has the same effect. If a plan

of domestication is filed as provided in this subsection, references in this [article] to a statement of domestication refer to the plan of domestication filed under this subsection.

(f) If the domesticated entity is a domestic limited cooperative association, the domestication becomes effective when the statement of domestication is effective. In all other cases, the domestication becomes effective on the later of:

(1) the date and time provided in the organic law of the domesticated entity; or

(2) when the statement is effective.

Comment

Regardless of whether a domestic limited LCA is the domesticating or domesticated entity:

- This section applies and, therefore, a foreign LCA seeking to domesticate and thereby become a domestic LLCA must comply with this section.
- The organic law of the foreign entity's jurisdiction must also be consulted.

The filing of a statement of domestication makes the transaction a matter of public record.

Subsection (b) – This subsection sets forth the requirements for a statement of domestication. They are essentially the same as the requirements for a statement of merger in Section 1025.

Subsection (e) – A plan of domestication can be used as a substitute for the statement of domestication so long as the plan satisfies the requirements in subsection (b).

Subsection (f) – Section 205 determines when a record delivered for filing under this act is effective. A statement of domestication may specify a delayed effective time and date, subject to the 90-day limit stated in Section 205(3) and (4).

When the statement of domestication becomes effective under this subsection, the domestication transaction occurs if the domesticated entity is a domestic LCA. A domestication in which the domesticated entity is a foreign LCA will usually also take effect when the statement of domestication takes effect because the best practice will be to coordinate the filings that need to be made in each jurisdiction so that they take effect at the same time. Because of the possibility, however, that the filing in the foreign jurisdiction will take effect at a different time, this subsection provides that the domestication transaction itself will take effect at the later of (i) when the statement of domestication takes effect, and (ii) when the domestication takes effect under the law of the foreign jurisdiction. This rule avoids the possibility that the domestication will take

effect in the domestic jurisdiction before it takes effect in the foreign jurisdiction, which would produce the undesirable result that the domesticating domestic LCA would cease to appear as an active entity on the records of the domesticating jurisdiction before appearing as its active, domesticated self on the records of the domesticating jurisdiction.

It is only necessary for the filing office to record the effective date of the statement of domestication and the filing office does not need to be concerned with the effective date of the domestication itself. Persons wishing to determine the effective date of a domestication will be able to do so by consulting the records of the filing offices in each jurisdiction.

SECTION 1656. EFFECT OF DOMESTICATION.

(a) When a domestication becomes effective:

(1) the domesticated entity is:

(A) organized under and subject to the organic law of the domesticated entity; and

(B) the same entity without interruption as the domesticating entity;

(2) all property of the domesticating entity continues to be vested in the domesticated entity without transfer, reversion, or impairment;

(3) all debts, obligations, and other liabilities of the domesticating entity continue as debts, obligations, and other liabilities of the domesticated entity;

(4) except as otherwise provided by law or the plan of domestication, all the rights, privileges, immunities, powers, and purposes of the domesticating entity remain in the domesticated entity;

(5) the name of the domesticated entity may be substituted for the name of the domesticating entity in any pending action or proceeding;

(6) the organic rules of the domesticated entity are effective; and

(7) the interests in the domesticating entity are converted to the extent and as approved in connection with the domestication, and the interest holders of the domesticating

entity are entitled only to the rights provided to them under the plan of domestication and to any appraisal rights they have under Section 1606.

(b) Except as otherwise provided in the organic law or organic rules of the domesticating entity, the domestication does not give rise to any rights that an interest holder, director, or third party would have upon a dissolution, liquidation, or winding-up of the domesticating entity.

(c) When a domestication becomes effective, a person that did not have interest holder liability with respect to the domesticating limited cooperative association and becomes subject to interest holder liability with respect to a domestic entity as a result of the domestication has interest holder liability only to the extent provided by this [act] and only for those debts, obligations, and other liabilities that are incurred after the domestication becomes effective.

(d) When a domestication becomes effective, the interest holder liability of a person that ceases to hold an interest in a domestic domesticating limited cooperative association with respect to which the person had interest holder liability is subject to the following rules:

(1) The domestication does not discharge any interest holder liability under this [act] to the extent the interest holder liability was incurred before the domestication became effective.

(2) A person does not have interest holder liability under this [act] for any debt, obligation, or other liability that is incurred after the domestication becomes effective.

(3) This [act] continues to apply to the release, collection or discharge of any interest holder liability preserved under paragraph (1) as if the domestication had not occurred.

(4) A person has whatever rights of contribution from any other person as are provided by this [act], law other than this [act] or the organic rules of a domestic domesticating limited cooperative association with respect to any interest holder liability preserved under

paragraph (1) as if the domestication had not occurred.

(e) When a domestication becomes effective, a foreign limited cooperative association that is the domesticated association may be served with process in this state for the collection and enforcement of any of its debts, obligations, and other liabilities as provided in Section 122.

(f) If the domesticating limited cooperative association is a registered entity, the registration of the entity is canceled when the domestication becomes effective.

(g) A domestication does not require a domestic domesticating limited cooperative association to wind up its affairs and does not constitute or cause the dissolution of the association.

Comment

Subsection (a)(1) – The domesticated entity is the same entity as the domesticating entity; it has merely changed its jurisdiction of formation.

Subsection (a)(2) – A domestication is not a sale, conveyance, transfer, or assignment and does not give rise to claims of reverter or impairment of title that may be based on a prohibition on transfer, assignment, or conveyance.

Subsection (a)(4) – All pending proceedings involving the domesticating entity are continued. The name of the domesticated entity may be, but need not be, substituted in any pending proceeding for the name of the domesticating entity.

Subsection (a)(7) – The interests of the domesticating limited cooperative association are reclassified into whatever rights were negotiated in the domestication and the members and transferees of the domesticating LCA are only entitled to those rights. Paragraph (7), on its face, allows for certain members of the domesticating LCA to be entitled to a continuing equity interest in the domesticated LCA whereas other members of the domesticating LCA may be cashed out as a result of the transaction.

Subsection (c) – This subsection provides the rule for future interest holder liability and parallels analogous provisions in Parts 2 (mergers), 3 (interest exchanges), and 4 (conversions). *See* Section 1626(c), comment.

Subsection (d) – This subsection provides the rule for past interest holder liability and parallels analogous provisions in Parts 2 (mergers), 3 (interest exchanges), and 4 (conversions). *See* Section 1626(d), comment and Section 1646(d), comment.

Subsection (e) – When a domestic domesticating LCA becomes a foreign LCA as a result of a domestication, some mechanism is needed to facilitate the enforcement of claims by the creditors and interest holders of the domesticating LCA. This subsection, which parallels analogous provisions in Parts 2 (mergers) and 4 (conversions), authorizes service of process for all such claims in this state.

Subsection (g) – When a domestication takes effect, the entity continues to exist – simply as a domestic entity under the laws of a different state. This subsection thus makes clear that the domestication does not require the LCA to wind up its affairs and does not constitute or cause the dissolution of the LCA.

[ARTICLE] 17

MISCELLANEOUS PROVISIONS

SECTION 1701. UNIFORMITY OF APPLICATION AND CONSTRUCTION. In applying and construing this uniform act, consideration must be given to the need to promote uniformity of the law with respect to its subject matter among states that enact it.

SECTION 1702. RELATION TO ELECTRONIC SIGNATURES IN GLOBAL AND NATIONAL COMMERCE ACT. This [act] modifies, limits, and supersedes the Electronic Signatures in Global and National Commerce act, 15 U.S.C. Section 7001 et seq., but does not modify, limit, or supersede Section 101(c) of that act, 15 U.S.C. Section 7001(c) or authorize electronic delivery of any of the notices described in Section 103(b) of that act, 15 U.S.C. Section 7003(b).

Comment

This section responds to specific language of the Electronic Signatures in Global and National Commerce act and is designed to avoid preemption of state law under that federal legislation.

SECTION 1703. SAVINGS CLAUSE. This [act] does not affect an action commenced, or proceeding brought, or right accrued before [the effective date of this [act]].

Comment

This section continues the prior laws included in the Code after the effective date of this act with respect to a rights accrued and proceedings. But for this section the new law of this act would displace any prior similar statute in some circumstances. The power of a new act to displace the old statute with respect to conduct occurring before the new act's enactment is substantial. Millard H. Ruud, *The Savings Clause – Some Problems in Construction and Drafting*, 33 Tex. L. Rev. 285, 286-293 (1955). A court generally applies the law that exists at the time it acts.

[SECTION 1704. SEVERABILITY CLAUSE. If any provision of this [act] or its application to any person or circumstance is held invalid, the invalidity does not affect other provisions or applications of this [act] which can be given effect without the invalid provision or application, and to this end the provisions of this [act] are severable.]

Legislative Note: *Include this section only if this state lacks a general severability statute or decision by the highest court of this state stating a general rule of severability.*

SECTION 1705. EFFECTIVE DATE. This [act] takes effect . . .

Legislative Note: *If the adopting jurisdiction has an existing act similar to this act (as of August 2, 2007, there were six such states), it should consider adding a new section immediately after Section 1704 providing for a phasing in of this act's application to existing limited cooperative associations and might consider repealing the existing statute. Section 110 of the Uniform Limited Liability Company act (2006)(Last Amended 2013) (which addresses this same issue because adopting jurisdictions of ULLCA have in place existing non-uniform act LLC statutes) provides an illustrative sample for phasing in application as follows:*

APPLICATION TO EXISTING RELATIONSHIPS

(a) Before [all-inclusive date], this [act] governs only:

(1) a limited liability company formed on or after [the effective date of this act]; and

(2) except as otherwise provided in subsection (c), a limited liability company formed before [the effective date of this act] which elects, in the manner provided in its operating agreement or by law for amending the operating agreement, to be subject to this [act].

(b) Except as otherwise provided in subsection (c), on and after [all-inclusive date] this [act] governs all limited liability companies.

(c) For the purposes applying this [act] to a limited liability company formed before [the effective date of this act]:

(1) the company's articles of organization are deemed to be the company's certificate of organization; and

(2) for the purposes of applying Section 102(1) and subject to Section 112(d), language in the company's articles of organization designating the company's management structure operates as if that language were in the operating agreement.

The Legislative Note to this Section states, in relevant part:

It is recommended that the "all-inclusive" date should be at least one year after the date of enactment but no longer than two years.

Each enacting jurisdiction should consider whether: (i) this act makes material changes to the "default" (or "gap filler") rules of jurisdiction's predecessor statute; and (ii) if so, whether subsection (c) should carry forward any of those rules for pre-existing limited liability companies. In this assessment, the focus is on pre-existing limited liability companies that have left default rules in place, whether advisedly or not. The central question is whether, for such limited liability companies, expanding subsection (c) is necessary to prevent material changes to the members' "deal."

For an example of this type of analysis in the context of another business entity act, see the Uniform Limited Partnership act (2001), § 1206(c).

Of course, the specific cross-references to ULLCA provisions in the sample language would not apply to this act. They are included here for illustrative purposes only.