

Uniform Limited Cooperative Association Act

Statement

According to a NCCUSL summary:

The Uniform Limited Cooperative Association Act (ULCAA) is designed to promote rural development by creating the option of a statutorily-defined entity that combines traditional cooperative values with modern financing mechanisms. The Act will be equally useful in an urban setting, where the cooperative value of individuals getting together to democratically own, run, and share in the benefit of their business can be combined with modern financing techniques. The ULCAA builds on traditional law governing cooperatives, but recognizes a growing trend toward the “New Generation Cooperative” (NGC), which can include combinations of features not readily available under traditional law, such as legally binding delivery contracts or the opportunity for outside equity investment. This Act creates a new form of business entity and is an alternative to other cooperative and unincorporated structures. It is more flexible than most current law, and provides a default template that encourages planners to utilize tested cooperative principles for a broad range of entities and purposes.

The cooperative industry includes many interests, including, but not limited to, farmers, consumers, financial groups, and insurance organizations. In the Act, a “cooperative” is defined as an unincorporated association (a “limited cooperative association”) of individuals or businesses that unite to meet their mutual interests by creating and using a jointly owned enterprise. The Act contemplates the formation of various types of limited cooperative associations, including marketing, advertising, bargaining, processing, purchasing, real estate, and worker owned cooperatives. A limited cooperative association under the Act can be organized to pursue any lawful purpose. For example, the Act would allow a group of wheat farmers to build a value-added pasta facility, keeping their business in a cooperative form while being able to attract and utilize investment capital. It might also be used by an urban food cooperative to attract investment capital to build facilities for the operation of the cooperative’s business.

Key highlights of the ULCAA include:

- Article 1 sets the operating definitions for the Act, and outlines the nature and powers of limited cooperative associations. Article 1 also deals with the effect of organic rules, required record retention, process service, and business dealings between members and the limited cooperative association.
- Article 2 outlines the form for records required to be filed with the state agency that regulates business entities, and the procedures for signing and filing of records with that appropriate agency. Article 2 also provides the form and content of the limited cooperative’s annual report to the responsible agency, and designates the appropriate state law governing filing fees.
- Article 3 governs the formation process for limited cooperative associations under the act, the required contents of articles of organization and bylaws, and the initial organizing directors. Article 14 of the Act governs amendments and restatements (and the requirements for such) to the organic rules of an association.
- Article 4 prescribes the qualifications for membership in a limited cooperative association, and the rights and powers that come with belonging to the organization. The article also addresses the required Annual Meeting of members and procedures for calling special members’ meetings. The article delineates the procedures for providing notices for member

meetings, quorum and voting, the allocation of voting power among patron members, voting by investor members, and action taken without meetings.

- Article 5 states that patron and investor member interests are personal property, and consist of governance rights, financial rights, and the possible right or obligation to do business with the association. The Act defers to the organic rules on transferability of interests and (in some cases) security interests in members' rights and set-offs, but in the event the rules are silent, does not allow transfer or security interests in non-financial rights. Article 5 also allows charging orders against debtor-members or transferees.

- Article 6 authorizes marketing contracts between the limited cooperative association and third parties (not necessarily patron members). If a marketing contract is for the sale of products, commodities, or goods to an association, then title transfers to the association absolutely upon delivery, or upon a specific time expressly provided for in the contract. The Act also authorizes the association to create an enforceable security interest in the products, commodities, or goods delivered, and to sell such, and pay the sales price on a pooled (or other) basis after deducting selling and processing costs, expenses, overhead, etc. Initially, marketing contracts cannot last longer than 10 years, but they may be made self-renewing for additional 5-year periods.

- Article 7 provides for the directors of the limited cooperative association, their qualifications, and their authority and powers. The article gives procedures for the election of directors and provides a default term of service in the event that the organic rules are silent on term length. In the event of a director's resignation, removal, or suspension from the board, or if a vacancy occurs otherwise, the article sets forth (at a minimum) default provisions on filling the vacancy while permitting a great deal of flexibility to the organic rules to tailor procedures to the association's needs. The article also details meeting and notice procedures for the board, and various rights and standards of conduct for directors, and gives authority for the appointment of association officers. Article 8 establishes the governing law for indemnification of other individuals who incur liability on behalf of the association and grants authority to the association to purchase insurance on these parties' behalf. Article 16 outlines member-approved and non-member-approved disposition of the association's assets.

- Article 9 states that (unless otherwise provided by the association's organic rules), member contributions to a limited cooperative association may consist of tangible or intangible personal property, or any other benefit to the association, including money, labor, services, promissory notes, agreements to contribute, and contracts to be performed. The board may determine the "value" of the contribution for purposes of determining whether a member has met its obligation to contribute. Unless an agreement to make a contribution varies the statutory requirements, Article 9 provides default provisions on contribution agreements and their obligation on members. Profits and losses must be allocated between patron members, unless the organic rules provide otherwise, and the patron membership cannot be allocated any less than 50% of profits even if investor members are allowed. Subject to the rules, before determining the amount of profits, the board may set aside a portion of the profits to create or accumulate: a capital reserve; reasonable reserves for specific purposes, such as expansion or replacement of capital assets, or education, training, and information. Distributions may be made in any form, including cash, capital credits, allocated patronage equities, etc. The interest of patron members in limited cooperative associations under the Act enjoy the same exemption from state securities laws that they would in similar cooperative associations under existing law.

- Articles 10 and 11 deal with the right of a member to dissociate and its effect, and dissolution of the limited cooperative association (judicial, voluntary, and administrative). Article 12 establishes the right of a member to maintain a derivative action to enforce an

association's right where the association fails to will not enforce that right. Article 15 governs the requisite process and filings for conversion of a limited cooperative association to another entity (or vice versa), and the effect of conversion on the rights, duties, liabilities, immunities and debts of the converting entity

- Article 13 allows "foreign" cooperatives to apply for and receive a certificate of authority to transact business in the enacting jurisdiction.

The Uniform Limited Cooperative Association Act offers cooperatives and their members a statutory mechanism that embodies the traditional elements of cooperative associations, and recognizes the changing needs and trends that cooperatives face. It recognizes the varied purposes a cooperative can and should be used for, and provides flexibility in their organization and development. The Act provides an effective vehicle for cooperatives to organize, develop, and thrive, and the Act should be enacted by all states."

Three states enacted The Uniform Limited Cooperative Association Act during the 2007-2008 state legislative session; Nebraska (LB 848), Oklahoma (SB 1708) and Utah (SB 69) .

According to NCCUSL legislative tracking, the ULCAA has been enacted in Nebraska, Utah, and Oklahoma as of June 15, 2009.

The following text is the *Prefatory Note* to the Uniform Limited Cooperative Association Act. by the National Conference of Commissioners on Uniform State Laws.

The Uniform 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 Iliopoulos, *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.

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

Cooperative Principles

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

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

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

Israel Packel, *The Organization and Operation of Cooperatives* p. 5-6 (4th ed. 1970); contra, David Barton, *What is a Cooperative*, in *Cooperatives in Agriculture*, p. 1 (David Cobia, ed., 1989).

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

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

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

Cooperative principles have historical roots that can be traced to the pre-revolutionary period in Pennsylvania where Benjamin Franklin helped form “what is considered the first

formal cooperative business in the United States” in 1752. It was a mutual fire insurance company. Gene Ingalsbe & Frank Groves, Historical Development, in *Cooperatives in Agriculture*, 106 at 110-11 (David Cobia, ed., 1989).

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

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

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

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

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

Justice Brandeis further stated:

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

Id.

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

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

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

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

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

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

Submitted as:

Utah

SB 69

Status: Enacted into law in 2008.