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# The New Uniform Limited Cooperative Association Act: A Capital Idea for Principled Self-Help Value Added Firms, Community-Based Economic Development, and Low-Profit Joint Ventures

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# THE NEW UNIFORM LIMITED COOPERATIVE ASSOCIATION ACT: A CAPITAL IDEA FOR PRINCIPLED SELF-HELP VALUE ADDED FIRMS, COMMUNITY-BASED ECONOMIC DEVELOPMENT, AND LOW-PROFIT JOINT VENTURES

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*Editors' Synopsis: In this Article, the authors, reporters for the newly adopted Uniform Limited Cooperative Association Act, discuss extensively the new uniform act. The authors survey the uniform act's various features. The Article serves as a thorough guide to the limited cooperative association, outlining the various considerations that go into creating this business entity, including creation, taxation, allocation of profits and losses, dissociation, winding-up, and dissolution.*

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## I. INTRODUCTION

The Uniform Limited Cooperative Association Act (ULCAA)<sup>1</sup> and the limited cooperative association (LCA) it spawns, is an evolutionary outgrowth of state unincorporated law featuring strong component parts of cooperative principles and values. These principles and values reflect the importance of patron members. Patron members, by design, are owners and users of the association; they are the association's owners and its primary customers or clients.

In recognizing the central role of the entire list of cooperative principles, however, ULCAA adapts two key cooperative principles to increase an entity's ability to attract equity beyond the limitations of patron members alone. It does so by permitting, but not requiring, an LCA to admit active investment members. Investor members, under the organic rules of a specific association, may share in the association's profit and may have a significant voice in its management. ULCAA is a separate and distinct freestanding act that does not repeal or amend any existing cooperative statutes or vary any regulatory law that generally applies to cooperatives.

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<sup>1</sup> 6A U.L.A. 141 (2008).



The purpose of this Article is to detail and analyze ULCAA in a relatively comprehensive way. All of Part V, which comprises over half the Article, is devoted to this purpose. Part V is designed to be both a discussion of ULCAA and a resource for later reference.

Fully understanding ULCAA and its individual provisions requires some basic awareness of its historical, legal, and business context. Part III of this Article provides context by placing the LCA within the law and lore of traditional state cooperative law and taxation. Part III also discusses cooperative principles and ULCAA's reasoned derivations from their standard interpretation. The comparative state chart, appearing as an appendix to this Article, provides further context for ULCAA by comparing its most basic features with those of the statutes upon which ULCAA developed and with statutes that were closely derived from ULCAA. Further, because LCAs are a relatively new addition to the entity choice algorithm, Part IV contains orienting suggestions for possible LCA uses. Part II, immediately following this introduction, begins the analysis with an executive summary of the Article, followed by the procedural history of ULCAA, including reasons for the genesis of the Act.

The Article is designed to be read and used in alternative ways dependent on the particular needs of the readers. It may be read from beginning to end, or read selectively. For example, readers with a solid background in cooperative law might skip much of Part III while readers with little background and desiring only an overview might choose to read only Parts II through IV. Another finding guide is the use of cross-referencing notes in Part II's Executive Summary and throughout the Article. The Article also contains notes to cooperative sources and literature.

## **II. ULCAA: EXECUTIVE SUMMARY, PERCEIVED NEED AND PROCEDURAL HISTORY**

### **A. ULCAA: An Executive Summary**

The Uniform Law Commission (ULC) promulgated ULCAA at its Annual Meeting in August 2007. ULCAA is functionally similar to the Minnesota Cooperative Associations Act adopted in 2003, which, in turn, evolved from an act adopted in Wyoming in 2001.<sup>2</sup> While the ULC was considering ULCAA, four other states adopted statutes, and three

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<sup>2</sup> See *infra* notes 34–36, 43–47 and accompanying text; State Comparative Chart, *infra* Appendix.

states—one state replacing its existing statute—adopted ULCAA the year following the year in which it was promulgated.<sup>3</sup>

ULCAA's primary purposes are to provide a uniform act on a subject of manifested general interest in state legislatures and to provide a vehicle for economic development. ULCAA is not intended to replace any existing state cooperative statutes. Rather, it is intended to provide another alternative entity choice to limited liability companies (LLCs), traditional corporate cooperatives, and multi-entity structures that include traditional corporate cooperatives.<sup>4</sup>

The entity formed under ULCAA is a "limited cooperative association." The word *limited* serves to distinguish the entity from traditional cooperatives.<sup>5</sup> It is also a reminder that open questions exist under other state and federal law concerning whether any given LCA will be treated as a cooperative or as operating on a cooperative basis for regulatory purposes. "As a matter of general legal principle, regulatory law is simply outside the scope and jurisdiction of [ULCAA] just as it is outside the scope of other statutes addressing the formation and operation of a specific entity."<sup>6</sup> Nonetheless, this common understanding is stated expressly in ULCAA's text to avoid any misunderstanding or unintended consequences. As promulgated, LCAs governed by the ULCAA "may be organized for any lawful purpose, whether or not for profit,"<sup>7</sup> though ULCAA's text indicates the appropriate place for adopting jurisdictions to identify any specific uses or purposes that they may deem inappropriate for LCAs.<sup>8</sup>

Three concepts animate ULCAA: it is a flexible unincorporated entity for state law purposes; it recognizes and reflects many known cooperative principles; and it expressly recognizes patron (user) members and investor (nonuser) members in a way to encourage equity investment in a

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<sup>3</sup> Nebraska first adopted a preliminary draft of ULCAA in 2007 but replaced it with an act based on the final ULCAA version promulgated in 2008. The other states adopting new cooperative associations legislation while ULCAA was being drafted were Tennessee, Iowa, and Wisconsin. In 2008, Utah and Oklahoma adopted ULCAA-based acts. Oklahoma's act was declared unconstitutional because of an infirmity concerning legislative procedure. See State Comparative Chart, *infra* Appendix.

<sup>4</sup> See *infra* Part II.B.

<sup>5</sup> See *infra* notes 57–58 and accompanying text.

<sup>6</sup> UNIF. LTD. COOP. ASS'N ACT, Prefatory Note, 6A U.L.A. 153 (2008); see generally *infra* Part V.H.

<sup>7</sup> UNIF. LTD. COOP. ASS'N ACT § 105(b), 6A U.L.A. 168; see *infra* notes 59–64 and accompanying text.

<sup>8</sup> See UNIF. LTD. COOP. ASS'N ACT § 105, 6A U.L.A. 168.

cooperative-based entity.<sup>9</sup> Unfortunately, these animating concepts sometimes conflict when applied to discrete operating provisions. In those instances one or all of the guiding concepts must be compromised. These compromises in large part define both ULCAA and the LCA organized pursuant to it.

LCAs are unincorporated entities under ULCAA and many of ULCAA's provisions are closely derived from the Revised Uniform Limited Liability Company Act (RULLCA)<sup>10</sup> and the Uniform Limited Partnership Act (ULPA).<sup>11</sup> For example, a member's interest in an association is personal property and includes financial rights that are very similar to transferable interests under RULLCA and ULPA.<sup>12</sup> The financial interest is subject to charging orders for the benefit of members' or transferees' judgment creditors. The dissociation and dissolution provisions of ULCAA, too, are aligned very closely to those in RULLCA and ULPA.<sup>13</sup>

The provisions relating to contributions, allocations, and distributions are grounded solidly in unincorporated law. However, ULCAA contains a unique and significant mandatory constraint on allocations.<sup>14</sup> This constraint reflects two cooperative principles. The first principle can be summarized as requiring patron members (user members) to have *economic participation*, but it is frequently translated in the cooperative world as *benefits proportional to use*.<sup>15</sup> The second principle is alternatively stated as *limited return on equity capital* or *subordination of capital*.<sup>16</sup> The compromise allocation constraint is that allocations in LCAs under ULCAA must meet a 50% test. That is, patron members must be allocated at least one-half of the association's profits and losses under a prescribed operational test. For purposes of meeting this important test, the definition of *profit* grants flexibility to conform to the needs of a given association.<sup>17</sup>

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<sup>9</sup> See *infra* note 32 and accompanying text.

<sup>10</sup> 6B U.L.A. 407 (2008).

<sup>11</sup> 6A U.L.A. 325 (2008).

<sup>12</sup> See *infra* notes 346–53 and accompanying text.

<sup>13</sup> See *infra* Part V.B.2.

<sup>14</sup> See UNIF. LTD. COOP. ASS'N ACT, Prefatory Note, art. 10 Preliminary Cmt., § 1004, and cmt., 6A U.L.A. 151–52, 262, 265–70 (2008).

<sup>15</sup> See generally *infra* notes 83–86 and accompanying text.

<sup>16</sup> See *id.*

<sup>17</sup> See UNIF. LTD. COOP. ASS'N ACT § 1004(c), 6A U.L.A. 265; *infra* notes 404–05 and accompanying text.

The real importance of the allocation provision is easy to miss: ULCAA permits but does not require investor members; and, investor members may share in profit. An LCA's extent of ability to allocate profits to nonpatron (investor) members is one of the distinguishing features between ULCAA and traditional corporate cooperative law.

Another cooperative principle is democratic patron member control.<sup>18</sup> As a result, ULCAA adopts a mandatory centralized management structure with a board of directors, as is common in traditional cooperatives. Board composition and election are central to ULCAA's control features. For example, if the board has nine or more members, at least one-third of the board members must be patron members. Furthermore, a majority of the board members must be elected by patron members.<sup>19</sup>

The other level of analysis for patron member control is member voting on amendments to the organic rules and fundamental changes. ULCAA requires a two-tier voting structure. For example, on issues requiring a two-thirds membership vote: (1) a majority of patron member voting power present at the meeting must vote affirmatively on the matter; and (2) the total vote—the aggregate of patron members and investor members present—must meet the two-thirds threshold.<sup>20</sup> This ULCAA formulation differs from all other non-ULCAA based unincorporated cooperative association statutes and has been amended in one adopting state.<sup>21</sup>

Two other features need to be discussed as a matter of executive summary. The first feature concerns the standard of conduct, liability, conflict of interest, and indemnification of directors. Here, again, ULCAA provides a rather novel solution. Simply put, ULCAA integrates these provisions from either the existing corporate or cooperative law of the adopting state.<sup>22</sup> ULCAA, however, contains a major modification to the imported provisions. The Act expressly allows the board to consider other constituencies, the community, and cooperative principles and values for its decisions.<sup>23</sup>

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<sup>18</sup> See generally *infra* notes 83–86 and accompanying text.

<sup>19</sup> See UNIF. LTD. COOP. ASS'N ACT, Prefatory Note, § 804(a)(2), 6A U.L.A. 148, 244; *infra* Part V.E.3.

<sup>20</sup> See UNIF. LTD. COOP. ASS'N ACT § 405 cmt., 6A U.L.A. 205–06; *infra* Part V.E.3; State Comparative Chart, *infra* Appendix.

<sup>21</sup> See State Comparative Chart, *infra* Appendix.

<sup>22</sup> See *infra* note 673 and accompanying text.

<sup>23</sup> See generally *infra* notes 683–87 and accompanying text.

The final animating feature of ULCAA concerns the rules that govern the association. LCAs are governed by organic rules, which are the articles of organization and bylaws. LCAs differ in several respects, however, from their corporate cousins and, indeed, are similar to at least one of the first LLC statutes.<sup>24</sup> The articles of organization are filed publicly and are the highest authority of organic rules. Articles of organization may be amended only with a supermajority vote of the members.<sup>25</sup> The default rule is that the bylaws, with one exception, may be amended by majority vote of the members but the articles of organization may delegate the power to amend to the board.<sup>26</sup> The exception concerns five specified fundamental items that may be amended only by supermajority member vote whether they appear in the articles of organization or the bylaws.<sup>27</sup>

Of course, ULCAA's express provisions are also part of the governing rules of an LCA. ULCAA, like its uniform law unincorporated entity counterparts, contains a section delineating the interpretive architecture of the Act. Here, too, ULCAA takes an approach that reflects the unique nature of the LCA.<sup>28</sup>

All these matters, and others, receive more comprehensive treatment in Part V of this Article.

## B. The Need for ULCAA and Its Procedural History

In 2002, the ULC established a Study Committee on an agricultural or business cooperative act. The Study Committee completed the Study Committee Report in June 2003, and ULC approved a drafting project the same year based, at least in part, on that report.<sup>29</sup>

The Study Committee was "to review state cooperative law, with an initial charge to contact potentially interested groups . . . to evaluate the viability, need, and support for such a project."<sup>30</sup> The charge added that

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<sup>24</sup> See UNIF. LTD. COOP. ASS'N ACT, Prefatory Note, 6A U.L.A. 147 (2008); *infra* note 256 and accompanying text.

<sup>25</sup> See UNIF. LTD. COOP. ASS'N ACT § 405(a), 6A U.L.A. 203; *infra* notes 652, 662–63 and accompanying text.

<sup>26</sup> See UNIF. LTD. COOP. ASS'N ACT § 405(a), 6A U.L.A. 203.

<sup>27</sup> See *id.* § 405(c), 6A U.L.A. 204.

<sup>28</sup> See *id.*

<sup>29</sup> See Memorandum prepared for the NCCUSL Study Committee on a Business Cooperative Act (June 20, 2003) [hereinafter Study Report] (on file with Thomas Earl Geu).

<sup>30</sup> *Id.* at 1.

“the initial scope of the study authorized by the resolution be limited to farm and related cooperatives.”<sup>31</sup>

The original policy reason for the study was to explore whether an unincorporated cooperative association act might enhance rural economic development.<sup>32</sup> The impetus for the study, however, was the Wyoming Processing Cooperative Law, enacted in 2001,<sup>33</sup> and the Minnesota Cooperative Association Act, enacted in 2003.<sup>34</sup> The Study Report noted that Iowa had studied legislative activity as early as 1996<sup>35</sup> and that Wisconsin introduced legislation similar to Minnesota’s.<sup>36</sup>

In addition to studying state legislative activity, the Study Report: noted awareness of the new statutes within the cooperative industry, reviewed academic scholarship on the cooperative structure, and found anecdotal evidence of structural change and innovation within the existing cooperative structure in the agricultural sector.

For example, the Study Report quoted and summarized materials presented by J. Gary McDavid at a conference of the Legal, Tax and Accounting Committee of the National Council of Farmer Cooperatives in 2002. The Study Report stated:

[McDavid] also identified several current structural challenges for cooperatives (and the viability of cooperative business organizations) given the advent of other entity choices. Structural challenges included “lack of outside equity” and the “inability to access going concern value.” Other challenges included “competition from LLCs” and the desire of investment return on the part of member-investors and stock options in order to retain qualified management. Specifically [McDavid] stated, “some cooperatives have converted to LLCs and many new ventures are structured as LLCs [because] LLCs are flexible vehicles and allow patronage and non-

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<sup>31</sup> *Id.*

<sup>32</sup> *See id.*; *see generally* Memorandum on the Agricultural and Agricultural Related Cooperative Act Proposed Scope and Name Change (NCCUSL) (June 2005) [hereinafter Proposed Scope Memorandum] (on file with Thomas Earl Geu).

<sup>33</sup> *See* WYO. STAT. ANN. §§ 17-10-201 to -253 (2005).

<sup>34</sup> *See* MINN. STAT. ANN. §§ 308B.001–.971 (West 2004 & Supp. 2008).

<sup>35</sup> *See* Study Report, *supra* note 29, at 11.

<sup>36</sup> *See id.* at 12.

patronage income to pass through to the members [with a single level income tax].”<sup>37</sup>

The Study Report determined McDavid’s presentation material was consistent with agricultural economist Michael L. Cook’s theoretical academic research conducted in 1995 and empirically confirmed in 1996 and 1997.<sup>38</sup> Cook summarized the five problems inherent within traditional cooperative structure as “vaguely defined property rights.”<sup>39</sup>

The Study Report did not cite a 2002 article appearing in *The McKinsey Quarterly*. The *McKinsey* article stated that the performance of one of “the [agricultural] industry’s traditional business models [the agricultural cooperative]” contributed to “destroy[ing] value.”<sup>40</sup> The article added, “most co-ops have . . . changed,” but “the world around them has changed even more.”<sup>41</sup> The article further observed that cooperatives using hybrid structures outside traditional single entity cooperative organizations had enjoyed success.<sup>42</sup>

ULCAA was adopted by the ULC at the organization’s annual meeting in July 2007, four years after the ULC formed the Drafting Committee.<sup>43</sup> Four additional states adopted unincorporated cooperatives statutes between the Drafting Committee’s formation and the adoption of the final Act: Tennessee (2004),<sup>44</sup> Iowa (2005),<sup>45</sup> Wisconsin (2006),<sup>46</sup> and

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<sup>37</sup> *Id.* (quoting J. Gary McDavid, *Evolving Cooperative Structures*, COOPERATIVE ACCT., Fall 2002, at 4).

<sup>38</sup> *See id.* (citing Michael L. Cook, *The Future of U.S. Agricultural Cooperatives: A Neo-Institutional Approach*, 77 AMER. J. AGR. ECON. 1153, 1156 (1995), and Michael L. Cook & Constantine Iliopoulos, *Beginning to Inform the Theory of the Cooperative Firm: Emergence of the New Generation Cooperative*, 1999 FINNISH J. BUS. ECON. 525, 530, available at <http://www.pellervo.fi/finncoop/material/cook.pdf>).

<sup>39</sup> Study Report, *supra* note 29, at 12 (quoting Cook, *supra* note 38, at 1156) According to Cook’s article, a free-rider problem exists for open-membership cooperatives because new members receive the same patronage dividends as do members who originally invested in the cooperative: Portfolio and horizon problems, due to lack of share transferability, and control and influence cost problems (for example, agency cost and monitoring costs), inherent in any nonpublicly traded businesses, are present in cooperatives.

<sup>40</sup> Jack J. Dempsey et. al., *A Value Culture for Agriculture*, THE MCKINSEY Q. 64, 64–66 (2002).

<sup>41</sup> *Id.* at 65.

<sup>42</sup> *See id.* at 66.

<sup>43</sup> *See* UNIF. LTD. COOP. ASS’N ACT, 6A U.L.A. 141 (2008).

<sup>44</sup> *See* TENN. CODE ANN. §§ 43-38-101 to -1109 (2007).

<sup>45</sup> *See* IOWA CODE ANN. §§ 501A.101–.1216 (West 2008).

Nebraska (2007).<sup>47</sup> The Tennessee, Iowa, and Wisconsin statutes are based generally on the Minnesota law.<sup>48</sup> Nebraska's original statute was based on an interim draft of ULCAA, but the state enacted the final version, with some modifications, a year later in 2008. Utah and Oklahoma adopted ULCAA in 2008 after ULCAA's final version was promulgated.<sup>49</sup>

Concurrent with the deliberation of ULCAA, the policy merits of the unincorporated cooperative entity concept and the Wyoming and Minnesota statutes' technical provisions continued to be debated in other venues. For example, a news report about a United States House of Representatives Agricultural Committee hearing in October 2003 stated:

Throughout the day, numerous references—pro and con—were made to the new Minnesota and Wyoming cooperative incorporation laws. Some said those laws go too far in expanding the co-op model and that co-ops organized under those statutes are vulnerable to takeovers by outside investors who may have little real interest in the fate of producers or rural communities. Further, they said if the nation winds up with 50 different definitions of what a cooperative is, it will lead to chaos.

“When is a cooperative no longer a cooperative?” was asked several times . . .

But others said that these new state laws are at least a step in the right direction, and that without changes such as they encourage, producers will be locked in a downward spiral. They will continue to lose the control in ag industries that they and their predecessors fought so hard to establish during the past century. They predicted that increasing numbers of co-ops will reluctantly

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<sup>46</sup> See WIS. STAT. ANN. §§ 193.001–.971 (West Supp. 2008).

<sup>47</sup> See NEB. REV. STAT. §§ 21-2901 to -29,134 (2007).

<sup>48</sup> See generally *infra* State Comparative Chart, Appendix.

<sup>49</sup> See OKLA. STAT. ANN. tit. 18, §§ 440-110 to -1704 (West Supp. 2009); UTAH CODE ANN. §§ 16-16-101 to -1703 (Supp. 2008). However, the Oklahoma Supreme Court declared that state's version of the Act unconstitutional on procedural grounds. See *Weddington v. Henry*, 202 P.3d 143 (Okla. 2008).



have to change their business structure to [LLCs], or some type of hybrid LLC co-op.<sup>50</sup>

The same news article quoted Thomas Dorr, Under Secretary for United States Department of Agriculture (USDA) Rural Development, as saying, in effect, “that impediments to attracting non-producer equity to co-ops can be found in federal and state laws enacted several decades ago” and directly quoted him as saying, “[i]f non-producer outsiders are to invest in a cooperative, they may well expect to have a voice in its affairs and the opportunity to earn a return on their investment commensurate with the success of the cooperative.”<sup>51</sup> The article also quoted testimony indicating that, in the value-added context, there “are numerous examples of . . . cooperatives that have converted to LLCs or formed LLC joint ventures with other co-ops or investor-owned corporations.”<sup>52</sup>

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<sup>50</sup> Dan Campbell, *Congressional Hearing Focuses on Possible Need for More Flexible Business Model*, RURAL COOPERATIVES, Nov./Dec. 2003, at 9, available at <http://www.rurdev.usda.gov/rbs/pub/nov03/nov03.pdf>.

Whether a cooperative is a cooperative depends upon one’s purpose for asking the question. Regulation and taxation schemes for cooperatives formed for different purposes provide distinct and separate requirements and restrictions. *See generally* James B. Dean & Thomas Earl Geu, *The Uniform Limited Cooperatives Association Act: An Introduction*, 13 DRAKE J. AGRIC. L. 63, 64–71 (2008). Packel viewed principles as “characteristics” and stated: “No single characteristic is necessarily all-controlling.” ISRAEL PACKEL, *THE ORGANIZATION & OPERATION OF COOPERATIVES* 5 (4th ed. 1970). A recent news story about cooperatives in Vermont captures the same sense of meaning as Packel by stating: “[A] certain amount of fuzziness surrounds the concept of a ‘cooperative.’ How do they differ from other traditional business entities or nonprofit organization[s]? Perhaps the definition is best provided by example.” Stephen Morris, *The State of Co-Ops: The Business Model Is Popular in Vermont. Why Is That?*, SUNDAY RUTLAND HERALD & SUNDAY TIMES ARGUS, Jan. 6, 2008, at 8, available at <http://www.vermonttoday.com/apps/pbcs.dll/article?AID=2008462833838>. For a general discussion of cooperative history, see *infra* Part III.A.

<sup>51</sup> Campbell, *supra* note 50, at 10 (internal quotations omitted).

<sup>52</sup> *Id.* Elsewhere, the co-authors of the present Article have stated:

The history of legislation is not the complete contextual narrative for this type of statute. Rather, the statutes seem to reflect need and practice within the cooperative sector and to implicitly recognize a trend to use cooperatives as a component part of larger synthesized multi-entity organizational structures. To some extent, therefore, the legislation on which ULCAA is based is reactive rather than revolutionary. For example, a 2004 article in *Rural Cooperative Magazine* reported how a South Dakota cooperative worked through the need for capital to build an ethanol plant. Ultimately, the co-op used Glacial Lakes Capital, LLC, a limited liability company (LLC) to solve the need for equity. Before settling on this form, the

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cooperative looked into partnerships with other entities. The group chose a free-standing LLC form rather than a joint venture form because partnering with other entities “soon ran into issues over who would control the cooperative.” Further:

Says Tom Branham, the current general manager, “the problem was, they [other entities] wanted management of the plant as part of the deal. The co-op members weren’t ready to accept being, as they saw it, passive spectators in their own operations. The alternative was raising the funds from individuals, not necessarily farmers—but this meant moving away from a strict farmer’s co-op model.

The Glacial Lakes project illustrates and evidences the use of LLC structures to form free-standing entities without any state law cooperative restraints. Another example of pure LLC planning involved the suggested sale of assets from a cooperative to its LLC subsidiary as described in Michael Boland and David Barton, “South Dakota Soybean Processors: Joint Ventures and Strategy,” Agricultural Marketing Resource Center, Arthur Capper Cooperative Center, Department of Agricultural Economics, Kansas State University (January 2003). Finally, the NCFC recently completed a member survey. The Farm Credit Council website quotes the president and CEO of NCFC as stating: “We were struck by the number of co-ops using other structures beneath the co-op umbrella.” And further: “You have LLCs, partnerships, joint ventures and other strategic alliances . . . [m]ost often it’s to acquire added equity capital . . .”

These anecdotes support a more general summary in a publication explaining the Tennessee Processing Cooperative Law published by the Extension Service at the University of Tennessee. It states:

[P]roducer-driven, value-added projects are often structured as joint ventures involving both a cooperative and a partnership or LLC. Some existing new-generation cooperatives have also converted . . . [into] the more flexible LLC format. Many existing cooperatives, including traditional cooperatives, have also turned to the LLC structure when setting up joint ventures or new, wholly-owned, non-member business ventures.

Thomas Earl Geu & James B. Dean, *The Uniform Limited Cooperative Association Act: Comparative Leverage Points and Principles*, COOPERATIVE ACCT. (forthcoming 2009) (footnotes omitted) (citing Steve Thompson, *Community Investments Helped Launch Plant, Rural Cooperatives*, July/Aug. 2004, at 21, available at <http://www.rurdev.usda.gov/rbs/pub/jul04/jul04.pdf>; *Iowa Farmers Find a New Way to Build an Ethanol Plant*, Farm Credit Council, <http://www.fccouncil.com/uploads/CoBank%20Testimonial.pdf> (last visited May 31, 2009); Phil Kenkel, *New Cooperative Statutes*, in COMMENTARY AND OVERVIEW OF THE TENNESSEE PROCESSING COOPERATIVE LAW 20 (2004), available at <http://cpa.utk.edu/pdf/PB1748.pdf>).

The use of multiple-party joint ventures that include cooperatives and existing cooperatives conversion to LLCs can be interpreted different ways in the context of the evolution of unincorporated cooperatives with investor members optional. One

Mark Hanson, private practitioner, is recognized as the primary draftsman for the Wyoming and Minnesota statutes.<sup>53</sup> He has commented:

For most corporate cooperatives, the amount of non-patron investment is increasing and for some corporate cooperatives, as allowed by Chapter 308A [Minnesota's corporate cooperative statute] and the corporate cooperative statutes of most states, the amount of non-patron investment exceeds the amount of patron investment . . .

....

Under many of the corporate cooperative statutes, a cooperative can be financed by 100 percent non-patron investment and under the commodity marketing act statutes, preferred stock can have voting rights . . .<sup>54</sup>

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interpretation is that entities or multiple-entity structures already are available and, therefore, another entity is unnecessary (at best) or damaging to cooperative values (at worst). A response to this interpretation is possibly for patron members of a cooperative to join a venture with, for example, an LLC that provides financing and management services. Legislation providing for LCAs, therefore, is simply a matter of legal efficiency. Moreover, allocations or control are not limited at the joint venture level, and cooperative principles and value are not applicable at that level. Worse, from that perspective, the joint venture agreement may not be transparent for members of the constituent cooperative.

The use of multiple-entity joint ventures may be why some existing non-ULCAA-based unincorporated cooperative association laws provide lower floors on allocations to patron members than does ULCAA. *See generally infra* State Comparative Chart, Appendix (*compare, e.g.,* Minnesota Cooperative Associations Act, *with* ULCAA under the column labeled "allocations"). As a result ULCAA is at a comparative disadvantage with statutes like Minnesota's for use as a substitute entity for joint ventures in some circumstances. ULCAA's higher allocation floor was a policy decision based on the cooperative principle that financial return is for those who use the cooperative as patron members.

If, on the other hand, an LLC is chosen as an organization's structure (or a traditional cooperative converts to an LLC), there may be no legal source of cooperative values at all except, perhaps, for federal income tax law. However, cooperative tax law will apply only if the LLC is to be taxed as a corporation. *See infra* note 183 and accompanying text (discussing, briefly, LLCs taxed as a corporation eligible for treatment as a cooperative under Code Subchapter T). ULCAA's primary or widest use may be as a substitute entity for organizations that otherwise would be formed as LLCs.

<sup>53</sup> *See* Tom Bengtson, *The Latest New Generation Cooperatives*, Vol. 188, NW. FIN. REV., Issue 21, Nov. 1, 2003, at 16, available on Westlaw at 2003 WLNR 10000843.

<sup>54</sup> *Id.* *See generally* UNIF. LTD. COOP. ASS'N ACT, Prefatory Note, 6A U.L.A. 142 (2008).

A sharp diversity of opinion therefore exists concerning unincorporated cooperatives that permit nonpatron member investment.<sup>55</sup> In response to criticism of other statutes, ULCAA attempts to recalibrate the balance between provisions reasonably necessary to attract outside capital, such as voting and financial return, and traditional cooperative values as they have evolved differently across different industries.<sup>56</sup>

In addition, and again in response to criticism of the other statutes, ULCAA introduced *limited* to the name of an entity formed pursuant to the Act. The purpose of the addition of *limited* is to help distinguish those entities organized under ULCAA from entities formed under more traditional corporate cooperative law.<sup>57</sup> The process to make the name change began within the ULC formally in the summer of 2005 with strong support of several observers to the drafting committee.<sup>58</sup>

Another noteworthy change during the drafting process also happened in 2005. The change was the deletion of any limiting reference to *agricultural or agriculturally related*, either in the name of the Act, or in

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<sup>55</sup> One of the stated concerns from within the existing cooperative community is that ULCAA will “fundamentally alter the definition of a cooperative” and create “uncertain[ty] about the benefit of new statutes allowing non-patron investors to claim governance and financial rights in a cooperative.” Letter to Peter Langrock, Drafting Committee Chair, from the CEOs of the Credit Union National Association, National Association of Federal Credit Unions, National Association of Housing Cooperatives, National Cooperative Business Association, National Rural Electric Cooperative Association, and National Telecommunications Cooperative Association (June 7, 2005) (on file with Thomas Earl Geu) (also urging the ULC to move deliberately and allow time for maximum input from the industry and others).

<sup>56</sup> See generally notes 12–19 and accompanying text; *infra* State Comparative Chart, Appendix; see also James R. Baarda, “Outside” Cooperative Equity: Obligations, Tradeoffs, and Fundamental Cooperative Character, NCR-194 Conference, Nov. 2, 2004, available at <http://ageconsearch.umn.edu/bitstream/31792/1/cp04ba10.pdf> (providing a detailed analysis of disadvantages of using nonpatron member equity in ventures organized as cooperatives). Baarda is an Agricultural Economist, Cooperative Services, Rural Business-Cooperative Service, U.S. Department of Agriculture. See *id.*

<sup>57</sup> See Letter in Support of Name Change to Peter F. Langrock from the CEOs of National Cooperative Business Association, National Rural Electric Cooperative Association, Credit Union National Association, National Association of Federal Credit Unions, National Association of Housing Cooperatives, and National Telecommunications Cooperative Association (November 6, 2006) (on file with Thomas Earl Geu) (listing concerns regarding democratic member control, subordination of capital, and operation at cost).

<sup>58</sup> See Proposed Scope Memorandum, *supra* note 32. The memo did not propose the name limited cooperative, but it began further discussion within the ULC and the Drafting Committee that ultimately resulted in the change.

its text. The Drafting Committee memorandum requesting the change in the scope of the project identified the following reasons for the change:

1. At the time of the request, the Minnesota law, and others under consideration of other states, did not contain the limitation;<sup>59</sup>
2. The existence of a very general trend among traditional cooperative law toward a general purpose with specific exceptions for special types of cooperatives;<sup>60</sup>

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<sup>59</sup> See *id.* at 3 (referencing the Iowa and Wisconsin legislation as pending at that date).

<sup>60</sup> See *id.* The memorandum represented that use of the terms *agricultural and agriculturally related* was a matter of floor comment at the 2004 ULC Annual Meeting. The floor comment addressed both the definition and the policy of restricting the scope of the Act. The report stated, in part:

(2) Drafting Committee “Agricultural” Definition Discussion

The Drafting Committee has made a good faith attempt to capture what is meant by “Agricultural and Agriculturally Related” and the definition (as well as the scope) was a matter of floor comment at the 2004 Annual Meeting in Portland. It was also a matter of discussion by the Scope and Program Committee when the Drafting Committee was formed.

The various definitions that have been discussed include those from Capper-Volstead, the 1929 Marketing Act and income tax (all at the federal level). Initially the definition from the Wyoming Processing Cooperative Act was used.

None of those definitions have proved satisfactory because (a) they are narrowly defined and do not accomplish the original purpose of the Committee charge to encourage rural economic development; and (b) adding additional language to meet the charge and specific contemplated uses makes the definition, at best, uncertain and confusing. As a result, the Committee’s current draft uses the terms “agricultural” and “agriculturally related” without definition; tentatively deciding that other law in each state would need to be consulted for context. In other words, the Committee decided any attempted definition caused more confusion than simply leaving the terms undefined.

(3) Intended Use of Statute

Consistent with the current charge, the Committee has attempted to think through the kinds of activities that *should* be contemplated by the act. Obviously, cooperatives that vertically integrate value added processing to agricultural products are squarely contemplated. More difficult definitional questions arise as the concept “agricultural products” is considered (the Committee did reference UCC Art. 9 in its discussion). For example, the Committee reached consensus that agricultural producers should be able to cooperate to pool acres to lease for carbon sequestration purposes in that developing market. The Committee reached consensus, as well, that livestock producers

3. The difficulty and uncertainty any attempt to define *agricultural or agriculturally related* creates;<sup>61</sup> and
4. The absence of strong policy reasons to narrowly limit the availability of limited cooperatives to one sector of the economy.<sup>62</sup>

Regarding item four above, the scope change request suggests that the Drafting Committee preferred ULCAA contain specific exclusions or, in the alternative, a statutory framework allowing enacting jurisdictions to provide such exclusions for industries.<sup>63</sup> The comparative chart appearing as an appendix to this Article indicates the scope and exclusions that some states have included thus far.<sup>64</sup>

In short, ULCAA followed the lead of independent adoption of unincorporated cooperative statutes in six states. These adoptions evidence an economic need for equity that outstrips its patron members' ability to provide it. The existence of this need is supported by theoretical academic work and reflects what is happening regarding the choice of entity for entrepreneurial activity in the field. The development of ULCAA, how-

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should be able to cooperate for bio-methane production (manure as an agricultural by-product). Both of those uses, however, are difficult to clearly fit into the definitions attempted thus far.

The use of a limitation tied to "producer" was considered. Unfortunately that leads to distinctions, for example, between landowners renting on a cash basis and those renting on crop-share basis. Any such distinction not only adds complexity but is inconsistent with the original charge for economic development. Moreover it affects other provisions in the Act encouraging members to contribute their membership to partnership upon retirement which seems inconsistent with traditional cooperative values (though it is a technique currently used in some of the largest agricultural marketing cooperatives).

The more difficult "purpose" issues, however, occur on the "supply" rather than the "marketing" side of cooperative organizations. For example, one of the popular reported uses of the Minnesota Cooperative Association is in the organization of health care purchasing cooperatives. Are those cooperatives providing "inputs for agricultural production"? Is it a principled policy decision to limit membership in those cooperatives to agricultural producers (no matter of the definition of "agricultural producers")?

*Id.* at 4–5 (citations omitted).

<sup>61</sup> See *id.* at 4.

<sup>62</sup> See *id.* at 5.

<sup>63</sup> But cf. *id.* at 6.

<sup>64</sup> See *infra* State Comparative Chart, Appendix. An early trend to exclude electric distribution cooperatives may exist.

ever, cannot be understood without placing it in the context of the larger history of the cooperative movement and within the framework of cooperative principles. This larger history and the principles are addressed in Part III of this Article.

### III. ULCAA CO-OP COSMOLOGY: HISTORY AND TAXATION

#### A. History and Cooperative Principles

“The social and economic history of the world records innumerable cases of individuals on all continents utilizing collective action to address common social and economic problems by forming cooperatives.”<sup>65</sup> “Cooperation as a basic tenet of civilized society has a broad connotation. Its essence is a joining together to obtain the benefit of association.”<sup>66</sup>

No one has been able to determine when the first formally organized cooperative enterprises began. One of the earliest efforts at cooperative formal organization in the United States was a mutual fire insurance company that Benjamin Franklin helped organize in 1752. Historians suggest this endeavor can be “considered the first formal cooperative business in the United States.”<sup>67</sup> In 1794, Baltimore cordwainers organized a cooperative boot and shoe factory.<sup>68</sup> The Union, a cooperative colony near present Potsdam, New York, was organized in 1804, followed in 1824 by a similar colony in New Harmony, Indiana, and another, the Brook Farm, in Massachusetts in 1841.<sup>69</sup> Cooperative stores, building and loan associations, mutual insurance companies, dairy cooperatives, and other cooperatives in agriculture developed during the nineteenth century.<sup>70</sup>

A modern cooperative, as a formal organization, shares similarities with other types of entities. However, it differs from those organizations because its owners are also its users or customers, and the organization is

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<sup>65</sup> Brian M. Henehan & Bruce L. Anderson, *Considering Cooperation: A Guide for New Cooperative Development*, EXTENSION BULL. 01-01 (Dept. of Applied Econ. & Mgmt., Cornell Univ.), Feb. 2001, at 1, available at <http://aem.cornell.edu/outreach/extensionpdf/eb0101.pdf>.

<sup>66</sup> PACKEL, *supra* note 50, at 1.

<sup>67</sup> Gene Ingalsbe & Frank Groves, *Historical Development*, in COOPERATIVES IN AGRICULTURE 106, 110–11 (David W. Cobia ed., 1989).

<sup>68</sup> See Milton Conover, *The Rochdale Principles in American Co-Operative Associations*, 12 W. POL. Q. 111, 116 (1959).

<sup>69</sup> See *id.*

<sup>70</sup> See *id.* at 116–17.

based on unique historical principles developed by cooperatives over time. ULCAA recognizes these principles and specifically references them in some of its provisions.<sup>71</sup> Nonetheless, beyond general statements, what constitutes a cooperative frequently is argued or misunderstood because cooperatives exist in a range of different ventures. Indeed, it does not seem that a “clear-cut commonly accepted understanding [exists] as to what a cooperative is.”<sup>72</sup>

In a decision addressing whether a stock (corporate) cooperative was the same as a nonstock (membership) cooperative for purposes of an Oklahoma regulatory statute, Mr. Justice Brandeis, joined by Mr. Justice Holmes, opined in dissent, “[T]hat 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. With the expansion of agricultural co-operation it has been recognized repeatedly.”<sup>73</sup> He further stated: “And experts in the Department of Agriculture, charged with disseminating information to farmers and legislatures, have warned against any crystallization of the cooperative plan so as to exclude any type of co-operation.”<sup>74</sup>

A cooperative’s focus on members banding together to improve the individual member’s economic well-being differentiates the cooperative from other types of organizations, even partnerships and LLCs. A cooperative organization is an economic institution, but its principles differentiate it from for-profit corporations in which the economic objective is to benefit investors. On the other hand, the economic incentives of a cooperative’s members differentiate it from not-for-profit corporations.<sup>75</sup> Moreover, adherence to cooperative principles provides a philosophical basis not found in other organizations. Indeed, some commentators suggest that failure to adhere to cooperative principles caused the economic failure of a number of cooperative organizations.<sup>76</sup>

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<sup>71</sup> See, e.g., UNIF. LTD. COOP. ASS’N ACT §§ 104, 113(a), 405, 511–514, 804, 816(a), 1004, 6A U.L.A. 166–270 (2008) (including the nature of LCAs, consent to reflect the voluntary nature of a cooperative organization, and democratic control).

<sup>72</sup> Abigail M. Hind, *The Changing Values of the Cooperative and Its Business Focus*, 79 AM. J. AGRIC. ECON. 1077, 1077 (1997).

<sup>73</sup> *Frost v. Corp. Comm. of Okla.*, 278 U.S. 515, 546 (1929) (Brandeis, J., dissenting) (citations omitted).

<sup>74</sup> *Id.*

<sup>75</sup> See generally PACKEL, *supra* note 50, at 6–10. For related discussion of the distinction of for-profit and not-for-profit in the context of cooperatives, see *infra* Part III.B.4.

<sup>76</sup> See Conover, *supra* note 68, at 117.



Cooperative principles may vary depending on the type of cooperative. Cooperatives of different types and in different industries have developed their own traditions. One type of cooperative may emphasize different principles over those emphasized by other types.<sup>77</sup> As a result, industry context is helpful, if not necessary, to ascertain current animating cooperative principles. For example, in order to qualify for particular federal benefits, agricultural cooperatives generally are required to have more stylized structures than worker-owned cooperatives for which there are few, if any, statutory requirements. Broadly and generally: “The aim [of a cooperative organization] is to ensure a genuine community of interest among a cooperative’s members based on something other than the amount of capital they have placed in the organization.”<sup>78</sup>

Modern cooperative principles and concepts probably emerged from the experiences of the Equitable Pioneers’ Society organized in England in 1844. The Society was formed by laborers to provide goods for themselves and to seek ways in which they might own the tools of commerce to provide for their future.<sup>79</sup> The rules of conduct and points of organization of the Society, published in 1860, coalesced over time into what are commonly called the Rochdale Principles. Although restated over time, the Rochdale Principles generally are considered to be the basis for modern cooperative principles.<sup>80</sup>

One statement of the Rochdale Principles emerged as settled policy in parts of the cooperative movement in the United States beginning in 1875 with the National Grange of the Patrons of Husbandry.<sup>81</sup> More comprehensive histories of cooperatives in the United States can be found in a number of publications.<sup>82</sup>

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<sup>77</sup> See James B. Dean, *Cooperative Businesses*, in PRACTITIONER’S GUIDE TO COLORADO BUSINESS ORGANIZATIONS §§ 11.2, 11.5–.6 (E. Lee Reichert & Allen E.F. Rozansky eds., 2008); see also *infra* Part III.B.2 (categorizing types by use).

<sup>78</sup> Hind, *supra* note 72, at 1077.

<sup>79</sup> See Ingalsbe & Groves, *supra* note 67, at 109.

<sup>80</sup> See David Barton, *Principles*, in COOPERATIVES IN AGRICULTURE, *supra* note 67, at 21, 24.

<sup>81</sup> See PACKEL, *supra* note 50, at 11.

<sup>82</sup> See JOSEPH G. KNAPP, THE ADVANCE OF AMERICAN COOPERATIVE ENTERPRISE: 1920–1945 (1973); JOSEPH G. KNAPP, THE RISE OF AMERICAN COOPERATIVE ENTERPRISE: 1620–1920 (1969); FARMERS COOP. SUC. U.S. DEP’T. OF AGRIC., LEGAL PHASES OF FARMER COOPERATIVES 19 n.47 (1976) [hereinafter LEGAL PHASES]. An article published in 1902 observed that cooperative “ideals were of two perfectly distinct types.” Anonymous, *The Present Ideals of Co-Operation*, 45 ECON. J. 29, 35 (1902), available at <http://www.jstor.org/stable/pdfplus/2959022.pdf>. One type, consumer societies,

Even though rooted in the Rochdale Principles, different versions or lists of cooperative principles have developed. The number of principles identified by different groups or authors varies from three to 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."<sup>83</sup> The 1995 list modified a previous list published in 1966 by deleting business at cost and limited return on capital and adding principles (3), (4), and (7).<sup>84</sup> Identifying a single mandatory list of principles is complicated further because principles are sometimes referred to as characteristics, rules, or practices.<sup>85</sup> One summary of the principles, though inconsistent with several principles listed by the ICA, groups them into four parts: (1) service at cost; (2) financial obligation and benefits proportional to use; (3) limited return on equity capital; and (4) democratic control.<sup>86</sup>

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developed in England: "In the consumers' societies, the English principle, that the society shall be managed by, and its profits shall go to, the purchasers, predominated . . ." *Id.* The other type, productive associations, developed in France: "[A]mong the productive associations the French ideal of the self-governing workshop, owned and managed by the employees, who are to take the profits of the business, prevailed." *Id.*

<sup>83</sup> UNIF. LTD. COOP. ASS'N ACT, Prefatory Note, 6A U.L.A. 145 (2008).

<sup>84</sup> For additional discussion of cooperative principles, see, for example, *id.*; Barton, *supra* note 80. See also Dean & Geu, *supra* note 50.

<sup>85</sup> See PACKEL, *supra* note 50, at 5, 12; see also LEGAL PHASES, *supra* note 82, at 4. In 1965, the United States Tax Court, in determining if a workers' cooperative was a cooperative association for federal income tax purposes, articulated three guiding principles that form the core of economic cooperative theory:

(1) Subordination of capital, both as regards control over the cooperative undertaking, and as regards the ownership of the pecuniary benefits arising therefrom; (2) democratic control by the worker-members themselves; and (3) the vesting in and the allocation among the worker-members of all fruits and increases arising from their cooperative endeavor . . . in proportion to the worker-members' active participation in the cooperative endeavor.

Puget Sound Plywood, Inc. v. Comm'r, 44 T.C. 305, 308 (1965), *acq.*, 1966-2 C.B. 6, cited in Carla Neely Freitag, *Taxation of Cooperatives and Their Patrons*, 744 2d TAX MGM'T PORT. (BNA) A-4 (2007).

<sup>86</sup> See Tammy Meyer, *Understanding Cooperatives: The American System of Business*, in COOPERATIVE INFORMATION REP. 45, § 2, at 2 (U.S. DEP'T OF AGRIC. 1994), available at <http://www.rurdev.usda.gov/rbs/pub/cir452.pdf>.

Most cooperatives are organized under state statutes in the same manner as corporations, LLCs, and limited partnerships. Most current state statutes provide a corporate model for cooperatives, but no fundamental principle exists that requires or even suggests a cooperative must be incorporated. In fact, unincorporated cooperatives currently exist even without ULCAA, which predated the other recent unincorporated cooperative statutes.<sup>87</sup> Many of the state corporate cooperative statutes were adopted between 1910 and 1925.<sup>88</sup> These statutes are typically consistent with the general principles of cooperation regardless of the exact formulation of those principles,<sup>89</sup> but both similarities and substantial differences can be found among them.<sup>90</sup>

While cooperative organizations exist for many purposes,<sup>91</sup> and consumer cooperatives outnumber agricultural and worker cooperatives, no sector of the United States economy exists in which the cooperative form of business has been more important than agriculture.<sup>92</sup> Much of the law that has developed in the United States regarding cooperatives has focused on agricultural (or farmer) cooperatives. Additionally, many federal tax rulings as well as federal and state judicial opinions involve agricultural cooperatives. This likely is because cooperatives have been a prominent factor in the United States rural economy.<sup>93</sup> Nonetheless, many states have laws that address particular types of cooperatives outside of agriculture, such as housing cooperatives, state chartered credit

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<sup>87</sup> See LEGAL PHASES, *supra* note 82, at 499.

<sup>88</sup> See Study Report, *supra* note 29, at 6–7 (quoting Mark Hanson, *Legal Framework of Cooperative Development*, in COOPERATIVES AND DEVELOPMENT 95, 98 (Merritt & Walzer eds., 2004)).

<sup>89</sup> See *id.*

<sup>90</sup> See Hanson, *supra* note 88, at 95; see also James R. Baarda, *State Incorporation Statutes for Farmer Cooperatives*, COOP. INFO. REP. 30, (U.S. DEP'T OF AGRIC./AGRIC. COOPERATIVE SERV., Oct. 1982) (although out of date, an excellent and still useful analysis and comparison of eighty-six state statutes applicable to the organization of agricultural cooperatives).

<sup>91</sup> See *infra* Part III.B.2.

<sup>92</sup> See Carol L. Goforth, *Application of the Federal Securities Law to Equity Interest in Traditional and Value-Added Agricultural Cooperatives*, 6 DRAKE J. AGRIC. L. 31, 33 (2001); see also Terence J. Centner, *Retained Equities of Agricultural Cooperatives and the Federal Securities Acts*, 31 U. KAN. L. REV. 245, 246 (1983).

<sup>93</sup> Nonetheless, questions arise concerning whether cooperatives will retain their preeminence in the field of agriculture. See Terence J. Centner, *The Role of Cooperatives in Agriculture: Historic Remnant or Viable Membership Organization?*, 3 J. AGRIC. COOPERATIVES 94, 103–04 (1988); Donald J. Frederick, *The Impact of LLCs on Cooperatives: Bane, Boon, or Non-Event?*, 13 J. AGRIC. COOPERATIVES 44, 51 (1998).

unions, rural electric cooperatives, worker-owned cooperatives, and mutual insurance companies. Additionally, some federal statutes relate to federally chartered credit unions and others. Therefore, care must be taken in examining statutes, administrative rulings, and judicial opinions regarding agricultural cooperatives because statements made in the context of one type of cooperative will not necessarily apply to other types. Even so, all sources inform how a cooperative organization generally should operate in order to be considered a cooperative.

Cooperatives continue to evolve.<sup>94</sup> In agricultural cooperatives one may observe this evolution as cooperatives adapt to business needs and expectations. For example, many so-called “tax exempt” cooperatives<sup>95</sup> have dropped their qualification under Section 521 of the Internal Revenue Code (Code).<sup>96</sup> One also can see the evolution in the development of value-added or new generation cooperatives.<sup>97</sup> “The differences between traditional and value-added coops, however, may be profound.”<sup>98</sup> State corporate cooperative statutes also have evolved by statutory revision during the last two decades.<sup>99</sup> Finally, the emergence of the unincorporated cooperative association statutes upon which ULCAA was developed<sup>100</sup> suggests a grass roots response to current problems cooperatives

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<sup>94</sup> See Goforth, *supra* note 92, at 36. Referencing agricultural cooperatives, Goforth wrote: “As business needs and expectations have changed, the traditional cooperative has been forced to adapt. These adaptations have taken many forms and have been the subject of much discussion.” *Id.*

<sup>95</sup> Because of historical roots, cooperatives that qualify for tax treatment under section 521 of the Code frequently are called “tax exempt” even though they no longer are.

<sup>96</sup> See Goforth, *supra* note 92. The number of cooperatives that seek to qualify for the tax treatment that does remain available under Section 521 has been decreasing. See JAMES R. BAARDA, UNITED STATES COOPERATIVES AND INCOME TAX POLICY 111 (1997); Jeffrey S. Royer, *Taxation*, in COOPERATIVES IN AGRICULTURE, *supra* note 67, at 287, 295.

<sup>97</sup> Goforth, *supra* note 92, at 37–38. For a discussion of the issues in organizing a value-added cooperative, see, for example, Jeffrey A. Mollet, *Value Added Cooperatives—Issues for Organization*, 7 DRAKE J. AGRIC. L. 87 (2002).

<sup>98</sup> Goforth, *supra* note 92, at 42.

<sup>99</sup> See, e.g., COLO. REV. STAT. ANN. §§ 7-56-101 to -901 (West 2008); OHIO REV. CODE ANN. §§ 1729.01–1729.99 (LexisNexis 2004 & Supp. 2008); OR. REV. STAT. §§ 62.005–.870 (2007).

<sup>100</sup> See IOWA CODE ANN. §§ 501A.501–.1216 (West 2008); MINN. STAT. ANN. §§ 308B.001–.971 (West 2004 & Supp. 2008); TENN. CODE ANN. §§ 43-38-101 to -1109 (2007); WIS. STAT. ANN. §§ 193.001–.971 (West Supp. 2008); WYO. STAT. ANN. §§ 17-10-201 to -253 (2007). ULCAA “draws from existing statutes in Minnesota, Tennessee, Iowa, and Wisconsin, and, to a lesser extent, Wyoming which contemplate

face in attempting to operate in strict adherence to narrow interpretations of cooperative principles.<sup>101</sup>

The integration of cooperative principles in ULCAA was complicated because ULCAA combines two groups of persons with traditionally (and at least stereotypically) different objectives.<sup>102</sup> One group consists of the traditional owner-users of a cooperative commonly known as “patron members.”<sup>103</sup> These members participate in the cooperative to further their individual activities without a direct return from investment.<sup>104</sup> The other group consists of investors primarily seeking an economic return based on their investment in the cooperative organization.<sup>105</sup> Some versions of cooperative principles emphasize that a cooperative is to be operated at cost.<sup>106</sup> Taken to its logical extreme, if a cooperative is operated at cost, there is no profit to be shared with investors in the form of dividends, other distributions, or even to be retained for future needs or expansion. A policy issue exists, therefore, whether the cooperative model leaves any room for investors.<sup>107</sup> A number of incorporated cooperatives, however, have issued nonvoting preferred stock and other financial instruments. Nonpatron-member owned preferred stock typically is allowed under corporate cooperative statutes.<sup>108</sup>

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unincorporated cooperative entities and which encourage a greater use of outside equity furnished by ‘investors.’” UNIF. LTD. COOP. ASS’N ACT, Prefatory Note, 6A U.L.A. 142 (2008).

<sup>101</sup> See Cook, *supra* note 38, at 1156–57 (identifying possible problems cooperatives face). For a description of new generation cooperatives, which are closed-end cooperatives requiring a substantial up-front capital investment by patrons and delivery contracts, see Christopher R. Kelley, “New Generation” Farmer Cooperatives: *The Problem of the “Just Investing” Farmer*, 77 N.D. L. REV. 185, 190–201 (2001).

<sup>102</sup> See generally Baarda, *supra* note 56.

<sup>103</sup> *Id.* at 20.

<sup>104</sup> See *id.* at 30.

<sup>105</sup> See *id.* at 29.

<sup>106</sup> See LEGAL PHASES, *supra* note 82, at 5–7.

<sup>107</sup> The National Cooperative Business Association, which provided valuable input through observers to the Drafting Committee, holds this view but nevertheless recognizes the need that some cooperatives have for additional capital and has explored creating a method to provide funds from outside sources, but presumably without voting power in the cooperatives to be funded. See Paul Hazen, *The Bottom Line, Redefined*, COVR. BUS. J., May-June 2007, at 2.

<sup>108</sup> See, e.g., CHS, Inc., Registration Statement (Form S-1) (Dec. 14, 2007), available at <http://www.sec.gov/Archives/edgar/data/823277/000095013707018547/c22106s1sv1.htm>; Farmland Indus., Registration Statement (Form S-1) (Jan. 19, 2000), available at <http://www.sec.gov/Archives/edgar/data/34616/0000034616-00-000002.txt>.

In summary, the history of cooperative principles indicates that they define a business model for self-help by members and that they have evolved and changed, at least on the margin, as required by business necessity. Moreover, the history indicates the definition of cooperative is a conundrum of highest order. ULCAA attempts to balance cooperative principles, which are at the core of the cooperative organizational structure, with the current business necessity of capital formation through both debt and equity investments. Any such balance, however, necessarily requires addressing investment by nonpatrons and the interpretation of the meaning of *member control*.

## B. Types of Cooperatives

### 1. Introduction

Cooperative organizations frequently are overlooked in examinations of profit and nonprofit entities.<sup>109</sup> Overlooking the cooperative enterprise may be a mistake, however, because cooperatives play a major role in the United States economy. As of 2008, according to the National Cooperative Business Association: (1) 29 cooperatives each had annual revenue in excess of \$1 billion; (2) the top 100 cooperatives had a combined revenue of \$117 billion; (3) 270 telephone cooperatives provided service to 2 million households; (4) approximately 250 purchasing cooperatives offered group buying and shared services to more than 50,000 independent businesses; (5) nearly 10,000 United States credit unions had 84 million members and assets in excess of \$600 billion; (6) over 3,000 agricultural cooperatives marketed about 30% of farmers' products in the United States; (7) approximately 900 rural electric cooperatives owned and maintained nearly half of the electric distribution lines in the United States, covered 75% of the land mass, and provided electricity to 37 million people; (8) more than 1,000 mutual insurance companies, with more

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<sup>109</sup> A survey of introductory economics textbooks revealed a de-emphasis on cooperatives. Of 114 books surveyed, 55 were general economics; 15 were agricultural economics; 19 were micro-economics; and 25 were macro economics. The books on micro- and macro-economics made no mention of cooperatives, while only four of the books on general economics and six of those on agricultural economics had more than one hundred lines on cooperatives.

Basil G. Coley, *Economic Factors Associated with the Growth and Development of Agricultural Cooperatives*, 10 SAN JOAQUIN AGRIC. L. REV. 7, 20 (2000) (citations omitted); see also Goforth, *supra* note 92, at 32 (observing the lack of courses on cooperative business forms in law schools and coverage of cooperatives in books on business associations).

than \$80 billion in premiums, were owned by their policyholders; (9) more than 6,400 housing cooperatives provided homes for 1.5 million households; and (10) in aggregate, United States cooperatives served some 120 million members, or 40% of the United States population.<sup>110</sup> These statistics necessarily suggest that there must be advantages inherent in the cooperative business model for certain types of businesses.

Cooperatives may be categorized in a myriad of ways. Three ways to categorize types of cooperatives are: (1) the use or business purpose of the cooperative (for example, to provide a source of organic food for personal use while taking advantage of volume discounts by upstream suppliers);<sup>111</sup> (2) the legal structure under which the cooperative is organized (for example, an agricultural marketing cooperative statute, a corporate statute, an unincorporated statute, a not-for-profit statute);<sup>112</sup> and (3) whether the cooperative is stock or nonstock (nonstock is sometimes called membership based).<sup>113</sup> This Part of the Article discusses the types of cooperatives based on use and briefly discusses the stock–membership dichotomy and the tension between whether cooperatives are best conceptualized as for-profit or as nonprofit entities. Categorization by underlying legal structure beyond the foregoing is best illustrated by example and appears elsewhere in the Article.<sup>114</sup>

## 2. Taxonomy by Use

In the United States, cooperative organizations have been used in many different types of activities. Broadly, “[t]he principal purpose of any cooperative association is to sell, buy, or furnish products, merchandise, or services, as the case may be, for its patrons at cost.”<sup>115</sup> The phrase “products, merchandise, or services” is interpreted liberally. For example, workers may form cooperatives to provide employment for

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<sup>110</sup> See National Cooperative Business Association, About Cooperatives, [http://www.ncba.coop/abcoop\\_stats.cfm](http://www.ncba.coop/abcoop_stats.cfm) (last visited May 31, 2009).

<sup>111</sup> See *infra* Part III.B.2.

<sup>112</sup> See *infra* notes 128–33, Parts III.D, III.E; see generally *supra* notes 37–52 and accompanying text. For example, the term *LLC cooperative* might mean an entity organized as an LLC under state law but operating on a cooperative basis such that it is taxed as a cooperative for federal income tax purposes. See generally Geu & Dean, *supra* note 52. For an introduction to the federal income taxation of cooperatives, see *infra* Part III.C. For tax classification of cooperatives, see *infra* Part III.D.

<sup>113</sup> See *infra* Part III.B.2.

<sup>114</sup> See *supra* note 52.

<sup>115</sup> Wilfrid E. Rumble, *Cooperatives and Income Taxes*, 13 L. & CONTEMP. PROB. 534, 535 (1948).

members.<sup>116</sup> Even employee stock ownership plans (ESOPs) are sometimes considered as under the cooperative umbrella.<sup>117</sup> The products or services offered by these kinds of cooperatives are opportunities for employment.

Israel Packel in his book *The Organization and Operation of Cooperatives*<sup>118</sup> states: "The functions performed by cooperatives in the economic life of a community can be practically without limit."<sup>119</sup> He highlights the following kinds of cooperatives by function: consumer cooperatives, including consumer stores; housing cooperatives; condominiums; electric, telephone, and other utility cooperatives; health cooperatives; marketing cooperatives; business purchasing cooperatives; workers' production cooperatives; financial cooperatives, including credit unions, mutual savings banks, savings and loan associations, and production credit associations; insurance cooperatives, often referred to as mutual companies; labor unions;<sup>120</sup> trade associations; and self-help cooperatives.<sup>121</sup>

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<sup>116</sup> Worker-owned cooperatives extend back to 1849 in England. See Anonymous, *supra* note 82, at 33.

<sup>117</sup> In ESOPs, ownership interests in an entity (usually stock in a corporation) are held in a trust the beneficiaries of which are employees of the entity. The trust votes and receives any distributions from the entity on behalf of the beneficiaries. For a discussion of various aspects of ESOPs, see ESOP Services FAQs, <http://www.esopservices.com/faqs.html> (last visited May 31, 2009).

<sup>118</sup> See PACKEL, *supra* note 50.

<sup>119</sup> *Id.* at 10.

<sup>120</sup> "In reality, the labor union is a cooperative, since it is an organization of workers that acts as the economic bargaining agency for the workers, and is owned and controlled on a substantially equal basis by all the workers for their common benefit." PACKEL, *supra* note 50, at 21.

<sup>121</sup> See *id.* For a basic overview of the corporate cooperative structure applied in the worker cooperative context see Lewis D. Solomon & Melissa B. Kirgis, *Business Cooperatives: A Primer*, 6 DEPAUL BUS. L.J. 233 (1994). FOR online sources for general information regarding cooperatives: consumer and business purchasing activities, see National Cooperative Business Association, <http://www.ncba.org> (last visited May 31, 2009); housing and condominiums, see National Association of Housing Cooperatives, <http://www.coophousing.org> (last visited May 31, 2009); electric cooperatives, see National Rural Electric Cooperative Association, <http://www.nreca.org> (last visited May 31, 2009); telephone cooperatives, see National Rural Telecommunications Cooperative, <http://www.nrtc.org> (last visited May 31, 2009); health care, see James P. Firman, *Health Care Cooperatives: Innovations for Older People*, <http://content.healthaffairs.org/cgi/reprint/4/4/50.pdf> (last visited May 31, 2009); marketing cooperatives, see National Council of Farmer Cooperatives, <http://www.ncfc.org> (last visited May 31, 2009), and United States Department of Agriculture—Rural Development, [www.rurdev.usda.gov](http://www.rurdev.usda.gov) (last visited May 31, 2009); worker cooperatives, see ICA Group, [www.ica-group.org](http://www.ica-group.org) (last visited May 31, 2009), and United States Federation of Worker Cooperatives,



In addition to the uses Packel highlights, many other cooperatives exist, including advertising cooperatives, bargaining cooperatives, processing cooperatives, wholesale buying cooperatives, service cooperatives, mutual ditch companies, mutual cemetery companies, investment cooperatives, and financial planning cooperatives, as well as others.<sup>122</sup>

### 3. *Stock and Nonstock (Membership) Cooperatives*

To some extent, the distinction between stock and nonstock cooperatives is a subcategory of the type of statute under which the cooperative is organized (for example, a cooperative organized as an unincorporated entity or formed under a corporate statute). Even as of 1970, Packel underscored the categorical difference between organizational form—albeit in the context of corporate farmer cooperatives—and the distinction between a stock or nonstock cooperative:

Statutes in many jurisdictions permit cooperatives to be incorporated either on a stock or on a nonstock basis. Sometimes there are two separate statutes, one applicable to stock cooperatives and the other applicable to nonstock cooperatives. The more recent trend, however, is to have one statute that provides for incorporation and that permits the charter to indicate whether the cooperative is being formed with or without capital stock.<sup>123</sup>

“Membership in a stock cooperative is obtained through the purchase of at least one share of stock and the meeting of any other requirements of the association.”<sup>124</sup> Further, “[t]he nonstock cooperative is frequently

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<http://www.usworker.coop> (last visited May 31, 2009); credit unions, see The Credit Union National Association, [www.cuna.org](http://www.cuna.org) (last visited May 31, 2009) and America’s Credit Unions, <http://www.creditunion.coop> (last visited May 31, 2009); and for mutual insurance companies, see National Association of Mutual Insurance Companies, [www.namic.org](http://www.namic.org) (last visited May 31, 2009).

<sup>122</sup> See generally National Cooperative Bank Association website, <http://www.ncba.coop> (last visited May 31, 2009).

<sup>123</sup> PACKEL, *supra* note 50, at 30.

<sup>124</sup> LEGAL PHASES, *supra* note 82, at 11. Observe that some unincorporated organizations may have stock; for example, some joint stock companies. Moreover, ownership interests in both incorporated and unincorporated organizations may be in either certificated or uncertificated form. See, e.g., REV. MODEL BUS. CORP. ACT § 6.26 (2008); UNIF. LTD. COOP. ASS’N ACT § 601(3), 6A U.L.A. 226 (2008). See generally Lynn Soukup, *It’s a Matter of Collateral*, BUS. L. TODAY, Jan.–Feb. 2005, at 53.

referred to as a membership cooperative.”<sup>125</sup> Use of the term *membership*, of course, is similar to use of the same term in the nonprofit world.

In a nonstock (membership) cooperative, “[m]embership . . . is obtained through application for membership and acceptance of the applicant by the association and the meeting of any other requirements.”<sup>126</sup> Both stock and nonstock cooperatives commonly require the member, as a condition of membership, to agree to purchase or sell services, supplies, or goods to or from the cooperative. For example, marketing associations sometimes require the member to execute a marketing contract to qualify for membership.<sup>127</sup>

#### 4. State Law, Nonprofit Organizations, Cooperatives As Nonprofits

The basic notion of cooperatives is that patron members form an association for their mutual benefit to further their own business or economic interest not by receiving monetary return on investment but, for example, by creating a market for their product, adding value to the product through processing, or increasing the quality or decreasing the price of the inputs used either in their business or personally. Conceptually, traditional corporate cooperatives return excess of revenues over expenses to patron members as savings or rebates by allocating them to a capital or equity account in the name of the patron member.<sup>128</sup> Conceptually, these accounts are similar to capital accounts in a partnership. Actual distribution of money or property to the member then reduces the amount reflected in the member’s capital account.<sup>129</sup>

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<sup>125</sup> PACKEL, *supra* note 50, at 30. The idea of members in the context of corporate cooperatives (nonstock) may seem confusing. It should not be confusing, however, because the concept is analogous to members of a nonprofit corporation. A casebook on nonprofit organization law succinctly states:

A nonprofit corporation may have one or more classes of members or it may have no members. If the corporation has members, the designation of the class of membership, the manner of election or appointment and the qualifications and rights of the members of each class must be set out in the articles of incorporation or bylaws.

MARILYN E. PHELAN & ROBERT J. DESIDERIO, *NONPROFIT ORGANIZATIONS LAW AND POLICY* 76 (2d. ed. 2007). For further discussion concerning the relationship between nonprofit organizations and cooperatives, see *infra* Part III.E.1.

<sup>126</sup> LEGAL PHASES, *supra* note 82, at 11.

<sup>127</sup> See *id.*; see also *infra* Part V.D (discussing marketing contracts under ULCAA).

<sup>128</sup> See generally PACKEL, *supra* note 50, at 2.

<sup>129</sup> See, e.g., *infra* note 379 and accompanying text.

Following the basic notion to its logical extreme at the very least suggests a cooperative is a form of nonprofit (not-for-profit) association.<sup>130</sup> As Israel Packel has said, some cooperative associations are formed, in fact, under state nonprofit corporation statutes:

The absence of a suitable statute specifically available for cooperatives often makes it necessary to investigate the possibility of using a general statute that provides for the incorporation of nonprofit organizations . . . . Of course, this does not mean that the cooperative would necessarily be deemed a nonprofit organization within the meaning of a tax exemption statute.<sup>131</sup>

Indeed, the term nonprofit historically appears in cooperative statutes. Many traditional agricultural marketing statutes starting in at least 1922, for example, stated: "Associations organized hereunder shall be deemed 'nonprofit' inasmuch as they are not organized to make profit for themselves, as such, . . . but only for their members as producers."<sup>132</sup> Federal income tax law recognizes the basic distinction between for-profit and nonprofit organizations.<sup>133</sup>

### C. Income Taxation of Cooperatives: An Overview

Agricultural cooperatives are, perhaps, the most recognized form of cooperative organizations in the United States. Nonetheless, cooperative organizations exist in many areas. In each area of economic enterprise in which the cooperative form of business is used, the types and models of cooperatives may be taxed in several different ways. The purpose of this Part is to provide a birds-eye introduction to the federal income taxation

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<sup>130</sup> Packel stated that the cooperative "mode of operation and its purpose is to enable the members to obtain the profits resulting from activities of the members themselves, and, therefore, the true cooperative should be deemed to be nonprofit within the meaning of the normal nonprofit corporation statute." PACKEL, *supra* note 50, at 59.

<sup>131</sup> *Id.* at 57–58 (citations omitted). *Cf.* Baarda, *supra* note 90, at 3.

<sup>132</sup> *Id.* at 20. The Uniform Agricultural Cooperative Association Act section 2(f), withdrawn by the ULC in 1943, went further and stated:

Associations shall be classified as and deemed to be nonprofit corporations, inasmuch as their primary object is not to pay dividends on invested capital, but to render service and provide means and facilities by or through which the producers of agricultural products may receive a reasonable and fair return for their products.

PACKEL, *supra* note 50, at 58–59 (quoting UNIF. AGRIC. COOP. ASS'N ACT § 2(f), 9 U.L.A. 42 (1942) (withdrawn)).

<sup>133</sup> See *infra* Part III.E.1.

of cooperatives. Citation to more detailed and comprehensive treatment of the taxation of cooperatives appears in the footnotes.<sup>134</sup>

Congress recognizes the organizational differences that exist in different forms of cooperatives by providing special provisions in various tax statutes, for example, for agricultural cooperatives.<sup>135</sup> Section 216 of the Code, for example, permits members of housing cooperatives to deduct the proportionate amounts paid by their cooperatives for real estate taxes and interest on indebtedness for the “acquisition, construction, alteration, rehabilitation, or maintenance of the houses or apartment building,”<sup>136</sup> and in acquiring “land on which the houses (or apartment building) are situated.”<sup>137</sup> In addition, that section permits depreciation to tenant-stockholders where the lease or right of tenancy in property is used for business purposes.<sup>138</sup>

Section 501(a), by virtue of section 501(c) of the Code,<sup>139</sup> exempts a number of organizations that are cooperatives, or have a close resem-

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<sup>134</sup> See Freitag, *supra* note 85; see also Donald Frederick, *Income Tax Treatment of Cooperatives*, COOPERATIVE INFO. RPT. 44, Pts. 1–5 (U.S. DEP’T OF AGRIC./AGRIC. COOPERATIVE SERV. 2005), available at <http://www.rurdev.usda.gov/rbs/pub/cooprpts.htm> (a leading reference for the taxation of cooperatives focusing on taxation under Subchapter T). A review of the publication states:

Tax lawyers who are used to reaching for a reference volume published by a regular commercial publisher may be surprised to learn that a leading reference tool in one area of tax is published by the Government Printing Office. Those who toil along the trails of subchapter T are now toasting the recent publication of a new edition of *Cooperative Information Report 44*, commonly known as *Income Tax Treatment of Cooperatives*, in five parts.

David J. Shakow, *Income Tax Treatment of Cooperatives*, COOPERATIVE ACCT., Spring 2006, at 73, 73, originally published in 2005 TAX NOTES 951, 951 (2005).

<sup>135</sup> See, e.g., War Revenue Act of 1898, ch. 448, 30 Stat. 448, 448–49 (repealed 1939); Payne–Aldrich Tariff Act of 1909, ch. 6, 36 Stat. 11, 112 (repealed by Revenue Act of 1913, ch. 16, 38 Stat. 114); Revenue Act of 1913, ch. 16, 38 Stat. 114, 166–67 (predecessor to current Internal Revenue Code); see generally Basil G. Coley, *Economic Factors Associated with the Growth and Development of Agricultural Cooperatives*, 10 SAN JOAQUIN AGRIC. L. REV. 7, 17–18 (2000); Christopher R. Kelley, “New Generation” Farmer Cooperatives, 17 AGRIC. L. UPDATE 200 (2000), available at <http://www.nationalaglawcenter.org/assets/aala/06-00.pdf> (discussing how organizing as a new generation farmer cooperative might negatively impact beneficial federal income tax treatment); Rumble, *supra* note 115.

<sup>136</sup> I.R.C. § 216(a)(2)(A).

<sup>137</sup> I.R.C. § 216(a)(2)(B).

<sup>138</sup> See I.R.C. § 216(c).

<sup>139</sup> See I.R.C. § 501(c)(4)–(7), (9)–(16). Packel discusses the judicial treatment of tax provisions to various types of cooperative organizations. Although somewhat dated,

blance to cooperatives, from federal income taxation. Prior to 1962, farmers' cooperatives meeting certain requirements were exempt from federal income taxation under sections 521 and 522 of the Code.<sup>140</sup> In the Revenue Act of 1962,<sup>141</sup> Congress adopted Subchapter T<sup>142</sup> and eliminated section 522.<sup>143</sup> Section 521 remains an alternative for farmers cooperatives but, because its requirements are difficult to meet<sup>144</sup> and its limits on operation rather severe, many farmers' cooperatives no longer seek to qualify for its limited tax exemption. Cooperatives qualifying for section 521 treatment are often still called "exempt [farmers] cooperatives."<sup>145</sup>

The adoption of Subchapter T created a federal income tax structure applicable to many, but not all, nonexempt cooperatives. Subchapter T excludes from its coverage specified cooperative organizations, such as most savings banks, mutual insurance companies, and cooperatives engaged in furnishing electric energy or providing telephone service to persons in rural areas.<sup>146</sup> A key to understanding the overall structure of fed-

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his discussion outlines the types of issues that different types of cooperatives may face under the Code as it existed prior to 1970. These issues remain with respect to most cooperative organizations today. See PACKEL, *supra* note 50, at 242–50.

<sup>140</sup> See I.R.C. § 101(12), (13) (1940) and similar provisions in previous Revenue Acts.

<sup>141</sup> See Revenue Act of 1962, Pub. L. No. 87-834, § 17, 76 Stat. 960, 1045 (codified in scattered sections of the Code).

<sup>142</sup> See I.R.C. §§ 1381–1388.

<sup>143</sup> See Freitag, *supra* note 85, at 8.

<sup>144</sup> See generally *id.* at 32–33.

<sup>145</sup> *Id.* at 31.

<sup>146</sup> See I.R.C. § 1381(a)(2). For a discussion of the relationship of other exempt organization tax law to organizations that, in fact, operate on a cooperative basis, see *infra* Part III.E.1.

The organization of the federal income tax law to electric cooperatives is analogous to that of farmer cooperatives. Moreover, the broad notions and mechanisms of that taxation are also similar. The technical requirements, however, as well as the specific Code sections and other sources of authority, are separate and distinct from either exempt or nonexempt farmers' cooperatives. The electric industry sometimes is divided into two broad categories: (1) generation and transmission cooperatives, and (2) distribution cooperatives. See Clayton S. Reynolds, *Tax Issues Raised for Rural Electric Cooperatives by the Advent of the Non-Bypassable Charge*, 52 TAX LAW. 335, 336 (1999). "A distribution cooperative typically purchases power from the G&T [generation and transmission] cooperative of which it is a member (pursuant to a long-term 'all-requirements' wholesale power contract)." *Id.* The distribution co-op, therefore, acts as a retail co-op selling power to its members.

eral income taxation of cooperatives is recognizing Subchapter T's general applicability beyond agricultural cooperatives. That is, "[a] business need not be a farmer cooperative to qualify for subchapter T tax status. Any business 'operating on a cooperative basis' uses subchapter T when computing its tax liability."<sup>147</sup>

That being said, defining "operating on a cooperative basis" has proved to be difficult. Notably, prior to 1991, whether a cooperative needed to conduct at least 50% of its business with its members in order to be a cooperative for purposes of Subchapter T was unclear.<sup>148</sup> However, in 1991, the Internal Revenue Service (Service) conceded that an organization may conduct more than 50% of its business with nonmembers

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The federal income taxation of electric cooperatives—whether G&T or distribution—like the taxation of farmers cooperatives, is bifurcated into exempt and nonexempt treatment.

Again, like farmers cooperatives, electric cooperatives can be either exempt under Subchapter F, *see* I.R.C. § 501(c)(12), or nonexempt (although, "[a]ll or virtually all distribution cooperatives are tax-exempt under section 501(c)(12) . . ." Reynolds, *supra*, at 337). Concerning exempt electric cooperatives:

Section 501(c)(12) of the Code grants tax exemption to certain "benevolent life insurance associations of a purely local character, mutual ditch or irrigation companies, mutual or cooperative telephone companies or like organizations; but only if 85% or more of the income consists of amounts collected from members for the sole purpose of meeting losses and expenses." (Emphasis added) Electric cooperatives are viewed as "like" organizations. *See* Rev. Rul. 67-265, 1967-2 C.B. 205. Accordingly, an electric cooperative can qualify as a tax-exempt entity, under section 501(c)(12) of the Code, during any year in which the cooperative collects at least 85% of its income "from members for the sole purpose of meeting losses and expenses." . . . *See* Announcement 96-24, 1996-16 I.R.B. 35 ("members are those entitled to voice in management of the cooperative and to share in patronage capital") . . .

*Id.* at 337 n.5.

Nonexempt cooperatives are cooperatives for purposes of the federal income tax but do not qualify as exempt cooperatives under section 501(c)(12). The analogous farmers cooperative would be taxed under Subchapter T, but recall Subchapter T expressly excludes any organization, "which is engaged in furnishing electric energy . . . to persons in rural areas." I.R.C. § 1381(a)(2)(c). "The underlying committee reports to the Revenue Act of 1962 state that taxable organizations engaged in furnishing electric energy to persons in rural areas will continue to be treated the same under present law." Reynolds, *supra*, at 339 n.9 (citations omitted). Thus, many electric cooperatives may exclude patronage allocations made to patrons under pre-1962 law in a general way analogous to Subchapter T. *See id.* at 339.

<sup>147</sup> Frederick, *supra* note 134, at 33.

<sup>148</sup> *See id.* at 10-11.

and still qualify for Subchapter T.<sup>149</sup> Instead of a bright-line percentage requirement, the Service now applies “a facts and circumstances test to determine whether an organization is operating on a cooperative basis.”<sup>150</sup>

Conceptually, Subchapter T’s provisions subject a cooperative to regular corporate income taxation in the same way as a business corporation.<sup>151</sup> In determining its income, however, the cooperative does not take into account net earnings allocated or distributed to patrons from business conducted with patrons—or amounts paid to patrons as something labeled, for example, a per-unit retain allocation—under a pre-existing agreement or obligation between the cooperative and the recipient.<sup>152</sup> In essence, the cooperative deducts those amounts.

To qualify for this treatment, the amounts allocated, distributed, or paid must meet a variety of tests set forth in Subchapter T.<sup>153</sup> The amounts meeting those tests instead are included in the gross income of the recipient (member) for federal income tax purposes.<sup>154</sup> As a result, the technical scheme of exclusion of income (looking and acting much like a deduction) at the entity (corporate) level provides a modified version of flow-through taxation. In a way, therefore, Subchapter T holds a place in the structure of the Code somewhat similar to the more familiar Subchapter S regime of flow-through corporate taxation.<sup>155</sup>

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<sup>149</sup> See *id.* at 11.

<sup>150</sup> *Id.*

<sup>151</sup> See I.R.C. § 1381(b).

<sup>152</sup> See I.R.C. § 1382(a).

<sup>153</sup> See I.R.C. §§ 1382–1388. The Code provides many of the terms that are ubiquitous in the practice of cooperative law. The terms also belie the distinctiveness of Subchapter T taxation:

Part III of Subchapter T consists of § 1388. This section contains an important set of definitions including such key cooperative tax terms as “patronage dividend (refund),” “written notices of allocation,” . . . and “qualified per-unit retains certificate.” Section 1388 also provides rules for obtaining consent from patrons to include noncash allocations in taxable income and for the netting of patronage gains and losses.

Roger A. McEowen & Neil E. Harl, *Taxation of Cooperatives*, 744 TAX MGM’T PORT. (BNA) A-3 (1999). Some of the additional requirements for the deduction are mentioned at *infra* note 448 and accompanying text.

<sup>154</sup> See I.R.C. § 1385.

<sup>155</sup> Shareholders in S-corporations have a kind of flow-through tax treatment. “Income, losses, deductions, and credits retain their corporate-level character and are allocated to the S corporation’s shareholders on a per-share, per-day basis . . . , and are

So, gross income for a cooperative taxed under Subchapter T is determined in the same way as the gross income of any corporation under the Code,<sup>156</sup> except the following payments are deducted:

- (1) patronage dividends . . . paid in money, qualified written notices of allocation . . . , or other property (except nonqualified written notices of allocation . . . ) with respect to patronage . . . ,
- (2) . . . money or other property (except written notices of allocation) in redemption of nonqualified written notice of allocation . . . paid as a patronage dividend during the payment period for the taxable year during which the patronage occurred;
- (3) . . . per-unit allocations . . . to the extent paid in money, qualified per-unit retain certificates . . . , or other property (except nonqualified per-unit retain certificates) . . . ; or
- (4) . . . money or other property (except per-unit retain certificates) in redemption of nonqualified per-unit retain certificate which was paid as per-unit retain allocations during the payment period for the taxable year during which the marketing occurred.<sup>157</sup>

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treated by the shareholders as if attributable directly to the source from which they were generated.” BORIS I. BITTKER & JAMES S. EUSTICE, *FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS* ¶ 6.06, at 6-25 (7th ed. 2000). Section 1381 of the Code states:

- (a) In general.—This part shall apply to—
  - (1) any organization exempt from tax under section 521 (relating to exemption of farmers’ cooperatives from tax), and
  - (2) any corporation operating on a cooperative basis other than an organization—
    - (A) which is exempt from tax under this chapter,
    - (B) which is subject to the provisions of—
      - (i) part II of subchapter H (relating to mutual savings banks, etc.), or
      - (ii) subchapter L (relating to insurance companies), or
    - (C) which is engaged in furnishing electric energy, or providing telephone service, to persons in rural areas.

I.R.C. § 1381(a). For a thorough discussion of Subchapter T and section 521 of the Code, see Frederick, *supra* note 134.

<sup>156</sup> See I.R.C. §§ 1381(b), 1382(a).

<sup>157</sup> I.R.C. § 1382(b).



For purposes of Subchapter T, “patronage dividends” are amounts paid to a patron by a cooperative (1) on the basis of the quantity or value of business done by the cooperative with or for the patron, (2) under a pre-existing legal obligation of the cooperative to make the payments before the cooperative received the amounts paid, and (3) which are determined by reference to the net earnings of the organization from business done with or for the cooperative’s patrons.<sup>158</sup> A patronage dividend does not include amounts paid out of earnings from business done by a cooperative with nonpatrons or from business done with other patrons who do not receive payments.<sup>159</sup>

Another allowed deduction, as previously listed, is for “per-unit retains.” A per-unit retain is any allocation by a cooperative “to a patron with respect to products marketed for [the patron], the amount of which is fixed without reference to the net earnings of the [cooperative] pursuant to an agreement between the organization and the patron.”<sup>160</sup> A “per-unit retain certificate” is “any written notice which discloses to the recipient the stated dollar amount of a per-unit retain allocation” to the recipient by the cooperative.<sup>161</sup>

Beyond the basic schema of cooperative taxation, of course, exist other tax planning opportunities and pitfalls, which are outside the scope of this Article.<sup>162</sup> Obviously, business planners must have far greater familiarity with income taxation of cooperatives than the rough sketch of the schema provided by this Article. Those opportunities, issues, and pitfalls are beyond the purpose and scope of this Article.

LCAs organized under ULCAA (and similar state law) are new. Little guidance exists, therefore, as to whether or how an organization would qualify for either nonexempt cooperative tax treatment under Sub-

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<sup>158</sup> See I.R.C. § 1388 (a)(1)–(3). See generally Frederick, *supra* note 134.

<sup>159</sup> See I.R.C. § 1388(a). If a cooperative has been approved for exempt status by Code section 521, some amounts paid out of earnings from business done with nonpatrons may be included in patronage dividends for purposes of Subchapter T. See generally Frederick, *supra* note 134.

<sup>160</sup> I.R.C. § 1388(f). For example, if a marketing cooperative and a patron agree for every bushel of wheat the patron markets to or through the cooperative, the cooperative may deduct and withhold from the price to be paid to the patron a fixed sum (such as five cents per bushel) as a per-unit retain.

<sup>161</sup> I.R.C. § 1388(g); see generally Frederick, *supra* note 134.

<sup>162</sup> One such issue, for example, concerns the recognition and deferral of income at the member level. See Kathryn J. Sedo & Mychal S. Brenden, *Fairness and Taxation: The Law of Deferred Income Recognition for the Members of Agricultural Cooperatives*, 23 AKRON TAX J. 81 (2008).

chapter T or other cooperative tax law.<sup>163</sup> If an LCA is subject to the check-the-box entity classification regulation, does not have investor members, elects to be treated as a corporation, and operates on a cooperative basis, then the association should be able to take advantage of Subchapter T.<sup>164</sup> Whether an LCA with investor members electing to be taxed as a corporation and operating on a cooperative basis may receive Subchapter T treatment for its patron member business is an open question. The resolution of both questions—but particularly the latter—are technical and may raise tax policy issues. In any event, those questions center on the application of the check-the-box entity classification regulations.

#### D. Partnership Income Taxation and the “Check-the-Box” Entity Classification

The federal income tax taxonomy of traditional corporate cooperatives and tax-exempt nonprofit organizations is tied inexorably to classification as a corporation for federal income tax purposes.<sup>165</sup> That is, as a ridiculously general matter, the taxation of cooperatives under Subchapter T and section 501 of the Code assumes or requires corporate tax treatment.<sup>166</sup> Partnership income tax treatment, however, under certain planning scenarios, may be superior when compared with taxation as a not-for-profit exempt entity or as a cooperative, or may provide a good alternative in circumstances where an entity cannot qualify under the eligibility requirements for a not-for-profit exemption or as a cooperative under another tax provision.<sup>167</sup> The authors of a leading tax treatise state the most basic conceptual distinction between corporate and partnership income tax as follows:

The principal difference in the tax treatment of “regular” corporations and partnerships is the “pass-through” characteristic of partnerships. This treatment of partnerships permits each item of income, gain, loss, deduction,

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<sup>163</sup> For a very general overview of other exempt cooperative organizations and the possible use of LCAs organized for exempt purposes, see *infra* Part IV.B. The exempt organizations are governed, in part, by Code sections 501 through 530 (Subchapter F). For an overview of the taxation of utility cooperatives, see *supra*, note 146.

<sup>164</sup> See *infra* Part III.D.

<sup>165</sup> See, e.g., *supra* note 135 and accompanying text.

<sup>166</sup> See *infra* notes 212–20 and accompanying text.

<sup>167</sup> See generally *supra* notes Part III.C.; *infra* notes 212–220 and accompanying text.

or credit of the partnership to retain its character as determined at the partnership level when reported by the partner, without first being taxed at the partnership level. A corporation is taxed as an entity that exists independently of its shareholders, and thus must report income and take tax credits and deductions as an entity, separate and distinct from its shareholders. Consequently, corporate income generally is taxed twice by the time it reaches the pockets of its participants—once when earned by the corporation and a second time when distributed to the shareholders.<sup>168</sup>

Even S-corporation tax status is, at best, an imperfect simulation or caricature of partnership taxation under Subchapter K of the Code (though with certain advantages in specific planning situations).<sup>169</sup> Indeed, the distinction between S-corporation taxation status and Subchapter K partnership taxation is an important reason why Revenue Ruling 88-76,<sup>170</sup> in retrospect, helped fuel the explosive growth in the use of LLCs.<sup>171</sup>

An LCA governed by ULCAA is driven by economic and financial needs,<sup>172</sup> and the selection of the appropriate entity for a venture involves a plethora of tax issues at several levels far beyond the scope of this Article.<sup>173</sup> Nonetheless, ULCAA contemplates the flexibility afforded by the check-the-box income tax classification rules because, at least under state law, it is an unincorporated entity.<sup>174</sup>

The application of the check-the-box rules provides default classification for eligible entities as either a partnership if the entity has two or more members or as a disregarded entity if the entity has a single mem-

<sup>168</sup> 1 JOHN S. PENNELL, PHILIP F. POSTLEWAITE & ARTHUR B. WILLIS, *PARTNERSHIP TAXATION* ¶ 1.02[1] (6th ed. 2002) (footnote omitted).

<sup>169</sup> See, e.g., ROBERT R. KEATINGE & ANN E. CONAWAY, *KEATINGE AND CONAWAY ON CHOICE OF BUSINESS ENTITY* (2006); Bruce P. Ely & Christopher R. Grissom, *Choice of Entity: Legal Considerations of Selection*, 50-4TH CORP. PRAC. SERIES (BNA 2001).

<sup>170</sup> See Rev. Rul. 88-76, 1988-2 C.B. 360 (determining an LLC could be classified as a partnership for purposes of federal income taxation).

<sup>171</sup> Cf. J. DENNIS HYNES & MARK J. LEWENSTEIN, *AGENCY, PARTNERSHIPS, & THE LLC: THE LAW OF UNINCORPORATED BUSINESS ENTERPRISES* 437-95 (6th ed. 2008).

<sup>172</sup> See, e.g., I.R.C. §§ 1381(b), 1382(a).

<sup>173</sup> See, e.g., *supra* note 162.

<sup>174</sup> See *infra* notes 186-88 and accompanying text (discussing ULCAA section 104(a) as it relates to entity classification; tax law, not state law, is determinative).

ber or owner for purposes of federal income taxation.<sup>175</sup> A disregarded entity, as a practical matter, simply is ignored for federal income tax purposes and the single member is treated as the taxpayer.<sup>176</sup> However, an eligible entity may elect to be taxed as a corporation.<sup>177</sup> A number of good, general treatise discussions of check-the-box regulations exist, and a representative list of citations to several of them appear in the footnotes.<sup>178</sup>

Scant administrative material discusses the application of the check-the-box regulations to LCAs and similar unincorporated cooperative associations that now exist under state law. Research uncovered only two relevant private letter rulings. However, they do illustrate nicely the operation of the regulation. In one of the rulings, the Service applied the check-the-box regulation to an entity to be formed under a “State Cooperative LLC Act” and determined that the entity would be an eligible entity for purposes of the regulation.<sup>179</sup> This means that under the regulation the entity would be treated as a partnership for federal income tax as a matter of default, or it could elect to be taxed as a corporation. The letter ruling specifically recited that the entity met the regulatory requirements because it was neither a business entity that is classified as a trust nor an entity listed in the regulation as a *per se* corporation.<sup>180</sup> The letter ruling emphasized that “[i]n the present case, Company A is organized as an unincorporated association under the Act, which does not refer to an association as incorporated or as a corporation, body corporate, or body politic.”<sup>181</sup>

A USDA publication that discusses this private letter ruling identifies the “State Cooperative LLC Act” in the letter ruling as the Wyoming Processing Cooperative Law.<sup>182</sup>

The other private letter ruling addressed whether an LLC, an eligible entity under the check-the-box regulations, could elect corporate tax sta-

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<sup>175</sup> See Treas. Reg. § 301.7701-3(a).

<sup>176</sup> See Treas. Reg. § 301.7701-1(a)(4) (showing that ULCAA requires at least two members). *But see infra* note 316 and accompanying text.

<sup>177</sup> See Treas. Reg. § 301.7701-2(b)(2).

<sup>178</sup> See, e.g., BRUCE R. HOPKINS, *THE LAW OF TAX EXEMPT ORGANIZATIONS* 68–70 (9th ed. 2007) (emphasizing exempt organizations); PENNELL, POSTLEWAITE & WILLIS, *supra* note 168, at 1-90 to 1-105; Ely & Grissom, *supra* note 169, at A-25 to A-26.

<sup>179</sup> See I.R.S. Priv. Ltr Rul. 01-39-020 (Sept. 28, 2001).

<sup>180</sup> See *id.*

<sup>181</sup> *Id.*

<sup>182</sup> See Frederick, *supra* note 134, at 29-30.

tus and, in turn, be taxed as a cooperative under Subchapter T (which applies to corporate taxpayers) if it met the other requirements of that subchapter.<sup>183</sup> The Service concluded that the LLC, which elected to be a corporation for tax purposes was eligible to be taxed as a cooperative under Subchapter T and, in this case, would be so taxed.<sup>184</sup> The unique facts in the private letter ruling involved the reorganization of an existing cooperative taxed under Subchapter T. The existing cooperative was operating on a cooperative basis before the reorganization. It desired to change its state law form, but not its manner of operation, to avoid a legal capital restriction present in the state corporate cooperative act on redemption of its shares.<sup>185</sup>

These private letter rulings do not directly address LCAs governed by ULCAA. Hypothetically, however, the LCA should be eligible for check-the-box entity classification treatment. The threshold question under the check-the-box regulations is whether the organization is an eligible entity. To be an eligible entity requires that the organization, first, be an entity and, second, be a business entity. The question of whether an organization is an entity is a matter of federal tax law, not a matter of state law.<sup>186</sup> Thus, ULCAA's express statement that an LCA is an entity separate and apart from its members<sup>187</sup> is not dispositive in determining whether an LCA is an entity for tax classification purposes. The primary provision in the regulation concerning entity status states: "A joint venture or other contractual arrangement may create a separate entity for federal tax purposes if the participants carry on a trade, business, financial operation, or venture and divide profits therefrom."<sup>188</sup>

Like other uniform unincorporated acts, ULCAA clearly provides for the division of profit;<sup>189</sup> even though, again, like other uniform unincorporated acts, it states that the purpose of an LCA does not require a profit motive for state law purposes.<sup>190</sup> Therefore, for purposes of entity status under the classification regulations, LCAs should be treated similarly to

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<sup>183</sup> See I.R.S. Priv. Ltr. Rul. 01-19-016 (Feb. 6, 2001).

<sup>184</sup> See *id.*

<sup>185</sup> See *id.*

<sup>186</sup> See Treas. Reg. § 301.7701-1(a)(1).

<sup>187</sup> See UNIF. LTD. COOP. ASS'N ACT § 104(a), 6A U.L.A. 166 (2008).

<sup>188</sup> Treas. Reg. § 301.7701-1(a)(2).

<sup>189</sup> See UNIF. LTD. COOP. ASS'N ACT § 1004, 6A U.L.A. 265-66.

<sup>190</sup> See *id.* § 105(b), 6A U.L.A. 168.

limited partnerships and LLCs to which the regulation has been applied.<sup>191</sup>

The election procedure to be taxed as a corporation, too, supports that an LCA's status is that of an entity under the regulation. The regulation's election provisions provide that an eligible entity that is exempt or claims to be exempt from federal income taxation under section 501 is treated as having made the election to be classified as a corporation.<sup>192</sup> In many instances, organizations exempt under section 501 would be prohibited from dividing profits among at least some participants and yet the regulations logically require them to be entities for purposes of being an eligible entity.<sup>193</sup>

The second part of the threshold question of whether an organization is an eligible entity is that it must be a "business entity." As stated by a treatise: "Basically, under . . . [the check-the-box] rules, an organization is either a trust or a *business entity*."<sup>194</sup> In turn, business entities may be eligible entities if they are not corporations.<sup>195</sup> The regulations contain eight categories of "per se corporations."<sup>196</sup> Probably the most frequently occurring category is the one previously discussed in Private Letter Ruling 01-39-020.<sup>197</sup> This category includes "[a] business entity organized under a Federal or State statute, or under a statute of a federally recognized Indian tribe, [that is referred to] as incorporated or as a corporate, body corporation, or body politic."<sup>198</sup>

Like the statute analyzed in the letter ruling, an LCA organized under ULCAA is "organized as an unincorporated association under the Act, which does not refer to an association as incorporated or as a corporation, body corporate, or body politic."<sup>199</sup> ULCAA section 104 expressly states that "[a] limited cooperative association organized under this [act] is an . . . unincorporated organization."<sup>200</sup>

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<sup>191</sup> Cf. BITTKER & EUSTICE, *supra* note 155, at 2-15 to 2-16.

<sup>192</sup> See Treas. Reg. § 301.7701-3(c)(1)(v)(A).

<sup>193</sup> See *infra* notes 212-20.

<sup>194</sup> HOPKINS, *supra* note 178, § 4.1(b)(i); see generally Treas. Reg. § 301.7701-4 (2008) (trusts).

<sup>195</sup> See *id.*

<sup>196</sup> Treas. Reg. § 301.7701-2(b) (2008).

<sup>197</sup> See *supra* notes 179-81 and accompanying text.

<sup>198</sup> Treas. Reg. § 301.7701-2(b)(1).

<sup>199</sup> I.R.S. Priv. Ltr. Rul. 01-39-020 (June 29, 2001).

<sup>200</sup> UNIF. LTD. COOP. ASS'N ACT § 104(a), 6A U.L.A. 166 (2008).

Moreover, ULCAA is unincorporated as a matter of substance even though an inquiry into substance is not relevant under the check-the-box rules. ULCAA's financial rights are aligned closely with partnership, limited partnership, and LLC law.<sup>201</sup> Its dissociation and dissolution provisions are the same as those in RULLCA<sup>202</sup> and ULPA<sup>203</sup> with only slight variation.<sup>204</sup> ULCAA, like RUPA, effectively requires capital accounting to be in member names.<sup>205</sup> Importantly, the organic rules are the governing authority for the entity and, unless restricted by ULCAA, may contain any provision concerning the relationship between the entity and the members, and the members to each other. The primacy of the organic rules is consistent with other state unincorporated acts.<sup>206</sup>

On the other hand, ULCAA does contain more mandated provisions than other unincorporated acts. Those provisions, however, relate to cooperative principles and, historically at least, cooperatives could be organized under unincorporated state law.<sup>207</sup> ULCAA also mandates centralized management very similar to corporate management schemes. Even corporate style management, however, sometimes is adopted by LLCs by operating agreement and is, therefore, not necessarily even a contraindication of unincorporated status.<sup>208</sup> Thus, a quick comparison of state law characteristics evidences that an LCA bears a far closer resemblance to other unincorporated entities than to corporate entities. It is soundly bottomed on unincorporated theory and jurisprudence.

#### E. The Separate but Intertwined Ideas of Exempt Organizations and the Deductibility of Contributions

##### 1. Generally

The tax law roughly classifies nonprofit corporations as "public benefit corporations (those benefitting the public, such as charitable organi-

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<sup>201</sup> See *infra* Part V.C.1.

<sup>202</sup> 6B U.L.A. 407 (2008).

<sup>203</sup> 6A U.L.A. 325 (2008).

<sup>204</sup> See *infra* Part V.B.2.

<sup>205</sup> See REV. UNIF. P'SHIP ACT § 401(a), 6 Pt. I U.L.A. 133 (2001); *infra* notes 400–

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<sup>206</sup> See *supra* notes 24–27 and accompanying text.

<sup>207</sup> See PACKEL, *supra* note 50, at 29.

<sup>208</sup> See *infra* notes 275–77 and accompanying text.

zations) and mutual benefit corporations (those benefitting their members, such as social clubs).<sup>209</sup>

Another common, but different, classification of nonprofit organizations is as either “donative nonprofits, those that obtain their funding from sources other than revenues, generally from donations, and . . . commercial nonprofits, those that obtain most of their financial resources from the selling of merchandise or from the rendering of services.”<sup>210</sup> While much of the literature addressing state nonprofit organizations focuses on nonprofit corporations, it is significant that nonprofit organizations may be formed as trusts or unincorporated associations.<sup>211</sup>

The scope of this Article does not extend to provide comprehensive, or even adequate, coverage of the federal income tax provisions relating to exempt organizations or the separate charitable deduction. However, introducing these topics is necessary for two reasons. First, even a cursory discussion of those tax concepts demarcates the separate notions of nonprofit organizations under state law, the exemption of an organization from the federal income tax, and the ability of a taxpayer to deduct donations from its income to a recognized subset of such organizations for purposes of calculating the taxpayer’s income tax liability. Second, it suggests possible uses, and limitations on use, of LCAs formed under ULCAA requiring careful planning analysis.

“A tax exempt organization is a type of nonprofit organization not subject to the federal income tax.”<sup>212</sup> As previously explained, traditional cooperatives sometimes are called nonprofit in the context of state law.<sup>213</sup> For example, homeowners associations are exempt organizations under Code section 528. The most visible kinds of tax exempt organizations,

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<sup>209</sup> PHELAN & DESIDERIO, *supra* note 125, at 2; see also Daniel Halperin, *Income Taxation of Mutual Nonprofits*, 59 TAX L. REV. 133 (2006).

<sup>210</sup> PHELAN & DESIDERIO, *supra* note 125, at 2.

<sup>211</sup> See, e.g., *id.* at 27–30. The American Law Institute currently has a Non-Profit Organizations Principles Project. Concerning charities it states:

§ 200 Choice of Form and of States of Organization and Operation

(a) The organizers of a charity may choose its legal form, as a charitable trust, a nonprofit corporation, an unincorporated association, or any other form permitted by state law.

AMERICAN LAW INSTITUTE, PRINCIPLES OF THE LAW OF NON-PROFIT ORGANIZATIONS COUNCIL DRAFT NO. 5 (Sept. 17, 2007).

<sup>212</sup> NICHOLAS P. CAFARDI & JACLYN FABEAN CHERRY, UNDERSTANDING NONPROFIT AND TAX EXEMPT ORGANIZATION 3 (2006).

<sup>213</sup> See *supra* Part III.B.4. Moreover, farmers’ cooperatives taxed under Code section 521 are identified as exempt cooperatives. See Freitag, *supra* note 85, at 24.



however, probably are governed by Code section 501. Subsection 501(c) alone has at least twenty-eight categories of exempt organizations.<sup>214</sup> The focus of this Part of the Article, however, is on the possible use of subsection 501(c)(3), under which charitable organizations may qualify for an exemption from federal income tax, in the context of LCAs.<sup>215</sup> The subsection 501(c)(3) exemption is available to the following types of organizations: religious, charitable, scientific, public safety testing, literary, educational, those fostering national and international amateur sports competitions, and those preventing cruelty to children and animals.<sup>216</sup> Private foundations and public charities are the two basic kinds of charitable organizations subsection 501(c)(3) contemplates.<sup>217</sup>

Generally, all organizations exempt under subsection 501(c)(3) are called charitable organizations because, with the exception of public safety testing organizations, the separate section providing a taxpayer a charitable deduction tracks the language of subsection 501(c)(3).<sup>218</sup> Thus, as a general matter, the ability to receive deductible contributions is one

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<sup>214</sup> See HOPKINS, *supra* note 178, § 1.2.

<sup>215</sup> See PHELAN & DESIDERIO, *supra* note 125, at 176.

<sup>216</sup> I.R.C. § 501(c)(3).

Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

*Id.*

<sup>217</sup> See generally PHELAN & DESIDERIO, *supra* note 125, at 281. Statutorily, Code section 501(c)(3) recognizes two types of organizations, “those that are private foundations and those that are not.” CAFARDI & CHERRY, *supra* note 212, at 6. Actually Code section 509 “defines those § 501(c)(3) organizations that qualify as public charities” by defining “private foundations” as “all § 501(c)(3) organizations *except* those listed in § 509 . . . that qualify as public charities.” PHELAN & DESIDERIO, *supra* note 125, at 281.

<sup>218</sup> See I.R.C. § 170 (the charitable deduction). For an overview of the charitable deduction, see, for example, CAFARDI & CHERRY *supra* note 212, at 275–76.

advantage of being exempt under subsection 501(c)(3) and is a distinguishing characteristic between subsection 501(c)(3) and other exemption provisions.<sup>219</sup>

Moreover, being exempt under subsection 501(c)(3) provides other advantages. For example, “most private foundations and governmental agencies will make grants only to 501(c)(3) organizations” and “[m]ost states exempt from taxation organizations that have [subsection] 501(c)(3) status.”<sup>220</sup>

## 2. ULCAA and Charitable Organizations

For purposes of this Article, the question is whether an LCA formed pursuant to ULCAA might be organized as a nonprofit association exempt under Code section 501(c)(3) or, separately, have members who are exempt under subsection 501(c)(3). Both of these questions have been analyzed recently in the context of LLCs.<sup>221</sup>

Consistent with state LLC statutes<sup>222</sup> and much state cooperative law,<sup>223</sup> ULCAA does not require an LCA organized under the Act to have a profit purpose or motivation. As promulgated, ULCAA states: “A limited cooperative association may be organized for any lawful purpose, whether or not for profit [except designated prohibited purposes].”<sup>224</sup> The bracketed language indicates that adopting jurisdictions should list in this subsection purposes they determine as a policy matter are inappropriate, if any, for LCAs. Conceivably, a jurisdiction might prohibit charitable purposes or certain kinds of charitable purposes. Absent the addition of non-uniform language, however, state law does not prohibit using an LCA for purposes of the subsection 501(c)(3) tax exemption.<sup>225</sup>

Assuming that the check-the-box federal income tax classification regulations apply the same way to LCAs as they do to LLCs,<sup>226</sup> the charitable use analysis of LCAs for purposes of the charitable exemption

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<sup>219</sup> See generally PHELAN & DESIDERIO, *supra* note 125, at 176.

<sup>220</sup> *Id.*

<sup>221</sup> See Robert R. Keatinge, *LLCs in the Nonprofit World*, XXXXII SUFFOLK U. L. REV. (forthcoming 2009).

<sup>222</sup> See *id.*

<sup>223</sup> See generally *supra* Part III.B.4. (discussing nonprofit nature of cooperatives).

<sup>224</sup> UNIF. LTD. COOP. ASS'N ACT § 105(b), 6A U.L.A. 168 (2008).

<sup>225</sup> Adopting jurisdictions should consider any variation in purpose language between their LLC statute and ULCAA and, further, the tentative draft of section 2007 in the *ALI Principles of the Law of Non-Profit Organizations* reproduced, *supra* note 211.

<sup>226</sup> See *supra* notes 182–83 and accompanying text.

should be the same as, or very similar to, that of LLCs. Therefore, performing the LLC analysis here is unnecessary. Simply raising the possibility that LCAs governed by ULCAA, under certain circumstances, might be organized as a nonprofit association exempt under Code section 501(c)(3), or have members who are exempt under that section, is enough. Any delimiting provisions in ULCAA that differ from the typical LLC statute could change the analysis under the detailed regulatory requirements of Code section 501(c)(3) as applied to LLCs. Any such comprehensive analysis is beyond the scope of this Article.<sup>227</sup>

Robert R. Keatinge has analyzed whether charitable organizations may be members of an LLC, and whether an LLC itself might be a charitable organization. His analysis clearly evidences that unincorporated associations for state law purposes may, under certain circumstances, be used for charitable purposes. Concerning whether an LLC may itself be an exempt organization under section 501(c)(3), Keatinge observes that the check-the-box classification regulations,<sup>228</sup> “expressly state that any organization that seeks to be treated as a tax-exempt organization will be treated as if it had made . . . an election [to be treated as a corporation for tax purposes].”<sup>229</sup>

Keatinge also analyzed the circumstances under which a charitable organization might be a joint venturer, partner, or LLC member without endangering its independent exempt status. As part of his analysis he discussed Revenue Ruling 98-15.<sup>230</sup> The given facts in the ruling involve a joint venture LLC comprised of a hospital exempt under section 501(c)(3) and a for-profit LLC. In addition, the revenue ruling contains further factual assumptions styled as Situation 1 and Situation 2 and analyzes the situations separately. The ruling concludes the hospital would not lose its exempt status under the facts as stated in Situation 1, but would lose its exempt status under the facts stated in Situation 2.<sup>231</sup>

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<sup>227</sup> See, e.g., *infra* note 229.

<sup>228</sup> See *supra* Part III.D. (discussing the classification regulations).

<sup>229</sup> Keatinge, *supra* note 221. Again, this Article does not attempt a comprehensive analysis of the other requirements to obtain section 501(c)(3) charitable tax status. For example, the Service has promulgated precise regulatory requirements concerning the distribution of assets upon the dissolution of a section 501(c)(3) organization. Compare UNIF. LTD. COOP. ASS'N ACT §§ 1004 (Allocation of Profits and Losses), 6A U.L.A. 265 and 1207, 6A U.L.A. 285 (Distribution of Assets in Winding Up Limited Cooperative Association) with Treas. Reg. § 1.501(c)(3)-(b).

<sup>230</sup> Keatinge, *supra* note 221 (citing Rev. Rul. 98-15, 1998-12 C.B. 718).

<sup>231</sup> See *id.*

Relatedly, a recent private letter ruling addressing the use of a corporate cooperative as a joint venture vehicle between political subdivisions is helpful.<sup>232</sup> For purposes of this Article, again, it is sufficient to note that it seems possible for a charitable organization to be a member of an LLC or, by reasonable analogy, an LCA governed by ULCAA.

#### IV. IDEAS: POSSIBLE USES

##### A. For-Profit Ideas

Many cooperatives have turned to the LLC or multiple-entity structures for the purpose of attracting capital because of difficulty in finding outside capital within the strict cooperative framework.<sup>233</sup> ULCAA offers an innovative alternative structure to traditional cooperatives for cooperative capital formation without the necessity of building a complicated multilevel legal architecture.

In general, a co-op that has a strong plan and uses alternative governance structures such as the LLC will find it easier to raise capital from both farmers (who are willing to invest in strong plans) and outside sources (which are now put off by the convoluted governance of most large co-ops).<sup>234</sup>

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<sup>232</sup> See I.R.S. Priv. Ltr. Rul. 08-36-005 (Sept. 5, 2008). The joint venture was between two political subdivisions of a state and a compact that included those subdivisions and others. The venture was formed to own and operate electric generation facilities and related goods and services on behalf of its members. The letter ruling stated that income derived from the cooperative would be exempt from federal income taxation under Code section 115(1) because the member entities were political subdivisions and the venture was a public utility or was the exercise of an essential government function. It also stated that contributions to the cooperative would be deductible as a charitable deduction and that bonds issued by the cooperative would be treated as bonds issued by its members (local governments).

Although the letter ruling addressed a corporate cooperative, it seems to evidence and generally support the nonprofit exempt use of cooperatives. See *supra* Part III.D. (discussing the check-the-box entity classification rules).

A nonprofit corporation operated on a cooperative basis by governmental entities and other nonprofit organizations to coordinate the provision of social services in Eagle County, Colorado, qualified for tax exempt status. See *infra* note 255 and accompanying text.

<sup>233</sup> See *supra* note 37 and accompanying text. For a summary of various structures, see ALBERTA AGRICULTURE, FOOD AND RURAL DEVELOPMENT in *Business Structure Options for New Generation Co-Ops*, INNOVATIVE BUSINESS ARRANGEMENTS (on file with Thomas Earl Geu).

<sup>234</sup> Dempsey et. al., *supra* note 40, at 72.

The LCA structure that ULCAA offers, as with any structure, may not be the correct fit for every potential investor. For example, ULCAA requires that an LCA with investor members allocate at least 50% of its profits to patron members.<sup>235</sup> This requirement may discourage outsiders from investing in the association for certain kinds of businesses. Nevertheless, ULCAA does provide investor members with a meaningful voice in governance and provides the LCA an opportunity to avoid or mitigate fixed cost debt financing with attendant loan covenants concerning governance decisions during the life of the loan. Those covenants, in effect, take away much of the association members' control on the topics addressed by those covenants.

Additionally, LCAs may represent a good vehicle for rural development.<sup>236</sup> ULCAA permits investor voting equity within a cooperatively based structure rather than forcing the entity to choose a different type of structure not based in cooperative principles. An example is Glacial Lakes Capital, LLC, which in 2004 addressed the problem of obtaining start-up equity by using an LLC structure that was not a strict co-op model in order to obtain local funding from nonproducers.<sup>237</sup>

The types of activity for which an ULCAA LCA may be used have few legal limitations.<sup>238</sup> Any limitation on an association's ability to attract outside investment will depend on factors outside ULCAA, such as

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<sup>235</sup> See UNIF. LTD. COOP. ASS'N ACT § 1004(c), 6A U.L.A. 265 (2008).

<sup>236</sup> See Study Report, *supra* note 29, at 2–3. See also Bill Oemichen, *New Wisconsin Cooperative Law: A Major Tool for Rural Economic Development*, AGRI-VIEW, Oct. 19, 2006, available at [http://www.agriview.com/articles/2006/10/19/capitol\\_news/producer03.txt](http://www.agriview.com/articles/2006/10/19/capitol_news/producer03.txt).

<sup>237</sup> See Steve Thompson, *Community Investments Helped Launch Plant*, RURAL COOPERATIVES, July/Aug. 2004, at 21, available at <http://www.rurdev.usda.gov/rbs/pub/jul04/jul04.pdf>.

<sup>238</sup> “A limited cooperative association may be organized for any lawful purpose . . . .” UNIF. LTD. COOP. ASS'N ACT § 105(b), 6A U.L.A. 168. An adopting jurisdiction may provide exceptions within section 105(b) or in other ways. See *id.* § 105, Legislative Note and cmt. (b), 6A U.L.A. 168. A close examination of the limited cooperative statutes that predate ULCAA also will show these structures can be used beyond agriculture, although agricultural activities usually are the predominant purpose stated in the statutes. See IOWA CODE ANN. § 501A.501 (West 2008) (referencing other statutes that permit “any lawful purpose” and “any lawful business”); MINN. STAT. ANN. § 308B.201(3) (West 2004 & Supp. 2008) (“[F]or any other purposes that cooperatives are authorized to perform by law.”); TENN. CODE ANN. § 43-38-201 (2008) (“[F]or purposes that cooperatives are authorized.”); WIS. STAT. ANN. § 193.201 (West 2002 & Supp. 2008) (“any other lawful purpose” with exceptions for cooperative utilities). The Tennessee statute requires all associations organized under it to receive the Tennessee Commissioner of Agriculture's approval. See TENN. CODE ANN. § 43-38-203 (2007).

an investor's view of the business's potential success (risk), the proposed division of profits, the investor's ability to influence decisions in the association through the association's voting structure, the investor's desire to support the activities of the association's activities, and other factors. For the foregoing reasons, an investment in an association organized under ULCAA may be more appealing to a merchant banker or a local citizen than to an investment banker or an individual seeking short term equity appreciation.<sup>239</sup>

A group of persons joining together in an activity related to the use of products, merchandise, or services (in a broad sense)<sup>240</sup> may consider a cooperative entity as part of the menu for entity selection. ULCAA is not intended to displace any existing state cooperative organization statute,<sup>241</sup> but ULCAA's flexibility enables it to construct an entity that fits the traditional cooperative model. Further, ULCAA has the flexibility to

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<sup>239</sup> One interesting possible use of the LCA, for example, is as an entity vehicle for multifamily dairy operations (MFDOs). An article that analyzed MFDOs stated:

[T]hree cases were found in which an MFDO was initiated not by farmers but by non-farmers interested in "community economic development". In one case, which actually arose in Utah, the non-farmer was a town doctor who was fast losing patients after the local sugar beet processing plant closed down, and area farmers lost the primary market for their farms products. The doctor led a group of community leaders and farmers to develop a 1400-cow dairy facility. The facility provided a market for feed grown on twenty separate farms, employed 17 full-time and 7 part-time employees, and produces about \$3 million dollars worth of milk per year.

Greg Lawless, Robert Cropp, & Phil Harris, *Cooperative Ownership Compared to Other Business Arrangements for Multi-Family Dairy Operations*, UCC OCCASIONAL PAPER No. 11 (Univ. of Wis. Center for Cooperatives), April 1996, available at <http://www.uwcc.wisc.edu/staff/lawless/coopvs3.html>.

Less optimistic for co-ops, the *Sioux City Journal* quotes an investment advisor as saying:

Limited liability corporations are soon going to dominate agriculture as the primary, preferred capitalization structure . . . .

. . .

Kruse said the structure of farm cooperatives is almost defunct and evolving to LLCs because the one-man, one-vote concept is inequitable, and a farmer must invest in order to do significant business with co-ops. Co-ops, he added, provide only restricted access to capital and are less profit driven.

Russ Oechslein, *Ag Leader Sees Growth in LLCs*, SIOUX CITY J., Mar. 16, 2008.

<sup>240</sup> See *supra* notes 1-3 and accompanying text.

<sup>241</sup> "ULCAA is a free standing act and its terms neither repeal nor modify existing state cooperative statutes nor entities formed under them." UNIF. LTD. COOP. ASS'N ACT, Prefatory Note, 6A U.L.A. 153 (2008).

encourage capital contributions to those LCAs whose activities require more capital than can be readily provided by patron members.

ULCAA anticipates that an investor's objective may include direct participation in the association's activities beyond the receipt of a direct return on investment. For example, assume a group of wheat farmers wants to construct a value-added pasta production facility that will cost \$2 million for construction and startup. To become a patron member, the farmers could require a five-year contract commitment to deliver the wheat from which pasta would be produced plus an investment of \$10,000. If 40 producers become patron members, their aggregate investment would be \$400,000, 20% of the cost. A commercial pasta maker agrees to contribute \$600,000, 30% of the cost. In addition, the pasta maker agrees to supply manufacturing management for five years. Finally, for the new venture to obtain the remaining \$1 million, the group turns to traditional lending sources and the pasta maker agrees to execute a \$300,000 stand-by letter of credit to help secure the loan.<sup>242</sup>

In the preceding example, the patron members will use the association as a premium market for the wheat they produce. Their respective \$10,000 investments may be seen simply as the cost of the opportunity to contract with the association to sell wheat at higher prices than available elsewhere. The \$10,000 also could be structured as an investment in the association, making the patron member also an investor member entitled to share in any allocations and distributions the association will make to investor members. The pasta maker would be an investor member, but the association also could be structured to permit the pasta maker to be a patron member as a worker instead of a contractor, like workers in a worker-owned cooperative are patrons by way of providing jobs for themselves. The pasta maker could be paid some amount under a separate contract for the agreement to provide the stand-by letter of credit, or the value of providing the letter could be an additional contribution (equity).

This example serves to illustrate the various ways in which an LCA can be planned to provide many different combinations of memberships, which provide a variety of financial results.<sup>243</sup> In the example, the association's investor members are confined to the pasta maker or a combination of the pasta maker and the patron members. Persons with a community spirit may be able to invest and become investor members as a

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<sup>242</sup> See Geu & Dean, *supra* note 52, at 96, Ex. 3.

<sup>243</sup> See *id.* at 102–08 (containing more extensive illustrations of various financial results that can be achieved through membership structuring and contracts).

means of supporting the community's economic life because the pasta factory will create jobs and presumably some level of additional local consumer spending.

The example also illustrates that persons utilizing the association in very different ways may be combined in an association under ULCAA (the producers of wheat and the pasta maker as a worker), as investor members (the pasta maker strictly as an investor and the producers as both patron members and as investor members), or both. This flexibility is not unique to associations under ULCAA, but ULCAA tends to focus the possibilities.

ULCAA may challenge traditional notions, which rise to the level of a cooperative principle, that outside investors should not be cooperative members.<sup>244</sup> ULCAA, or a similar statute, provides an alternative entity that permits persons who would be traditional members of a cooperative to affiliate cooperatively with providers of capital who have an opportunity to influence the cooperative's affairs through voting rights. This alternative can be seen as a bifurcation point in cooperative organizations' evolutionary development. ULCAA's importance is that its mandatory and default rules require an association organized pursuant to the Act to recognize specific cooperative principles to a greater degree than entities organized under similar statutes as an LLC.

#### B. Nonprofit and Low-Profit Ideas: The Emerging Social Sphere

Flexible state law organizations are needed to leverage the ability of exempt organizations to perform their exempt purposes.<sup>245</sup> Further, a growing interest exists in applying for-profit business management techniques and law for social purposes whether or not those ventures qualify for special federal income tax benefits or exemptions.<sup>246</sup> ULCAA is potentially useful in this social sphere because of its historical values based on cooperative principles<sup>247</sup> and its market orientation.<sup>248</sup>

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<sup>244</sup> See *supra* notes 75–76 and accompanying text.

<sup>245</sup> See *id.* (discussing the advent of a variation to LLC law termed the L3C, an acronym for “low-profit limited liability companies,” whose purpose is to accomplish one or more charitable purposes of a private foundation).

<sup>246</sup> See *infra* notes 249–50 and accompanying text.

<sup>247</sup> See *supra* notes 83–86 (discussing cooperative values).

<sup>248</sup> See generally *supra* Part III.B.2. (discussing purposes of cooperatives).



Nobel Peace Prize laureate (and banker) Muhammad Yunus popularized “social business” or “social enterprise.”<sup>249</sup> A recent news story suggested that Yunus “has proposed and already tested” an answer to “the profit maximization vs. charity dilemma.”<sup>250</sup> The answer is “to create a new hybrid option: the social business.”<sup>251</sup> As explained in the news story: “Social businesses have investors—but they’re neither hoping to maximize profits nor writing off their investment as a charitable gift. The first profits from a social business go to paying back the investors.”<sup>252</sup> One of the goals of social businesses is to “create solutions that are self-sustaining.”<sup>253</sup> Yunus identifies a number of causes that might be appropriate for a social business, for example, providing health care “to those currently left out.”<sup>254</sup>

Perhaps, hypothetically, a group of families in need of home health care could form an LCA. The patron members (family members) could combine to buy health care products in larger lots for cost savings (features of a purchasing cooperative) and agree to contribute a certain amount of time to provide short-term care for other families. The investor member might be a home health care product or service provider that would invest start-up capital and enter into a contract to provide products and to provide a visiting nurse to the pooled group of patron members. In effect, the investor service and product provider would be guaranteeing full utilization of the constant demand for its products and full utilization of the nurse. Any profit beyond the contract price then would be returned

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<sup>249</sup> See, e.g., Muhammed Yunus, Speech, *Social Enterprise: Doing Well by Doing Good*, 1 J. BUS. ENTREPRENEURSHIP & L. 99 (2007).

<sup>250</sup> Alan M. Webber, *Giving the Poor the Business*, USA TODAY, May 21, 2008, at A11.

<sup>251</sup> *Id.*

<sup>252</sup> *Id.*

<sup>253</sup> *Id.*

<sup>254</sup> *Id.* Yunus is not the only champion of social enterprises. Former president Bill Clinton’s Clinton Foundation’s HIV/AIDS program uses the same techniques. See Jonathan Rauch, *This Is Not Charity*, ATLANTIC MONTHLY, Oct. 2007, at 65–76. In2Books, which converted from a nonprofit to a for-profit model, also uses the same techniques. See Steve Lohr, *Capitalist Jolt for Charity: Can Business Extend the Reach of Nonprofits*, N.Y. TIMES, Feb. 24, 2008, at Sunday Business 1. See also, Christopher Lim, Google.org, *For-Profit Charitable Entity: Another Smart Decision by Google*, 17 KAN. J.L. & PUB. POL’Y 28 (2007). Other countries have passed specific social organization legislation. Some of the legislation is based in cooperative law. See Fabrizio Cataggi & Paola Iamicel, *New Frontiers in the Legal Structure and Legislation of Social Enterprises in Europe: A Comparative Analysis*, EUR. UNIV. INST. WORKING PAPERS, Law 2008/16, available at <http://ssrn.com/abstract=1303407>.

to the individual patron members on the basis of some combination of their purchased supplies and the amount of contributed time.

Finally, ULCAA also might provide another vehicle for creative public-private partnerships. For example, nonprofit and governmental organizations formed the Eagle Valley Family Center in 1995 as a section 501(c)(3) organization, based and operated on cooperative principles, to address coordination of health and human services needs and programs in the county.<sup>255</sup>

## V. ULCAA: EXPLANATION, ANALYSIS, AND USER GUIDE

### A. Nature, Structure, and Interpretation

#### 1. Necessary Background and Overview

ULCAA's structure generally follows the structure of RULLCA,<sup>256</sup> ULPA,<sup>257</sup> and RUPA.<sup>258</sup> Many of the section captions are similar to those used in the other uniform unincorporated acts.<sup>259</sup>

Sections 107 (Governing Law), 108 (Supplemental Principles of Law), and 113 (Effect of Organic Rules) relate to how to interpret and apply ULCAA's provisions.<sup>260</sup> The starting point in interpretation, however, is that an LCA is contractually based and intended to be an unincorporated organization.<sup>261</sup> Of course, the organization is an entity,

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<sup>255</sup> See Ry Southard, *The Rural Heartbeat: Health Network Enhances Services in Mountain Community*, RURAL COOPERATIVES, May/June 1996, at 32, available at [http://www.uwcc.wisc.edu/info/farmer/pre2001/63\\_3\\_32.html](http://www.uwcc.wisc.edu/info/farmer/pre2001/63_3_32.html).

<sup>256</sup> 6B U.L.A. 407 (2008).

<sup>257</sup> 6A U.L.A. 325 (2008).

<sup>258</sup> 6 Pt. I U.L.A. 1 (2001 & Supp. 2008).

<sup>259</sup> See, e.g., REV. UNIF. LTD. LIAB. CO. ACT §§ 105 (Powers), 401 (Becoming a Member), 503 (Charging Orders), 6B U.L.A. 438, 478, 498 (2008); UNIF. LTD. COOP. ASS'N ACT §§ 106 (Powers), 116 (Dual Capacity), 502 (Becoming a Member), 605 (Charging Orders for Judgment Creditor of Member or Transferee), 1101 (Member's Dissociation), 6A U.L.A. 169, 182, 208, 233, 276; UNIF. LTD. P'SHIP ACT (2001) §§ 113 (Dual Capacity), 601 (Powers and Dissociation as Limited Partner), 703 (Rights of Creditor of Partner or Transferee), 6A U.L.A. 384, 450, 463 (2008).

<sup>260</sup> See UNIF. LTD. COOP. ASS'N ACT §§ 107, 108, 113, 6A U.L.A. 170-71, 176-80.

<sup>261</sup> See *infra* notes 263-70 and accompanying text. Unlike Delaware alternative entities (but like other uniform laws), ULCAA does not state specifically that LCAs are contracts. This is more than semantics. Nonetheless ULCAA intends that LCAs are contract based. See *infra* notes 263-70 and accompanying text and Part V.D. See also, e.g., DEL. CODE ANN. tit. 6, § 18-1101(b) (1999).

too,<sup>262</sup> and its separate provisions fall on a continuum stretching from statutory mandates to default rules. Stated another way, the result of being both contract and entity creates the same tension in ULCAA as it does in other unincorporated acts. This tension animates ULCAA's interpretation.

The contractual nature of the LCA is not merely because of its unincorporated nature.<sup>263</sup> Historically, courts recognize that even traditional corporate cooperatives have strong contractual underpinnings.<sup>264</sup> Contract law takes on an added dimension because, unlike most other business organizations, a cooperative's owners are also customers or the suppliers of the goods, commodities, or services purveyed or used by the cooperative. Further, some contracts for goods or services between the owner and the cooperative expressly or impliedly establish an agency relationship. Under those contracts the cooperative is an agent for its members.<sup>265</sup> Even purchase or sale contracts between the member and the cooperative that do not establish an agency relationship nonetheless drag contract principles, including the principle of good faith performance of contractual obligations, into that aspect of the relationship. The reason a member's interest in a cooperative frequently includes "the right

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<sup>262</sup> UNIF. LTD. COOP. ASS'N ACT § 105(a), 6A U.L.A. 168 ("A limited cooperative association is an entity distinct from its members.").

<sup>263</sup> ULCAA section 104 states:

(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.

*Id.* § 104, 6A U.L.A. 166.

<sup>264</sup> See, e.g., *Rifle Potato Growers' Coop. Ass'n v. Smith*, 240 P. 937 (Colo. 1925); *State ex rel. Boldt v. St. Cloud Milk Producers Ass'n*, 273 N.W. 603 (Minn. 1937); *Boyle v. Pasco Growers' Ass'n, Inc.*, 17 P.2d 6 (Wash. 1932).

<sup>265</sup> See, e.g., *Sharlene F. Roberts-Caudle, Agricultural Cooperative Member Equity: You Don't Have to Die for It!*, 7 SAN JOAQUIN AGRIC. L. REV. 1, 8 (1997).

or obligation . . . to do business with the . . . cooperative” belies the fundamental contractual economic purpose for which the cooperative is organized.<sup>266</sup> Indeed, the use of the cooperative by its patron members is the economic reason for the existence of cooperatives, is their legal purpose, and rises to the level of one of the cooperative principles.<sup>267</sup>

Private provision for use of the cooperative by members in corporate cooperatives historically has been written in one, or a combination of, the following places: discrete contracts, the bylaws, the articles of incorporation, or the separate membership agreements.<sup>268</sup> These contracts implicate a deep and unavoidable interrelationship between the use and governance of a cooperative. The members’ use of the cooperative directly relates to the members’ ownership of the cooperative because profit (surplus) is allocated to members’ capital accounts, and those accounts are intended to be distributed or redeemed at a future time.<sup>269</sup> Redemptions in traditional corporate cooperatives, therefore, are treated somewhat similarly to distributions from capital accounts in general partnerships whether during winding-up or on an interim basis.<sup>270</sup>

On the other hand, an LCA is an entity, just as partnerships and LLCs are entities under modern law.<sup>271</sup> Historically, cooperative statutes evolved to be corporate-based entities “to take advantage of the limited liability and the formal structures for decision making available under corporation law.”<sup>272</sup> Furthermore, “[concerning] . . . decisions about day-to-day management, such as hiring, firing, promotion, salaries of em-

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<sup>266</sup> UNIF. LTD. COOP. ASS’N ACT § 601(2)(C), 6A U.L.A. 226 (2008). For further discussion of members’ interests, see *infra* note 346 and accompanying text.

<sup>267</sup> See *supra* notes 71, 82–86 and accompanying text (discussing cooperative principles).

<sup>268</sup> See Roberts-Caudle, *supra* note 265, at 11. For a discussion of a related aspect of member contracts and the cooperative, see *infra* Part V.D.

<sup>269</sup> See Roberts-Caudle, *supra* note 265, at 15. (“Most state [corporate cooperative] statutes allow cooperatives through bylaws and other documents to control the redemption of members’ and former members’ deferred patronage refunds.”) (citing 14 NEIL E. HARL, AGRICULTURAL LAW § 131.04(2)(c), (e) (1993)). For further discussion of redemptions, see *infra* Part V.C.4.a.

<sup>270</sup> Cf. REV. UNIF. P’SHP ACT § 807(b), 6 Pt. I U.L.A. 206 (2001). See *infra* Part V.C.4.a.

<sup>271</sup> Compare UNIF. LTD. COOP. ASS’N ACT § 105, 6A U.L.A. 168, with REV. UNIF. P’SHP ACT § 201, 6 Pt. I U.L.A. 91, and REV. UNIF. LTD. LIAB. CO. ACT § 104, 6B U.L.A. 437 (2008).

<sup>272</sup> Roberts-Caudle, *supra* note 265, at 7.

ployees, expansion, [and] downsizing, . . . the cooperative operates like a for-profit corporation.”<sup>273</sup>

Members, therefore, have an ownership relationship with the cooperative entity similar to shareholders in corporations and limited partners in limited partnerships. The quoted material is important for an additional reason: It emphasizes that cooperative decision making in many, or even most, traditional cooperatives is structured in a centralized way.<sup>274</sup> ULCAA mandates centralized management at least simulating the corporate board structure.<sup>275</sup> Such management is not inconsistent with unincorporated law. For example, LLCs may be manager managed, and operating agreements that establish a decision making system that simulates corporate structure by establishing a board of directors is not uncommon.<sup>276</sup>

## 2. *Structure and Interpretation: The Effect of Organic Rules*

The governance structure ULCAA contemplates means that directors manage the entity and the members own the entity. Members, however, contract for use of the entity.<sup>277</sup> The membership relationships and governance of cooperatives, therefore, contain layers of interrelated but

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<sup>273</sup> *Id.*

<sup>274</sup> See *infra* Part V.E.3. Relatedly, hierarchical and representative centralized management are hallmark characteristics of corporations, though the default provisions of limited partnership law arguably invest more discretion and, thus, centralized management authority in the general partner than corporations do in the board of directors. According to Packel, “the avoidance of personal liability” and “continuity of existence [of life]” are reasons for a cooperative to incorporate. PACKEL, *supra* note 50, at 33. These advantageous features are no longer limited to corporations and are reasons why LLCs are popular. Packel also stated:

Most cooperatives, other than the labor unions, have preferred to become incorporated. The lines of authority and the internal rights of the members, as well as the relations of the cooperative to third persons becomes much clearer and more certain with incorporation. Incorporation tends to produce more orderly administration of the affairs of the cooperative.

*Id.* at 34–35.

<sup>275</sup> See UNIF. LTD. COOP. ASS’N ACT § 801, 6A U.L.A. 241 (2008); *infra* notes 523–26 and accompanying text.

<sup>276</sup> See, e.g., JEAN L. BATMAN, ADVISING THE SMALL BUSINESS: FORMS AND ADVICE FOR THE LEGAL PRACTITIONER 255–307 (2007) (Form 7J: Operating Agreement Delaware Series). The form agreement provides for a board of directors and officers. Illustratively, it expressly provides for the election and qualification of directors. The directors are elected at an annual meeting. See *id.* at 275.

<sup>277</sup> See *infra* note 346 and accompanying text (discussing membership interests).

discrete characteristics unique to cooperatives. ULCAA's interpretative provisions and its organic rules' effect<sup>278</sup> reflect this layering. Moreover, unlike general LLC law, which does not mandate centralized management or a board structure, ULCAA does mandate such a structure. The purpose of the mandate is to imbue the LCA with the cooperative principle of democratic control by members as currently interpreted in the dominant corporate cooperative context. In effect, ULCAA hard wires a board structure (making the board structure mandatory) in an attempt to assure that an LCA is a kind of cooperative in more than name alone.<sup>279</sup> Unfortunately, both the mandatory provisions and the cooperative principles reflected add to the number of provisions contained in ULCAA and may complicate its interpretation. In turn, the complication emphasizes the importance of proper planning and drafting.<sup>280</sup>

Section 113 of ULCAA is captioned "Effect of Organic Rules",<sup>281</sup> section 110 of ULPA is captioned "Effect of Partnership Agreement; Nonwaivable Provisions",<sup>282</sup> and section 110 of RULLCA is captioned "Operating Agreement, Scope, Function, and Limitations."<sup>283</sup> Although the corresponding sections share a similar purpose, section 113 of ULCAA operates in a differently nuanced way because of the nature of a cooperative and the addition of cooperative principles.<sup>284</sup>

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<sup>278</sup> See *infra* notes 286–93 and accompanying text (discussing organic rules).

<sup>279</sup> Corporate cooperative statutes also use mandatory provisions that reflect cooperative principles. As of 1982, the corporate cooperative statutes of thirty-two states defined cooperative as "doing business on a cooperative plan." BAARDA, *supra* note 96, at 19–20.

<sup>280</sup> Although in a different context (a discussion of cooperatives and antitrust law), the following quote underscores the importance of careful planning and drafting:

In order to avoid misunderstandings by members, by customers, by the public, it is important that the constitution and bylaws be carefully drawn so as to express in full the purposes of the association and every agreement underlying its organization. This is advisable everywhere. . . . The fundamental propositions must be framed that even a judge not versed in business will be able to understand the plan.

Gilbert H. Montague, "Cooperation" and the Anti-Trust Laws, 63 ANNALS AM. ACAD. POL. & SOC. SCI. 69, 71 (1916) (quoting ARTHUR J. EDDY, THE NEW COMPETITION (1915)); cf. Randy E. Dunn & James B. Dean, "1001 Questions" Concerning Bylaws of Agricultural Cooperatives, 4 AGRIC. L.J. 297 (1982).

<sup>281</sup> UNIF. LTD. COOP. ASS'N ACT § 113, 6A U.L.A. 176 (2008).

<sup>282</sup> UNIF. LTD. P'SHIP ACT (2001) § 110, 6A U.L.A. 378 (2008).

<sup>283</sup> REV. UNIF. LTD. LIAB. CO. ACT § 110, 6B U.L.A. 442 (2008).

<sup>284</sup> See UNIF. LTD. COOP. ASS'N ACT § 113(a), 6A U.L.A. 176.

Section 113 of ULCAA contains four subsections. By way of overview, subsection (a) states, in part: “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.”<sup>285</sup>

The textual language following the introductory phrase is similar in function, operation, and scope with both ULPA and RULLCA.<sup>286</sup> Simply stated, this language means that the organic rules govern the internal affairs of an LCA.

Section 113(a)’s introductory phrase differs from those in ULPA or RULLCA. The introductory phrase’s language is significant in the mechanical operation of the balance of section 113 as well as having independent substantive significance. The phrase reads, “Unless required, limited, or prohibited by this [Act]. . . .”<sup>287</sup> Two subsections follow the general statement. Those subsections identify sections distributed throughout ULCAA that contain specific restrictions on the flexibility inherent in the organic rules as stated generally in subsection (a).<sup>288</sup>

Subsection 113(b) identifies provisions that can be varied only in the articles of organization.<sup>289</sup> Subsection 113(c) identifies provisions that may be varied anywhere in the organic rules, that is, either in the articles of organization or the bylaws.<sup>290</sup> Unlike RUPA, ULPA, and RULLCA, the specific provisions identified in subsections 113(b) and (c) in ULCAA do not contain the operative text of the restrictions and limitations. Thus, subsections (b) and (c) operate more like corporate law statutes, which (mostly) list what can be varied in the articles of incorpora-

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<sup>285</sup> *Id.*

<sup>286</sup> Compare *id.* with REV. UNIF. LTD. LIAB. CO. ACT § 110, 6B U.L.A. 442, and UNIF. LTD. P’SHP. ACT (2001) § 110, 6A U.L.A. 378.

<sup>287</sup> UNIF. LTD. COOP. ASS’N ACT § 113(a), 6A U.L.A. 176 (2008). The corresponding phrase in RULLCA is, “Except as otherwise provided in subsections (b) or (c). . . .” REV. UNIF. LTD. LIAB. CO. ACT § 110(a), 6B U.L.A. 442 (2008). The corresponding phrase in ULPA is “Except as provided in subsection (b). . . .” UNIF. LTD. P’SHP. ACT (2001) § 110(a), 6A U.L.A. 378. Note, by comparison, that RULLCA and ULPA attempt to list comprehensively and conclusively what cannot be varied or what may be varied only within prescribed limits, and ULCAA does not follow that scheme.

<sup>288</sup> See UNIF. LTD. COOP. ASS’N ACT § 113(b)–(c), 6A U.L.A. 176–77 (2008).

<sup>289</sup> See *id.* § 113(b), 6A U.L.A. 176.

<sup>290</sup> See *id.* § 113(c), 6A U.L.A. 177.

tion, rather than like unincorporated laws, which list what cannot be varied.<sup>291</sup>

Subsection 113(d) is categorically similar to subsections (b) and (c), but is different in kind from them. This subsection simply cross-references the requirement that the organic rules must address member contributions. Subsection 113(d) is different in kind from subsections (b) and (c) because it neither identifies a section, nor purports to limit the terms of the organic rules; instead, it identifies the only place in ULCAA where a topic is required to be addressed by the organic rules without a default.<sup>292</sup> Subsection (d) also serves as an example of a mandatory provision required under subsection (a)'s introductory clause. More precisely, contributions must be addressed by the terms of the organic rules, but the substance of terms themselves is not circumscribed.

As described in this Article so far, the parsing of section 113 yields: first, the background law of LCAs, like other state law unincorporated organizations, is contractual and, as a result, "[u]nless required, limited, or prohibited by this [Act]," the parties have contractual freedom to decide matters not addressed in ULCAA (or where there is a gap in its provisions).<sup>293</sup> Second, subsections (b) and (c) identify specific sections of ULCAA that contain limitations on the contractual freedom inherent in subsection (a). These latter subsections are helpful in understanding the operation of subsection (a) and, in addition, should help practitioners use the Act more efficiently.

Two other interpretive matters require further discussion. While subsections (b) and (c) identify express limitations, they do not identify all required provisions as set out by subsection (a)'s introductory clause. In addition, many of ULCAA's provisions expressly contain the phrases

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<sup>291</sup> Compare REV. UNIF. P'SHIP ACT § 103, 6 Pt. I U.L.A. 73–74 (2001), with REV. MODEL BUS. CORP. ACT § 2.02 (2008).

<sup>292</sup> ULCAA does address the form, manner, and valuation of contributions. See *infra* notes 387–94 and accompanying text (discussing ULCAA sections 1001 through 1003).

<sup>293</sup> Perhaps as importantly, it also avoids a nettlesome dormant preemption interpretation that requires the statute give express permission in order for the organic rules (or members) to even address a topic. For example, the Minnesota Cooperative Association Act has provisions about member-control agreements. See MINN. STAT. ANN. § 308B.627 (West 2004); see also REV. MODEL BUS. CORP. ACT § 7.32 (2008) (shareholder agreements). ULCAA does not contain those provisions. Nonetheless, the general rule in ULCAA section 113(a) is intended to mean that the organic rules can address member-control agreements, and in absence of prohibitions in the organic rules, individual members are not prohibited from entering such agreements. See UNIF. LTD. COOP. ASS'N ACT § 113(a), 6A U.L.A. 176 (2008). Other law (including, perhaps, equity) is left to govern those agreements as may be appropriate in the context of an LCA.



“unless the organic rules otherwise provide”<sup>294</sup> or “unless the articles of organization otherwise provide.”<sup>295</sup> Those provisions are not identified in subsections (b) and (c) because they do not contain any limitation on what the organic rules may supply as terms.

The provisions that contain the phrases “unless the organic rules otherwise provide” or “unless the articles of organization otherwise provide” appear in provisions where the flexibility under the general rule of subsection (a) would apply even without the phrase. The phrase emphasizes inherent flexibility and provides certainty of interpretation where used.<sup>296</sup> The use of such phrases is unique to the ULCAA as compared to other uniform unincorporated acts, which use the section addressing the effect of the operating agreement purportedly to identify all “nonwaivable” provisions.<sup>297</sup> In that regard, ULCAA imports notions of drafting

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<sup>294</sup> *E.g.*, UNIF. LTD. COOP. ASS’N ACT § 515(a), 6A U.L.A. 222 (2008) (stating, in part: “[U]nless the organic rules otherwise provide, voting by a proxy at a members meeting is prohibited.”).

<sup>295</sup> *E.g.*, *id.* § 504 (stating, in part: “[U]nless the articles of organization otherwise provide, a debt obligation, or other liability of a limited cooperative association is solely that of the association.”).

<sup>296</sup> *Cf.* UNIF. LTD. COOP. ASS’N ACT § 113(a), 6A U.L.A. 176.

<sup>297</sup> The express language of RULLCA states:

- (a) Except as otherwise provided in subsections (b) and (c), the operating agreement governs:
  - (1) relations among the members as members and between the members and the limited liability company;
  - (2) the rights and duties under this [act] of a person in the capacity of manager;
  - (3) the activities of the company and the conduct of those activities; and
  - (4) the means and conditions for amending the operating agreement.

REV. UNIF. LTD. LIAB. CO. ACT § 110(a), 6B U.L.A. 442 (2008).

This contrasts with ULCAA’s corresponding language which states:

- (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.

UNIF. LTD. COOP. A’SSN ACT § 113, 6A U.L.A. 176 (2008).

The corresponding provision in ULPA states:

- (a) Except as otherwise provided in subsection (b), the partnership agreement governs relations among the partners and between the partners and the partnership. To the extent the

style from “alternative entity statutes” from Delaware and corporate law.<sup>298</sup> Generally, ULCAA provisions that do not contain the phrase “unless otherwise provided” remain subject to the broadly flexible rule of subsection (a) which, in relevant part, states: “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.”<sup>299</sup>

The final analytical issue addressed in this portion of the Article, is the rubric used for identifying ULCAA requirements in the absence of either an express limitation or a confirmation that the provision is a default rule. The determination of what is required is a matter of interpretation on a provision-by-provision basis. The determination, however, is unambiguous for most provisions. For example, ULCAA frequently uses the words “shall”<sup>300</sup> or “must”<sup>301</sup> without the clause “unless otherwise provided”<sup>302</sup> to indicate that the text in which it appears is required.<sup>303</sup>

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partnership agreement does not otherwise provide, this [Act] governs relations among the partners and between the partners and the partnership.

UNIF. LTD. P'SHIP ACT (2001) § 110(a), 6A U.L.A. 378 (2008).

The Revised Uniform Unincorporated Nonprofit Associations Act arguably adopts a style closer to ULCAA than to RULLCA or ULPA. *See* REVISED UNINCORPORATED NONPROFIT ASS'NS ACT (2008), [http://www.law.upenn.edu/bll/archives/ulc/hunaa/2008\\_amdraft.pdf](http://www.law.upenn.edu/bll/archives/ulc/hunaa/2008_amdraft.pdf) (last visited May 31, 2009).

<sup>298</sup> Illustratively, the Delaware Limited Liability Company Act states: “*Unless otherwise provided in the limited liability company agreement*, a member or manager of a limited liability company. . . .” DEL. CODE ANN. tit. 6, § 18-407 (2005) (emphasis added).

This approach may have marginal advantages of efficiency in the opinion process because sections that include the “unless” preface may be cited authoritatively without the additional necessity of citing (and perhaps discussing) the broader general rule.

RMBCA, for example, states:

- (a) Except as otherwise provided in this section, a corporation may indemnify an individual . . . if: . . .
- (2) he engaged in conduct for which broader indemnification has been made permissible or obligatory under a provision of the articles of incorporation (as authorized by section 2.02(b)(5)) . . . .

REV. MODEL BUS. CORP. ACT § 8.51(a) (2008) (emphasis added) (section 2.02 is captioned “Articles of Incorporation”).

<sup>299</sup> UNIF. LTD. COOP. ASS'N ACT § 113(a), 6A U.L.A. 176 (2008).

<sup>300</sup> *See, e.g.*, UNIF. LTD. COOP. ASS'N ACT §§ 508, 1207, 6A U.L.A. 216, 285.

<sup>301</sup> *See, e.g., id.* §§ 113(d), 501, 6A U.L.A. 178, 208.

<sup>302</sup> *See supra* note 296 and accompanying text.

ULCAA also expresses required prohibitions by using the term “may not,” “may only,” and, infrequently, close derivations on those phrases.<sup>304</sup>

Perhaps the most difficult interpretive issues raised by the word *required* are provisions styled as unmodified declarative statements in ULCAA. Such statements appear, for example, in the filing and other administrative provisions.<sup>305</sup> Section 120 captioned, “Service of Process,” exemplifies such a provision. Although not expressly stated as mandatory, service of process nonetheless is required. This particular section is required for two independent reasons. The first reason does not rely on the word *required*. Simply, section 113(a)’s general rule of flexibility does not apply because it is not the kind of “activities of the association” that are susceptible to members’ agreement.<sup>306</sup> Even RULLCA’s approach of identifying mandatory rules (through exclusion) does not include the parallel service of process as an exception to its general rule.<sup>307</sup> The second reason service of process is mandatory under ULCAA is because, unlike RULLCA, ULCAA subsection 113(a) contains the introductory clause “[u]nless . . . required.”<sup>308</sup>

As a practical matter, recognizing where interpretation of the “[u]nless . . . required . . .” phrase will even be an issue is helpful. First,

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<sup>303</sup> See NAT’L CONF. OF COMM. ON UNIF. STATE LAWS, DRAFTING RULES, Rule 203, at 7 (2006) [hereinafter DRAFTING RULES].

<sup>304</sup> *Id.* Rule 204, at 7. The word “may” is used frequently in ULCAA. There are at least three meanings of the word “may” that are relevant:

- (1) “To be allowed or permitted. . .”;
- (2) “[u]sed to indicate a certain measure of possibility,” like in having a choice among alternatives;
- (3) “[t]o be obliged; must.”

THE AMERICAN HERITAGE DICTIONARY 1112 (3d ed. Houghton Mifflin Co. 1992).

The use of “may” in ULCAA conforms with (1) above, though sometimes with the additional gloss of a possible sense of (2). See generally NCCUSL DRAFTING RULES, *supra* note 303, Rule 203, at 7. In ULCAA, “may” is frequently used to confirm a power that often would exist by applying section 113(a). The convention used in uniform projects is to use “must” or “shall,” but not “may,” to mean “to be obliged.” *Id.* at Rule 203(d). The word “may” itself does not typically cause ambiguity. Instances in which a declarative statement without modification uses the term “may,” however, might require statutory interpretation based on context.

<sup>305</sup> See UNIF. LTD. COOP. ASS’N ACT § 120, 6A U.L.A. 185–86 (2008).

<sup>306</sup> *Id.* § 113(a), 6A U.L.A. 176.

<sup>307</sup> Compare REV. UNIF. LTD. LIAB. CO. ACT § 110(c), 6B U.L.A. 442–43 (2008) with REV. UNIF. LTD. LIAB. CO. ACT § 116, 6B U.L.A. 454–55 (2008).

<sup>308</sup> UNIF. LTD. COOP. ASS’N ACT § 113(a), 6A U.L.A. 176.

interpretive questions will arise only where the LCA's prospective members want to pursue a course of action that would be outside the activity the declatory provision contemplates. That is, if the provision is assumed to be mandatory, and it is not inconsistent with the desired course of action, interpretation is not necessary. Second, if interpretation is necessary, the determination of whether the provision is required will be determined within the entire context of ULCAA, the general policies of cooperative principles, and perhaps within the unique factual planning context. Therefore, any ambiguity or uncertainty on the margin allows, and implicitly directs, planners and judges to account for whether a provision should apply within the unique context of the factual circumstances surrounding a given LCA.

The practical necessity to interpret *required* as used in subsection 113(b) (even in limited circumstances), on one hand, reflects the fluid nature of cooperative law and the meaning of "operating on a cooperative basis" under other law as they continue to evolve over time. In that regard this relatively small measure of uncertainty allows the expansion joint for the continuing development of cooperative jurisprudence, policy, and philosophy as applied to this new type of cooperative entity. Finally, it encourages planners to carefully weigh derivation from provisions that, in many instances, may reflect underlying cooperative principles.<sup>309</sup>

On the other hand, the necessity to resort to even-reasoned interpretation in order to determine whether a provision is required by the ULCAA can be perceived as a weakness in the Act. If it is a weakness, however, it is not fatal. After all, the same kind of weakness appears in aggravated form in corporate statutes.<sup>310</sup>

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<sup>309</sup> This ambiguity is neither as artful nor, probably, as well conceived, as the one in *Restatement (Second) of Contracts*, on which Grant Gilmore observed: "This may well be all to the good. A wise draftsman when he is dealing with novel issues in course of uncertain development, will deliberately retreat into ambiguity." GRANT GILMORE, *THE DEATH OF CONTRACT* 76 (1974).

<sup>310</sup> Sometimes it proves difficult to determine, based on the text alone, whether a provision is mandatory under corporate law. In the case of corporate law, a typical statement about interpretation is something like, "[t]hus, under the Organic Statutes governing business corporations, *most rules are Mandatory Rules*." KEATINGE & CONAWAY, *supra* note 169, § 2.2, at 23 (emphasis added). Corporate statutes, however, do not contain the equivalent of ULCAA subsection 113(a), which at least tempers how interpretation is approached. The trend in unincorporated entities, which are in large measure based on contract, is toward "increased flexibility." *Id.* The Official Comments to RULLCA state that a "limited liability company is a creature of contract as well as a creature of statute." REV. UNIF. LTD. LIAB. CO. ACT §§ 110 cmt., 112 cmt. d, 6B U.L.A.

## B. The Life Cycle: Formation, Dissociation, Dissolution, and Winding-Up

### 1. Formation and Admission of Members

The policy issues concerning how an LCA comes into being under ULCAA run surprisingly deep. The issues are an aggravated version of similar issues in other unincorporated entities, like LLCs, and all revolve around the core definition of the entity. In the context of the LLC, the question is whether an LLC can be formed without members—framed as whether a “shelf” LLC can exist.<sup>311</sup> In the context of traditional cooperatives, the question is whether a cooperative may exist separate and apart from its “cooperators.”<sup>312</sup> Different types of entities and different acts

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444, 451 (2008). Both ULCAA and RULLCA share similar interpretive issues. ULCAA’s approach is different than RULLCA’s approach, in part, because of the greater structural requirements caused by the necessary inclusion of at least some cooperative principles in ULCAA, such as a board structure.

<sup>311</sup> In an article explaining RULLCA, its Reporters stated:

In practice, many attorneys (and their clients) wish to have a limited liability company formed and on the public record while the relevant deal coalesces—i.e., before the precise identity and relationship of the members has been finally determined. In theory, according to some advisors to the Drafting Committee, a memberless LLC is an oxymoron and having an LLC waiting “on the shelf” for the members to be identified is an example of “corpufuscation” of partnership law.

Daniel S. Kleinberger & Carter G. Bishop, *The Next Generation: The Revised Uniform Limited Liability Company Act*, 62 BUS. LAW 515, 528 (2007) (citing Daniel S. Kleinberger, *The Closely Held Business Through the Entity Aggregate Prism*, 40 WAKE FOREST L. REV. 827, 872–73 (2005)).

“No issue roiled the drafting process to this Act more than the question of ‘shelf LLCs’ . . .” Kleinberger & Bishop, *supra*, at 528 (citations omitted). The article also noted: “Other ‘theorists’ point out that the LLC departed from its partnership moorings when LLC statutes recognized the single-member LLC.” *Id.* at 528, n.74 (citation omitted).

<sup>312</sup> Historically, corporate cooperative statutes reached a different compromise than unincorporated statutes on the chicken-and-egg issue of members before, during, or after the formation process because a corporation, as the prototypical entity, can “exist” without owners. The tact the older statutes took was to require multiple organizers. As of 1982, Baarda’s article on farmers cooperatives stated:

[A]nd 80 statutes set a minimum number of persons or associations that may incorporate a cooperative association . . . Mississippi [] has a minimum of 5 for associations for growing, breeding, selling, and handling livestock or poultry, as opposed to 20 for associations organized for other purposes under the same statute.

have reached different compromise solutions.<sup>313</sup> In addition to these jurisprudential issues, practical issues of efficiency exist.<sup>314</sup>

ULCAA adopts a “back to the future” compromise concerning the necessity of members for organization and recognition by the state. The compromise is that an LCA is permitted to have one organizer,<sup>315</sup> but must have at least two patron members to commence business.<sup>316</sup> This system is similar to the historical compromise made by corporate law, and with it comes a disadvantage inherent in the older corporate statutes.<sup>317</sup>

With one exception, single member LCAs are not allowed.<sup>318</sup> The one exception to the two-patron-member requirement is when the single

The majority of statutes, 48, set a minimum of 5 incorporators.

*Baarda, supra* note 90, § 7.01.03, at 35. Apparently, these statutes rely on the fiction that a large number of incorporators or organizers somehow reflect a core of future cooperators (members).

Another type of historical compromise is retained in the Tennessee Processing Cooperative Law which requires a cooperative plan and further requires the Tennessee Commissioner of Agriculture to approve the articles. *See* TENN. CODE. ANN. § 43-38-201, -203(g) (2007). *See also infra* State Comparison Chart, Appendix, “Scope.”

Finally, while not entirely on point, many corporate farmers’ cooperative statutes have a definitional requirement that the corporation be operated on a cooperative plan. *See Baarda, supra* note 90, § 3.02, at 19. *See, e.g., infra* State Comparison Chart, Appendix.

<sup>313</sup> Compare REV. UNIF. LTD. LIAB. CO. ACT § 201, 6B U.L.A. 456 (2008), with UNIF. LTD. LIAB. CO. ACT § 202, 6B U.L.A. 574 (2008).

<sup>314</sup> *See infra* notes 315–17 and accompanying text.

<sup>315</sup> *See* UNIF. LTD. COOP. ASS’N ACT §§ 102(21), 301, 6A U.L.A. 161, 195 (2008) (stating the organizer must be an individual).

<sup>316</sup> *See id.* § 501, 6A U.L.A. 208.

<sup>317</sup> The ULCAA compromise is that an LCA have at least two patron members to do business. *See id.* Older corporate law often required a minimum amount of paid-in capital to conduct business. *See, e.g.,* BAYLESS MANNING & JAMES J. HANKS, JR., MANNING’S LEGAL CAPITAL (3d ed. 1990). The two solutions are similar because they are a condition subsequent to the filing of the required document with the state. This creates another due diligence step concerning “validly formed” and “authorized to do business.” *But see* UNIF. LTD. COOP. ASS’N ACT § 206, 6A U.L.A. 191 (discussing certificate of good standing). Note that ULCAA adopts a “certificate of good standing” provision as opposed to the more modern “certificate of existence” approach. *See* REV. UNIF. LTD. LIAB. CO. ACT § 208, 6B U.L.A. 465.

<sup>318</sup> *See* UNIF. LTD. COOP. ASS’N ACT § 1202, 6A U.L.A. 280 (providing a ninety-day period in which to admit a member after the dissociation causing the association to have less than two members); UNIF. LTD. P’SHP ACT (2001) § 801, 6A U.L.A. 466 (2008) (providing similar result).

member is another cooperative. Cooperative is defined as “a limited co-operative association or an entity organized under any cooperative law of any jurisdiction.”<sup>319</sup>

An LCA is recognized upon the filing of the articles of organization with the secretary of state.<sup>320</sup> Because ULCAA mandates a board of directors, the balance of the provisions concerning an association’s organization is analogous to corporate law. For example, ULCAA charges the initial board of directors or, in its absence, the organizer, with holding an organizational meeting to admit members<sup>321</sup> and complete other organizational functions consistent with the filed articles of organization. Otherwise, a person becomes a member: (1) “as provided in the organic rules,”<sup>322</sup> (2) “as the result of a merger or conversion,”<sup>323</sup> or (3) by the other members’ unanimous consent.<sup>324</sup>

## 2. *Dissociation, Dissolution, and Winding-Up*

Little novelty exists in ULCAA’s dissociation provisions. The provisions are consistent with other acts, under which other unincorporated entities are organized, and are derived closely from other uniform unincorporated acts.<sup>325</sup> A member is dissociated by its express will or upon the occurrence of events specified in section 1101. Upon dissociation the member ceases to have any of the rights of being a member and holds its financial rights<sup>326</sup> as a transferee.<sup>327</sup> The biggest distinction between ULCAA and the other acts is that the authority vested in the partners, members, or managers under the other acts is exercised by the board of directors under ULCAA.<sup>328</sup>

Another distinction between ULCAA and the other uniform unincorporated acts is that, under ULCAA, dissociation upon a member being adjudged incompetent is not automatic but requires action by the board

<sup>319</sup> UNIF. LTD. COOP. ASS’N ACT § 102, 6A U.L.A. 160.

<sup>320</sup> *See id.* § 302(c), 6A U.L.A. 196.

<sup>321</sup> *See id.* § 303, 6A U.L.A. 197.

<sup>322</sup> *Id.* § 502(1), 6A U.L.A. 208.

<sup>323</sup> *Id.* § 502(2), 6A U.L.A. 208.

<sup>324</sup> *See id.* § 502(3), 6A U.L.A. 208.

<sup>325</sup> *See* REV. UNIF. P’SHP ACT art. 6, 6 Pt. I U.L.A. 163–64 (2001); UNIF. LTD. P’SHP ACT (2001) art. 6, 6A U.L.A. 450–60 (2008); REV. UNIF. LTD. LIAB. CO. ACT art. 6, 6B U.L.A. 502–05 (2008).

<sup>326</sup> *See* UNIF. LTD. COOP. ASS’N ACT §§ 601(2), 603, 6A U.L.A. 226, 228 (2008).

<sup>327</sup> *See id.* § 1102, 6A U.L.A. 278–79.

<sup>328</sup> *See id.* § 1101(d)(4), 6A U.L.A. 276–77.

of directors. As in LLCs, for example, a member's death does not cause automatic dissolution.<sup>329</sup>

The dissolution and winding-up process contains provisions generally consistent across all types of entities. For example, ULCAA provides an association may be dissolved four ways: voluntarily,<sup>330</sup> nonjudicially,<sup>331</sup> judicially,<sup>332</sup> and administratively.<sup>333</sup> Further, and similar to other unincorporated entity law, nonjudicial dissolution occurs, *inter alia*, when only one patron member remains unless the association admits another patron or investor member within ninety days.<sup>334</sup> Moreover, ULCAA provides for the winding-up of an LCA upon dissolution, the distribution of its assets, court supervision for winding-up, if necessary, and the disposition of claims against the dissolved association.<sup>335</sup>

ULCAA provides a mechanism for the association to cut off claims by "known" and "other" claimants similarly to RULLCA, ULPA, and corporate law.<sup>336</sup> Like corporate law,<sup>337</sup> ULCAA contains a section, in addition to those for known and other claimants, specifically authorizing a court proceeding to determine adequate security for unknown or contingent claims and claims based on events occurring after dissolution.<sup>338</sup> The purpose of this section is to allow the dissolved association to distribute remaining assets confidently and to protect the recipients of those assets from recovery by claimants of the association.

Section 1010 is the one novel provision regarding distributions when compared to organizational law, generally.<sup>339</sup> All of section 1010 is bracketed meaning that adopting jurisdictions should consider, but not necessarily adopt, the provision. Section 1010 recognizes that some state

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<sup>329</sup> See *id.* § 1101(d)(4)(E), 6A U.L.A. 277.

<sup>330</sup> See *id.* §§ 1204–05, 6A U.L.A. 282–283.

<sup>331</sup> See *id.* § 1202, 6A U.L.A. 280.

<sup>332</sup> See *id.* § 1203, 6A U.L.A. 281.

<sup>333</sup> See *id.* § 1211, 6A U.L.A. 290.

<sup>334</sup> See *id.* § 1202(3), 6A U.L.A. 280. Observe that this provision is asymmetrical with the requirement that there be two patron members to commence business under section 501. See *supra* note 316 and accompanying text. This result, though somewhat unusual, is intended because of the notion of cooperation during the process of initially organizing an LCA.

<sup>335</sup> See UNIF. LTD. COOP. ASS'N ACT §§ 1206–1210, 6A U.L.A. 284–89 (2008).

<sup>336</sup> See *id.* §§ 1208–1209, 6A U.L.A. 286–88.

<sup>337</sup> See *id.* § 1210 cmt., 6A U.L.A. 289.

<sup>338</sup> See *id.* § 1210, 6A U.L.A. 289.

<sup>339</sup> See *id.* § 1010, 6A U.L.A. 274.



cooperative statutes contain an exception from the state's unclaimed property law for cooperatives.<sup>340</sup> The exceptions, when applicable, generally allow a cooperative to distribute unclaimed property to a charity rather than to the state.<sup>341</sup> Section 1010 does not contain substantive content; rather, it incorporates the provision contained elsewhere in the law of the adopting jurisdiction and makes the provision expressly applicable to an LCA organized under ULCAA.<sup>342</sup>

Finally, ULCAA permits, but does not require, an LCA that is dissolved, or is about to dissolve, to deliver a statement of dissolution to the secretary of state for filing<sup>343</sup> and a statement of termination when winding-up has been completed.<sup>344</sup> These statements provide a public record of the association's status.<sup>345</sup>

## C. Financial Rights: Allocations, Contributions, and Distributions

### 1. Introduction and Background

Members' financial rights in an LCA are one of three defined sub-parts of a membership interest.<sup>346</sup> Simply, they are the member's rights to participate in allocations of profits and losses of the association and in distributions made by the association and are distinguishable from amounts receivable by a patron member under a marketing contract.<sup>347</sup> The default rule under ULCAA is that financial rights may be transferred

<sup>340</sup> See, e.g., OR. REV. STAT. § 62.425 (2007).

<sup>341</sup> See UNIF. LTD. COOP. ASS'N ACT § 1010, 6A U.L.A. 274 (2008).

<sup>342</sup> See *id.* ("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].").

The incorporation of another statute by cross reference in ULCAA section 1010 is similar to the method used for state antitrust or restraint-of-trade laws and state securities regulation. See *infra* Parts V.H.1.–V.H.2.

<sup>343</sup> See UNIF. LTD. COOP. ASS'N ACT § 1214, 6A U.L.A. 293. Cf. UNIF. LTD. P'SHIP ACT (2001) § 203, 6A U.L.A. 397–98 (2008) (statement of termination). ULCAA, unlike the other uniform unincorporated acts, does not contain statements of authority because of ULCAA's centralized management architecture. See, e.g., REV. UNIF. LTD. LIAB. CO. ACT §§ 302–303, 6B U.L.A. 472–75 (2008).

<sup>344</sup> See UNIF. LTD. COOP. ASS'N ACT § 1215, 6A U.L.A. 293–94.

<sup>345</sup> ULCAA does not contain provisions governing notice. The effect of filing statements is left to other law.

<sup>346</sup> The others are governance rights and "the right or obligation, if any, to do business with the limited cooperative association." UNIF. LTD. COOP. ASS'N ACT § 601, 6A U.L.A. 226 (2008).

<sup>347</sup> See *id.* § 102(11) and cmt., 6A U.L.A. 160, 162.

to, and held by, a transferee.<sup>348</sup> The judgment creditors' exclusive remedy is a charging order.<sup>349</sup> In effect, financial rights are very much like transferable interests in other unincorporated entities.<sup>350</sup> In operation, financial rights are similar to membership interests, stock, and capital (or equity) accounts in traditional cooperatives.<sup>351</sup>

Allocations to member capital accounts in an LCA are central to understanding members' financial rights; they serve the same functional purpose and operate roughly the same as allocations in other unincorporated entities.<sup>352</sup> Importantly, as discussed later, they also play a key role under ULCAA to integrate cooperative principles within the Act.<sup>353</sup> These principles mandate ULCAA detail allocations in a far more detailed way than other unincorporated statutes.

The vast majority of cooperatives in operation today are formed under statutes solidly grounded in corporate concepts and, correspondingly, are taxed under special provisions of corporate tax law for purposes of

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<sup>348</sup> See *id.* § 603 and cmt., 6A U.L.A. 228–31.

<sup>349</sup> See *id.* § 605, 6A U.L.A. 233–34. The charging order provision is RULLCA section 503. It is noteworthy that ULCAA contains a separate section on voluntary security interests and setoffs. See UNIF. LTD. COOP. ASS'N ACT § 604, 6A U.L.A. 232.

<sup>350</sup> See, e.g., REV. UNIF. LTD. LIAB. CO. ACT §§ 501, 502(a), 6B U.L.A. 496 (2008).

<sup>351</sup> Jerry Voorhis has stated:

“American Cooperatives,” states . . . [A]ny business whose purpose is to make a profit for one group of people, its stockholders, out of the sale of goods and services to *other* people, its customers, is *not* a cooperative. Neither is any business whose owners are *not* the same people who are its patrons or the users of its services.

ACCOUNTING AND TAXATION FOR COOPERATIVES 7-8 (Touche Ross & Co., 4th ed. 1978).

<sup>352</sup> See REV. UNIF. P'SHIP ACT § 401(a), 6 Pt. I U.L.A. 133 (2001) (discussing member's capital account). The character of member equity in cooperatives for accounting purposes has received a great deal of recent attention by both the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB). The issue highlights the general similarity of accounting for equity in corporate cooperatives and unincorporated entities. A roundtable meeting with FASB and IASB was held on September 8, 2008.

According to an electronic message to members of the National Society of Accountants for Cooperatives (NSAC) sent by its president, Greg Taylor, on September 25, 2008, NSAC was asked to assist FASB and IASB “reach a consensus theory” on member equity. Interestingly, the request reportedly extended beyond cooperative accounting: “[F]or revisions that work, not only for cooperatives, *but also for other entities; Limited partnerships, S-Corps, etc. that have similar pass-thru residual capital . . .*” Email from Greg Taylor, President, National Society of Accountants for Cooperatives, to members (Sept. 25, 2008) (emphasis added) (on file with author).

<sup>353</sup> See *infra* Part V.C.3(a)–(b).

federal income taxation.<sup>354</sup> The mechanisms and nomenclature used to provide a single-level tax (avoiding taxation at the cooperative entity level) in the corporate scheme is based not on member recognition upon allocation as it is in partnership taxation,<sup>355</sup> but also by allowing an entity-level deduction upon distribution.<sup>356</sup> The member must consent to one of three permitted ways to take the amount allocated into its income.<sup>357</sup> This adds orders of magnitude to the complexity required for the retention of earnings by a corporate cooperative on a tax-free basis. In effect, the mechanism for retention of earnings on a tax-free basis for corporate cooperatives uses the legal fiction of a deemed distribution taxable to the member followed by a deemed recontribution by the member to the corporate cooperative.<sup>358</sup> In turn, when these recontributed amounts are finally distributed, they are treated for both tax and state law purposes as redemptions or retirement of equity.<sup>359</sup>

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<sup>354</sup> See *supra* Part III.C.

<sup>355</sup> PENNELL, POSTLEWAITE & WILLIS, *supra* note 168, ¶10.01, at 10-4.

<sup>356</sup> See *supra* notes 151–52 and accompanying text.

<sup>357</sup> The three ways are: by written consent, by becoming or remaining a member when a bylaw provides that membership in the cooperative constitutes consent and the member has received notice of the bylaw, or by cashing a qualified check that contains a statement that endorsement will constitute consent. See I.R.C. § 1388(c)(2).

<sup>358</sup> For example, a USDA publication describes the effect of “written notice of allocations” as follows: “Payment [of patronage refunds] through such a written notice was considered payment in money to the patron, followed by either reinvestment in the cooperatives’ capital or a loan to the cooperative. [Even before the formal definition of a written notice of allocation in the Code.]” Donald A. Frederick, *Income Tax Treatment of Cooperatives: Distribution, Retains, Redemptions, and Patrons’ Taxation*, USDA COOP. INFO. RPT. 44, pt. 3, at 27 (2005), available at <http://www.rurdev.usda.gov/rbs/pub/cir443.pdf>.

<sup>359</sup> The nonprofit notion is embedded in the idea of cooperatives as mutual organizations. See *supra* notes 65–66 and accompanying text. Historically, therefore, the term *refund* was used instead of *distribution*. A comprehensive composition of state incorporation statutes for farmers cooperatives published in 1982, for example, stated:

The form in which patronage refunds are paid is specifically mentioned in 29 statutes . . .

Thirteen statutes list several different forms in which patronage refunds may be given to patrons. Provisions include cash, credits, capital stock, certificates of interest, revolving fund credits, letters of advice, and other securities or certificates issued by the association or another association.

BAARDA, *supra* note 96, § 14.03.12, at 99.

There is no evidence, however, that the Rochdale Society used these terms in the nineteenth century. See *generally supra* notes 79–80 and accompanying text.

In operation, then, the corporate treatment of deductions and recontributions in corporate-styled cooperatives (broadly and at a level of gross generality) simulates partnership allocation operationally, as well as for income tax and accounting purposes.<sup>360</sup> Unfortunately for purposes of ULCAA, the corporate tax nomenclature is ubiquitous even if undefined in state cooperative statutes. Reconciling this common language of cooperatives with ULCAA's unincorporated approach was an ongoing thematic current in the ULCAA drafting process through and including amendments during the ULC's 2007 Annual Meeting when ULCAA was finally promulgated.<sup>361</sup> This general background is helpful to appreciate and better understand ULCAA because the reconciliation animates ULCAA's contribution, allocation, and distribution provisions. Making sense out of statements like one quoted in the next subpart of this Article that a "per unit retain *allocation is a distribution*"<sup>362</sup> is necessary.

Financial rights are, at base, a capital accounting concept that includes member contribution, allocations of profits and losses, and distributions.

## 2. *Capital and Contributions*

### a. *More Background: Capital Accounting in Traditional Cooperatives*

Traditional cooperatives, just like other business organizations, require capital for the purchase of assets and for working capital.<sup>363</sup> Under most business models, capital is obtained or derived from one or more of three sources:

- (1) Owners investing in a business serving other people and who expect a return on their investment (equity);
- (2) Creditors lending money to a business in return for the payment of an interest rate the organization is willing to pay (debt);

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<sup>360</sup> Cf. REV. UNIF. P'SHIP ACT § 401(a), 6 Pt. I U.L.A. 133 (2001).

<sup>361</sup> See NCCUSL 2007 Annual Meeting Minutes, Third Session, Uniform Limited Cooperative Association Act, July 28, 2007, 284–90 (on file with Tom Geu).

<sup>362</sup> *Infra* note 384 and accompanying text (emphasis added).

<sup>363</sup> See C. H. Kirkman, Jr., *Understanding Your Cooperatives*, USDA COOP. INFO. RPT. 6, at 37–39 (1979).

- (3) Customers willing to pay for goods and services delivered to them at prices that provide a profit (retained earnings).<sup>364</sup>

A significant difference between cooperatives and other forms of business entities is that the primary customers (patrons and users) of a cooperative are also its owners (the members).<sup>365</sup> As a result, members are often the primary ultimate source, if not the only source, of the cooperative's invested or retained equity.

A repeated theme in this Article is that, according to stated cooperative principles, a cooperative's members provide the capital.<sup>366</sup> Today, however, even some traditional cooperatives obtain investment from nonmember sources. Indeed, a few well-known cooperatives have used nonmember investment, often through nonvoting instruments, such as preferred stock.<sup>367</sup> The distinction between ULCAA (as well as similar unincorporated cooperative statutes) and traditional cooperative statutes is that ULCAA specifically contemplates voting by nonpatron members.<sup>368</sup>

A general discussion of how members of traditional cooperatives provide capital to cooperatives is necessary to understand the cooperative

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<sup>364</sup> *Id.* at 37.

<sup>365</sup> See *infra* note 382 and accompanying text; *supra* notes 71, 83, 264–67 and accompanying text.

<sup>366</sup> See *supra* notes 83–86 and accompanying text.

<sup>367</sup> A news article, which reported on a House Agricultural Committee in 2003, stated:

Hanson points out that under Minnesota's old cooperative law, outside investment is possible. "Under many of the corporate cooperative statutes, a cooperative can be financed by 100 percent non-patron investment and under the commodity marketing act statutes, preferred stock can have voting rights," he notes . . . "For most corporate cooperatives, the amount of non-patron investment is increasing and for some corporate cooperatives, as allowed by . . . the corporate cooperative statutes of most states, the amount of non-patron investment exceeds the amount of patron investment," he writes.

Tom Bengston, *The Latest New Generation Cooperatives*, 188 NW. FIN. REV. 21 (2003).

<sup>368</sup> Participation in a cooperative by nonpatron investors may cause an association, especially in agriculture, to fail to qualify for benefits under various statutes, for example, the Capper-Volstead Act, as not being a qualified cooperative organization. See generally *infra* note 743 and accompanying text.

model.<sup>369</sup> Of course, a general discussion cannot consider all the various methods used by cooperatives. It can, however, offer necessary background to appreciate the traditional cooperative model. The following discussion will outline a few common techniques cooperatives use to acquire or accumulate capital.

Initially, under the traditional model, members acquire memberships in a cooperative by paying a membership fee in nonstock cooperatives or paying for one or more shares of common stock as a qualification for membership (contributions) in membership cooperatives with stock.<sup>370</sup> The membership or common stock carry voting rights, usually one vote per member.<sup>371</sup> These payments are frequently modest in amount. Illustratively, for decades the cost to become a member of a traditional<sup>372</sup> Midwestern grain marketing cooperative was \$5 or \$10. Today the cost may be more in the range of \$50 to \$100.

In processing cooperatives, which may have greater need for capital to construct new processing plants, members may be required to make a more substantial capital contribution and to agree to production or delivery obligations. These obligations by the members include the right and obligation of a member to grow and deliver a particular commodity to the cooperative for processing. For example, in the Red River Valley, the members of American Crystal Sugar Company (a cooperative)<sup>373</sup> contract with the cooperative for the right to deliver (with the concurrent obligation to grow) a specified number of acres of sugar beets. The cooperative agrees to purchase and process the sugar beets delivered under the contract. The value given for membership and delivery rights is often

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<sup>369</sup> While the ways in which capital is provided to cooperatives today frequently is driven by tax law, the tax laws do not necessarily keep up with innovations used by cooperatives to raise capital. Generally, however, the tax laws do reflect at least one model of cooperative practice at the time the laws were written. Thus, questions may arise as to the tax treatment of those new innovations.

<sup>370</sup> See *supra* Part III.B.3 (discussing the distinction between stock and nonstock cooperatives). Note that some cooperatives may require a small or modest annual membership fee. The accounting for annual fees varies and is beyond the scope of this Article.

<sup>371</sup> See *infra* Part V.E.

<sup>372</sup> For a brief discussion of new generation cooperatives see *supra* note 101 and accompanying text; *infra* note 374 and accompanying text.

<sup>373</sup> See American Crystal Sugar Company website, <http://www.crystalsugar.com> (last visited May 31, 2009).

substantial.<sup>374</sup> The amount contributed represents capital to the cooperative. The new generation cooperatives designed to capture the margins or profits of processors are structured similarly to this model with closed membership.

Many traditional cooperatives, however, do not have the means of obtaining significant capital from members through either the value of production and delivery rights or initial capital contributions made for membership. These cooperatives use several other approaches to obtain capital from members over time.

One frequently used way for a traditional cooperative to accumulate capital is through retained patronage refunds from its members.<sup>375</sup>

A “patronage refund” consists of net margins (profits) from business done [by a cooperative] with or for patrons that are *allocated* or *distributed* to patrons on a patronage basis. For example, if a cooperative has a net margin for the year of \$5,000, and Ms. Jones accounted for 5 percent of the business conducted on a cooperative basis that year, then Ms. Jones receives a patronage refund of \$250 (\$5,000 x .05).<sup>376</sup>

Of course, the terms “allocations” and “distributions” in the foregoing quote are not synonymous.<sup>377</sup> Amounts allocated to members are not necessarily required to be currently distributed to members.<sup>378</sup> Undi-

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<sup>374</sup> Prices for the rights at American Crystal Sugar Company are available only in the “Members Only” portion of the cooperative’s website.

<sup>375</sup> Patronage refunds are called “patronage dividends” in the Code. *See, e.g.*, I.R.C. §§ 1382(b), 1388(a).

In a technical sense, a ‘patronage dividend’ (within the meaning of the Code) is a ‘patronage refund’ that meets certain Code requirements, such as being paid pursuant to a preexisting legal obligation on the cooperative to make the refund. In most instances, ‘patronage refunds’ that do not qualify as ‘patronage dividends’ (for tax purposes) are treated as ‘dividends’ for tax purposes. *See, e.g.*, *People’s Gin Co. v. Comm’r*, 41 B.T.A. 343 (1940), *aff’d*, 118 F.2d 72 (5th Cir. 1941); *Juneau Dairies, Inc. v. Comm’r*, 44 B.T.A. 759 (1941).

Frederick, *supra* note 134, at 16 n.11.

<sup>376</sup> *Id.* at 15–16 (emphasis added).

<sup>377</sup> *See, e.g.*, UNIF. LTD. COOP. ASS’N ACT §§ 1004, 1005, and cmts., 6A U.L.A. 265, 270 (2008).

<sup>378</sup> To qualify for tax treatment under Subchapter T of the Code, among other requirements, allocated amounts must be made by a “qualified written notice of

distributed allocations made to members, in a sense, are retained by the cooperative as additional capital or equity from the member even though they are credited by the cooperative to a capital or equity account in the name of the member.<sup>379</sup> In turn, these retained allocations are subject to subsequent payment or redemption by the cooperative as capital needs decrease, upon the member's termination of membership, in accordance with the cooperative's program to redeem capital (or equity), or upon dissolution and winding-up of the cooperative.<sup>380</sup>

The basic capital accounting treatment of members by cooperatives is remarkably similar to the way allocations are handled in general and limited partnerships and LLCs.<sup>381</sup> The primary difference between unincorporated allocations in entities and cooperatives is that allocations in cooperatives are calculated, consistent with cooperative principles, on the relative amount of business done with the cooperative (patronage) by the member. Allocations in the other entities are pro rata, proportional to the amount of contributions, or in any other agreed manner, including patronage.<sup>382</sup>

A second patronage-based financing technique used by some marketing cooperatives for capital accumulation is the use of "per-unit" retains.<sup>383</sup>

A per-unit retain allocation is a distribution by a cooperative to a patron based on the quantity of products, measured by physical volume or dollar value, marketed through the cooperative by the patron. . . .

. . . [T]he cooperative deducts a fixed amount of money per-unit of product marketed from the check it sends the patron for sales proceeds as a patron equity or debt interest in the cooperative. The patron receives a

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allocation" (a specified term in the Code) and at least 20% of the amounts allocated must be paid (distributed) to the recipient of the allocation in money or a qualified check. I.R.C. § 1388(c)(1).

<sup>379</sup> A thorough discussion of the nature and operation of patronage refunds is contained in Frederick, *supra* note 134.

<sup>380</sup> See *infra* Part V.C.4.

<sup>381</sup> See generally KEATINGE & CONAWAY, *supra* note 169, §§ 13:7–13:9, at 314–15.

<sup>382</sup> See generally Frederick, *supra* note 134, Pt. 1, at 23–29. LLCs can and have been recognized as operating on a cooperative basis. In those instances, at least, allocations based on patronage can be inferred from the recognition. See *id.* at 29–31. See also *supra* notes 183–85 and accompanying text.

<sup>383</sup> The Code uses the term "per-unit retain allocation" which is often shortened to "per-unit retain." Frederick, *supra* note 358, at 54.



per-unit retain certificate evidencing the particular interest. The certificate's stated value is the amount invested in the cooperative.<sup>384</sup>

*b. ULCAA and Capital Contributions: The Start of an Asymmetrical Comparison with Capital Accumulation in Traditional Corporate Cooperatives*

As a matter of introduction and comparison, ULCAA provides flexibility to permit an LCA to use the patronage refunds, per-unit retains, or other techniques to accumulate capital.<sup>385</sup> Indeed, the ubiquitous use of statutory tax terminology suggests that an important reason corporate cooperatives use these techniques is the corporate tax scheme of subchapter T.<sup>386</sup> LCAs that are taxed as partnerships, however, will not need to use the terms or the specific techniques they represent in order to conform to tax treatment. Even so, these terms do describe distribution techniques that have been useful in cooperatives, and the concepts these terms represent may remain useful in some LCAs regardless of tax issues.

ULCAA requires the organic rules to "establish the amount, manner, or method of determining any contribution requirements for members [to make to an LCA] or must authorize the board of directors to establish the amount, manner, or other method of determining any contribution requirements for members."<sup>387</sup> No statutory penalty exists if the organic rules do not meet this requirement, but the requirement acknowledges that the terms of contribution and membership rise to the highest level of governance.<sup>388</sup> The absence of default rules in ULCAA for the amount,

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<sup>384</sup> *Id.* at 54–55. Another USDA publication states:

In addition to equity capital based on membership fees and capital stock, whether preferred or common, contributions to capital may be related to the patronage relationship. The most common examples of patronage-based equity contribution are retained patronage refunds and per-unit capital retains. Contributions may also include regular direct payments to the association or payments to cover costs of services provided.

Baarda, *supra* note 90, § 15.07, at 112.

<sup>385</sup> See UNIF. LTD. COOP. ASS'N ACT §§ 1001, 1003, 6A U.L.A. 262, 264 (2008); see also *infra* notes 387–94 and accompanying text.

<sup>386</sup> See generally *supra* notes 361–62 and accompanying text.

<sup>387</sup> UNIF. LTD. COOP. ASS'N ACT § 1001, 6A U.L.A. 262.

<sup>388</sup> See *infra* note 665 and accompanying text (discussing voting requirements to enact fundamental changes).

manner, or other method for providing capital recognizes that how an association is to be capitalized at its inception, or by new members, is part of the “deal” among those who will be the association’s members and, if not contained in the original deal, no such contributions may be required of members.<sup>389</sup> Unless the organic rules provide for additional capital contributions by members, the organic rules must be amended if additional capital contributions are to be required.<sup>390</sup>

Few restrictions limit the form of contributions an LCA may accept. Contributions may be made in tangible or intangible property or another benefit “including money, labor or other services performed or to be performed, promissory notes, other agreements to contribute money or property, and contracts to be performed.”<sup>391</sup> Similar to corporate law, contributions are valued by the board of directors.<sup>392</sup> ULCAA requires that contributions be addressed in the organic rules.<sup>393</sup> Conversely, ULCAA contains default rules for contribution agreements entered into before the formation of the LCA.<sup>394</sup>

As mentioned previously,<sup>395</sup> the presence of nonpatron investor members who may, or may not, use the association’s services presents a

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<sup>389</sup> Limited partnerships organized under a statute such as ULPA are creatures of contract as well as statute. *See* UNIF. LTD. P’SHIP ACT (2001) § 201(d) cmt., 6A U.L.A. 393 (2008). Similarly LCAs organized under ULCAA and like statutes are creatures of both. ULPA does not require capital contributions be addressed in the limited partnership agreement or the certificate of limited partnership, but if not contained in the partnership agreement, a limited partnership must maintain a record stating “the amount of cash, and a description and statement of the agreed value of the other benefits, contributed and agreed to be contributed by each partner” and “the times at which, or events on the happening of which, any additional contributions agreed to be made by each partner are to be made.” *Id.* § 111(9)(A), (B), 6A U.L.A. 382 (2008). *Compare* REV. UNIF. LTD. LIAB. CO. ACT § 402, 6B U.L.A. 479 (2008) (failing to address where or how obligations to make contributions are to be stated, but addressing the form in which contributions may be made) *with id.* § 403, 6B U.L.A. 479 (discussing liability for contributions for which commitments have been made).

<sup>390</sup> *See* UNIF. LTD. COOP. ASS’N ACT § 1001 cmt., 6A U.L.A. 262–63 (2008).

<sup>391</sup> *Id.* § 1002(a), 6A U.L.A. 263.

<sup>392</sup> *See id.* § 1002(c), 6A U.L.A. 263. *See, e.g.,* REV. MODEL BUS. CORP. ACT § 6.21 (2008). Although not contained in other uniform unincorporated entity acts, section 1002 practically addresses a creditor’s right to question the valuation of the contribution and require additional contributions for members. In corporate law this issue is referred to as the “watered stock” problem. *See, e.g.,* 11 WILLIAM MEADE FLETCHER ET AL., FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS, § 5241 (perm. ed., rev. vol. 2003).

<sup>393</sup> *See* UNIF. LTD. COOP. ASS’N ACT § 1001, 6A U.L.A. 262.

<sup>394</sup> *See id.* § 1003, 6A U.L.A. 264.

<sup>395</sup> *See supra* notes 102–08 and accompanying text.

tension within the financial structure balancing by all unincorporated cooperatives acts, including ULCAA. For financial purposes, all these acts use allocation provisions to reach a balance. It is, nonetheless, worth repeating that benefits under other law may be conditioned on strict limitations on return on equity paid to members, especially nonpatron members. Some statutes, for example, limit a return on capital only if a cooperative does not use a "one-member, one-vote" voting scheme.<sup>396</sup> Thus, laws providing beneficial treatment to cooperatives directly link governance and financial rights of members, but the operation of those laws is outside ULCAA's scope.<sup>397</sup> Because allocations to the members of an LCA are a significant feature of the association, the following subpart of the Article will describe, detail, and analyze ULCAA's provisions dealing with allocations to its members and nonmember patrons.

### 3. *Allocations of Profits and Losses: The ULCAA Solution*

#### a. *Background*

Allocations of profit and loss play a pivotal role under ULCAA and are central to LCAs organized under the Act.<sup>398</sup> At least three commonly accepted animating cooperative principles directly relate to allocations: (1) financial obligation and benefits proportional to use, (2) limited return on equity capital, and (3) service at cost.<sup>399</sup> The addition of investor members to LCAs made possible by ULCAA requires that ULCAA detail the manner in which allocations are made to maintain consistency with cooperative principles. This aspect is a distinctive feature of ULCAA.<sup>400</sup>

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<sup>396</sup> Banks for cooperatives require dividends on a cooperative's stock or membership capital be limited to an annual rate fixed by regulations of the Farm Credit Administration for cooperatives to be eligible for loans, if voting is on an other than one-member, one-vote basis. See FREDERICK, *supra* note 134, Pt. 1, at 58.

<sup>397</sup> See *infra* Part V.H.

<sup>398</sup> For a detailed discussion of the reasons and the manner in which ULCAA addresses the topic of allocations, see the comments to ULCAA section 1004.

<sup>399</sup> For a discussion of cooperative principles, see *supra* notes 71, 83–86 and accompanying text.

<sup>400</sup> The trend in the uniform unincorporated laws is to address distributions but to allow allocation of profit and loss to follow the agreements among the owners, subject to the laws of taxation and generally accepted accounting principles. The default rules under RUPA deem each partner to have a capital account, and require that the account reflect a partner's share of partnership profits and losses, as well as distributions to the partner. See REV. UNIF. P'SHIP ACT § 401(a), 6 Pt. I U.L.A. 133 (2001). Additionally, RUPA requires these accounts to be settled upon dissolution and provides that a partner will

ULCAA seeks boundaries for the relationship between patron members and investor members to balance their interests and reflect cooperative principles. Therefore, the Act requires a minimum of 50% of the profits of an LCA be allocated to patron members, with the default rule allocating all profits and losses to patron members.<sup>401</sup> ULCAA permits or requires certain adjustments to be made in calculating profits for purposes of this allocation requirement. Nevertheless, ULCAA allows a great deal of flexibility for the members to fashion their own economic relationship.

*b. Parsing the Operative Provisions*

Article 10 serves a definitional and regulatory purpose. The article contains core provisions dealing with allocations of profits and losses among the LCA's members, distributions to the members, and redemptions of capital, as well as making clear that member contributions may be in almost any form.

The manner in which profits and losses are allocated among members acts as a defining element of a cooperative. ULCAA contains more detail than frequently found in the statutes under which other types of entities are organized. Emphatically, however, article 10 governs allocations for state law purposes only. Financial reporting and income taxation are clearly beyond the scope of ULCAA, although the operation of its provisions will affect the results of financial and tax accounting. Moreover, both the detail and, paradoxically, the article's flexibility generally follow the historical law of cooperatives organized under corporate statutes.<sup>402</sup>

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restore any negative account balance. *See id.* § 807(a), (b), 6 Pt. I U.L.A. 206 (2001). More recently, the default rules under RULLCA do not contain a capital account requirement and RULLCA uses total unreturned contribution and undistributed profit for purposes of settlement upon dissolution. *See* REV. UNIF. LTD. LIAB. CO. ACT § 806, 6B U.L.A. 625–26 (2008).

<sup>401</sup> *See infra* note 407. This arrangement may be a trap for purposes of federal income taxation allocation limitations under the partnership taxation regime. *See* JEROLD A. FRIEDLAND, UNDERSTANDING PARTNERSHIP AND LLC TAXATION § 6.04, at 231 (2d ed. 2003) (discussing special allocation rules in partnership taxation).

<sup>402</sup> For example, a USDA compilation of corporate farmers cooperative statutes, as of 1982 stated:

The amount of net margins or savings available to be distributed depends on (1) what gross income is included and (2) what deductions are made before distributable margins are determined. Some of the statutes note specific deductions that may be made or must be made before allocation and distribution to patrons.

ULCAA recognizes the relationships between an LCA and its members are consensual.<sup>403</sup> Thus, those relationships are based substantially on agreement, if not contract. That is, the terms of the deal between the association and its members, and among its members, are in many respects left to freedom of contract. ULCAA does, however, provide significant detail in the manner of allocating profits and losses in an association organized under the Act because of the importance of maintaining adherence to cooperative principles. This feature explains why ULCAA contains substantial detail concerning allocations, even though such detail diverges from the modern trend in other organizational law.<sup>404</sup>

Section 1004 of ULCAA addresses the allocation of profit and loss among the members of an LCA.<sup>405</sup> This technical section of ULCAA can be misunderstood easily. It provides for how allocations are to be made by establishing boundaries, and permits a deduction for reserves in determining profits within its operation. The organic rules may (and should) provide details of how allocations are to be made within the boundaries prescribed by section 1004.

The organic rules govern the allocation of profits so long as the results of those allocations meet the test of section 1004. Section 1004 contemplates allocations to investor members, to patron members, among persons who patronize the association but who are not members (called "nonmember patrons" in the vernacular of cooperative literature), to an unallocated account, or to a combination of these accounts. Unless the

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Baarda, *supra* note 90, § 14.03.04, at 97.

Further, from the same 1982 compilation:

- 1) "Eleven statutes note among deductions expenses of doing business." *Id.* § 14.03.05.
- 2) "Thirty-seven statutes. . . mention deductions for payment of dividends on capital stock." *Id.* § 14.03.06.
- 3) "Thirty-seven statutes refer to some form of addition to reserve funds as a deduction prior to determining the amount." *Id.* § 14.03.07.
- 4) "Seventeen statutes. . . list additions to an educational fund as a deduction that may or must be made to arrive at amounts available for distribution to patrons."

*Id.* § 14.03.08.

<sup>403</sup> See UNIF. LTD. COOP. ASS'N ACT § 113(a), 6A U.L.A. 176 (2008).

<sup>404</sup> See *id.* § 1004 cmt., 6A U.L.A. 266–70. This change apparently began with ULCAA section 1006, which diverges from RUPA (which was substantially completed before ULCAA) in that it did not provide for capital accounts.

<sup>405</sup> See *id.* § 1004, 6A U.L.A. 265.

organic rules otherwise provide, loss is allocated in the same way as profit.<sup>406</sup>

The default rule for the allocation of profit and loss between investor members, if any, and patron members is that all profit and loss is allocated to patron members.<sup>407</sup> If the LCA has investor members, the organic rules may not reduce the profit allocated to patron members to less than 50%.<sup>408</sup>

Except for one optional deduction discussed later, the ULCAA test starts with the determination of profit.<sup>409</sup> The association will, first, determine its profit without regard to subsection 1004(c). Once profit is determined, it is allocated between the patron members and the investor members<sup>410</sup> in accordance with the organic rules. The allocation as set forth in the organic rules, however, must meet the Act's requirement that the percentage of profit allocated to the patron members as a group may not be less than 50%.

In determining the total amount of profit allocated, for purposes of the 50% test, two items receive special treatment under section 1004(c). These items are:

- (1) amounts paid or due on contracts for the delivery to the association by patron members of products, goods, or services;<sup>411</sup> and
- (2) amounts paid, due, or allocated to investor members as a stated fixed return on equity.<sup>412</sup>

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<sup>406</sup> See *id.* ULCAA does not require that loss allocations always be consistent with profit allocations. This approach is consistent with other unincorporated entity law. See, e.g., REV. UNIF. P'SHIP ACT § 401 cmt. 3, 6 Pt. I U.L.A. 133–36 (2001).

<sup>407</sup> See UNIF. LTD. COOP. ASS'N ACT § 1004(b), 6A U.L.A. 265 (2008). This rule places the burden of negotiating the allocation of profit on the investor members. ULCAA does not require investor members. See *supra* notes 17–19 and accompanying text. An association with only patron members is similar to a traditional cooperative. See generally FREDERICK, *supra* note 134.

<sup>408</sup> See UNIF. LTD. COOP. ASS'N ACT § 1004(c), 6A U.L.A. 265. The 50% test applies only to profit. This test is consistent with provisions regarding governance rights in which patron members must hold at least a majority of voting power if investor members are present in an LCA. See *id.* § 514(1), 6A U.L.A. 221.

<sup>409</sup> ULCAA section 1004(d) provides for one adjustment to profit for purposes of the 50% test. See *id.* § 1004(d), 6A U.L.A. 265; see also *infra* note 415 and accompanying text.

<sup>410</sup> For this purpose, investor members are aggregated into one group and patron members are aggregated into a separate group.

<sup>411</sup> See UNIF. LTD. COOP. ASS'N ACT § 1004(c)(1), 6A U.L.A. 265 (2008).

These items are not considered to be allocated to either patron or investor members, respectively, for purposes of applying the 50% test; that is, those amounts come out of profit before the test is applied.<sup>413</sup>

As previously mentioned, one exception exists to the general rule that ULCAA does not interfere with the calculation of profits of an LCA.<sup>414</sup> The exception is subsection 1004(d), which allows an optional deduction for calculating the amount of profit (again, only for purposes of ULCAA's 50% test). Unless the organic rules specifically prohibit it, "the board of directors may first deduct and set aside a part of the profits to create or accumulate" an unallocated capital reserve and unallocated reserves for specified purposes.<sup>415</sup> The specified purposes relate to cooperative principles.<sup>416</sup>

Illustratively, assume an LCA of five corn producers as patron members and three investor members. The investor members provide capital necessary to build a processing plant. Each investor member contributes \$10,000, for a total of \$30,000, and is entitled to receive a fixed return on investment of 5% per annum on the amount contributed, an aggregate return of \$1,500 per year. Each patron member contributes \$1,000, for a total of \$5,000, and has the right and obligation to sell 10,000 bushels of corn to the cooperative. In year X, the total revenue of the association is

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<sup>412</sup> See *id.* § 1004(c)(2), 6A U.L.A. 265.

<sup>413</sup> ULCAA section 1004(c) deals with the amount to be allocated to the patron members and the investor members, and is distinct from determining the amount of profit. Numbers representing both profits and allocations are necessary to determine whether the 50% test is met. Nonetheless, the numbers are related. In most instances, payments to patron members selling product or services to the LCA will have been taken into account as an expense for purposes of determining profit. Whether allocations to investor members will have been taken into account for purposes of determining profit will depend on the nature of the particular obligation in question under the accounting rules the association uses to determine the association's profit. For further discussion of determination of profit for purposes of the 50% test, see *supra* notes 408–12 and accompanying text.

<sup>414</sup> See *supra* note 409 and accompanying text.

<sup>415</sup> UNIF. LTD. COOP. ASS'N ACT § 1004(d), 6A U.L.A. 265. This method is only for the purpose of determining the profit to which the 50% test will be applied. Accounting and tax rules and regulations may require a different treatment of these items for financial and tax reporting purposes. The specific purposes under subsection 1004(d)(2) include "expansion and replacement of capital assets; education, training, cooperative development; creation and distribution of information concerning principles of cooperation; and community responsibility." *Id.* § 1004(d)(2), 6A U.L.A. 265.

<sup>416</sup> See, e.g., *supra* note 83 and accompanying text (identifying cooperative principles as education, training, and information for members; and concern for community).

\$300,000. The price for corn payable to the patron members is \$5.00 per bushel, a total of \$250,000. Cost of operations is \$20,000. The association's accountant opines the \$1,500 due to the investor members is an expense under generally accepted accounting principles. Total expense for the year is \$271,500: \$20,000 cost of operations; \$250,000 cost of goods sold for the corn; and \$1,500 due the investor members. Therefore, the association has a profit of \$38,500—\$300,000 revenue minus \$271,500 expenses—before setting aside any amount for unallocated reserves. The board of directors decides to set aside \$10,000 as an unallocated capital reserve. Under subsection 1004(d)(1), the \$10,000 unallocated reserve is deducted from \$38,500 to determine the amount of profit to be allocated. The result, for purposes of section 1004, is profit of \$28,500 that is available for allocation. In order to meet the 50% test in this example, and regardless of the allocation requirements of the organic rules or for purposes of federal income taxation, in aggregate at least \$14,250 must be allocated to the patron members, or 50% of \$28,500. Note that the \$250,000 the association paid to the patron members for their corn is not counted in determining whether the patron members received at least 50% of the profit of \$14,250.

Once profits or losses available for allocation are determined by applying the preceding discussion, the board of directors must next allocate the profits or losses to individual members within the investor member and patron member groups. Observe that section 1004 permits allocations of profit, if the organic rules so provide, to nonmembers conducting business with the LCA (nonmember patrons).<sup>417</sup> Amounts allocated to patron members are to be allocated among them in the ratio that the patronage of each patron member bears to the total patronage of all patron members for the period for which the allocations are to be made.<sup>418</sup> Amounts to be allocated to investor members are to be allocated among them in the ratio that the contributions of each investor member bears to

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<sup>417</sup> See UNIF. LTD. COOP. ASS'N ACT § 1004(a), (e), 6A U.L.A. 265. Section 1004 primarily addresses allocations to members. In effect, any allocations to nonmember patrons will reduce the amounts available for allocation to investor members because the 50% test measures amounts to be allocated to patron members. Other ways in which patrons (members or nonmembers) could be provided financial benefits may exist, such as a cash or in-kind rebate based on the purchase price of goods from a consumer association.

<sup>418</sup> See *id.* § 1004(e)(1), 6A U.L.A. 265. This provision is a default rule. See *id.* § 1004(f), 6A U.L.A. 266 (expressly permitting allocations to be based on separate classes of members, districts, or pooling arrangements).



the total contributions of all investor members.<sup>419</sup> Again, these allocation rules within the patron member and investor member groups are default rules. That is, in both cases, the organic rules may provide for other methods of allocation.<sup>420</sup>

Obviously, the framework provided for allocations uses different approaches for allocations to patrons and for allocations to investor members. The framework is a central feature of the balance between patrons and investors achieved under ULCAA. The flexibility afforded the organic rules and the board of directors' decisions under section 1004 provides an essential mechanism to harmonize the expectations of both patrons and investor members. While similar results could be obtained in other entity forms, statutes governing those entities do not provide the detailed framework and built-in (hard-wired) protections for the cooperative expectations of both patrons and investor members. Stated in a slightly different way, ULCAA cleaves to cooperative principles while at the same time addressing the reasonable expectations and needs of all members, including investor members.

Accounting in many LCAs organized under ULCAA likely will be performed on a partnership basis using the framework provided in article 10 for allocations and distributions. Nonetheless, ULCAA does not require accounting on any particular basis. Each individual association will determine the choice of accounting approaches in accordance with any applicable accounting rules. The organic rules for an association might contain provisions for a proper accounting system. While not required, such provisions should be considered in the planning process.

The operation of section 1004 and the organic rules can cause significant variations in the results of allocations in different LCAs. These variations can produce substantially different economic results. The comments to section 1004 contain examples of several hypothetical variations.<sup>421</sup> The examples illustrate how, in a hypothetical marketing associ-

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<sup>419</sup> See *id.* § 1004(e)(2), 6A U.L.A. 265. This provision is also a default rule. See *id.* § 1004(f), 6A U.L.A. 266. This rule is similar to default distributions under, for example, ULPA. See UNIF. LTD. P'SHIP ACT (2001) § 503, 6A U.L.A. 444 (2008). Where allocations based on patronage are to be made among patron members or among nonpatrons entitled to receive allocations under the organic rules, "'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." UNIF. LTD. COOP. ASS'N ACT § 102(23), 6A U.L.A. 161 (2008).

<sup>420</sup> See *id.* § 1004(e), (f), 6A U.L.A. 265–66.

<sup>421</sup> See *id.* § 1004(c) cmt., 6A U.L.A. 268–69.

ation, the amounts paid to the members for goods an association is to sell might affect the amounts of profits to be allocated to members.<sup>422</sup> The more the association pays its members for the goods and services they provide, the smaller the profits allocated among the members.

*c. A Road Not Taken by ULCAA: The Minnesota Capital Account Book-Up*

The Minnesota Cooperative Association Act has a section captioned, "Restatement of value of previous contributions."<sup>423</sup> ULCAA, as a policy

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<sup>422</sup> See *id.*

<sup>423</sup> MINN. STAT. ANN. § 308B.705 (West Supp. 2008). The statute states in its entirety:

**Subdivision 1. Definition.** As used in this section, an "old contribution" is a contribution reflected in the required records of a cooperative before the time the cooperative accepts a new contribution.

**Subd. 2. Restatement required.** Whenever a cooperative accepts a new contribution, the board shall restate, as required by this section, the value of all old contributions.

**Subd. 3. Restatement as to particular series or class to which new contribution pertains.** (a) Unless otherwise provided in the articles or bylaws, this subdivision sets forth the method of restating the value of old contributions that pertain to the same series or class to which the new contribution pertains. To restate the value:

(1) state the value the cooperative has accorded to the new contribution under section 308B.701, subdivision 3, clause (1);

(2) determine what percentage the value stated under clause (1) will constitute, after the restatement required by this subdivision, of the total value of all contributions that pertain to the particular series or class to which the new contribution pertains;

(3) divide the value stated under clause (1) by the percentage determined under clause (2), yielding the total value, after the restatement required by this subdivision, of all contributions pertaining to the particular series or class;

(4) subtract the value stated under clause (1) from the value determined under clause (3), yielding the total value, after the restatement required by this subdivision, of all the old contributions pertaining to the particular series or class;

(5) subtract the value, as reflected in the required records before the restatement required by this subdivision, of the old contributions from the value determined under clause (4), yielding the value to be allocated among and added to the old contributions pertaining to the particular series or class; and

(6) allocate the value determined under clause (5) proportionally among the old contributions pertaining to the particular series or

matter, does not address the topic, leaving such arrangements to the organic rules, independent accounting rules, and tax law.<sup>424</sup> The issue the Minnesota Act addresses concerns allocations upon the admission of a new member and is similar to booking-up capital accounts for federal income tax purposes.<sup>425</sup>

The thrust of the Minnesota provision is, very generally, to allocate the excess unrecognized value of the organization over the aggregate of the existing capital accounts of existing members, to the capital accounts of existing members, immediately before the admission of a new member. The capital account of the existing members, therefore, would reflect the appreciated value of the entity in addition to their contributions and previous allocation of profit.<sup>426</sup> The purpose of the book-up is easily explained:

Generally, when new members are admitted into a successful [unincorporated entity], the existing members want to retain the current value of the business [includ-

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class, add the allocated values to those old contributions, and change the required records accordingly.

(b) The values determined under paragraph (a), clause (5), and allocated and added under paragraph (a), clause (6), may be positive, negative, or zero.

**Subd. 4. Restatement method for other series or class.** Unless otherwise provided in the articles or bylaws, this subdivision sets forth the method of restating the value of old contributions that do not pertain to the same series or class to which the new contribution pertains. To restate the value:

(1) determine the percentage by which the restatement under subdivision 3 has changed the total contribution value reflected in the required records for the series or class to which the new contribution pertains; and

(2) as to each old contribution that does not pertain to the same series or class to which the new contribution pertains, change the value reflected in the required records by the percentage determined under clause (1). The percentage determined under clause (1) may be positive, negative, or zero.

**Subd. 5. New contributions may be aggregated.** If a cooperative accepts more than one contribution pertaining to the same series or class at the same time, then for the purpose of the restatement required by this section, the cooperative may consider all the new contributions a single contribution.

*Id.*

<sup>424</sup> See generally Part V.A.2 (describing the effect of organic rules).

<sup>425</sup> See PENNELL, POSTLEWAITE & WILLIS, *supra* note 168, ¶ 10.04(3)(c), at 10-59.

<sup>426</sup> See *id.*

ing the value of the appreciation of the assets of the entity not reflected in their capital accounts], and offer the new member the benefit of any capital he or she invests, as well as an interest in future profits.<sup>427</sup>

The capital account balances are important for many purposes, but the prototypical example is the effect of the book-up on what individual members receive upon dissolution and winding-up.<sup>428</sup>

The federal income tax provisions addressing book-ups make clear they are optional and not required.<sup>429</sup> Obviously, because of the possible economic effect on members, book-ups are an item planners carefully should consider including in the organic rules.

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<sup>427</sup> Herrick K. Lidstone, Jr., *Admitting New Members to an LLC and "Booking-Up" Capital Accounts*, COLO. LAW., Apr. 2008, at 19, 20.

<sup>428</sup> Illustration: Assume Pete and Marilyn each contribute \$1,000 to an unincorporated organization; for current illustrative purposes, assume it is a general partnership. The capital accounts of Pete and Marilyn would each reflect their \$1,000 contribution. The partnership purchases a painting for \$2,000. Assume the partnership has no other transactions or expenses, and at the end of the third year, the painting has a fair market value of \$6,000. Craig becomes a partner at that time and makes a contribution of \$2,000, one-third of the fair market value of the painting. He immediately yells "I dissociate," which requires the dissolution and winding up of the partnership.

The painting is sold for \$6,000 and added to the \$2,000 cash in the partnership bank account to which Craig contributed. Thus, the bank account balance is \$8,000. Before allocating the sales proceeds, Pete's capital account is \$1,000, Marilyn's capital account is \$1,000, and Craig's capital account is \$2,000. Each account is allocated their pro rata share of the \$4,000 profit from the painting, \$6000 minus \$2000. The pro rata allocation is \$1,333. So the capital accounts are:

Pete	\$2,333
Marilyn	\$2,333
Craig	\$3,333

The accounts total \$8,000 and the bank account has \$8,000. Each of the partners will receive a liquidating distribution equal to their respective capital account balance. That is, each partner receives a return of their contribution plus a profit of \$1,333. This outcome is probably not the result that Pete and Marilyn wanted.

Now, alternatively, assume a book-up of Pete's and Marilyn's capital accounts to reflect one-half the built-in appreciation of the painting—one-half is \$2,000—upon Craig's admission, such that the accounts are deemed to be:

Pete	\$3,000
Marilyn	\$3,000
Craig	\$2,000

Craig again yells, "I dissociate," causing the dissolution and winding up of the partnership. The same \$8,000 is in the bank account. Each receives a liquidated distribution equal to their capital account. Craig doesn't share in the appreciation of the value of the painting, which occurred before his admission.

<sup>429</sup> See Treas. Reg. § 1.704-1; Lidstone, *supra* note 427, at 19, 20.

Book-ups do solve one of the issues in cooperative structure that Professor Cook has described in summary as “vaguely defined property rights.”<sup>430</sup> A book-up does provide existing members a way to capture, eventually, the increase in the value of the LCA. An example in which a book-up might be desirable is a closed cooperative in a value-added business where few new members are admitted, and where the members desire to get a full share of the appreciated value of the plant upon dissolution or dissociation.

Book-ups affect the real economics of the entity and its members. However, whether every LCA in every industry should adopt book-ups is unclear. On the other hand, depending on a particular entity’s type of assets owned and distribution policy, a book-up may not have any effect. Executing book-ups is not a costless transaction because the value of the entity must be appraised or otherwise determined upon the admission of every new member. Alternatives to book-ups may exist. For example, a buy-sell or redemption agreement might provide some of the advantages of a book-up. Perhaps for these reasons, neither ULCAA nor any of the other uniform unincorporated acts governing other types of unincorporated entities have statutory book-up provisions.

#### 4. *Distributions, Redemptions, and Repurchases*

##### a. *Interim Distributions, Redemptions, and Repurchases*

Allocations of profits of an LCA do not constitute authorization to pay or distribute the allocated amounts to the recipients of the allocations. Therefore, the distribution (or in the vernacular of corporate cooperatives, the redemption and repurchases of allocated profits and capital contributions)<sup>431</sup> must be handled as a separate subject from contributions and allocations. The right to receive distributions is one of the financial rights of members and a transferee of financial rights in an association.<sup>432</sup> “Distribution,” as used in ULCAA, “means a transfer of money or other property from an LCA to a member because of the member’s financial rights or to a transferee of a member’s financial rights.”<sup>433</sup> The term includes interim (nonliquidating) distributions the board of directors

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<sup>430</sup> Study Report, *supra* note 29, at 12; *see also supra* note 39 and accompanying text.

<sup>431</sup> *See supra* notes 269–70 and accompanying text.

<sup>432</sup> *See* UNIF. LTD. COOP. ASS’N ACT § 102(11), 6A U.L.A. 160 (2008).

<sup>433</sup> *Id.* § 102(9), 6A U.L.A. 160.

may make unless the organic rules prohibit,<sup>434</sup> as well as distributions in winding up an association following dissolution.<sup>435</sup>

In traditional cooperatives, capital provided to a cooperative, either through contribution or retention of patronage refunds, generally is denominated equity. Persons who hold equity in a cooperative generally cannot liquidate those holdings in the same way a stockholder in a publicly held corporation can liquidate stock. The equity in a cooperative is tied to membership and, therefore, typically not transferable, or express limitations on transfer may exist in the articles of incorporation or bylaws. Somewhat related, it is generally desirable for each member to provide investment in the cooperative in the approximate proportion that the member's patronage bears to the patronage of all members.<sup>436</sup> As part of achieving this objective, and given the illiquidity of the member's equity, traditional cooperatives frequently have established equity retirement programs to redeem or repurchase equity from persons who are no longer members of the cooperative. This arrangement serves as a means to achieve the objective of members providing equity in proportion to their patronage with the cooperative, or to return excess equity to the cooperative's members.<sup>437</sup>

ULCAA addresses the subjects of distributions, redemptions, and repurchases of capital in several sections. The sections are based upon similar provisions in other uniform unincorporated acts.<sup>438</sup> The language anticipates some LCAs will use techniques and nomenclature based on traditional cooperatives' corporate model of finance. Thus, ULLCA's language also contains similarities to traditional cooperative and corporate law.

Section 1005(a) of ULCAA simply states "the board of directors may authorize, and a limited cooperative association may make, distributions to members" unless the organic rules otherwise provide or the limi-

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<sup>434</sup> See *id.* § 1005(a), 6A U.L.A. 270.

<sup>435</sup> See *id.* § 1207, 6A U.L.A. 285.

<sup>436</sup> See Barton, *supra* note 80, at 30.

<sup>437</sup> See generally DAVID W. COBIA ET AL., EQUITY REDEMPTION: ISSUES AND ALTERNATIVES FOR FARMER COOPERATIVES, ACS RESEARCH REPORT NO. 23, at 11–12 (U.S. Dep't of Agric. 1982). See also Frederick, *supra* note 358, at 4. For different types of equity retirement or redemption programs and their effects on a cooperative's financial condition, see, for example, David W. Cobia, Jeffery S. Royer & Gene Ingalsbe, *Equity Redemption*, in COOPERATIVES IN AGRICULTURE 267 (David W. Cobia ed., 1989).

<sup>438</sup> See, e.g., REV. UNIF. LTD. LIAB. CO. ACT § 404, 6B U.L.A. 480 (2008); UNIF. LTD. P'SHIP ACT (2001) §§ 503–509, 6A U.L.A. 444–49 (2008); REV. UNIF. P'SHIP ACT §§ 402, 807(a), 6 Pt. I U.L.A. 139, 206 (2001).

tations of section 1007 prohibit.<sup>439</sup> Section 1007 limits the power of an association to make a distribution if after the distribution (1) the association could not pay its debts as they become due, or (2) the distribution would cause the association's total assets to be less than the sum of its liabilities.<sup>440</sup> The language of section 1005(a) supports broad but not unfettered power in the board of directors to manage the association's capital. Together with section 1006, section 1005 allows the board to distribute profit<sup>441</sup> or capital from time to time as the board determines appropriate.<sup>442</sup> A member has no right to receive or force a distribution until the board has acted to authorize a distribution to a member.<sup>443</sup> Of course, the organic rules can modify many of these rules;<sup>444</sup> for example, mandating distributions under certain circumstances.

Distributions 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."<sup>445</sup> These listed items are not exclusive. As the comment to section 1005(b) states: "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."<sup>446</sup>

Because the Act's terminology contains certain tax driven content, providing a touchstone to income taxation for context may be helpful. One of the requirements under Subchapter T of the Code<sup>447</sup> for a cooperative to obtain a deduction for amounts of income allocated is that at

<sup>439</sup> UNIF. LTD. COOP. ASS'N ACT § 1005(a), 6A U.L.A. 270 (2008).

<sup>440</sup> See *id.* § 1007(a) cmt., 6A U.L.A. 272. The same type of provision appears in RULLCA § 405. See REV. UNIF. LTD. LIAB. CO. ACT § 405, 6B U.L.A. 481.

<sup>441</sup> Once allocated but not yet distributed, profit will be treated as capital in the association.

<sup>442</sup> See UNIF. LTD. COOP. ASS'N ACT § 1005(a), 6A U.L.A. 270. This sentence uses the language of corporate cooperatives and, in a way, seems to anticipate "nimble dividends." FLETCHER, *supra* note 392, § 5329.15.

<sup>443</sup> See UNIF. LTD. COOP. ASS'N ACT § 1005(a) cmt., 6A U.L.A. 270. A person holding capital in an LCA is entitled to receive a distribution from available assets in the case of winding up following dissolution of an association. See *id.* § 1207, 6A U.L.A. 285.

<sup>444</sup> See *supra* Part V.A.2.

<sup>445</sup> UNIF. LTD. COOP. ASS'N ACT § 1005(b), 6A U.L.A. 270.

<sup>446</sup> *Id.* § 1005(b) cmt., 6A U.L.A. 270.

<sup>447</sup> See I.R.C. §§ 1381–1388.

least 20% of the allocated amounts must be paid (distributed) to the recipients in money or qualified check.<sup>448</sup> The balance may be distributed—that is, allocated and taxed to the member, and deducted and retained by the corporate cooperative—if a qualified written notice is distributed to the member.<sup>449</sup>

ULCAA section 1006 addresses the redemption or repurchase of “property distributed to a member” other than money.<sup>450</sup> If an LCA has distributed evidence of an allocated amount to a member, the board of directors may in its sole discretion redeem or repurchase the amount distributed if the organic rules affirmatively authorize the redemption or repurchase.<sup>451</sup> The organic rules ideally should provide direction as to when and how redemption or repurchase is to occur and, perhaps, should emphasize that the board of directors has authority to make the final decision on when distributions to redeem or repurchase capital may occur, or should mandate the manner and amount of distributions and redemptions. These decisions go to the heart of the financial arrangement between the LCA as an entity and its members.

Section 1007(a) places the only limitations contained in ULCAA on the authority of the board for making distributions,<sup>452</sup> although the organic rules could provide additional limitations.<sup>453</sup> The limitations or tests

<sup>448</sup> See *id.* § 1382(c)(1). Among other requirements for deduction of allocated amounts, a pre-existing condition or requirement for the cooperative to make allocations to the members must be present, see *id.* § 1388(a)(2), and the member must agree to take allocated amounts into the member’s income for federal income tax purposes, see *id.* § 1388(c)(1)(B), (c)(2). These conditions frequently are addressed in a cooperative’s bylaws and should be addressed in an LCA’s bylaws, if one believes the association may qualify for tax treatment under Subchapter T. See also *supra* note 129 and accompanying text.

<sup>449</sup> See generally Treas. Reg. 1.1388-1(c)(2); *supra* note 157 and accompanying text. See also FREDERICK, *supra* note 134, at pt. 3.

<sup>450</sup> See UNIF. LTD. COOP. ASS’N ACT § 1006, 6A U.L.A. 271 (2008).

<sup>451</sup> See *id.*

<sup>452</sup> See UNIF. LTD. COOP. ASS’N ACT § 1007(a), 6A U.L.A. 272. This subsection provides:

- (a) A limited cooperative association may not make a distribution if, after the distribution:
  - (1) the association would not be able to pay its debts as they become due in the ordinary course of the association’s activities; or
  - (2) the association’s assets would be less than the sum of its total liabilities.

*Id.*

<sup>453</sup> See *id.* § 1005(a), 6A U.L.A. 270.



contained in section 1007(a) are to be applied at the time a distribution is made.<sup>454</sup> If a distribution is made in property other than money (such as a capital retain certificate), and the property is to be redeemed or repurchased at a future time, the limitations or tests in section 1007(a) will be applicable both when the initial distribution is made and when the subsequent redemption or repurchase is to occur.<sup>455</sup>

*b. Distributions in Dissolution and Winding Up*

Section 1007 applies to all distributions made by an LCA, including distributions in winding up after dissolution.<sup>456</sup> In effect, section 1007 provides an additional statement of protection for creditors of an association and applies more broadly than the provisions in ULCAA article 12 governing the winding-up process.

In connection with the payment of creditors as part of the process of winding up an LCA, ULCAA provides procedures for a dissolved association to deal with known claims<sup>457</sup> and unknown claims.<sup>458</sup> These provisions bar the assertion of some claims against the association if the claimant does not follow the requirements of the applicable ULCAA provisions.<sup>459</sup>

With respect to known claims, a dissolved association may give notice to known claimants of the association's dissolution in a "record," meaning that the notice must be in either a tangible form (for example, paper) or in an electronic form "retrievable in perceivable form."<sup>460</sup> The notice, among other things, must set a deadline of at least 120 days within which a claimant must state its claim to the association.<sup>461</sup> If the association receives the claim but does not act on it, the claimant has a ninety-day window within which it may commence an action to enforce its

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<sup>454</sup> See *id.* § 1007(d), 6A U.L.A. 272.

<sup>455</sup> See *id.*

<sup>456</sup> See *id.*

<sup>457</sup> See *id.* § 1208, 6A U.L.A. 286–87. Compare REV. UNIF. LTD. LIAB. CO. ACT § 703, 6B U.L.A. 508–09 (2008) with UNIF. LTD. P'SHIP ACT (2001) § 806, 6A U.L.A. 473 (2008).

<sup>458</sup> See UNIF. LTD. COOP. ASS'N ACT § 1209, 6A U.L.A. 287 (2008). Compare REV. UNIF. LTD. LIAB. CO. ACT § 704, 6B U.L.A. 509–10, with UNIF. LTD. P'SHIP ACT (2001) § 807, 6A U.L.A. 476–77.

<sup>459</sup> See UNIF. LTD. COOP. ASS'N ACT §§ 1208(c), 1209(c), 6A U.L.A. 287, 288.

<sup>460</sup> *Id.* § 102(26), 6A U.L.A. 162.

<sup>461</sup> See *id.* § 1208(b)(4), 6A U.L.A. 286.

claim.<sup>462</sup> An action may not be commenced before 120 days after the deadline for submission of claims, nor more than ninety days after that 120-day period.<sup>463</sup> For example, if on March 1 a known claimant of a dissolved association receives a notice to submit a claim, the claimant must submit its claim by June 28. If the dissolved association does not respond by October 26, the claimant must commence an action to enforce the claim by the following January 25, but not before the preceding October 26. If the claimant does not commence the action within that ninety-day window, the claimant's claim will be barred.

### 5. *Final Thoughts: Contributions, Allocations, Distributions*

The provisions of ULCAA that deal with contributions, allocations, distributions, redemptions, and repurchases offer a great amount of flexibility for LCAs organized under ULCAA. A few basic rules for distributions, common to other organizational law, limit this flexibility. ULCAA differs greatly from other entity law, however, by including parameters designed to assume identity with the cooperative model and its underlying principles by balancing the interests of patron members with those of investor members (in those associations where investor members are present). Indeed, ULCAA requires a higher percentage of profits be allocated to patron members than almost all existing unincorporated cooperative association state laws require; one early adopting jurisdiction has modified ULCAA to follow that existing law.<sup>464</sup> If no investors are present in an association, the organic rules can be written in such a way to be identical to a traditional cooperative. In drafting the organic rules, care should be taken to address the areas where ULCAA permits the organic rules to prescribe how the association will be structured and oper-

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<sup>462</sup> See *id.* § 1208(c)(3), 6A U.L.A. 287.

<sup>463</sup> See *id.*

<sup>464</sup> Other laws allow the organic rules to reduce the allocated percentage to patron members to as low as 15%. See *infra* State Comparative Chart, Appendix. This allocation was a major policy issue in the drafting of ULCAA, often expressed as a variant of the question, "What is a cooperative?" See *supra* note 50 and accompanying text. The authors of this Article have observed elsewhere that this problem may inhibit the use of LCAs formed under ULCAA in circumstances currently structured as joint ventures between a cooperative and an "investment group" organized separately as an LLC. See Geu & Dean, *supra* note 52. That observation should be tempered, however, with a recognition of the existence of a plethora of structural building techniques outside ULCAA (indeed, outside organizing acts of any kind) such as management contracts and asset leasing and with an awareness of the creativity of business planners. Examples of the creative use of these techniques are provided elsewhere by the authors of this Article. See Dean & Geu, *supra* note 50, at 95–98.

ate, especially with respect to the financial rights of members and related financial matters of the association and its members.

#### D. Marketing Contracts

Since the early 1900s, many agricultural marketing cooperatives have utilized marketing contracts with their members. Under a marketing contract, the members of the cooperative commit to sell and deliver commodities to their cooperative, and the cooperative agrees to purchase the commodity or act as an agent for the sale of the commodity.<sup>465</sup> In more recent history, new generation (closed-end) cooperatives have expanded the use and need for such contracts.<sup>466</sup>

These contracts commonly contain provisions for specified liquidated damages and injunctive relief if an agricultural producer fails to sell and deliver commodities as required under the contract. Initially, courts held the liquidated damages void as a penalty that the courts would not enforce.<sup>467</sup> In response, a number of state legislatures placed provisions in state agricultural cooperative statutes authorizing liquidated damages and providing they would not be void as penalties.<sup>468</sup>

The steps state legislatures have taken to support agricultural marketing cooperatives' use of marketing contracts illustrate both the singular nature of cooperatives and the general legislative support cooperatives have received from both the federal and state legislatures, especially in agriculture. Provisions similar to those dealing with agricultural marketing contracts are not found in any of the statutes under which other (non-cooperative) incorporated and unincorporated entities are organized.

ULCAA follows the tradition of statutes governing agricultural marketing cooperatives, and the continuation in the new unincorporated cooperative association statutes, by addressing marketing contracts in ar-

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<sup>465</sup> See LEGAL PHASES, *supra* note 82, at 158–211 (generally discussing marketing contracts in agricultural cooperatives). See also *Mountain States Beet Growers' Mktg. Ass'n v. Monroe*, 269 P. 886 (Colo. 1928) (containing a discussion of the history of marketing contracts).

<sup>466</sup> See, e.g., Shannon L. Ferrell, Note, *New Generation Cooperatives and the Capper-Volstead Act: Playing a New Game by the Old Rules*, 27 OKLA. CITY U. L. REV. 737, 741 (2002); Scott Flynn, Comment, *Putting the New Generation Cooperatives in Perspective Within the Value-Added Industry*, 85 IOWA L. REV. 1473, 1488–91 (2000).

<sup>467</sup> See, e.g., *Burns v. Wray Farmers' Grain Co.*, 176 P. 487, 490 (Colo. 1918).

<sup>468</sup> See Baarda, *supra* note 90, § 14.04.12, tbl. 14.04.12 (providing an illustrative list of state law provisions as they existed in 1982).

ticle 7.<sup>469</sup> The focus of article 7 is on marketing contracts between LCAs and their members, but it covers both contracts of sale by a member to an association, and contracts under which a member authorizes the association to act as the member's sales agent or in another capacity with respect to the member's commodities.<sup>470</sup> The marketing contract provisions do not extend to contracts for the purchase of goods by members or the provision of services to members.<sup>471</sup>

The absence of specific authorization for purchasing or service contracts does not imply LCAs and their members may not utilize these types of contracts. An association is permitted to enter into any type of contract necessary or desirable for the conduct of its business under general legal principles.<sup>472</sup> Whether contracts outside the marketing area that provide for liquidated damages for breach by a member would fall subject to the infirmities courts found in the early marketing contracts in the absence of statutory authorization remains debatable. The drafting committee considered, but rejected, extending the special provisions of article 7 concerning marketing contracts to supply or services contracts.<sup>473</sup>

ULCAA does, however, broaden the express authorization of marketing contracts beyond agriculture to extend to any type of marketing contracts as is done in the current Oregon cooperative statutes for traditional corporate cooperative entities.<sup>474</sup> The Colorado Cooperative Act, on the other hand, extends its terms to marketing and purchasing contracts, but does not extend them to service contracts in service cooperatives or employment contracts in worker-owned cooperatives.<sup>475</sup>

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<sup>469</sup> Compare UNIF. LTD. COOP. ASS'N ACT art. 7, 6A U.L.A. 237-40 (2008), with MINN. STAT. ANN. § 308B.311 (West Supp. 2008), TENN. CODE ANN. § 43-38-114 (2007), and WIS. STAT. ANN. § 193.311 (West Supp. 2008). ULCAA does not provide specific penalties for third-party interference with a marketing contract, a topic addressed in many traditional cooperative and new cooperative association statutes regarding marketing contracts.

<sup>470</sup> See UNIF. LTD. COOP. ASS'N ACT § 701, 6A U.L.A. 238.

<sup>471</sup> See *id.*; *id.* art. 7 preliminary cmt., 6A U.L.A. 237-38.

<sup>472</sup> See *In re Farmers' Dairy Co.'s Receivership*, 225 N.W. 22 (Minn. 1929).

<sup>473</sup> See UNIF. LTD. COOP. ASS'N ACT art. 7 preliminary cmt., 6A U.L.A. 238.

<sup>474</sup> Compare *id.* art. 7, 6A U.L.A. 238, with OR. REV. STAT. § 62.355 (2007).

<sup>475</sup> See COLO. REV. STAT. § 7-56-502 (2008). In worker cooperatives, the possibility of running afoul of the constitutional proscription against indentured servitudes and attendant constitutional tort liability exists.

For purposes of ULCAA,

[a] “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 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.<sup>476</sup>

Further, ULCAA provides that a marketing contract allows an LCA to create an enforceable security interest in a member’s commodities when those commodities are delivered under the marketing contract.<sup>477</sup> This provision is consistent with article 9 of the Uniform Commercial Code (UCC)<sup>478</sup> and recognizes that an association may need to borrow money and provide collateral for the loan before it can remarket the member’s commodities.<sup>479</sup> Although the default rule under ULCAA provides that title passes to the association upon delivery, the contract may provide for a different time when title is to pass.<sup>480</sup> Both of these provisions clarify issues that have arisen concerning marketing contracts in some traditional marketing cooperatives. A marketing contract also may provide for marketing on a pooled basis, where prices received for commodities marketed by the LCA and various charges are pooled, and amounts payable to the person whose commodities are marketed are determined on the results derived from the pool as a whole.<sup>481</sup>

The initial term of a marketing contract may not exceed ten years, but it may be made self-renewing for additional terms no longer than five years each.<sup>482</sup> The specified maximum terms are mandatory, though the contract may provide shorter terms. Furthermore, the contract may provide means for termination. If it does not do so, either party may termi-

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<sup>476</sup> UNIF. LTD. COOP. ASS’N ACT § 701, 6A U.L.A. 238 (2008).

<sup>477</sup> See *id.* § 702(b)(1), 6A U.L.A. 239.

<sup>478</sup> See UNIF. COMM. CODE art. 9 (amended 2000), 3 U.L.A. 38–598 (2002).

<sup>479</sup> See UNIF. LTD. COOP. ASS’N ACT § 702(b)(1) cmt., 6A U.L.A. 239.

<sup>480</sup> See *id.* § 702(a), 6A U.L.A. 238.

<sup>481</sup> See *id.* § 702(b)(2), 6A U.L.A. 239.

<sup>482</sup> See *id.* § 703, 6A U.L.A. 239.

nate the contract by giving ninety days notice in a record before the end of the then current term.<sup>483</sup> These terms are relatively standard provisions in traditional agricultural cooperative statutes addressing marketing contracts.<sup>484</sup> If a contract is not for a reasonable fixed term or does not provide a means for its termination by a member, it might be unenforceable by the association as an unreasonable restraint of trade under other law.<sup>485</sup>

Section 704 of ULCAA addresses remedies for breach of a marketing contract but does so in language that differs from that found in older traditional marketing cooperative statutes. It is, however, consistent with two of the newer corporate cooperative statutes.<sup>486</sup> Three remedies are acknowledged specifically: liquidated damages, injunctive relief, and specific performance.<sup>487</sup> These remedies explicitly are stated to be in addition to any other remedies (such as actual damages) that might be available to the nonbreaching party.<sup>488</sup>

With respect to liquidated damages, section 704 recognizes limitations placed on liquidated damages in the UCC.<sup>489</sup> Liquidated damages provided in a marketing contract will not be considered a penalty if they are in an amount or determined under a formula “that is reasonable in light of the actual or anticipated harm caused by the breach or repudiation” of the contract.<sup>490</sup> Thus, an amount specified as liquidated damages in a marketing contract likely will be unenforceable if it constitutes a penal sum parading as liquidated damages. This position is a middle ground between the early cases, in which liquidated damages were highly disfavored and struck down by courts, and the many traditional agricultural cooperative statutes, which place no limitation on liquidated damages (unless a court were to import and impose a limitation under the UCC consistent with the cooperative statute on the same subject).

Because of the general contractual nature of the relationship between a cooperative and its members, provisions of a marketing contract are sometimes found embedded in the organic rules or in membership

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<sup>483</sup> See *id.*

<sup>484</sup> See Baarda, *supra*, note 90, § 14.04.09.

<sup>485</sup> See PACKEL, *supra* note 50, § 40(a) (collecting cases).

<sup>486</sup> Compare UNIF. LTD. COOP. ASS’N ACT § 704, 6A U.L.A. 240 (2008), with OHIO REV. CODE ANN. § 1729.67 (LexisNexis 2004).

<sup>487</sup> See UNIF. LTD. COOP. ASS’N ACT § 704, 6A U.L.A. 240 (2008).

<sup>488</sup> See *id.* § 704(c), 6A U.L.A. 240.

<sup>489</sup> See UNIF. COMM. CODE § 2-718 (amended 2003), 1 U.L.A. 549 (2004).

<sup>490</sup> UNIF. LTD. COOP. ASS’N ACT § 704(a), 6A U.L.A. 240.

agreements.<sup>491</sup> Section 702(c) specifically recognizes that some or all of the provisions may be placed in the organic rules. However, this method may not be a best practice because, *inter alia*, modification of the contract would then require an amendment to the organic rules. The existence of the practice, however, is evidence of the centrality of the marketing contract to the economic relationship underlying many cooperatives.<sup>492</sup>

Marketing contracts have been construed, from time to time, as creating obligations among and between all the members having marketing contracts with the cooperative, limiting the ability of a member to avoid its performance.<sup>493</sup> Further, a member may not avoid performance under a marketing contract because of a breach of the contract by officers of the cooperative.<sup>494</sup> Courts likely would give consideration to precedents established with respect to marketing contracts in connection with agricultural cooperatives when construing marketing contracts between an LCA and its patron members, because many of ULCAA's unique provisions are drawn from cooperative law.<sup>495</sup>

Finally, some authority exists that a cooperative entity acts in a fiduciary capacity for the contracting member under a marketing contract.<sup>496</sup> Therefore, LCAs using marketing contracts need to understand the possible implications of their use.<sup>497</sup>

Marketing contracts have been useful tools for marketing cooperatives and their members. They should serve a similar function with similar benefits for LCAs that market the commodities (in any form) of their patron members. ULCCA provides support for contracts similar to those provided by statutes governing traditional marketing cooperatives. Some of the remedies included in older statutes, like special provisions on spe-

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<sup>491</sup> See *id.* art. 7 preliminary cmt., 6A U.L.A. 237; Roberts-Caudle, *supra* note 265, at 20.

<sup>492</sup> See *supra* notes 465–69 and accompanying text.

<sup>493</sup> See LEGAL PHASES, *supra* note 82, at 199–200 and cases cited therein.

<sup>494</sup> See *id.* at 200. Cf. *McCauley v. Arkansas Rice Growers' Co-op Ass'n*, 287 S.W. 419, 423 (Ark. 1926).

<sup>495</sup> This topic is discussed further in conjunction with the “duties” portion of this article. See *infra* Part V.G.

<sup>496</sup> See Roberts-Caudle, *supra* note 265, at 17–22 and authorities cited therein.

<sup>497</sup> See Jeffrey A. Mollet, *Value Added Cooperatives—Issues for Organization*, 7 DRAKE J. AGRIC. L. 87, 102 (2002) (discussing marketing contracts in value-added cooperatives); Jeffrey A. Mollet, *Agricultural Production and Marketing Contracts*, ILL. L. & AGRIBUSINESS (Ill. Inst. for Continuing Legal Ed. 2001) (providing further information and a bibliography of resources).

cific performance and liquidated damages, served special historical needs and are helpful to the cooperative. Remedies of that kind are not included in ULCAA because they conflict with modern commercial practice outside of cooperatives, and any conflict with the UCC is, at best, confusing. Initial drafts of the Act contained the special remedies of older traditional cooperative statutes but those provisions were amended during final reading in 2007.<sup>498</sup>

## E. Voting Control

### 1. Introduction

A primary cooperative principle found in virtually every list of cooperative principles is democratic control by members of a cooperative entity.<sup>499</sup> For example, a cooperative has been “defined for practical purposes as a democratic association of persons organized to furnish themselves an economic service under a plan that eliminates entrepreneur profit and that provides for substantial equality in ownership and control.”<sup>500</sup> This democratic principle frequently has been translated into a limitation of voting power to “one-member, one-vote.” The principle has been included as a requirement in a number of federal statutes as a crucial factor in defining a cooperative for purposes of the statute. For example, to obtain federal income tax treatment as a cooperative under Subchapter T of the Code,<sup>501</sup> an organization must be recognized under a state coopera-

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<sup>498</sup> See e.g., NCCUSL Annual Meeting Minutes, *supra* note 361, at 126–49, 293–300.

<sup>499</sup> See *supra* notes 83, 86 and accompanying text.

<sup>500</sup> PACKEL, *supra* note 50, at 2. A 1965 USDA Farmer Cooperative Service Report provided a definition of cooperatives that is instructive in connection with various factors, including who should have control of the organization:

A cooperative is a voluntary contractual organization of persons having a mutual ownership interest in providing themselves a needed service on a non-profit basis. It is usually organized as a legal entity to accomplish an economic objective through joint participation of its members. In a cooperative the investment and operational risks, benefits gained, or losses incurred are shared equitably by its members in proportion to their use of the cooperative's services. A cooperative is democratically controlled by its members on the basis of their status as member-users and not as investors in the capital structure of the cooperative.

LEGAL PHASES, *supra* note 82, at 4 (emphasis added) (quoting JOB K. SAVAGE & DAVID VOLKIN, COOPERATIVE CRITERIA, FCS SERVICE REPORT 71 (FARMER COOPERATIVE SERV., U.S. DEP'T AGRIC. 1965)).

<sup>501</sup> See I.R.C. §§ 1381–1388.



tive statute or be “operated on a cooperative basis.”<sup>502</sup> The Service often has taken the position that operating on a cooperative basis generally will include a one-member, one-vote requirement.<sup>503</sup>

Although often considered a defining characteristic of cooperatives, a “one-member, one-vote” approach to member voting is not the only way voting can be conducted in cooperatives. State statutes authorize alternative voting approaches implemented through the organizing documents (such as articles of incorporation and bylaws) of a corporate cooperative.<sup>504</sup> Voting does not necessarily have to be equal if governing

<sup>502</sup> I.R.C. § 1381(a). *See also* *Beaver Valley Canning Co. v. Commissioner*, 9 TCM (CCH) 1120 (1950) (taxpayer organized under general incorporation laws but operated as a true cooperative may be a cooperative for tax purposes, but cooperative treatment denied because of no pre-existing obligation to allocate patronage dividends to members).

<sup>503</sup> *See e.g.*, I.R.S. Priv. Ltr. Rul. 200224017 (March 15, 2002); I.R.S. Priv. Ltr. Rul. 77-26-040 (Mar. 30, 1977). *See also* UNIF. LTD. COOP. ASS’N ACT § 511 cmt., 6A U.L.A. 218 (2008). *See generally* PACKEL, *supra* note 50, § 24; LEGAL PHASES, *supra* note 82, at 151–52. Note that an LCA organized under ULCAA or another of the state unincorporated cooperative association statutes may not qualify for treatment as a cooperative under any existing state or federal statutes relating to cooperative organizations. *See supra* notes 28, 107 and accompanying text.

Concerning the one-member, one-vote principle in the world of federal income taxation “Democratic control of the cooperative, as envisioned in *Puget Sound* [44 T.C. 305 (1965), *acq.* 1966-2 C.B. 3] at 308, is typically achieved by voting on a one-member, one-vote basis.” I.R.S. Priv. Ltr. Rul. 200224017 (Mar. 15, 2002).

A treatise on the taxation of cooperatives states:

In *Puget Sound Plywood*, the Tax Court said a cooperative association with certain attributes clearly comes within the scope of “operating on a cooperative basis” under subchapter T. The Service appears to be reading the decision to say only cooperatives with those specific traits can be considered as “operating on a cooperative basis.”

Cooperatives assert that the IRS interpretations of subordination of capital (returns on equity capital must be limited) and democratic control (one-member, one-vote) are unduly restrictive. They further contend that the only Code requirement to single tax treatment of patronage refunds and per-unit retains is that they be returned or allocated to patrons on the basis of patronage, pursuant to a pre-existing legal obligation.

Frederick, *supra* note 134, at 52 (citation omitted).

For purposes of the Capper-Volstead Act, the democratic control requirement concept is that “[e]ither no member may have more than one vote because of the amount of equity owned or dividends on equity cannot exceed 8 percent per year.” *Id.* at 57. Federal income taxation of cooperatives and the Capper-Volstead Act are discussed elsewhere in this Article. *See supra* note 368 and accompanying text.

<sup>504</sup> *See* PACKEL, *supra* note 50, at 106–09.

statutes permit unequal voting.<sup>505</sup> Statutes that do permit an alternative voting method to one-person, one-vote frequently place limits on the voting power any one member may have<sup>506</sup> or may only permit voting based on patronage.<sup>507</sup>

The concept of democratic control in cooperative organizations is not confined to any one approach so long as, ultimately, the organization is subject to democratic rule.<sup>508</sup> “[V]ariations in equality of voting are but one factor to be considered in determining the cooperative character of an organization.”<sup>509</sup> On the other hand, another treatise opines, “Failure to follow one or more of the [cooperative] criteria weakens the others. This is particularly true with respect to democratic control, mutuality of interest, equitability of treatment, and the nonprofit nature of cooperatives.”<sup>510</sup>

For cooperative statutes to permit voting by persons who are not patron members or stockholder members of a cooperative is unusual; although, within limits, such voting apparently is allowed under German cooperative law.<sup>511</sup> As a practical matter, “control” has been interpreted in ULCAA and the other unincorporated cooperative statutes to mean not

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<sup>505</sup> PACKEL, *supra* note 50, § 24(c). See also LEGAL PHASES, *supra* note 82, at 151–52.

<sup>506</sup> See UNIF. LTD. COOP. ASS’N ACT § 511 cmt., 6A U.L.A. 218 (2008) (“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.”). See also COLO. REV. STAT. ANN. § 7-56-305(3) (West 2008).

<sup>507</sup> See UNIF. LTD. COOP. ASS’N ACT § 511 cmt., 6A U.L.A. 218 (“The Ohio Cooperative Law and the Oregon Cooperative Corporation Act permit voting based on patronage.”). See also OHIO REV. CODE ANN. § 1729.17 (LexisNexis 2004); OR. REV. STAT. § 62.265 (2003).

<sup>508</sup> See PACKEL, *supra* note 50, at 108–09.

<sup>509</sup> *Id.* at 108–09. See also *id.* at 109 n.16. With citation to authorities, Packel generally recognizes far greater variation in voting methods in cooperative entities than other authorities in the field recognize, so long as statutes support the variations and so long as other characteristics are present in sufficient number to demonstrate that an entity is organized and operated as a true cooperative. See generally *id.*

<sup>510</sup> LEGAL PHASES, *supra* note 82, at 4–5.

<sup>511</sup> See Email from Hagen Henry, Adj. Prof. of Comparative Law, The University of Helsinki, to Thomas Geu, Professor of Law, The University of South Dakota School of Law (June 16, 2006, 07:54 CST) (on file with Thomas Geu).

only member voting but also the ability of patron members to elect a specified percentage of seats on the board of directors.<sup>512</sup>

That a cooperative exists for the benefit of the persons who use and control it, coupled with a lack of entrepreneurial profit motive, may make conceiving how investors can be embedded into the cooperative model difficult, especially if those investors are given a share of governance control in the enterprise. However, a simple example may provide an illustration of where the presence of voting investors in a cooperative setting would not necessarily contradict cooperative concepts.

**EXAMPLE:** Three elderly owners of a privately owned manufacturing plant in a rural area determine they no longer wish to operate the plant, which is the primary economic influence in the community outside of agriculture. The plant employs 100 workers who will lose their jobs if the plant is closed. The workers arrange with the owners to acquire the plant through a worker-owned cooperative, but the workers cannot provide sufficient capital on their own to make the needed equity portion of the acquisition cost. Members of the community, recognizing the loss to the local economy if the plant closes, are prepared to make significant investments in the cooperative but will do so only if they have some level of influence in the cooperative's organization and operation. That the local investors desire to have some level of reasonable return on their potential investments may be assumed, but they are just as—if not more so—concerned with the potential economic effect on the community from the loss of the plant. While the investors could form an entity and join with the worker-owned cooperative by contract or through a third entity,<sup>513</sup> a more direct approach in which the parties join together in one organization with all persons having some say in the organization might make more practical sense.<sup>514</sup>

Variations of this scenario in the agricultural sector led to the concept of state statutes authorizing unincorporated cooperatives.<sup>515</sup> These statutes, in combining cooperative and LLC features, permit flexibility in

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<sup>512</sup> See *infra* notes 576–77 and accompanying text; State Comparative Chart, Appendix.

<sup>513</sup> See MICHAEL BOLAND & DAVID BARTON, SOUTH DAKOTA SOYBEAN PROCESSORS: JOINT VENTURES AND STRATEGY 1 (2003), [http://www.agmrc.org/media/cms/ksasdsoy\\_BE94D8B9D2550.pdf](http://www.agmrc.org/media/cms/ksasdsoy_BE94D8B9D2550.pdf) (last visited May 31, 2009); Thompson, *supra* note 237, at 21.

<sup>514</sup> See generally Dean & Geu, *supra* note 50.

<sup>515</sup> See *id.*

voting and generally allow significant, if not controlling, voting power to be held by investor members in an LCA.<sup>516</sup>

## 2. *Vote Allocation and Manner of Voting*

The Minnesota Cooperative Associations Act and the Iowa Cooperative Associations Act permit the bylaws of an LCA to reduce the collective patron vote to 15% of the total voting power in the association, leaving up to 85% of the voting power in investor members.<sup>517</sup> In contrast, Wisconsin does not permit the patron member vote to be less than 51% of the total member vote.<sup>518</sup> At the same time, the Minnesota, Iowa, Wisconsin, and Wyoming statutes require a collective block vote with respect to patron-member voting. Collective block voting means all of the patron member votes present must be cast together, and they must be cast in the way the majority of the patron members voted.<sup>519</sup> No similar provision for investor-member voting exists. Under the Minnesota statute, nonpatron (investor) members simply have the voting rights provided in the bylaws of the cooperative association.<sup>520</sup> Wisconsin, on the other hand, generally limits voting rights of patron members and nonpatron members to one vote per member<sup>521</sup> with specifically delineated exceptions.<sup>522</sup>

The drafting committee of ULCAA examined the voting schemes in existing state statutes and considered in depth the appropriate balance of voting power between patron members and investor members with substantial input from the committee's observers from cooperative communities. The committee's ultimate conclusions, as adopted by the conference, struck a different balance from those in other limited cooperative statutes. As a result, most matters can require at least a majority vote of patron members, and fundamental changes can require the possibility of a supermajority vote. At the same time, investor members can be allowed

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<sup>516</sup> See, e.g., IOWA CODE ANN. §§ 501A.501–.1216 (West 2008); MINN. STAT. ANN. §§ 308B.001–.975 (West 2004 & Supp. 2008); NEB. REV. STAT. §§ 21-2901 to -29,134 (2007 & Supp. 2007); TENN. CODE ANN. §§ 43-38-101 to -1109 (2007); WIS. STAT. ANN. §§ 193.001–.971 (West Supp. 2008); WYO. STAT. ANN. §§ 17-10-201 to -253 (2005).

<sup>517</sup> See IOWA CODE ANN. § 501A.810; MINN. STAT. ANN. § 308B.545 subdiv. 1 (West 2004).

<sup>518</sup> See WIS. STAT. ANN. § 193.545(1)(a).

<sup>519</sup> IOWA CODE ANN. § 501A.810; MINN. STAT. ANN. § 308B.545 subdiv. 1; WIS. STAT. ANN. § 193.545; WYO. STAT. ANN. § 17-10-230.

<sup>520</sup> See MINN. STAT. ANN. § 308B.545 subdiv. 1.

<sup>521</sup> See WIS. STAT. ANN. § 193.545(1)(a).

<sup>522</sup> See *id.* § 193.551.

substantial influence and, in some cases, a veto or blocking power. ULCAA uses a two-tier voting structure with respect to patron members in an LCA that has investor members.<sup>523</sup>

Section 514 of ULCAA provides the breastwork for balancing the voting power of the two groups of members, assuming an association has both patron members and investor members by providing a two-tier voting structure.<sup>524</sup> In this structure, the total voting power of all patron members must not be less than a majority of the entire voting power entitled to vote in the association.<sup>525</sup> "Voting power" is defined in ULCAA as "the total current power of members to vote on a particular matter for which a vote may or is to be taken."<sup>526</sup>

For the membership of the association to approve an action, it must first receive an affirmative vote of a majority of all members voting at the meeting (patron members and investor members combined), with certain specified exceptions.<sup>527</sup> Second, the membership must receive an affirmative vote of a majority of the votes patron members cast, unless the organic rules require a larger affirmative patron-members vote.<sup>528</sup> In addition, the organic rules may provide specifically the percentage of affirmative votes needed from investor members for approval on a matter.<sup>529</sup> These provisions, taken together, permit fine-tuning the membership voting structure within prescribed bounds to achieve a balance that meets the needs of both the association and its two types of members.

The two-tier approach for voting also is used for amendment of the organic rules, voluntary dissolutions, disposition of assets, conversions, and mergers. In those instances, however, the default provides for a larger quantum of patron-member votes.<sup>530</sup>

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<sup>523</sup> ULCAA does not require an LCA organized under it to have investor members. See UNIF. LTD. COOP. ASS'N ACT Prefatory Note, 6A U.L.A. 142 (2008); *id.* § 513 cmt., 6A U.L.A. 220. The two-tier voting structure is established under ULCAA section 514. See *id.* § 514, 6A U.L.A. 221. See also *infra* notes 638–50 and accompanying text.

<sup>524</sup> See *infra* notes 638–50 and accompanying text.

<sup>525</sup> UNIF. LTD. COOP. ASS'N ACT § 514(1), 6A U.L.A. 221 (2008).

<sup>526</sup> See *id.* § 102(33), 6A U.L.A. 162. See also *id.* § 102(33) cmt., 6A U.L.A. 165.

<sup>527</sup> The exceptions relate to fundamental changes to the entity, such as amendments to the organic rules, dissolutions, dispositions of assets, conversions, and mergers that are addressed specifically in ULCAA articles 4, 12, 15, and 16. For a general discussion of fundamental changes under ULCAA, see *infra* Part V.F.

<sup>528</sup> UNIF. LTD. COOP. ASS'N ACT § 514(2), 6A U.L.A. 221.

<sup>529</sup> See *id.* § 514(3), 6A U.L.A. 221.

<sup>530</sup> See *supra* notes 18–19 and accompanying text.

ULCAA does not state expressly that the organic rules may provide for voting requirements beyond a simple majority of patron members if no investor members are involved, except with respect to fundamental changes under articles 4, 12, 15, and 16. The operation of subsection 113(a), however, supports the existence of that flexibility.<sup>531</sup> The comments to ULCAA sections 512 through 514 provide examples of how voting power is determined and how the voting provisions operate. The comments also illustrate the extent to which the organic rules can alter voting.<sup>532</sup>

ULCAA uses the same two-tiered voting scheme for fundamental changes in an LCA. The fundamental changes and the specific voting requirements applicable to them are amendments to the articles of organization,<sup>533</sup> certain amendments to the bylaws,<sup>534</sup> dissolution,<sup>535</sup> certain dispositions of assets,<sup>536</sup> conversions,<sup>537</sup> and mergers.<sup>538</sup>

The default rules for fundamental changes require a two-thirds vote of all members voting (both patron members and investor members taken together) to approve the change. The organic rules may modify the default rules to a different quantum of votes (or in the case of patron-member votes, to a greater percentage of the patron-member votes) so long as that quantum is not less than a majority.<sup>539</sup> These default rules actually mean the patron members may, as a practical matter, have a greater say in day-to-day matters than fundamental changes when compared to the voting power of investor members.<sup>540</sup> ULCAA expressly provides the default rules on voting may be varied to require a percentage be measured against the voting power of all members rather than against those actually voting.<sup>541</sup>

ULCAA permits the organic rules to create geographic districts of patron members or classes of patron or investor members; conduct meet-

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<sup>531</sup> See *supra* note 285 and accompanying text.

<sup>532</sup> See UNIF. LTD. COOP. ASS'N ACT § 511 cmt., 6A U.L.A. 218 (2008).

<sup>533</sup> See *id.* § 405(a), 6A U.L.A. 203.

<sup>534</sup> See *id.* § 405(e), 6A U.L.A. 204.

<sup>535</sup> See *id.* § 1205, 6A U.L.A. 283.

<sup>536</sup> See *id.* § 1504(a), 6A U.L.A. 308.

<sup>537</sup> See *id.* § 1603(b)(1), 6A U.L.A. 311.

<sup>538</sup> See *id.* § 1608(a)(1), 6A U.L.A. 316.

<sup>539</sup> See *id.* §§ 405(c), 1205(c), 1504(b), 1603(c), 1608(b), 6A U.L.A. 204, 283, 308, 311, 317.

<sup>540</sup> See *supra* note 19 and accompanying text.

<sup>541</sup> See *supra* notes 18–21.

ings of the members within districts or classes; elect directors at those meetings; or provide for the election of district or class delegates to represent and vote for the districts or classes at members meetings.<sup>542</sup> The concept of geographic districts is relatively common in larger traditional cooperatives that have many members and a large geographic territory.<sup>543</sup> Other unincorporated cooperative association acts contain express provisions concerning districts.<sup>544</sup> Cooperatives typically have uniform requirements for membership and, as a result, classification of members is not common. Nonetheless, districts of members are available in unincorporated entities and are, likewise, addressed expressly in ULCAA.<sup>545</sup>

Even though ULCAA expressly addresses the use of districts or classes, the Act provides no detailed default rules for their structure or operation. This flexibility in designing districts and classes is implicit in LLC statutes but is without express prompting by statute. Thus, ULCAA's flexibility is common with that of LLCs.<sup>546</sup> Cooperative statutes, perhaps because most are now based on corporate law, expressly prompt the power to delineate classes, as does the Minnesota Cooperative Association Act.<sup>547</sup> ULCAA follows these statutes as a matter of cooperative custom. ULCAA's inclusion of districts and classes should assuage any negative interpretation that might result from their absence.

If the organic rules provide for voting by districts or classes of members, voting on an amendment to the articles or the bylaws requires the same percentage of member votes by the members of the districts or classes for approval of the amendment that would be required if no districts or classes existed.<sup>548</sup> This rule also applies to identifiable voting

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<sup>542</sup> See UNIF. LTD. COOP. ASS'N ACT § 517, 6A U.L.A. 224 (2008).

<sup>543</sup> See *id.* § 517 cmt. (a), (b), 6A U.L.A. 225.

<sup>544</sup> See, e.g., MINN. STAT. ANN. § 308B.545 subdiv. 4(b) (West 2004); TENN. CODE ANN. § 43-16-116(b) (2007); WIS. STAT. ANN. § 193.551(2)(a) (West Supp. 2008).

<sup>545</sup> See UNIF. LTD. COOP. ASS'N ACT § 517 cmt. (c), (d), 6A U.L.A. 225. See also REV. UNIF. LTD. LIAB. CO. ACT § 407(b)(2), 6B U.L.A. 483 (2008) (providing that "[e]ach member [in a member-managed limited liability company] has equal rights in the management and conduct of the company's activities," presumably creating one member, one vote); but see *id.* § 110(a)(1), 6B U.L.A. 442 (allowing arrangement to vary by company's operating agreement). See also UNIF. LTD. P'SHIP ACT (2001) § 110(a), 6A U.L.A. 378 (2008).

<sup>546</sup> See, e.g., REV. UNIF. LTD. LIAB. CO. ACT §§ 110(a), 407, 6B U.L.A. 442, 483.

<sup>547</sup> See MINN. STAT. ANN. § 308B.545 subdiv. 4(b) (West 2004).

<sup>548</sup> See UNIF. LTD. COOP. ASS'N ACT § 404(a), 6A U.L.A. 202.

groups that would be affected differently by a proposed amendment than other members<sup>549</sup> if the amendment relates to

- (1) the equity capital structure of the limited cooperative association . . . ;
- (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.<sup>550</sup>

Finally, if a proposed amendment would affect in the same or a substantially similar way two or more districts or classes<sup>551</sup> entitled to vote separately as a single voting group, the districts or classes so affected must vote as a single voting group (unless, of course, the organic rules otherwise provide).<sup>552</sup> This arrangement is consistent with, and roughly similar to, both general unincorporated and corporate law.

The organic rules may provide that member action may be taken only at a meeting of the members. Absent such a provision, action may be taken without a meeting by consent of every member—unanimous consent—in a record. The record may provide for a date and time when the consent will be effective.<sup>553</sup> This provision, too, is similar to other organizational law.<sup>554</sup>

Voting by a proxy is uncommon in traditional general or agricultural cooperatives but often required in housing cooperatives.<sup>555</sup> ULCAA's default rule disallows proxy voting, but the organic rules can change this rule, with certain restrictions.<sup>556</sup> If the organic rules permit proxies, the organic rules may also provide the manner and provisions for appoint-

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<sup>549</sup> See *id.*

<sup>550</sup> *Id.* § 405(e), 6A U.L.A. 204. ULCAA defines a "voting group" as "any combination of one or more voting members in one or more districts or classes that under the organic rules or [ULCAA] are entitled to vote and can be counted together collectively on a matter at a members meeting." *Id.* § 102(31), 6A U.L.A. 162.

<sup>551</sup> Presumably the members in the districts or classes.

<sup>552</sup> See UNIF. LTD. COOP. ASS'N ACT § 404(b), 6A U.L.A. 202 (2008).

<sup>553</sup> See *id.* § 516, 6A U.L.A. 223.

<sup>554</sup> See, e.g., REV. UNIF. LTD. LIAB. CO. ACT § 404(c), 6B U.L.A. 480 (2008).

<sup>555</sup> Cf. COLO. REV. STAT. ANN. § 7-56-305(1)(d) (West 2008).

<sup>556</sup> See UNIF. LTD. COOP. ASS'N ACT § 515(a), 6A U.L.A. 222.



ment of a proxy.<sup>557</sup> The Wyoming, Minnesota, Tennessee, and Iowa statutes governing LCAs prohibit voting by a proxy, but the Wisconsin statute allows it.<sup>558</sup> The word “proxy” in ULCAA means the person to whom authority to vote is granted, not the authority itself or the document in which the authority is granted,<sup>559</sup> but it does not refer to a delegate voting for a district or a class.<sup>560</sup>

A patron member may only appoint another patron member as a proxy. An investor member may only appoint another investor member to vote as a proxy.<sup>561</sup> The comment to subsection 515(b) notes this rule is mandatory;<sup>562</sup> thus, the rule comes within the introductory phrase “[u]nless required, limited, or prohibited by this act” as a provision that cannot be varied under the authority of the general language of subsection 113(a).<sup>563</sup> As a result, if a person is both a patron member and an investor member, the person would be required to appoint either two different persons—a patron member and an investor member—as proxies to vote in both capacities or appoint someone who is both a patron member and an investor member as the proxy.

The detailed voting provisions found in ULCAA are different from statutes governing unincorporated organizations, which usually have little, if any, information regarding the voting rights and procedures for partners or members. In those organizations, voting procedures are left completely to the organic rules. In this sense, ULCAA follows in its detail the provisions more frequently found in for-profit incorporated entity statutes and corporate cooperative statutes.<sup>564</sup> This detail, however, necessarily follows the policy of member control.

### 3. *Voting and the Board of Directors*

An additional voting provision related to the protection of patron members in LCAs appears in provisions of the statutes related to voting and the board of directors. ULCAA and all of the statutes governing entities similar to LCAs under ULCAA, except Tennessee, provide that at

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<sup>557</sup> See *id.* § 515(c), 6A U.L.A. 222.

<sup>558</sup> See *infra* State Comparative Chart, Appendix, col. E.

<sup>559</sup> See UNIF. LTD. COOP. ASS'N ACT § 515(a) cmt., 6A U.L.A. 222–23.

<sup>560</sup> See *id.* § 515(a), 6A U.L.A. 222.

<sup>561</sup> See *id.* § 515(b), 6A U.L.A. 222.

<sup>562</sup> See *id.* § 515(b) cmt., 6A U.L.A. 223.

<sup>563</sup> See *id.* § 113(a), 6A U.L.A. 176. For a discussion of ULCAA section 113 and interpretation of ULCAA, see *supra* notes 284–93 and accompanying text.

<sup>564</sup> See, e.g., REV. MODEL BUS. CORP. ACT §§ 7.20–.32 (2008).

least half of the voting power on general matters must be in one or more directors elected exclusively by patron members.<sup>565</sup> According to ULCAA, “[T]he 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].”<sup>566</sup>

The board structure and its responsibilities are similar to those found in traditional cooperative law. Even so, some traditional cooperative law does not contain the phrase “or under the direction of” found in ULCAA and in modern for-profit corporate acts.<sup>567</sup> Interestingly, the board structure in traditional corporate cooperative organizations conceivably can be interpreted as inconsistent with the principle of patron-member control because it is a representational, not pure, democratic governing scheme.<sup>568</sup> Perhaps because of the member-control principle, older corporate statutes frequently required all directors to be (patron) members of the cooperative organization. The modern trend, however, is to allow at least some nonmember directors. More importantly, all existing new unincorporated cooperative statutes provide for some flexibility on the issue.<sup>569</sup>

The default rule in ULCAA attempts to continue the traditional interpretation of the member-control principle by providing that all directors must be members or, in the case of members who are entities, an individual the member entity designated.<sup>570</sup> Additionally it limits the flexibility otherwise inherent in the organic rules<sup>571</sup> by limiting the number of nonmember directors who may serve on the board.<sup>572</sup> For example, if nine or more directors serve, no more than one-third of the directors may be nonmembers.<sup>573</sup> In any event, the board is required to have at

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<sup>565</sup> See *infra* State Comparative Chart, Appendix, col. C.

<sup>566</sup> UNIF. LTD. COOP. ASS’N ACT § 801(b), 6A U.L.A. 241 (2008).

<sup>567</sup> See *e.g.*, REV. MODEL BUS. CORP. ACT §801(b); Baarda, *supra* note 90, tbl. 12.07.01, at 491–94. According to the observers to the ULCAA Drafting Committee, the lack of this phrase has caused confusion in practice.

<sup>568</sup> In LCAs with few members, to have all members serve on the board of directors would be possible in many instances, simulating a pure democracy, with each director/member having fiduciary duties to the entity. See *generally infra* Part V.G.

<sup>569</sup> See, *e.g.*, MINN. STAT. ANN. § 308B.411 subdiv. 2(b) (West 2004).

<sup>570</sup> See UNIF. LTD. COOP. ASS’N ACT § 803(a), 6A U.L.A. 243.

<sup>571</sup> See *supra* Part V.A.

<sup>572</sup> See UNIF. LTD. COOP. ASS’N ACT § 803(c), 6A U.L.A. 243 (2008).

<sup>573</sup> See *id.* § 803(c)(3), 6A U.L.A. 243.

least three directors, unless it has fewer than three members in which case it may have the same number of directors as members.<sup>574</sup>

Board composition is another topic in which the economic necessity for some LCAs to have investor members complicates the application of cooperative principles. The principle of member control traditionally has been interpreted and applied to mean patron-member control.<sup>575</sup> Most of the new unincorporated cooperative association statutes that preceded ULCAA require at least one-half the voting power on the board of directors to be held by board members elected by patron members.<sup>576</sup> ULCAA further strengthens the user (patron) members' control by requiring, at a minimum, patron members elect the majority of the board of directors.<sup>577</sup> Under ULCAA, this requirement translates to voting power on the board of directors because ULCAA, unlike the new predecessor unincorporated cooperative statutes, limits each director to one vote.<sup>578</sup> This provision echoes, at the board level, the democratic one-person, one-vote theme<sup>579</sup> and is consistent with cooperatives formed under state corporate statutes.<sup>580</sup>

ULCAA manifests user control in another way: it provides, in addition to patron members electing the majority of the directors, at least a minimum number of directors must be patron members.<sup>581</sup> For example, if nine or more directors are on the board, then at least one-third of them

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<sup>574</sup> ULCAA does not allow a single member LCA, unless the association is a subsidiary of a cooperative organization. *See supra* notes 318–19 and accompanying text (discussing formation).

<sup>575</sup> Care needs to be taken in examining statutes, regulations, and literature, which frequently refer to control being in members as opposed to patrons or patron members. Usually a great overlap, if not a total identity, between members and patron members exists in a cooperative organization, with the result that control is in fact in patron members. *See generally* Frederick, *supra* note 134, pt. 1, at 15 (discussing the distinction between patrons and members).

<sup>576</sup> *See infra* State Comparative Chart, Appendix, col. C. The exception is Tennessee, which requires patron members elect at least 51% of the voting power on the board. *See* TENN. CODE ANN. § 43-38-606(a) (West 2008).

<sup>577</sup> *See* UNIF. LTD. COOP. ASS'N ACT § 804(a)(2), 6A U.L.A. 244 (2008).

<sup>578</sup> *See id.* § 816(a), 6A U.L.A. 253.

<sup>579</sup> *See id.*

<sup>580</sup> *See, e.g., id.*; REV. MODEL BUS. CORP. ACT § 8.24(b), (c) (2008).

<sup>581</sup> *See* UNIF. LTD. COOP. ASS'N ACT § 804(a)(1), 6A U.L.A. 244.

must be patron members. Of course once elected, the directors have duties to the entity and not the group that elected them.<sup>582</sup>

An illustration of the board composition may be helpful. Assume a board of nine directors. Patron members exclusively must elect a majority, five.<sup>583</sup> At least three directors must be patron members and only three directors may be nonmembers. One way to solve the planning puzzle would be to classify the board so that patron members elect five directors, no more than three of which are patron members (the minimum required), and two who are nonpatron directors (the two could be investor members or nonmembers). In turn, the investor members could elect four directors. One of those directors could be a nonmember (for a total of three, the maximum nonmember directors permitted under these circumstances, if the patron members elected two nonmember directors).<sup>584</sup> The results in this illustration are: three patron-member directors, elected exclusively by patron members; three investor-member directors, elected by investor members; and three independent, nonmember directors, two elected by patron members and one elected by investor members.

Myriad other election strategies exist that also could comply with ULCAA. In short, ULCAA's board provisions (1) allow investor members to "be at the table" and protect their investment in ways similar to those venture capitalists sometimes require and (2) provide a stronger argument, compared with other new unincorporated cooperative laws, that patron members can control the LCA through their ability to elect the majority of the directors. Moreover, under the default rule, members may remove a director with or without cause at any time.<sup>585</sup>

Consistent with any entity that has a board structure, ULCAA contains provisions concerning board meetings,<sup>586</sup> action without a meeting,<sup>587</sup> vacancies,<sup>588</sup> and remuneration.<sup>589</sup> Two provisions, however, are remarkable for purposes of this Article: (1) suspension of directors<sup>590</sup> and

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<sup>582</sup> Compare *infra* Part V.G. (discussing duties) with REV. MODEL BUS. CORP. ACT § 8.30 (2008) (standards of conduct for board of directors).

<sup>583</sup> See UNIF. LTD. COOP. ASS'N ACT § 804(a)(2), 6A U.L.A. 244 (2008).

<sup>584</sup> See *id.* § 803(c)(3), 6A U.L.A. 243.

<sup>585</sup> See *id.* § 807, 6A U.L.A. 247.

<sup>586</sup> See *id.* § 811, 6A U.L.A. 250.

<sup>587</sup> See *id.* § 812, 6A U.L.A. 251.

<sup>588</sup> See *id.* § 809, 6A U.L.A. 249.

<sup>589</sup> See *id.* § 810, 6A U.L.A. 250. Article 8 covers other matters as well, thus the list in the text of the Article is meant as merely exemplary.

<sup>590</sup> See *id.* § 808, 6A U.L.A. 248.

(2) composition of board committees.<sup>591</sup> Both the suspension and non-member service on the board committee are remarkable because they underscore the unique character of cooperative organizations as they have evolved, even though both are rather novel.

ULCAA has a specific provision captioned "Suspension of Director by Board."<sup>592</sup> This provision allows the board of directors to suspend one of its directors for a thirty-day period for a limited set of egregious behaviors: "(1) fraudulent conduct with respect to the association; (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."<sup>593</sup> The suspension automatically terminates after thirty days, unless the director-removal process is begun.<sup>594</sup>

The suspension provision is not meant pejoratively but rather reflects the nature of some cooperatives whose members may be rather unsophisticated in their knowledge of organizational law. In those organizations, relying on norms that exist in more sophisticated settings might be inefficient.<sup>595</sup> The suspension provision also shifts the burden of going to court for relief away from the LCA.

The other rather remarkable provision concerns the composition of board committees. ULCAA's default rule allows the board to appoint nondirector nonmembers to serve on committees of the board.<sup>596</sup> If appointed, the nonmember "has the same rights, duties, and obligations as a director serving on the committee."<sup>597</sup>

The ability to appoint nondirectors—whether or not members<sup>598</sup>—"provides substantial flexibility . . . to establish committees."<sup>599</sup> Many cooperative statutes require, for example, audit committees.<sup>600</sup> ULCAA does not. Likewise, RULLCA, another unincorporated act, expressly

<sup>591</sup> See *id.* § 817, 6A U.L.A. 254.

<sup>592</sup> See *id.* § 808, 6A U.L.A. 248.

<sup>593</sup> *Id.* § 808(a), 6A U.L.A. 248.

<sup>594</sup> See *id.* § 808(b), 6A U.L.A. 248. ULCAA section 807 governs removal.

<sup>595</sup> An example the drafting committee discussed was a director engaging in sexually harassing behavior toward employees of the organization.

<sup>596</sup> See UNIF. LTD. COOP. ASS'N ACT § 817(b), 6A U.L.A. 254 (2008).

<sup>597</sup> See *id.* § 817(c), 6A U.L.A. 254.

<sup>598</sup> See *id.* § 817, 6A U.L.A. 254.

<sup>599</sup> *Id.* § 817 cmt., 6A U.L.A. 254.

<sup>600</sup> See, e.g., MINN. STAT. ANN. § 308B.445 (West 2004).

provides for a special litigation committee.<sup>601</sup> ULCAA does not.<sup>602</sup> The ability to appoint nondirectors to committees, however, allows the flexibility to appoint special committees, and also allows the flexibility to provide appropriate expertise in a variety of situations that best business practices make necessary, with a minimum of mandated provisions.<sup>603</sup>

#### 4. *Manner of Voting on Voluntary Fundamental Changes and the Organic Rules*

ULCAA provides for patron members to hold voting power<sup>604</sup> and, if investor members exist, the voting power may be shared with the investor members.<sup>605</sup> ULCAA contemplates that each patron member of an LCA will have at least one vote.<sup>606</sup> This potential requirement is subject to modification by the organic rules, which may allocate voting power among patron members in one or a combination of four ways: “(1) one member, one vote; (2) use or patronage; (3) equity [investment by the patron member]; or (4) if a patron member is a cooperative, the number of its patron members.”<sup>607</sup> The comment to subsection 512(a) says “[t]he Act permits the organic rules to provide for more than one vote per member . . . but . . . defaults to one member one vote.”<sup>608</sup>

A strict reading of sections 511 and 512 together does not demand each patron member must have at least one vote. If, for example, the or-

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<sup>601</sup> See REV. UNIF. LTD. LIAB. CO. ACT § 905, 6B U.L.A. 524 (2008). The Comment to RULLCA section 905 states in part: “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.” *Id.* § 905 cmt., 6A U.L.A. 524.

<sup>602</sup> Therefore, ULCAA does not contain a provision concerning the effect courts must give the special litigation committees’ determinations. The provision in RULLCA states in part: “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.” *Id.* § 905(e), 6A U.L.A. 524.

<sup>603</sup> See generally *infra* notes 683–87 and accompanying text. ULCAA allows for the creation and usage of committees, much like other uniform acts, and it even allows nondirectors to serve on said committees in order to assure disinterest or special expertise. However, the courts ultimately will determine whether ULCAA’s committees will be lent the same credence as those used in other uniform acts.

<sup>604</sup> See UNIF. LTD. COOP. ASS’N ACT §§ 511, 512 cmt., 6A U.L.A. 217–18 (2008).

<sup>605</sup> See *id.* § 513, 6A U.L.A. 220.

<sup>606</sup> See *id.* §§ 511, 512(a)(2) cmt., 6A U.L.A. 217, 219.

<sup>607</sup> *Id.* § 512(a), 6A U.L.A. 218.

<sup>608</sup> *Id.* § 512(a) cmt., 6A U.L.A. 218.

ganic rules provided for patron voting to be based strictly on use or patronage of the association,<sup>609</sup> and a patron member had no patronage with the association, then the patron might not have any vote under ULCAA. The example in the comment to subsection 512(a)(2) recognizes this issue, suggesting such matters be addressed in drafting the organic rules.<sup>610</sup> ULCAA's text makes operationally clear that voting among patron members does not need to be equal if the organic rules provide for unequal voting based on one of the methods provided for patron voting in subsection 512(a). Unfortunately, reaching that conclusion does require a modicum of interpretation.

If an LCA has investor members, by default each investor member must have one vote, but the organic rules may provide for an entirely different voting scheme.<sup>611</sup> The organic rules may also classify investor members and provide for different voting arrangements by class.<sup>612</sup>

ULCAA conceptually follows the other new unincorporated cooperative statutes in balancing the patron members' interests with those of investor members in a way that will enhance the availability of equity investment while remaining true to the cooperative principle of (patron) member control in the limited cooperative. This balancing is done in all the statutes largely through voting provisions that, within limits, the organic rules can modify. ULCAA however has, taken a different default approach by not mandating patron member block voting and providing more patron member choice on the eligibility of board members whom they elect.

#### F. Quantum Mechanics: Voluntary Fundamental Changes and the Organic Rules—Together but Separately

##### 1. *General Overview and Procedure for Member Voting*

Fundamental changes generally are understood in organizational law. They typically include life-altering changes to the entity, including the amendment of the highest organic authority, the sale of substantially all of the entity's assets, mergers, conversions, domestications, and volun-

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<sup>609</sup> See *id.* § 512(a)(2), 6A U.L.A. 218.

<sup>610</sup> See *id.* § 512(a)(2) cmt., ex., 6A U.L.A. 219.

<sup>611</sup> See *id.* § 513, 6A U.L.A. 220. The Wisconsin statute provides that the patron members shall determine through the organic rules the voting power of nonpatron members, which may be withheld entirely. See WIS. STAT. ANN. § 193.545(1)(a) (West Supp. 2008).

<sup>612</sup> See UNIF. LTD. COOP. ASS'N ACT § 513, 6A U.L.A. 220 (2008).

tary dissolutions. This Part of the Article discusses the treatment of fundamental changes in the context of an LCA.

ULCAA follows both incorporated and unincorporated entity law by making specific provisions governing certain fundamental changes.<sup>613</sup> Fundamental changes ULCAA anticipates are: article 4 (amendments to specific organic rules), article 12 (dissolutions), article 15 (dispositions of assets), and article 16 (conversions and mergers).<sup>614</sup>

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<sup>613</sup> The statutes governing different types of entities do not always approach the subjects of amending the organic rules, dissolutions, dispositions of assets, or conversions and mergers in the same ways because of the different underlying nature of the different entities. Compare REV. MODEL BUS. CORP. ACT § 9.52 (2008) (requiring two-thirds of the board of directors to adopt a plan for conversion) with REV. UNIF. P'SHIP ACT § 902, 6 Pt. I U.L.A. 214 (2001) (requiring partners' unanimous consent to adopt a plan of conversion).

<sup>614</sup> See UNIF. LTD. COOP. ASS'N ACT arts. 4, 12, 15, 16, 6A U.L.A. 200, 280, 306, 309 (2008). RMBCA provides for shareholder approval of amendments to the articles of incorporation with some exceptions, REV. MODEL BUS. CORP. ACT § 10.03 (2008), voluntary dissolution, *id.* § 14.02, disposition of assets other than those in the ordinary course of business, providing security for indebtedness, in a transfer to a wholly owned entity and to distribute the assets to shareholders pro rata, *id.* § 12.02, conversions, *id.* § 9.52, mergers and share exchanges, *id.* § 11.04, and domestications, *id.* § 9.21. It does not address divisions.

RULLCA section 110(a)(4) states that the operating agreement may provide for how it can be amended. See REV. UNIF. LTD. LIAB. CO. ACT § 110(a)(4), 6B U.L.A. 442 (2008). Subsections 407(b)(5) and 407(c)(4)(D) provide the default rule that, unless otherwise provided in the operating agreement the operating agreement can be amended only with the consent of all the members. See *id.* § 407(b)(5), (c)(4)(D), 6B U.L.A. 484. Likewise, RULLCA section 701(a)(2) states all members must consent to a voluntary dissolution by the members. See *id.* § 701(a)(2), 6B U.L.A. 506. The consent of all members is required in a manager-managed LLC for the disposition of all, or substantially all, of the company's property outside the ordinary course of the company's business. See *id.* § 407(c)(4)(A), 6B U.L.A. 484. Likewise, all members must approve a merger, conversion, or domestication in a manager-managed LLC. See *id.* § 407(c)(4)(B), 6B U.L.A. 484. All these rules probably can be varied by the operating agreement because of the general authority given the operating agreement. See *id.* § 110, 6B U.L.A. 442.

ULPA requires the consent of each partner to amend a limited partnership agreement and to dispose of all, or substantially all, of a limited partnership's property other than in the usual and regular course of the partnership's activities. See UNIF. LTD. P'SHIP ACT (2001) § 406(b)(1), (3), 6A U.L.A. 434 (2008). For voluntary dissolution of a limited partnership, all general partners and limited partners owning a majority of the rights to receive distributions as limited partners must consent for it to be effective. See *id.* § 801(2), 6A U.L.A. 479. A conversion or merger must receive the consent of all the partners in the limited partnership, with limited exceptions. See *id.* §§ 1103(a), 1107(a), 1110, 6A U.L.A. 506, 514, 520. All of the unanimity requirements may be modified by the limited partnership agreement. See, e.g., *id.* § 1110(a)(1), 6A U.L.A. 520.



No provisions are contained in ULCAA for domestications,<sup>615</sup> interest exchanges,<sup>616</sup> or divisions.<sup>617</sup> The lack of provisions for interest exchanges and divisions is consistent with many other unincorporated entity acts. For example, reporters Daniel S. Kleinberger and Carter G. Bishop stated the reason no provisions for interest exchanges are in RULLCA is “because that type of transaction would be novel in the unincorporated context and is far from universally accepted in corporate law.”<sup>618</sup> With respect to traditional cooperative statutes, this novelty can be stated with equal force for domestications, interest exchanges, and divisions, which usually are not addressed in traditional cooperative statutes. Although ULCAA draws significantly from RMBCA and RULLCA, it does not provide for domestications and, as with RULLCA and the Model Entities Transaction Act,<sup>619</sup> does not address divisions or dissolutions.<sup>620</sup> It also does not address share or interest exchanges. The drafting committee for ULCAA did not believe addressing these three topics in ULCAA was necessary, or perhaps even appropriate.<sup>621</sup>

ULCAA only addresses the LCA in the case of a fundamental change that involves another entity, such as a conversion or merger. The other entity’s power to engage in a conversion or merger, for example, must be derived from that entity’s organic law and organic rules.<sup>622</sup>

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<sup>615</sup> See MODEL ENTITY TRANSACTION ACT §§ 501–506, 6A U.L.A. 63 (2008).

<sup>616</sup> See *id.* §§ 301–306, 6A U.L.A. 42.

<sup>617</sup> See 2 LARRY RIBSTEIN & ROBERT KEATINGE, RIBSTEIN AND KEATINGE ON LIMITED LIABILITY COMPANIES § 20:10 (2d ed. 2004).

<sup>618</sup> Kleinberger & Bishop, *supra* note 311, at 540–41 (footnote omitted). RULLCA does provide for domestications. See REV. UNIF. LTD. LIAB. CO. ACT § 1010, 6B U.L.A. 535–36 (2008).

<sup>619</sup> MODEL ENTITY TRANSACTION ACT, 6A U.L.A. 1 (2008).

<sup>620</sup> See UNIF. LTD. COOP. ASS’N ACT § 1601 cmt., 6A U.L.A. 309 (2008).

<sup>621</sup> See *id.* § 1602 cmt., 6A U.L.A. 310.

<sup>622</sup> For example, if a traditional cooperative desires to “convert” to a limited cooperative association governed by this Act [ULCAA], the statute under which the cooperative is formed must allow such a conversion. This operational aspect of the Act, however, reflects more than just the typical boundary of scope between acts governing different types of organizations. It also reflects policy at a deeper level because the limited cooperative association permits investor members which may change the dynamic as compared to existing cooperatives. For both scope and policy reasons, therefore, this Act does not attempt to change the law of other organizations by allowing or encouraging conversion, in the illustration, from a traditional cooperative form to a limited cooperative form. Effecting those kinds

Generally, fundamental changes under ULCAA may be made only with a vote of the members.<sup>623</sup> There are two exceptions to the member requirement for amendments to the organic rules: “(1) amendments by the initial directors [before members] permitted by Sections 401(a) and [304(c)]; and (2) that the articles may delegate authority to the board to adopt and amend most bylaws under Section 405(f).”<sup>624</sup>

Voluntary dissolution is a fundamental change and has the same voting requirement of the members.<sup>625</sup> The following causes of dissolution, however, are not voluntary dissolutions: (1) dissolution because of an event or at a time specified in the articles of organization;<sup>626</sup> (2) dissolution ninety days after the dissociation of a member that leaves only one patron member and no other members, subject to certain stated exceptions;<sup>627</sup> (3) voluntary dissolution before an LCA commences activity;<sup>628</sup> (4) judicial dissolution;<sup>629</sup> or (5) administrative dissolution.<sup>630</sup>

Not all dispositions of assets are fundamental changes. Members do not need to vote on dispositions of assets if they occur in the ordinary course of business or for secured credit transactions.<sup>631</sup> Members need to vote on dispositions of assets “if the disposition leaves the association without significant business activity.”<sup>632</sup> For example, a disposition of assets conceivably would not be in the ordinary course of business if the sale were of all the assets at one location, if an LCA operates at multiple locations. Under these circumstances, however, the association would still have “significant continuing business activity.”

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of policy decisions is beyond the scope of this Act. Conversions implicate the federal income tax and, depending on the particular parties to the conversion, could have significant tax consequences.

*Id.*

<sup>623</sup> This restriction is stated specifically in ULCAA section 401(a) for amendments to the organic rules. *See id.* § 401(a), 6A U.L.A. 200.

<sup>624</sup> *Id.* § 402 cmt., 6A U.L.A. 201.

<sup>625</sup> *See id.* § 1205, 6A U.L.A. 283.

<sup>626</sup> *See id.* § 1202(1), 6A U.L.A. 280.

<sup>627</sup> *See id.* § 1202(3), 6A U.L.A. 280.

<sup>628</sup> *See id.* §§ 1202(2), 1204, 6A U.L.A. 280, 284. A majority of the organizers or initial directors may dissolve an LCA that has not yet begun business activity or the conduct of its affairs. *See id.* § 1204, 6A U.L.A. 282.

<sup>629</sup> *See id.* § 1203, 6A U.L.A. 281.

<sup>630</sup> *See id.* § 1211, 6A U.L.A. 290.

<sup>631</sup> *See id.* § 1501, 6A U.L.A. 306.

<sup>632</sup> *See id.* §§ 1501, 1502, 6A U.L.A. 306–07. *Compare* REV. MODEL BUS. CORP. ACT §§ 12.01, 12.02 (2008).

The general authority provided to the board of directors in subsection 801(b) should be sufficient for the board to authorize the transaction without a membership vote.<sup>633</sup> Section 1501 expressly states the articles of organization can provide for member approval of a disposition of assets in the ordinary course of business, and the articles could clarify the definition for purposes of the vote under section 113(a).<sup>634</sup> Given subsection 113(a), a careful draftsman might be well advised to consider addressing this subject in the articles of organization.

The procedures when a membership vote is required for a fundamental change are the same with respect to each type of fundamental change. Three steps are required:

Step 1: A majority of the board of directors, or a greater percentage if required by the organic rules, must propose the matter to be voted on;<sup>635</sup>

Step 2: The board must call a membership meeting to consider the matter, with the meeting to be held within ninety days after the proposal of the matter;<sup>636</sup>

Step 3: The board must give notice of the meeting in a record and provide relevant materials specified in ULCAA regarding the matter to be considered at the meeting.<sup>637</sup>

At the meeting, the members vote on the matter being considered. The two-tier approach for voting<sup>638</sup> is used to determine whether the matter is approved. The minimum default rules for fundamental changes provide: (1) at least two-thirds of the voting power of the members

<sup>633</sup> This particular circumstance is not addressed expressly by ULCAA or by RMBCA. ULCAA sections 1501 and 1502 are somewhat similar to RMBCA sections 12.01 and 12.02, but no “express counterparts [exist] in RULLCA, ULPA, or RUPA, though in application those acts provide for similar heightened voting as a matter of default in the context of a disposition of assets.” UNIF. LTD. COOP. ASS’N ACT § 1501 cmt., 6A U.L.A. 306 (2008).

<sup>634</sup> See *id.* § 113(a), 6A U.L.A. 176.

<sup>635</sup> See *id.* § 402(a) (amendments to the organic rules); § 1205(a)(1) (voluntary dissolution); § 1503(1) (disposition of assets); § 1603(a) (conversion); § 1607(a) (merger) 6A U.L.A. 201, 283, 311, 316 (2008). An amendment to the organic rules may also be proposed by petitions “signed by at least 10 percent of the patron members or at least 10 percent of the investor members.” *Id.* § 402(a)(2), 6A U.L.A. 201.

<sup>636</sup> See *id.* § 402(b) (amendments to the organic rules); § 1205(a)(2) (voluntary dissolution); § 1503(2) (disposition of assets); § 1603(a) (conversion); § 1607(b) (merger) 6A U.L.A. 201, 283, 307, 311, 316 (2008).

<sup>637</sup> See *id.* §§ 402(b), 1205(a)(3), 1503(2), 1603(a), 1607(b), 6A U.L.A. 201, 283, 307, 311, 316.

<sup>638</sup> See *supra* notes 523–637 and accompanying text.

present at a meeting must approve the matter being considered for it to be approved; and (2) if the LCA has investor members, at least a majority of votes cast by the patron members must approve the matter, unless the organic rules require a larger percentage.<sup>639</sup> The default rules may be modified by the organic rules to require the percentage of required votes to 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 (1) and (2).<sup>640</sup>

The higher vote quantum, whether required by the default rules or by organic rules, drastically changes the dynamic of the vote. For example, assume: (1) an LCA with fifty patron members and twenty investor members; (2) the articles of organization require that 80% of the patron members must approve any disposition of assets, and 60% of all the members must approve the disposition; (3) each member has one vote; (4) the association has four operating plants, each in a different community; (5) one of the plants loses so much money each year that it causes the association to realize losses, even though the other plants each regularly book a profit; and (6) a buyer is willing to pay an appropriate price and continue operation of the plant in the community where it is located. The board of directors decides to sell the losing plant to the buyer and submits the matter to the members for their action. Fearful of losing their entire association because of the losses, thirty-eight patron members—76% of the patron members—and all of the investor members vote to sell the plant. Twelve of the patron members—24%—vote against the sale, all of them from the community where the plant is located. Approval of the sale fails, even though 76% of the patron members and 82.8% of all the members voted in favor of the sale.

In submitting a proposal for a fundamental change to the members, the board of directors is to provide a recommendation for approval by the members or, if the board believes that because of a conflict of interest or other special circumstances it cannot make a favorable recommendation, it must state the basis of its determination.<sup>641</sup> In addition, the board may place conditions on the board's submission of the matter for a vote, but if

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<sup>639</sup> See UNIF. LTD. COOP. ASS'N ACT §§ 405(a), 1205(b), 1504(a), 1603(b), 1608(a), 6A U.L.A. 203–04, 283, 308, 311, 316.

<sup>640</sup> See *id.* §§ 405(c), 1205(c), 1504(b), 1603(c), 1608(b), 6A U.L.A. 204, 283, 308, 311, 317.

<sup>641</sup> See *id.* §§ 402(b)(2), 1205(a)(3)(B), 1503(2)(B), 1603(a)(2), 1607(b)(2), 6A U.L.A. 201, 283, 307, 311, 316.

it does so, it must state the conditions.<sup>642</sup> For example, in submitting a proposal for voluntary dissolution to the members for a vote, the board of directors could condition the vote on a greater percentage of affirmative votes for the dissolution than the ULCAA default rules require or a greater vote than the articles of organization require. The board could condition a sale of assets on receiving a price at least equal to a specified amount, even if the members voted to approve the sale. If the board imposes such conditions with respect to a matter submitted to the members for approval, the conditions must be stated in materials provided to the members prior to the vote being conducted.

If an amendment to the articles of organization, a conversion, or a merger is approved, a record evidencing the change must be delivered for filing with the appropriate state agency.<sup>643</sup> The action becomes effective when the record is filed with the filing officer or on a stated later effective date and time contained in the record.<sup>644</sup>

In connection with dissolution of an LCA, ULCAA permits, but does not require, the delivery for filing of a statement of dissolution<sup>645</sup> and a statement of termination.<sup>646</sup> These are voluntary filings. If they are made, they provide constructive notice of actions being taken in connection with the dissolution, winding up, and termination of the association.<sup>647</sup> During the winding up of an association, a member or a holder of financial rights may seek judicial supervision of the winding-up activities, including court appointment of a person—who does not need to be a member—to carry out the winding-up activities.<sup>648</sup> In effect, the appointment of a person to wind up not only authorizes the person to conduct the winding up of the association's activities, but also requires an amendment to the articles of organization to be delivered for filing to the appropriate state agency without a vote of the members.<sup>649</sup> As with other

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<sup>642</sup> See *id.* §§ 402(b)(3), 1205(a)(3)(C), 1503(2)(C), 1603(a)(3), 1607(b)(3), 6A U.L.A. 201, 283, 307, 311, 316.

<sup>643</sup> See *id.* §§ 407(a), 1604(a), 1609(c), 6A U.L.A. 206, 312, 318.

<sup>644</sup> See *id.* § 203(c), 6A U.L.A. 189.

<sup>645</sup> See *id.* § 1214, 6A U.L.A. 293.

<sup>646</sup> See *id.* § 1215, 6A U.L.A. 293.

<sup>647</sup> See *id.* §§ 1214 cmt., 1215 cmt., 6A U.L.A. 293, 294.

<sup>648</sup> See *id.* § 1206(c), 6A U.L.A. 284. Compare UNIF. LTD. P'SHIP ACT (2001) § 803(c), (d), 6A U.L.A. 470 (2008) (limited partnership with no remaining general partner) with REV. UNIF. LTD. LIAB. CO. ACT § 702(c), (d), 6B U.L.A. 507–08 (2008) (dissolving LLC with no remaining members).

<sup>649</sup> See UNIF. LTD. COOP. ASS'N ACT § 1206(d), 6A U.L.A. 284 (2008).

amendments, this amendment becomes effective when filed by the filing officer.<sup>650</sup>

In summary, ULCAA contains detailed provisions regarding fundamental changes that are only outlined here. Its rules governing fundamental changes are largely, although not entirely, mandatory, and they provide default rules for a minimum quantum for a vote.

## 2. Organic Rules and Their Amendment

The LCA's organic rules are its articles of organization and bylaws.<sup>651</sup> The articles of organization are the publicly filed document under which the LCA is formed. The articles of organization are the highest governing authority of the LCA,<sup>652</sup> which is unusual for unincorporated organizations but not without precedent.<sup>653</sup>

ULCAA also requires the bylaws be stated in a record<sup>654</sup> but does not limit them to be contained in a single source or be styled or captioned "bylaws."<sup>655</sup> Like other filed organizational documents, the articles of organization require little content and in that regard are similar to certificates of limited partnership and more modern articles of incorporation.<sup>656</sup>

ULCAA requires seven items to be in either the articles of organization or the bylaws, making their interrelationship different than the interrelationship of corporate articles of incorporation and corporate bylaws.<sup>657</sup> The composition of required items, "draws upon the statutory

<sup>650</sup> See *id.* § 203(c), 6A U.L.A. 189.

<sup>651</sup> See *id.* § 102(20), 6A U.L.A. 161 (defining "organic rules").

<sup>652</sup> See *id.* §§ 102(20) (defining "organic rules"), 113 ("Effect of Organic Rules"), 405 ("Approval of Amendment"), 6A U.L.A. 161, 176, 203.

<sup>653</sup> TEX. BUS. CORP. ACT ANN art. 1528, § 2.09 (Supp. 2008).

<sup>654</sup> The term record is used consistently in uniform unincorporated acts. See REV. UNIF. LTD. LIAB. CO. ACT § 102(17), 6B U.L.A. 430 (2008); UNIF. LTD. P'SHIP ACT (2001) § 102(17), 6A U.L.A. 360 (2008). "'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." UNIF. LTD. CO. ASS'N ACT § 102(26), 6A U.L.A. 162 (2008).

<sup>655</sup> Nonetheless, this formulation does provide flexibility concerning what rules and operating procedures might be included as a bylaw or, alternatively and in narrower circumstances, what might be part of a marketing or similar contract under ULCAA. Compare REV. UNIF. LTD. LIAB. CO. ACT § 110 (operating agreement), 6B U.L.A. 442 (2008).

<sup>656</sup> See, e.g., UNIF. LTD. P'SHIP ACT (2001) § 201, 6A U.L.A. 392 (2008); REV. MODEL BUS. CORP. ACT § 2.02 (2008).

<sup>657</sup> ULCAA section 304 states in its entirety:

requirements for bylaws of traditional cooperatives” and “[i]n addition, . . . contains matters within the scope of limited liability company operating agreements and limited partnership agreements.”<sup>658</sup> The items,

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- (a) Bylaws must be in a record and, if not stated in the articles of organization, must include:
    - (1) a statement of the capital structure of the limited cooperative association, including:
      - (A) the classes or other types of members’ interests and relative rights, preferences, and restrictions granted to or imposed upon each class or other type of member’s interest; and
      - (B) the rights to share in profits or distributions of the association;
    - (2) a statement of the method for admission of members;
    - (3) a statement designating voting and other governance rights, including which members have voting power and any restriction on voting power;
    - (4) a statement that a member’s interest is transferable if it is to be transferable and a statement of the conditions upon which it may be transferred;
    - (5) a statement concerning the manner in which profits and losses are allocated and distributions are made among patron members and, if investor members are authorized, the manner in which profits and losses are allocated and how distributions are made among investor members and between patron members and investor members;
    - (6) a statement concerning:
      - (A) whether persons that are not members but conduct business with the association may be permitted to share in allocations of profits and losses and receive distributions; and
      - (B) the manner in which profits and losses are allocated and distributions are made with respect to those persons; and
    - (7) a statement of the number and terms of directors or the method by which the number and terms are determined.
  - (b) Subject to Section 113(c) and the articles of organization, bylaws may contain any other provision for managing and regulating the affairs of the association.
  - (c) In addition to amendments permitted under [Article] 4, the initial board of directors may amend the bylaws by a majority vote of the directors at any time before the admission of members.

UNIF. LTD. COOP. ASS’N ACT § 304, 6A U.L.A. 198 (2008).

<sup>658</sup> *Id.* § 304 cmt., 6A U.L.A. 199 (citing REV. UNIF. LTD. LIAB. CO. ACT § 110, 6B U.L.A. 442 (2008)). *See also* UNIF. LTD. P’SHP ACT (2001) § 110, 6A U.L.A. 378 (2008).

set forth below, all relate to significant topics within governance or finance.

The Act is silent concerning the effect failure to include the seven required items in the organic rules would have on the association.<sup>659</sup> No penalties are provided within ULCAA's text if the requirements are not met, and almost all the items are the subject of statutory default rules. Moreover, bylaws do not need to be filed publicly. The foregoing is the basis for the following comments:

"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."<sup>660</sup> As a result, other law and the courts ultimately will determine whether failure to include the specified items gives rise to a cause of action.<sup>661</sup>

The default rule for amending the articles of organization is applicable to five of the seven required items that may appear in either the articles of organization or the bylaws, and they require the same vote quantum as fundamental changes.<sup>662</sup> That is, the default rule requires a two-

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<sup>659</sup> See UNIF. LTD. COOP. ASS'N ACT § 304 cmt., 6A U.L.A. 199.

<sup>660</sup> *Id.* (emphasis added).

<sup>661</sup> The drafting committee discussed this resolution and, in a perfect world, the Act would address this matter. However, virtually no guidance from the courts exists on this matter in the context of the other unincorporated cooperative statutes. Moreover, this entity is "new" and the resolution seems dependent on the varied facts and circumstances in a given case. Nonetheless, the listed matters are of such importance to this particular type of entity that the best approach was to require them to be in record form. In effect, this decision is a nod for future evolution under this Act, and planners may avoid any uncertainty simply by ensuring these terms are contained in the articles of organization or bylaws—record form.

<sup>662</sup> ULCAA section 405(e) states in its entirety:

- (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



tier vote of a majority of patron members and two-thirds of all members—the aggregate of patron members and investor members.<sup>663</sup> ULCAA expressly confirms that bylaw amendments, with the exception of the five enumerated items, may be delegated to the board of directors by the articles of organization.<sup>664</sup>

More specifically, the subsection concerning the delegation of authority to amend the articles states: “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.”<sup>665</sup>

This subsection could be misinterpreted to have a far broader application than the words actually state. Its application is limited to amendment of the bylaws themselves and does not prohibit the bylaws from giving broad discretionary power to take action under a specific bylaw. For example, one of the five items that cannot be delegated for amendment by the board of directors is “the manner or method of allocation of profits or losses among members,”<sup>666</sup> within prescribed limits discussed elsewhere.<sup>667</sup> Thus, on one hand, if the bylaws state *X%* of profits are to be allocated to patron members, the board may not amend *X%* to *Y%*. On the other hand, if the bylaws state, “the board shall make allocations based on their sole discretion subject only to the limitations contained in ULCAA,” the board has the authority to determine allocations in its discretion, which may result in different allocations in different years.<sup>668</sup> In the second bylaw example, the manner of making allocations is vested in the board’s discretion by the bylaws. Using such discretion is not an amendment of the bylaws and, therefore, is not within the Act’s prohibition on delegation. Indeed, the board’s exercise of discretion is the mandated manner in which allocations are to be determined.

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

UNIF LTD. COOP. ASS’N ACT § 405(e), 6A U.L.A. 204 (2008).

<sup>663</sup> See *id.*

<sup>664</sup> See *id.* § 405(f), 6A U.L.A. 204.

<sup>665</sup> *Id.*

<sup>666</sup> *Id.* § 405(e)(3) (reproduced at *supra* note 662).

<sup>667</sup> See *supra* Part V.C.3.b.

<sup>668</sup> This issue is, of course, a matter of state law under ULCAA. Other regulatory matters and taxation are distinct from ULCAA, and their effects need to be analyzed separately.

### G. Rights and Duties: Sources and Explanation

Few more controversial or nebulous topics exist in organization law than “fiduciary” duties.<sup>669</sup> Statute and case law vary by state in both corporate and unincorporated law.<sup>670</sup> ULCAA adopts a board-of-director style, centralized management,<sup>671</sup> while the Minnesota Cooperative Association Act, for example, adopts board duties consistent with those used in corporate structure.<sup>672</sup> ULCAA, therefore, takes a unique statutory approach to the duties of loyalty and care, and its attendant liability and indemnification provisions for directors; it simply cross-references and incorporates those provisions from other state cooperative or corporate law.<sup>673</sup> The relevant provisions all contain the following instruction: “[insert reference to this state’s cooperative corporation act or to the general business corporation act].”<sup>674</sup>

As the Prefatory Note to ULLCA explains:

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. . . . The standards of conduct of officers, on the other hand, are left to agency law as a matter of affirmative policy, not of omission.

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<sup>669</sup> See, e.g., Carter G. Bishop, *A Good Faith Revival of Duty of Care Liability in Business Organizational Law*, 41 TULSA L. REV. 477 (2006); Elizabeth S. Miller & 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); see generally REV. UNIF. LTD. LIAB. CO. ACT § 409 cmt., 6B U.L.A. 489 (2008).

<sup>670</sup> See generally KEATING & CONAWAY, *supra* note 169, §§ 8.6, 8.8.

<sup>671</sup> See UNIF. LTD. COOP. ASS’N ACT §§ 801–823, 6A U.L.A. 241–59 (2008).

<sup>672</sup> MINN. STAT. ANN. § 308B.401 (West 2004).

<sup>673</sup> See UNIF. LTD. COOP. ASS’N ACT §§ 801–823, 6A U.L.A. 241–59.

<sup>674</sup> See *id.* §§ 818, 819, 901, 6A U.L.A. 255, 256, 260.

This Act, however, contains an important modification concerning the matters that may be appropriately considered by the board of directors.<sup>675</sup>

The structure of modern cooperative law, one of ULCAA's touchstones, contemplates a specific kind of governance structure, which includes elected directors. ULCAA adopts this structure of governance by a board of directors<sup>676</sup> and with it protects the ability of members to elect those who govern.<sup>677</sup> Even so, differences exist between the corporate board structure and the structure applicable to the LCA. The board of directors under ULCAA may have more flexibility in some respects of its decision-making process than does its corporate cousin. For example, the board may, unless otherwise provided in the organic rules, establish committees and appoint nondirectors to serve on those committees.<sup>678</sup> Those nondirector committee members have coexistent rights, duties, and responsibilities with directors serving on the same committee,<sup>679</sup> including informational rights.<sup>680</sup>

Another distinction between the corporate board of directors and the LCA board of directors concerns "[o]ther [c]onsiderations of [d]irectors."<sup>681</sup> This provision is similar to antitakeover provisions in some state corporate law. The provision explicitly provides that the directors may consider "the long and short term interest of the association and its *patron* members" in fulfilling their duty to the association.<sup>682</sup>

Other constituencies the directors may consider are: (1) "the interest of employees, customers, and suppliers of the association;"<sup>683</sup> (2) "the interest of the community in which the association operates;"<sup>684</sup> and (3) "other cooperative principles and values that may be applied in the context of the decision."<sup>685</sup> These considerations are permissive; that is, the

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<sup>675</sup> *Id.* prefatory note, 6A U.L.A. 150 ("Board of Directors: 'Fiduciary' Duty").

<sup>676</sup> *See id.* art. 8, preliminary cmt., 6A U.L.A. 241.

<sup>677</sup> *See id.* § 804, 6A U.L.A. 244.

<sup>678</sup> *See id.* § 817, 6A U.L.A. 254.

<sup>679</sup> *See id.* § 817(c), 6A U.L.A. 254.

<sup>680</sup> *See id.* § 821, 6A U.L.A. 257.

<sup>681</sup> *Id.* § 820, 6A U.L.A. 257.

<sup>682</sup> *Id.* (emphasis added).

<sup>683</sup> *Id.* § 820(1), 6A U.L.A. 257.

<sup>684</sup> *Id.* § 820(2), 6A U.L.A. 257.

<sup>685</sup> *Id.* § 820(3), 6A U.L.A. 257.

board is not required to include them in the decision-making process.<sup>686</sup> The stated rule is also a default rule because the articles of organization may “otherwise provide.”<sup>687</sup>

Even though nonmandatory, other additional considerations are important both practically and aesthetically. As a practical matter the inclusion of other considerations implicitly recognizes LCAs as self-help organizations and, further, that the primary purpose of many cooperatives is to establish customer or supplier relationships for the ultimate benefit of patron members. In the stereotypical agricultural marketing cooperative, for example, the members’ primary economic purpose is to receive a higher price for their products. In other marketing cooperatives, the goal may be to make a market for a niche product. In those circumstances, to acknowledge the underlying economic purpose of the association and expressly to allow the board of directors to consider the effect a decision has on all parties relevant to fulfillment of that purpose, is consistent and perhaps necessary.

Another place that illustrates the operation of the other constituency provision is in an LCA used for local economic development. Business leaders in a community may become investor members in an association to create jobs in the community. In that case, too, the board of directors should be able to consider the effect a decision may have on the community. And, because ULCAA does not require a for-profit or business purpose, it might be suitable for public-private partnerships and sustainable low-income social enterprises. Again, the ability for the board to consider purposes beyond investor profit is practical because it is consistent with the purpose of the particular LCA.

The provision is aesthetically significant because it specifically references cooperative principles and values. While some state cooperative laws use the phrase “cooperative basis”<sup>688</sup> (a phrase also used in other contexts, such as federal income taxation),<sup>689</sup> ULCAA references principles, which allow a more flexible and evolvable interpretation.<sup>690</sup> Indeed, ULCAA’s express reference to cooperative principles may be more transparent than the phrase “on a cooperative basis” to those unfamiliar with cooperative lore and jargon, and it suggests that state law determine

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<sup>686</sup> See *id.* § 820, 6A U.L.A. 257.

<sup>687</sup> *Id.*

<sup>688</sup> Baarda, *supra* note 90, at 19.

<sup>689</sup> See I.R.C. § 1381.

<sup>690</sup> See UNIF. LTD. COOP. ASS’N ACT § 820(3), 6A U.L.A. 257 (2008).

cooperative principles rather than adopting a phrase with specific meanings in other contexts.

Finally, as a default rule subject to the organic rules, section 820 encourages those establishing LCAs to engage in a values conversation to modify and select the undergirding cooperative principles that apply best to the particular association.<sup>691</sup>

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<sup>691</sup> See *id.* § 820, 6A U.L.A. 257. A strong argument can be made that cooperatives are principle or value-based organizations as much as they are rule-based organizations. Obviously, this position can complicate the use of a cooperative form of business. Such principle-based organizations might, however, be timely additions to the entity selection menu, and a niche response to criticism of the exclusive use of the wealth-maximization approach to business entity law. One such criticism of the wealth-maximization approach is that it contains oversimplifying assumptions. For example, Nobel prize recipient Muhammad Yunus stated:

Because the way theoreticians stipulated, human being the way it is kind of a robot-like people. The only thing they want is to make money, nothing else. So we created a world like that. We all been playing the role of robots, because theory told us. So we are imitating theory, we are trying to fit the theory.

Yunus, *supra* note 249, at 107–08.

Economist Robert H. Frank, in a book chapter entitled *Does Studying Economics Inhibit Cooperation?*, examines and summarizes the available evidence that economists behave in a more self-interested manner than non-economists. He also examines the cause of economists' greater self-interested behavior, if that behavior exists. After reviewing the literature and his own experimental results, he suggests:

Clearly, our evidence for the existence of a difference between the behavior of economists and noneconomists is more compelling than our evidence for the causal role of economics training in creating that difference. But there is additional indirect evidence for such a role. One of the clearest patterns to emerge in several decades of experimental research on the prisoner's dilemma is that the behavior of any given player is strongly influenced by that player's prediction about what his partner will do. In experiments involving noneconomists, people who expect their partners to cooperate usually cooperate themselves, and those who expect their partners to defect almost always defect. In our experiments, economists were 42 percent more likely than noneconomists to predict that their partners would defect. It would be remarkable indeed if none of this difference in outlook were the result of repeated exposure to a behavioral model whose unequivocal prediction is that people will defect whenever self-interest dictates.

ROBERT H. FRANK, WHAT PRICE THE MORAL HIGH GROUND? ETHICAL DILEMMAS IN COMPETITIVE ENVIRONMENTS 77 (2004) (citations omitted).

Several other recent books continue a trend of examining general and economic behavior through the lens of biology or brain science. See, e.g., *MORAL MARKETS: THE CRITICAL ROLE OF VALUES IN THE ECONOMY* (Paul Zak ed., 2008); *LAW & THE BRAIN* (Semir Zeki & Oliver Goodenough eds., 2006).

Whether the directors of an LCA under ULCAA will have fiduciary duties depends, among other things, on the state law cross-referenced in a state's version of ULCAA, and the case law that has developed with respect to that law. Whether the differences between ULCAA and the cooperative or corporate law of the adopting state will cause courts in that state to reach different conclusions is a matter that time and experience will need to see developed.

Two other possible sources of fiduciary duty are present in cooperatives. They stem from the notion that cooperatives are mutual self-help organizations. One possible source is the entity–aggregate distinction most often associated with partnership law, concerning member-to-member duties.<sup>692</sup> The second possible source of fiduciary duty arises from the nature of a marketing contract or from a membership agreement. The second source relates to a duty the association owes members.

The entity–aggregate distinction in ULCAA follows the established pattern in modern unincorporated law. ULCAA expressly provides that a “limited cooperative association is an entity distinct from its members,”<sup>693</sup> and then states rules—either mandatory or default—governing the internal affairs of the entity.<sup>694</sup> Additionally, sections relating to member liability,<sup>695</sup> lack of agency status for members as members,<sup>696</sup> and derivative proceedings by members emphasize the entity concept.<sup>697</sup> The combination of those provisions should operate in a manner similar to the combination of sections in other unincorporated law to erode older common law cooperative authority that might be interpreted to imply something close to a direct member-to-member fiduciary duty.<sup>698</sup>

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<sup>692</sup> See, e.g., REV. UNIF. P'SHIP ACT § 404(a) (1997), 6 Pt. I U.L.A. 143 (2001) (“The only fiduciary duties a partner owes to the partnership and the other partners are the duty of loyalty and the duty of care. . .”).

<sup>693</sup> UNIF. LTD. COOP. ASS'N ACT § 105(a), 6A U.L.A. 168 (2008).

<sup>694</sup> See *id.* § 113, 6A U.L.A. 176.

<sup>695</sup> See *id.* § 504, 6A U.L.A. 210.

<sup>696</sup> See *id.* § 503, 6A U.L.A. 209.

<sup>697</sup> See *id.* § 1301, 6A U.L.A. 295.

<sup>698</sup> One circumstance possibly including such an implication concerns the breach of a marketing contract. One summary, for example, includes the following statements: “The effectiveness and efficiency of an association depends to a high degree on the faithfulness with which each member works with all the other members.” *LEGAL PHASES supra* note 82, at 199 (discussing breach of a marketing contract); see also *supra* Part V.D. Under rather unique circumstances, such a breach might lead to members being reciprocal third-party beneficiaries under contract law.

Unlike some other unincorporated law, however, ULLCA does not contain an express statement that members do not owe duties to one another.<sup>699</sup> One reason supporting the absence of such a statement is that ULCAA's mandated centralized structure infers no agency authority to the members as members, unlike the default structure typical of many LLC statutes. Therefore, the need for such a provision is mitigated.

Another possible source of fiduciary duty relates to the central role of the contract for goods or services between members and the cooperative. Such contracts may be independent sources of duties, for example, when the association acts as agent on behalf of its members.<sup>700</sup> In those situations, the fiduciary duties of agency would accrue to the LCA as agent for its members.

Informational rights of members and a list of information the organization is required to maintain are topics organization statutes commonly address.<sup>701</sup> The LCA governed by ULCAA has a duty to maintain certain "required information,"<sup>702</sup> and current members have the right to inspect or receive that information.<sup>703</sup> The provisions on information are derived from similar provisions in ULPA<sup>704</sup> and generally are similar to information serving the same purpose under corporate law.<sup>705</sup> The information must be kept "in a record,"<sup>706</sup> meaning that it must be in either a tangible form—for example, paper—or in an electronic form "retrievable in perceivable form."<sup>707</sup>

Two types of information are available to members. The first type is available to a member as a matter of right within ten business days after

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<sup>699</sup> Thus, for example, members in a manager-managed LLC under RULLCA have no "fiduciary duty to the company or any other member solely by reason of being a member." REV. UNIF. LTD. LIAB. CO. ACT § 409(g)(5), 6B U.L.A. 489 (2008).

<sup>700</sup> Cf. LEGAL PHASES, *supra* note 82, at 332 ("Cooperatives frequently act as agents for members in the sale of produce or the purchase of supplies. It is therefore important to consider the rights and liabilities of such associations and of their members under these circumstances.").

<sup>701</sup> See REV. UNIF. LTD. LIAB. CO. ACT § 410, 6B U.L.A. 492 (2008); UNIF. LTD. P'SHIP ACT (2001) §§ 304, 407, 6A U.L.A. 419, 437 (2008); REV. UNIF. P'SHIP ACT § 403, 6 Pt. I U.L.A. 140 (2001).

<sup>702</sup> UNIF. LTD. COOP. ASS'N ACT § 114, 6A U.L.A. 180 (2008).

<sup>703</sup> See *id.* § 505, 6A U.L.A. 210.

<sup>704</sup> See UNIF. LTD. P'SHIP ACT (2001) § 111, 6A U.L.A. 381.

<sup>705</sup> See, e.g., MODEL BUS. CORP. ACT § 16.01 (2005).

<sup>706</sup> UNIF. LTD. COOP. ASS'N ACT § 114(a), 6A U.L.A. 180.

<sup>707</sup> *Id.* § 102(26), 6A U.L.A. 162.

the LCA receives a demand from a member “in a record.”<sup>708</sup> The association, however, is not required to provide information to the same member more than once in a six-month period.<sup>709</sup> Information of this type includes, for example, items found in the articles of organization,<sup>710</sup> the bylaws,<sup>711</sup> the names and addresses of each director and officer of the association,<sup>712</sup> and a “description of the member’s [own] interest or information from which the description and statement can be derived.”<sup>713</sup>

The second type of information is available to a member only if: (1) “the member seeks the information in good faith and for a proper purpose reasonably related to the member’s interest”;<sup>714</sup> (2) “the demand includes a description with reasonable particularity of the information sought and the purpose for seeking the information”;<sup>715</sup> (3) “the information sought is directly connected to the member’s purpose”;<sup>716</sup> and (4) “the demand is reasonable.”<sup>717</sup> The LCA reasonably may restrict the use of this second type of information.<sup>718</sup> Several informational items the association is required to keep or maintain are not available to members under the minimum default rules of ULCAA because they are not included in either of the two types of information available to members. This information includes internal accounting information and information concerning contributions of members other than those of the requesting member.<sup>719</sup>

The member’s right to information does not extend to transferees of the financial rights of the member, but dissociated (former) members have the same rights as current members, limited to the time period for which they were a member.<sup>720</sup> In addition, dissociated members are re-

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<sup>708</sup> *Id.* § 505(a), 6A U.L.A. 210.

<sup>709</sup> *See id.* § 505(a), 6A U.L.A. 210–11.

<sup>710</sup> *See id.* § 114(a)(2), 6A U.L.A. 180.

<sup>711</sup> *See id.* § 114(a)(3), 6A U.L.A. 180.

<sup>712</sup> *See id.* § 114(a)(1), 6A U.L.A. 180.

<sup>713</sup> *Id.* § 114(a)(17), 6A U.L.A. 180.

<sup>714</sup> *Id.* § 505(b)(1), 6A U.L.A. 211.

<sup>715</sup> *Id.* § 505(b)(2), 6A U.L.A. 211.

<sup>716</sup> *Id.* § 505(b)(3), 6A U.L.A. 211.

<sup>717</sup> *Id.* § 505(b)(4), 6A U.L.A. 211.

<sup>718</sup> *See id.* § 505(g), 6A U.L.A. 211–12.

<sup>719</sup> *See id.* § 505 cmt., 6A U.L.A. 212.

<sup>720</sup> *See id.* § 505(j), 6A U.L.A. 212.



quired to exercise good faith in all requests for information.<sup>721</sup> Lastly, directors have very broad access to information.<sup>722</sup>

## H. Illustrations of Other Law: Mostly Antitrust, Securities, Credit Facilities

### 1. Generally

Both federal and state law recognize the unique needs of cooperatives.<sup>723</sup> Both levels generally have been supportive of the cooperative movement in the United States.<sup>724</sup> Four substantive areas frequently are listed to illustrate how cooperatives are treated differently than other organizations:<sup>725</sup> (1) antitrust laws; (2) federal and state securities laws; (3) regulation of public utilities; and (4) licensing and other regulations affecting business operations.<sup>726</sup>

The drafting committee for ULCAA approached these topics aware that cooperatives are treated differently than other organizations for selected matters including taxation, other regulation, and credit sources. The committee endeavored to avoid varying the application of other statutes, or regulations under other law, that apply equally to a plethora of entities, including LCAs.<sup>727</sup> Sections or parts of sections in ULCAA ex-

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<sup>721</sup> See *id.* § 505(d), 6A U.L.A. 211.

<sup>722</sup> See *id.* § 821, 6A U.L.A. 257.

<sup>723</sup> See, e.g., *supra* notes 135–36 and accompanying text (discussing taxation of cooperatives).

<sup>724</sup> “American public policy has encouraged the formation of farmer cooperatives since the early 20th century.” John K. Lauck & Edward S. Adams, *Farmer Cooperatives and the Federal Securities Laws: The Case for Non-Application*, 45 S.D. L. REV. 62, 62, 67–69 (2000). See *supra* Part V.D (regarding marketing contracts).

<sup>725</sup> Income taxation is another example of law that contains provisions unique to cooperatives. The federal income taxation of cooperatives is discussed separately in this Article. See *supra* Part III. Other specific topics in which cooperatives sometimes have been treated differently than other organizations include enforcement of marketing contracts and disposition of property under the unclaimed property law. These latter two topics are matters of state law and are mentioned elsewhere in this Article. See *supra* Part V.D. (discussing enforcement of marketing contracts); *supra* notes 340–42 and accompanying text (discussing unclaimed property).

<sup>726</sup> See PACKEL, *supra* note 50, § 63. LCAs could be organized to operate like new generation cooperatives but are not required to do so. See *supra* note 101 (discussing new generation cooperatives). For a discussion concerning new generation status on tax, antitrust, ability to borrow from the farm credit system, and securities regulation see Kelley, *supra* note 101, at 201.

<sup>727</sup> See UNIF. LTD. COOP. ASS’N ACT § 109(c), 6A U.L.A. 171 (2008). Optional subsection 109(c) addresses the interrelationship of ULCAA to common interest

pressly address its interrelationship with other laws that may exist in adopting jurisdictions.<sup>728</sup> As with other governing law that provides for the organization and operation of entities, ULCAA makes clear that general law, regulating activities and behavior in specific contexts applied equally to LCAs, is outside the scope of ULCAA.<sup>729</sup> ULCAA section 109 makes this boundary explicit “to avoid unintended interpretations because limited cooperative associations are a relatively new and unfamiliar entity.”<sup>730</sup>

Section 109 is arguably unnecessary; neither the existing unincorporated cooperative association laws nor the other uniform unincorporated acts include such a provision. Nonetheless, concern was expressed in the drafting process that ULCAA mistakenly could be interpreted to override other regulatory law in an adopting jurisdiction. Thus, ULCAA section 109, “Requirements of Other Laws,” seeks to clarify that laws outside of ULCAA are neither altered nor amended by ULCAA.<sup>731</sup> That is, if an entity must meet specific requirements to conduct an activity under other law, an ULCAA LCA may not conduct the activity unless it meets those requirements.<sup>732</sup>

Relatedly, how unique provisions from other law concerning the treatment of cooperatives apply to LCAs organized under ULCAA or similar statutes is an open definition question. The answer hinges on whether an LCA is a cooperative and may be highly contextually based on the operation of the individual LCA. For example, an LCA is not re-

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ownership statutes. It also illustrates how ULCAA could reference a specific outside statute to avoid an implication that ULCAA might override the other statutes, if an adopting jurisdiction for policy or other reasons believed doing so advisable. *See id.* § 105, 6A U.L.A. 168. Also, an adopting jurisdiction could prohibit an LCA from conducting a particular business or activity by excluding it from the lawful purposes for which an LCA may be organized. *See id.* § 105(b), 6A U.L.A. 168.

<sup>728</sup> *See, e.g., id.* § 110, 6A U.L.A. 173 (relating ULCAA to state trade and antitrust laws); *id.* § 111(a), 6A U.L.A. 174 (use of the term “cooperative”); *id.* § 604, 6A U.L.A. 232 (coordinating ULCAA with the UCC on security interests in members’ interests); *id.* § 1009, 6A U.L.A. 274 (relating ULCAA to state securities laws); *id.* § 1010, 6A U.L.A. 274 (applying unclaimed property acts).

<sup>729</sup> *See id.* prefatory note, 6A U.L.A. 153.

<sup>730</sup> *Id.*

<sup>731</sup> *See id.* § 109(a), 6A U.L.A. 171. ULCAA is not intended to “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 [similar in type to an association organized under a statute similar to ULCAA], or its members.” *Id.*

<sup>732</sup> *See id.* § 109(b), 6A U.L.A. 171.

quired to have investor members and because of its flexibility may adopt organic rules that operate in close identity with the corresponding provisions governing cooperatives organized even under traditional corporate cooperative law.

As a result, finding a principled policy reason to exclude at least that subset of limited cooperatives from being treated similarly to other cooperatives is difficult. For other LCAs, the better policy analysis appears to be to examine the underlying policy purpose of the law in question and then, in turn, to determine whether including LCAs within the definition of cooperatives for that particular law or regulation advances the policy. Those decisions, however, at the very least, will take time to accumulate, and no current definitive guidance exists concerning the direction policy makers and administrators will take to these issues, even on the analytical approach.

Further, whether a given LCA desires or needs different treatment under law for its microeconomic planning must be evaluated on a case-by-case basis. As Israel Packel stated in discussing the application of antitrust laws to cooperatives: "It seems clear that the normal activities of cooperatives do not run afoul of antitrust laws, whether or not the statutes have an exemption in favor of cooperatives."<sup>733</sup> This comment might have equal application in contexts other than antitrust laws.

Subsection 109(c) of ULCAA is bracketed, meaning that an adopting jurisdiction should exercise independent judgment on adopting the provision based within the context of the broader laws and policy of that jurisdiction.<sup>734</sup> The subsection addresses the interrelationship of ULCAA to common interest ownership statutes, for example, housing cooperatives.<sup>735</sup> The bracketed language states that the provisions of the Uniform Common Interest Ownership Act (UCIOA) govern an LCA organized under ULCAA if the association is conducting activities governed by UCIOA.<sup>736</sup> Beyond its specific content, optional subsection 109(c) has

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<sup>733</sup> PACKEL, *supra* note 50, § 63(a). *See also* Sugar Inst. v. United States, 297 U.S. 553, 598 (1936). DONALD A. FREDERICK, U.S. DEP'T OF AGRIC., AGRIC. COOP. SERV., MANAGING COOPERATIVE ANTITRUST RISK, (COOPERATIVE INFORMATION REPORT NO. 38) (1989), available at <http://www.rurdev.usda.gov/rbs/pub/cir38/cir38.pdf>.

<sup>734</sup> *See* UNIF. LTD. COOP. ASS'N ACT § 109(c), 6A U.L.A. 171 (2008).

<sup>735</sup> *See id.* The optional subsection makes specific reference to the Uniform Common Interest Ownership Act or the Model Real Estate Cooperative Act if an adopting state has one of those Acts.

<sup>736</sup> *See id.*

provisions illustrating ways to avoid confusion regarding ULCAA's scope and prohibiting specific LCA activities.<sup>737</sup>

Specific provisions of many federal and state statutes have particular applications to various types or classifications of cooperative entities. The next Part of the Article tries to describe selected law that historically has, or currently does, provide special treatment for some types of cooperatives.

## 2. Antitrust

The federal antitrust and related laws are broad in scope.<sup>738</sup> This recognition led Congress to provide an exemption from the provisions of the Clayton Act for labor, agricultural, or horticultural organizations.<sup>739</sup> The difficulty with this exemption was its limitation to organizations not having capital stock. This difficulty was remedied, with respect to agricultural marketing cooperatives, in 1922 with the passage of the Capper-Volstead Act.<sup>740</sup> The Capper-Volstead Act permits:

[M]arketing combinations for the mutual benefit of members as producers if (1) no member is allowed more than one vote because of his stock or membership capital or the association does not pay dividends on capital in excess of eight per cent and (2) the association does not deal in the products of nonmembers to an amount greater in value than those of members.<sup>741</sup>

The Capper-Volstead Act's language illustrates how technically and narrowly exemptions from antitrust laws have been drawn. State restraint

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<sup>737</sup> See *supra* notes 224, 727 and accompanying text.

<sup>738</sup> See e.g., Sherman Antitrust Act, 15 U.S.C. § 1 (2000); Clayton Act of 1914, 15 U.S.C. § 12 (2000); Federal Trade Commission Act, 15 U.S.C. § 41 (2000); Miller-Tydings Act, 15 U.S.C. § 1 (2000); Robinson-Patman Act, 15 U.S.C. § 13-13b.21a (2000). A general discussion of federal antitrust laws and their application to agricultural cooperative organizations appears in 14 NEIL E. HARL, *AGRICULTURAL LAW*, ch. 137 (1996).

<sup>739</sup> Clayton Act, 15 U.S.C. § 17 (2000 & Supp. 2009). The Act is not to "be construed to forbid the existence and operation of labor, agricultural, or horticultural organizations, instituted for the purposes of mutual help, and not having capital stock or conducted for profit or to forbid or restrain individual members of such organizations from lawfully carrying out the legitimate objects thereof." *Id.*

<sup>740</sup> 7 U.S.C. §§ 291, 292 (2000 & Supp. 2009). Cf. Fishermen's Coop. Marketing Act, 15 U.S.C. § 521 (2000).

<sup>741</sup> PACKEL, *supra* note 50, § 63(a).

of trade laws are similar. Many judicial opinions have analyzed the language of various federal and state antitrust law as applied to cooperatives, especially those in agriculture, and those cases continue today.<sup>742</sup> An antitrust analysis has not been done in ULCAA-type entities, but an article does analyze the application of Capper–Volstead to new generation cooperatives.<sup>743</sup>

The federal exemptions, for example, only protect an agricultural cooperative from *per se* violations based solely on operating as a marketing association; the exemptions do not provide protection if the cooperative engages in other activities prohibited by the antitrust laws.<sup>744</sup> Only rarely do the exemptions or immunities remove all possible activities of a cooperative from the scope of restraint of trade or antitrust law.<sup>745</sup>

The ULCAA Drafting Committee was aware of the variety of state restraint of trade and antitrust provisions related to cooperatives, and ULCAA contains a bracketed section inviting consideration of this issue within the policy framework for an adopting jurisdiction's existing exemption, if any.<sup>746</sup> ULCAA does not seek to create any new exemption or immunity for LCAs under state antitrust laws.<sup>747</sup> It simply recognizes the existence of such state exemptions and immunities within the adopting jurisdiction, anticipates that some associations organized under ULCAA will operate in close identity with those organized under other statutes, and provides for a case-by-case analysis of those associations, stating:

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],

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<sup>742</sup> See *id.* at 265–270, n.212–34, n.236, n.239, n.241 (collecting agricultural cooperative cases). See also HARL, *supra* note 738.

<sup>743</sup> See generally Shannon L. Ferrell, *New Generation Cooperatives and the Capper–Volstead Act: Playing a New Game by the Old Rules*, 27 OKLA. CITY U. L. REV. 737 (2002) (discussing in detail the interrelationship between new generation cooperatives and the Capper–Volstead Act).

<sup>744</sup> See, e.g., Clayton Act, 15 U.S.C. § 17; Capper–Volstead Act, 7 U.S.C. §§ 291, 292.

<sup>745</sup> See e.g., COLO. REV. STAT. § 7-56-508 (2008) (broad state law exemption).

<sup>746</sup> See UNIF. LTD. COOP. ASS'N ACT § 110, 6A U.L.A. 173 (2008).

<sup>747</sup> See *id.*

the association and its activities are entitled to the exemption or immunity.<sup>748</sup>

ULCAA, therefore, seeks to clarify that an association having the same attributes of a cooperative organized under traditional cooperative statutes in that jurisdiction can be afforded the same protection, if any, a similar cooperative organized under other law would enjoy.<sup>749</sup> As a result, this provision places responsibility on the creators and the drafters of the organic rules to craft an LCA meeting the material requirements for antitrust exemptions and immunities provided by the existing and settled law and policy of the jurisdiction.<sup>750</sup> In turn, the courts would determine the exemptions and immunities on a case-by-case basis. This approach recognizes the variation among the states and is intended to coordinate the law under ULCAA with the settled policy of the adopting state with respect to this subject.<sup>751</sup> If the bracketed section is not adopted, no guidance as to the manner or result of the application of existing exemptions to LCAs will be had. Obviously, legislatures could adopt nonuniform language that would deem LCAs to be, or not to be, cooperatives for purposes of these exemptions.

### 3. *Securities Laws*

The securities laws at the federal level and in many states<sup>752</sup> contain limited exemptions for certain kinds of cooperatives.<sup>753</sup> Under federal law, for example,

[e]ven if the membership agreement, stock structure, or capital accumulation plan of a farmers' cooperative is within the definition of 'security' under the federal securities laws, the security is exempt from the registration requirements of the [Securities Act of 1933] [only] if the

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<sup>748</sup> *Id.*

<sup>749</sup> *See id.*

<sup>750</sup> *See id.* § 110 cmt., 6A U.L.A. 173.

<sup>751</sup> *See id.*

<sup>752</sup> "Some [state] legislatures have expressly recognized that there is no need to regulate dealings in cooperative interests." PACKEL, *supra* note 50, § 63(c). State securities laws commonly are referred to as "Blue Sky Laws." *See id.* Compare UNIF. SEC. ACT (amended 2002), §§ 101–703, 7C U.L.A. 22 (2006) with KAN. STAT. ANN. §§ 17-12a101 to 17-12a703 (2007).

<sup>753</sup> *See, e.g.,* Securities Act of 1933, 15 U.S.C. § 77c(b) (2000); IOWA CODE ANN. §§ 502.101–502.503 (West 2008); KAN. STAT. ANN. §§ 17-12a101 to 17-12a703.

cooperative qualifies as exempt under Section 521 of the Internal Revenue Code.<sup>754</sup>

This exemption is narrow because the cooperative must qualify under section 521 of the Code, which applies only to certain types of cooperatives whose members are farmers.<sup>755</sup>

Beyond the narrow exemption from selected aspects of federal securities laws, some interests in cooperatives conceivably are not securities at all. The facts and circumstances related to a member interest in a cooperative will determine whether the interest constitutes a security. For example, “[a]s is usually the case, substance governs rather than form; that is, just as some things that look like real estate are securities, some things that look like securities are real estate.”<sup>756</sup>

The very nature of traditional cooperatives can lead to the conclusion that the ownership rights in a cooperative are not in the nature of securities, even if called stock.<sup>757</sup> Some interests in cooperatives arguably should not be subjected to the registration requirements of the federal securities laws,<sup>758</sup> but good arguments exist that other interests in cooperatives are securities and that purchasers should receive the protections of the federal securities laws.<sup>759</sup> As a point of analytical reference and illustration, the United States Supreme Court has held certificates of indebtedness issued by a cooperative to both members and the general public are securities for purposes of the federal securities laws based on public expectations, “even where an economic analysis of the circumstances of the particular transaction might suggest that the instruments are not ‘securities’ as used in that transaction.”<sup>760</sup>

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<sup>754</sup> PACKEL, *supra* note 50, § 63.

<sup>755</sup> See *supra* note 140 and accompanying text.

<sup>756</sup> 2 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 1036 (3d ed. 1999).

<sup>757</sup> “The character of ownership interests in cooperatives should normally lead to the conclusion that they are not securities within the meaning of *blue sky legislation*.” PACKEL, *supra* note 50, § 63(c), at 286 n.325 (emphasis added). See also *United Hous. Found., Inc. v. Forman*, 421 U.S. 837 (1975) (determining that the ownership of a condominium does not constitute a security under the Securities Act of 1933). For a general discussion of the *Forman* decision, see LOSS & SELIGMAN, *supra* note 756, at 997–1003.

<sup>758</sup> See Lauck & Adams, *supra* note 724.

<sup>759</sup> See Frank A. Taylor & Patrick A. Reinken, *Are Financial Instruments Issued by Agricultural Cooperatives Securities?: A Framework for Analysis*, 5 DRAKE J. AGRIC. L. 171 (2000). See generally Centner, *supra* note 92.

<sup>760</sup> *Reves v. Ernst & Young*, 494 U.S. 56, 66 (1990).

Once again, ULCAA cannot affect directly how the federal securities law exemption will apply to LCAs.<sup>761</sup> It does, however, address the interrelationship between state securities regulation and LCAs in an optional bracketed provision.<sup>762</sup> It provides that "Patron members' interest in a limited cooperative association has the same exemption as provided for substantially similar interests in cooperatives under" the appropriately referenced state law.<sup>763</sup> This approach is consistent with ULCAA's approach to state law restraint of trade and antitrust exemptions.<sup>764</sup> Section 1009 invites an adopting jurisdiction to coordinate patron interests in an LCA with the settled policy of the jurisdiction with respect to cooperative members if the jurisdiction desires to do so.<sup>765</sup> Section 1009's language is limited to patron-member interests because they are similar to membership interests in a cooperative that most likely are exempted under state securities laws.<sup>766</sup> Investor member interests in an LCA are, by their nature, distinguishable from patron-member interests and raise potentially different policy considerations outside the settled policy concerning patron-member cooperatives. At the very least, section 1009 highlights the issue for the adopting jurisdiction.

#### 4. *Public Utilities and Other Regulations*

Utility cooperatives play a significant role in delivery of electricity and telephone service to large segments of the United States.<sup>767</sup> Does the regulation of public utilities extend to utility cooperatives?<sup>768</sup> Again, the analysis has turned on substance, not form. For example, the United States Supreme Court said, "The character of the service, that is, whether it is public or private, and not the character of the ownership, determines ordinarily the scope of the power of regulation."<sup>769</sup> ULCAA does not address directly the application of public utility law to LCAs organized under ULCAA.<sup>770</sup> Rather, this particular type of regulation is simply out-

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<sup>761</sup> See UNIF. LTD. COOP. ASS'N ACT § 1009, 6A U.L.A. 274 (2008).

<sup>762</sup> See *id.*

<sup>763</sup> *Id.*

<sup>764</sup> See, e.g., *id.* § 110, 6A U.L.A. 173.

<sup>765</sup> See *id.* § 1009 cmt., 6A U.L.A. 274.

<sup>766</sup> See *id.*

<sup>767</sup> See *supra* note 110 and accompanying text.

<sup>768</sup> See generally PACKEL, *supra* note 50, § 63(b).

<sup>769</sup> Van Dyke v. Geary, 244 U.S. 39, 44 (1917).

<sup>770</sup> See UNIF. LTD. COOP. ASS'N ACT § 109(a), (b), 6A U.L.A. 171 (2008).



side ULCAA's scope and left to general legal analysis as expressly adopted in ULCAA section 109.<sup>771</sup>

### 5. *Credit Facilities*

A final example of a way the federal government encourages cooperatives is the existence of specialized lending institutions or other sources of funds. Congress established Banks for Cooperatives as part of the federal Farm Credit System, most of which subsequently have been consolidated into CoBank.<sup>772</sup> Today, CoBank, an entity formed through the merger of several of the original Banks for Cooperatives, plays a significant role in the Farm Credit System.<sup>773</sup> CoBank describes itself as a "\$58 billion member of the \$208 billion Farm Credit System."<sup>774</sup> CoBank is a privately owned cooperative but is eligible to receive funds from the sale of Farm Credit System Securities.<sup>775</sup> CoBank operates on a cooperative basis and is owned by its borrowers.<sup>776</sup> The Farm Credit System provides loans and other credit facilities to its cooperative members and to entities related to cooperatives or utilized by cooperatives in carrying out their cooperative purposes.<sup>777</sup> According to statute, the rates and other charges are to be as low as commercially possible, taking into account the financial health of the lending institution.<sup>778</sup> Thus, those who qualify for loans from these institutions potentially receive lower rates than those offered in the open lending market. To be eligible for a loan, the borrower must be a farmer cooperative, or a cooperative involved in defined activities involving energy, communications, or water.<sup>779</sup>

The Farm Credit Act further requires a cooperative, for purposes of loan eligibility, to meet three other criteria:

1. Regardless of stock amount or membership capital, each member of a qualifying entity may have only one vote, or, in the alterna-

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<sup>771</sup> See *supra* notes 728–43 and accompanying text.

<sup>772</sup> See CoBank's History, [http://www.cobank.com/About\\_CoBank/General\\_Info/CoBank\\_history.htm](http://www.cobank.com/About_CoBank/General_Info/CoBank_history.htm) (last visited May 31, 2009).

<sup>773</sup> See General Information, [http://www.cobank.com/About\\_CoBank/General\\_Info/General\\_Info\\_index.htm](http://www.cobank.com/About_CoBank/General_Info/General_Info_index.htm) (last visited May 31, 2009).

<sup>774</sup> *Id.*

<sup>775</sup> See *id.*

<sup>776</sup> See *id.*

<sup>777</sup> See 12 U.S.C. § 2001 (2000).

<sup>778</sup> See *id.* § 2131.

<sup>779</sup> See *id.* §§ 2128, 2129.

- tive, the entity may “not pay dividends on stock or membership capital in excess of” Farm Credit Administration demands.<sup>780</sup>
2. The value of products supplied or services performed for cooperative members must exceed the value of products supplied or services performed for nonmembers, excluding any transactions with the federal government.<sup>781</sup>
  3. At least 80%, 60% in some limited circumstances, of the cooperative voting control must be “held by farmers, producers or harvesters of aquatic products, or eligible cooperative associations as defined.”<sup>782</sup>

Finally, each borrower must own at least one share of voting stock in the lending bank, and the statute requires the borrowers to purchase additional shares of either voting or nonvoting stock, as the lending institution sees fit.<sup>783</sup> “[T]he requirement for investment in stock at the time the loan is closed shall not exceed an amount equal to 10 per centum of the face amount of the loan.”<sup>784</sup> The stock then becomes collateral for the debts the borrower has with the lending cooperative.<sup>785</sup> In the event of loan default, the bank has the right to retire or cancel all or part of the stock, or any other equity the borrower owns in the bank.<sup>786</sup>

Congress also has established the National Consumer Cooperative Bank (NCCB), which, like CoBank, makes loans and offers other credit facilities to its cooperative member owners.<sup>787</sup> The stated purpose of this legislation was to increase consumer participation in the production of goods and services by encouraging cooperatives.<sup>788</sup> The NCCB may not make loans to agricultural cooperatives eligible to borrow from the Banks for Cooperatives unless given permission by the applicable Bank for Cooperatives, or the Banks for Cooperatives have refused to provide loans or credit facilities to an agricultural cooperative or other eligible

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<sup>780</sup> *Id.* § 2129(a)(1)–(2).

<sup>781</sup> *See id.* at (a)(3).

<sup>782</sup> *Id.* at (a)(4).

<sup>783</sup> *See id.*

<sup>784</sup> *Id.*

<sup>785</sup> *See id.* § 2131(c).

<sup>786</sup> *See id.* § 2131(d).

<sup>787</sup> *See id.* § 3001.

<sup>788</sup> *See id.*

borrower.<sup>789</sup> In 1981, Congress passed legislation privatizing NCCB, making it a bank owned by its customer-stockholders.<sup>790</sup>

The statute creating NCCB contains eligibility requirements for the bank's lending services.<sup>791</sup> A borrower is eligible for a loan from NCCB in one of two ways.<sup>792</sup> First, eligibility exists for "an organization chartered or operated on a cooperative, not-for-profit basis for producing or furnishing goods, services or facilities, primarily for the benefit of its members or voting stockholders who are ultimate consumers of such goods, services, or facilities."<sup>793</sup> Second, and alternatively, entities owned by a cooperative fitting the above definition are eligible if:

1. The "goods [or] services [p]rovided to . . . members [are done so] on a not-for-profit basis",<sup>794</sup>
2. The entity complies with NCCB dividend regulations;<sup>795</sup>
3. The entity distributes to members, based upon patronage, all net savings not used for the improvement of the organization;<sup>796</sup>
4. Membership is voluntary and not discriminatory against any one class of peoples;<sup>797</sup>
5. "[E]conomic democracy" is ensured through means including limiting each member to a single vote (in most circumstances);<sup>798</sup> and
6. The entity "is not a credit union, mutual savings bank, or mutual savings and loan association."<sup>799</sup>

The Rural Electrification Act of 1936 authorized the Secretary of Agriculture to provide loans "for the purpose of furnishing and improving electric and telephone service in rural areas, . . . and for the purpose of assisting electric borrowers to implement demand side management, energy conservation programs, and on-grid and off-grid renewable ener-

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<sup>789</sup> See *id.* § 3015(d).

<sup>790</sup> See NCB History, <http://www.ncb.coop/default.aspx?id+714> (last visited May 31, 2009).

<sup>791</sup> See 12 U.S.C. § 3015 (2000).

<sup>792</sup> See *id.*

<sup>793</sup> *Id.* § 3015(a).

<sup>794</sup> *Id.* § 3015(a)(1).

<sup>795</sup> See *id.* § 3015(a)(2).

<sup>796</sup> See *id.* § 3015(a)(3).

<sup>797</sup> See *id.* § 3015(a)(4).

<sup>798</sup> *Id.* § 3015(a)(5).

<sup>799</sup> *Id.* § 3015(a)(6).

gy systems.”<sup>800</sup> Cooperatives that provide retail electric service needs to rural areas or supply the power needs of distribution borrowers in rural areas are eligible for loans under the Rural Electrification Act of 1936.<sup>801</sup> “A rural electrical cooperative that obtained a loan has the power to purchase, with part of the funds obtained through the loan, all of the stock of an electric power company, and to operate that company.”<sup>802</sup>

In addition to funds available under the Rural Electrification Act, private financing is available to rural electrics. “The National Rural Utilities Cooperative Finance Corporation . . . is the premier private-market lender for the nation’s electric cooperatives—an independent source of financing that supplements the credit programs of the U.S. Department of Agriculture’s Rural Utilities Service . . .”<sup>803</sup>

## VI. CONCLUSION

The LCA is a *sui generis* state law unincorporated entity. It combines much of the flexibility of other types of unincorporated entities with the principle-based features of traditional cooperatives. Its purpose is to enhance the capacity of a cooperative-based entity to attract equity capital. It expressly permits, but does not require, voting investor members who may share in profits of the association. It is a separate alternative entity choice to traditional cooperatives and other entities. It does not replace or modify any existing entity law.

Investor members may have a significant voice in the management of LCAs, but control is mediated through a centralized board structure. The majority of the board of directors of each LCA organized pursuant to ULCAA must be elected by patron members and a significant proportion, but not necessarily a majority, of board membership must be individual patron members.

Moreover, ULCAA’s two-tier voting system requires that a majority of patron members must vote affirmatively for a proposal to succeed. This system is flexible and it allows full deliberation of issues subject to membership vote. Patron members realistically, and theoretically, have control of the LCA in all votes requiring a majority because patron members are required to have a majority of votes. Nonetheless, patron members have far less than dictatorial control. Moreover, unlike under

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<sup>800</sup> 7 U.S.C. § 902(a) (2000).

<sup>801</sup> *See id.* § 904.

<sup>802</sup> *Energy and Power Sources*, 27A AM. JUR. 2D, § 148 (2008).

<sup>803</sup> CFC, What We Do, <http://www.nrucfc.org/aboutcfc/whatWeDo.htm> (last visited May 31, 2009).

block or collective voting, each member's vote—either patron member or investor member—counts at the level of the second (aggregate) voting tier. In this way, ULCAA acknowledges the important user-control cooperative principle but, at the same time, encourages equity contribution by investor (nonpatron) members through permitting them a significant voice in management and encouraging deliberation that might cause even a minority of patron members to vote with investment members. Of course, the entire discussion of voting in this Article is based on the false dichotomy that most patron members and most investor members will take different voting postures based on whether they are patron members or investor members. As a practical matter, this opposition seems unlikely always, or perhaps even typically, to be the case. The voting and governance structure adds to the length of the Act because of the practical necessity of addressing such things as member meetings.

Another of ULCAA's defining features is that it is based largely on state unincorporated law. This feature might lead to rather sophisticated tax planning. As the Prefatory Note to ULCAA observes, however, it "is important, too, because cooperatives have historically functioned for specific purposes in a way analogous to, and sometimes in fact as, unincorporated associations."<sup>804</sup> Additionally, the unincorporated capital architecture provides allocations to be a legal metric with which to measure another cooperative principle because patron members must be allocated 50% or more of the profits.

In summary, the LCA governed by ULCAA may provide a superior alternative entity choice in a selected range of situations. It is cost efficient because it provides an off-the-rack starting point for an organization seeking a single-entity architecture with strong cooperative features. It provides a value-based alternative entity that specifically recognizes the importance of patron members (users) but whose activity requires additional equity investment. ULCAA may, indeed, be a capital idea for principled self-help, value-added firms; community-based economic development; and low profit joint ventures. It is likely to have application in other select situations. Therefore, the LCA is a valuable addition to the entity selection menu.

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<sup>804</sup> UNIF. LTD. COOP. ASS'N ACT, prefatory note, 6A U.L.A. 142 (2008).

APPENDIX – STATE COMPARATIVE CHART  
Scope, Voting, and Allocation

Citation <sup>805</sup>	A Scope	B Patron Votes	C Patron Elected Directors	D Amendment of Articles	E Member Voting	F Allocation <sup>806</sup>
"Wyoming Processing Cooperative law [sic]" (enacted 2001). WYO. STAT. ANN. § 17-10-201 (2007).	Formed under a cooperative plan to market and "change the form or marketability of crops, livestock and other agricultural products . . . and other purposes that are necessary or convenient to facilitate the production or marketing of agricultural products by patron members and other purposes that are related to the business of the cooperative." WYO. STAT. ANN. § 17-10-205 (2007).	Each patron has one vote but may have more. "On any matter of the cooperative, the entire patron members voting power shall be based collectively upon the majority of patron members voting on the issue." WYO. STAT. ANN. § 17-10-230 (2007).	"[A]t least one-half (½) of the voting power on general matters . . . shall be allocated to one (1) or more directors elected by members holding patron membership interests." WYO. STAT. ANN. § 17-10-217 (2007).	Typical corporate-like process. Majority of member votes cast (assuming a quorum). See WYO. STAT. ANN. § 17-10-209 (2007).	Present, alternative method if authorized by the board; no proxy (but delegate voting not proxy). See WYO. STAT. ANN. § 17-10-230.	Based on contributions unless otherwise provided. Patrons, collectively, shall have not less than 15%; same rule for distributions. See WYO. STAT. ANN. §§ 17-10-222, 17-10-233 (2007). For reserves, etc., see WYO. STAT. ANN. § 17-10-234 (2007).
"Minnesota Cooperative Associations Act" (2003 session laws). MINN. STAT. ANN. § 308B.001 (West 2004).	"for any lawful purpose." The general language is followed by delineated items preceded by "including." The delineated items themselves are broad including "for any other purposes that cooperatives are authorized by law." MINN. STAT. ANN. § 308B.201 (West 2004).	Patron vote based on block voting; bylaws may not reduce the collective patron vote to less than 15% of the total vote. See MINN. STAT. ANN. § 308B.545(1) (West 2004). <sup>807</sup>	At least one-half of the voting power on general matters shall be allocated to one or more directors elected by patron members. See MINN. STAT. ANN. § 308B.41 (b), (c) (West 2004).	Typical corporate process; default by majority of votes cast (assuming quorum is present). MINN. STAT. ANN. § 308B.221 subd. 1(2)(i) (West 2004).	Present; alternative method if authorized by board; proxy available (but delegate voting, not proxy). See MINN. STAT. ANN. § 308B.565 (West 2004).	Based on contributions unless otherwise provided. Patrons must have 50% of profits allocation in any fiscal year except articles or bylaws may reduce to 15%. Same rule for distributions. See MINN. STAT. ANN. § 308B.721 (West 2004).
"Tennessee Processing Cooperative Law" (effective 2005). TENN. CODE ANN. § 43-38-101 (2007).	Requires a cooperative plan, lists specific agricultural processing and marketing functions and "for [all other] purposes that cooperatives are authorized." TENN. CODE ANN. § 43-38-201 (2007). Commissioner of Agriculture must	Each patron member has one vote, but may have more under certain narrow exceptions. "On any matter of the cooperative, the entire patron members voting power shall be voted	At least one director must be elected by patron members, but at least 51% of the voting power on general matters must be allocated to directors elected	Typical corporate process; default is by majority of votes cast (assuming a quorum is present). See	Present; mail or alternative method if authorized by board; not by proxy (district etc. not proxy). See TENN. CODE ANN. § 43-38-522(c).	Based on contributions unless otherwise provided and patrons must have at least 15% of both allocations and distributions. See TENN. CODE ANN. §§ 43-38-501(c), -902 (creation of reserves) (2007).

<sup>805</sup> Listed in chronological order.

<sup>806</sup> The required percentage possibly may be reduced further in some states through a provision that reserves be allocated solely from patron members.

<sup>807</sup> It appears section 308B.555 may reduce the percentage further through transfer, but the provision is subject to different interpretation. Subdivision 3 states: "The articles or bylaws may give or prescribe the manner of giving a creditor, security holder, or other person a right to vote on patron membership interests under this section."

Citation <sup>805</sup>	A	B	C	D	E	F
	Scope	Patron Votes	Patron Elected Directors	Amendment of Articles	Member Voting	Allocation <sup>806</sup>
"Iowa Cooperative Associations Act" (effective 2005) IOWA CODE ANN. ch. 501A (West 2008).	approve articles, and its approval seems constrained to agricultural processing. <i>See</i> TENN. CODE ANN. § 43-38-203(g) (2007).	collectively based upon the vote of the majority of patron members. <i>See</i> TENN. CODE ANN. § 43-38-522 (2007). <i>See</i> TENN. CODE ANN. § 43-38-501 (2007).	exclusively by patron members. <i>See</i> TENN. CODE ANN. § 43-38-606(a) (2007).	TENN. CODE ANN. § 43-38-402(q)(2) (2007).	(d): 43-38-521 (2007).	
	"[A]ny lawful purpose followed by a nonexclusive listing ("including but not limited to"). One of the listed items is "[f]or any other purpose that a cooperative is authorized by law under chapter 499 ["Cooperative Associations"; "any lawful purposes" therein, expressly including agriculture and electric by discussing them elsewhere] or 501 ["Cooperative Corporations"; any lawful business therein.]" IOWA CODE ANN. § 501A.501.	Patron members vote on a collective block vote; bylaws may not reduce patron member vote to less than 15% of the total vote. <i>See</i> IOWA CODE ANN. § 501A.810 (West 2008).	The quick rule of thumb is at least one-half of the voting power "shall be allocated" to the board members elected by patron members. However, it may be less on certain matters. <sup>809</sup>	Typical corporate process; majority of the votes cast, assuming a quorum is present. <i>See</i> IOWA CODE ANN. § 501A.506 (West 2008).	Present, mail, or other authorized method. No proxy (delegates not proxy). <i>See</i> IOWA CODE ANN. § 501A.810.	Based on contributions unless otherwise provided and patrons must be allocated at least 50% of profits in any fiscal year. Articles, bylaws, or patron member votes may reduce to 15%. <i>See</i> IOWA CODE ANN. § 501A.1005(1) (West 2008). Distributions are governed similarly. <i>See id.</i> § 501A.1005(2). <i>See also id.</i> 501A.1006 (defining net income).
"Wisconsin Cooperative Associations Act" (effective 2006) WIS. STAT. ANN. § 193.005 (West 2002 & Supp. 2008) (noting that the reviser of statutes captions the chapter, "Unincorporated Cooperative Associations").	Any lawful purpose. <i>See</i> WIS. STAT. ANN. § 193.201 (West 2002 & Supp. 2008); BUT not "furnishing natural gas, heat, light, power, or water to its members." WIS. STAT. ANN. § 193.203 (West 2002 & Supp. 2008).	Patron members vote on a collective block vote; "[t]he articles or bylaws may not reduce the collective patron member vote to less than 51% of the total member vote." WIS. STAT. ANN. § 193.545(1)(a) (West 2002 & Supp. 2008).	"[A] majority of the directors shall be elected exclusively by patron members, unless otherwise provided in the articles or bylaws." WIS. STAT. ANN. § 193.411(2)(b).	Assuming a quorum, by a majority of votes cast. <i>See</i> WIS. STAT. ANN. § 193.221 (West 2002 & Supp. 2008).	Present, mail, authorized alternate ballot, proxy. <i>See</i> WIS. STAT. ANN. §§ 193.545(2), (3), 193.565 (proxy) (West 2002 & Supp. 2008).	Patron members must have 51% of both profit allocations and distributions. The patron members, by majority vote, may authorize lower amount but not less than 30%. <i>See</i> WIS. STAT. ANN. § 193.601(4) (West 2002 & Supp. 2008).

<sup>808</sup> Iowa uses the same language as Minnesota with the same effect. *See* IOWA CODE ANN. § 501A.812(2).

<sup>809</sup> The statutory provision follows:

b. A majority of the directors shall be members and a majority of the directors shall be elected exclusively by the members holding patron membership interests unless otherwise provided in the articles or bylaws. c. The voting power of the directors may be allocated according to equity classifications or allocation units of the cooperative. If the cooperative authorizes nonpatron membership interests, one of the following must apply: (1) At least one-half of the voting power on matters of the cooperative that are not specific to equity classifications or allocation units shall be allocated to the directors elected by members holding patron membership interests. (2) The directors elected by the members holding patron membership interests shall have at least an equal voting power or shall not have a minority voting power on general matters of the cooperative that are not specific to equity classifications or allocation units."

IOWA CODE ANN. § 501A.703(2)(b), (c).

Citation <sup>805</sup>	A Scope	B Patron Votes	C Patron Elected Directors	D Amendment of Articles	E Member Voting	F Allocation <sup>806</sup>
		The following language appears in the same section: "Unless the articles or bylaws provide otherwise, no issue that patron members may vote upon may be approved unless, in determining the collective vote of the patron members, the number of patron members voting to approve the issue is a majority of all members voting on the issue." <sup>810</sup>	(West 2002 & Supp. 2008). Also provides for a nonvoting financial expert. <i>See id.</i>			
"Nebraska Limited Cooperative Association Act" (effective 2007, amended 2008, effective July 18, 2008). <i>See</i> NEB. REV. STAT. §§ 21-29-01 to -29.134 (2007 & Supp. 2009).	Any lawful purpose; BUT not "for the purpose of being a financial institution which is subject to supervision by the Department of Banking and Finance under section 8-102 or which would be subject to supervision by the department if chartered by the State of Nebraska or the business of an insurer as described in section 44-102." NEB. REV. STAT. § 21-2904(2) (2007 & Supp. 2009).	Each patron member has one vote but may have more. <i>See</i> NEB. REV. STAT. § 21-2939(1) (2007 & Supp. 2009). Patron vote based on block voting. <i>See id.</i> § 21-2939(3)(b). Articles or bylaws may not reduce the collective patron vote to less than 15% of the total vote. <i>See id.</i> § 21-2939(3)(a).	At least 50% of the board must be elected exclusively by patron members. <i>See</i> NEB. REV. STAT. § 21-2956(1) (2007 & Supp. 2009).	Approval of amendments to articles is by two-thirds of all members voting at meeting. <i>See</i> NEB. REV. STAT. § 21-2913(1) (2007 & Supp. 2009). Approval of amendments to bylaws by a majority vote of all members voting at meeting of investor members voting at meeting. <i>See</i> NEB. REV. STAT. § 21-2913(2) (2007 & Supp. 2009).	Present; alternative method if provided in organic rules; proxies are prohibited. <i>See</i> NEB. REV. STAT. § 21-2943 (2007 & Supp. 2009).	The default is to all members; if investor members are present then default allocation is based on ratio of "limited contribution to total initial contribution of all investor members" and patronage for patron members. NEB. REV. STAT. § 21-2980 (2007 & Supp. 2009) (emphasis added). Fifty percent of allocations are to be to patron members; the organic rules may reduce allocations to patron members to not less than 15%. Sums paid to members on product or services and sums due as "state fired return on equity" do not count in determining the numerator. The board may set aside, whether allocated or unallocated, capital reserves and reserves "for specific purposes, including expansion and replacement of capital assets and other necessary business purposes." <i>Id.</i> Distributions are similar to ULCAA. <i>See id.</i> § 21-2981.

<sup>810</sup> The articles or bylaws may provide for voting by nonmembers. *See* WIS. STAT. ANN. § 193.555 (West 2002 & Supp. 2008). It does not effect, however, the required percentage of patron member vote.



Citation <sup>605</sup>	A Scope	B Patron Votes	C Patron Elected Directors	D Amendment of Articles	E Member Voting	F Allocation <sup>606</sup>
"Utah Uniform Limited Cooperative Association Act," UTAH CODE ANN. § 16-16-101 (Supp. 2009).	Identical to ULCAA except for changing "[except designated purposes]" to "except for the operation of a financial institution as defined in Section 7-1-103" UTAH CODE ANN. § 16-16-105(a) (Supp. 2009).	Same as ULCAA. See UTAH CODE ANN. §§ 16-16-511, -512, -514 (Supp. 2009).	Same as ULCAA. See UTAH CODE ANN. §§ 16-16-804, -816 (Supp. 2009).	Same as ULCAA. See UTAH CODE ANN. § 16-16-405 (Supp. 2009).	Same as ULCAA. See UTAH CODE ANN. § 16-16-515 (Supp. 2009).	Same as ULCAA allocations and distributions. See UTAH CODE ANN. § 16-16-1004 to -1005 (Supp. 2009).
"Oklahoma Uniform Limited Cooperative Association Act" OKLA. STAT. ANN. tit. 18, § 440-101 (West Supp. 2009) (effective January 1, 2010). [The Oklahoma Supreme Court declared that state's version of the Act unconstitutional on procedural grounds. See <i>Weddington v. Henry</i> , No. 106330, 2008 WL 5047615 (Okla. Nov. 24, 2008).]	Identical to ULCAA except for changing "[except designated purposes]" UNIF. LTD. COOP. ASS'N ACT § 105, 6A U.L.A. 168 (2008), to "except for supplying electric energy or natural gas in rural areas. A cooperative organized for the purpose of supplying electric energy and promoting and extending the use thereof in rural areas must be organized under the Rural Electric Cooperative Act." OKLA. STAT. ANN. tit. 18, § 440-105 (West Supp. 2009).	Same as ULCAA. See OKLA. STAT. ANN. tit. 18, § 440-511 (West Supp. 2009).	Same as ULCAA. See OKLA. STAT. ANN. tit. 18, § 440-804, -806 (West Supp. 2009).	Same as ULCAA. See OKLA. STAT. ANN. tit. 18, § 440-515 (West Supp. 2009).	Same as ULCAA. See OKLA. STAT. ANN. tit. 18, §§ 1004-1005 (West Supp. 2009).	Same as ULCAA allocations and distributions. See OKLA. STAT. ANN. tit. 18, §§ 1004-1005 (West Supp. 2009).
Uniform Limited Cooperative Association Act. See UNIF. LTD. COOP. ASS'N ACT § 101. Official Approved Act (July 2007 with Final Official Comments as of Feb. 2008) <a href="http://www.law.upenn.edu/bll/archives/ule/uarcra/2007_final.pdf">http://www.law.upenn.edu/bll/archives/ule/uarcra/2007_final.pdf</a> (last visited May 31, 2009).	For "any lawful Purpose, whether or Not for profit [except designated prohibited purposes]." ULCAA § 105(b) (no designated prohibited purposes). Cf. ULCAA § 104 ("Nature of Limited Cooperative Association").	Each patron member has at least one vote. See ULCAA § 511. See also ULCAA § 512 ("Determination of Voting Power of Patron Member"). Requires the affirmative majority vote of patron members and a majority of all members voting at the meeting unless it is an extraordinary matter. See ULCAA § 514.	A majority of the board must be elected exclusively by patron members. See ULCAA § 804. Each director has one vote. See ULCAA § 816.	Approval of amendment of article and specific items whether in article or bylaws is by two-thirds vote and at least a majority of the patron vote. The two-thirds may be modified by organic rule. The majority can be modified upward. See ULCAA § 405.	Present; alternative method if provided in organic rules; no proxies. See ULCAA § 515.	The default is "allocated [to] patron members"; if investor members are present then default allocation is based on contributions for investor members and patronage for patron members. See ULCAA § 1004. The organic rules may not reduce to less than fifty percent but sums paid to members on products or services and sums due "as a stated fixed return on equity" do not count in determining the numerator. <i>Id.</i> The board may set aside, whether allocated or unallocated, capital reserves and reserves for specific purposes. See ULCAA § 1004. Distributions are at the discretion of the board and (implicitly) are not subject to the allocation requirements. See ULCAA §§ 1004, 1005.

Miscellaneous Comparisons

State	G	H	I	J	K	L
Wyoming	"Cooperative" "The name of a cooperative shall distinguish the cooperative upon the records . . . from the name of a domestic business entity or foreign business entity . . ." WYO. STAT. ANN. § 17-10-207 (2007).	"Member." See WYO. STAT. ANN. § 17-10-202 (2007).	"A cooperative may enter into or become a party to a contract or agreement . . . between the cooperative and its members." WYO. STAT. ANN. § 17-10-213(c) (2007).	Refund for "surrendered financial rights . . . the lesser of the book value or market value . . . payable" within seven years. The board may transfer patron's membership interest to other members for a liquidation right at par within seven years of transfer. WYO. STAT. ANN. § 17-10-224(b) (2007).	Surrender of financial rights if member "knowingly, intentionally, or repeatedly violates . . . the articles, bylaws, member control agreement or marketing contract." WYO. STAT. ANN. § 17-10-224(a).	A membership interest can be purchased by "cash or a cash equivalent or property with the agreed upon value of the property to be contributed." WYO. STAT. ANN. § 17-10-222(b) (2007).
Minnesota	"Cooperative" "The name of a cooperative shall distinguish the cooperative upon the records . . ." MINN. STAT. ANN. § 308B.211 (West Supp. 2008).	"Member." MINN. STAT. ANN. § 308B.005 (West 2004).	"The cooperative may enter into or become a party to a contract . . . between the cooperative and its members." MINN. STAT. ANN. § 308B.301.	Book up with new contributions. "Whenever a cooperative accepts a new contribution, the board shall restate . . . the value of all old contributions." MINN. STAT. ANN. § 308B.705 (West Supp. 2008). "The cooperative shall refund . . . the lesser of the book value or market value of the financial right . . . payable in not more than seven years from the date of surrender." The board may transfer patron's membership interest to other members for a liquidation right at par within seven years after transfer. MINN. STAT. ANN. § 308B.501 (West 2004).	Surrender of financial rights if member "knowingly, intentionally, or repeatedly violates . . . the articles, bylaws, member control agreement, or marketing contract." MINN. STAT. ANN. § 308B.501 (West 2004).	Money; transfer of property interest, or rendering services. Also, "through a written obligation signed by the person" to provide money, a property interest, or services. MINN. STAT. ANN. § 308B.701 (West 2004).
Tennessee	"Cooperative" unless the secretary of state authorizes another name. TENN. CODE ANN. § 43-38-105(a)-(b) (2007).	"Member." TENN. CODE ANN. § 43-38-103 (2007).	"Enter into or becomes a party to a contract or agreement . . . between the cooperative and its members." TENN. CODE ANN. § 43-38-113(2) (2007).	If cooperative is continued, member "loses all governance rights" and is "considered merely an assignee of the [pretermination] financial rights." If cooperative does not continue, unless the articles or bylaws say otherwise, retain all governance rights and may	"Unless otherwise provided in the articles, a member may not be expelled." TENN. CODE ANN. § 43-38-502(b) (2007).	Membership interest can be purchased "in cash or a cash equivalent or property with the value of the property to be contributed approved by the board." TENN. CODE ANN.

State	G Name	H Designation of Owners	I Ability of Owners to Transact Business with Organization	J Rights on Dissociation	K Default Ability to Expel Owners	L Permissible Contribution
Iowa	"A cooperative name must contain the word 'cooperative,' 'coop,' or the abbreviation 'CP.'" IOWA CODE ANN. § 501A.301(1) (West 2008).	"Member." IOWA CODE ANN. § 501A.102(15) (West 2008).	"A cooperative may enter into or become a party to a contract or agreement . . . between the cooperative and its members or patrons." IOWA CODE ANN. § 501A.601(3) (West 2008).	exercise those rights to wind up and terminate cooperative. If the cooperative is a going concern after the dissociation of the member, the member is entitled to "the lesser of the fair market value . . . determined on a going concern basis or the fair market value . . . determined on a liquidated basis." TENN. CODE ANN. § 43-38-502 (2007).  "The cooperative shall refund . . . the lesser of the book value or market value of the financial right . . . or transfer . . . patron member's rights to a class . . . held by [non-patron] members, or transfer refund to "certificate of interest" within seven years after the transfer. IOWA CODE ANN. § 501A.801(3)(b) (West 2008).	If the member "knowingly, intentionally, or repeatedly violates a provision of . . . the articles or bylaws . . . member control agreement or marketing contract," she may have to give up voting power or financial rights or lose both. IOWA CODE ANN. § 501A.801(3)(a) (West 2008).	Money, transfer of property interest to cooperative, and "rendering services to or for the benefit of the cooperative." Also, executing an agreement to provide any of the three above. IOWA CODE ANN. § 501A.1001(2)(a)-(b) (West 2008).
Wisconsin	"The name of a cooperative shall distinguish the cooperative . . . from the name of all business entities authorized to do business in this state . . ." WIS. STAT. ANN. § 193.211(1) (West 2002 & Supp. 2008).	"Member." WIS. STAT. ANN. § 193.005(15) (West 2002 & Supp. 2008).	"A cooperative may enter into or become a party to a contract . . . between the cooperative and its members." WIS. STAT. ANN. § 193.301(3) (West 2002 & Supp. 2008).	Book-up. See WIS. STAT. ANN. § 193.705 (West 2002 & Supp. 2008) (similar to MN. STAT. ANN. § 308B.501(10)). Unless there is a member violation, "the cooperative shall refund . . . the lesser of the book value or market value of the membership interest . . . payable in not more than 7 years from the date of surrender." WIS. STAT. ANN. § 193.501(3)(b)(1) (West 2002 & Supp. 2008).	Member who "knowingly, intentionally, or repeatedly violates a provision of the articles or bylaws . . . member control agreement or marketing contract . . . may be required to surrender . . . membership interest . . . or [g]overnance rights and right to assign governance rights . . . or [f]inancial rights and right to assign financial rights." WIS. STAT. ANN. § 193.501(3) (West 2002 & Supp. 2008).	Money, transfer of property interest to cooperative or "performing services to or for the benefit of the cooperative." Also, executing an agreement to provide any of the three above. WIS. STAT. ANN. § 193.701(2)(a)-(b) (West 2002 & Supp. 2008).

State	G Name	H Designation of Owners	I Ability of Owners to Transact Business with Organization	J Rights on Dissociation	K Default Ability to Expel Owners	L Permissible Contribution
Nebraska "Nebraska Limited Cooperative Association Act" NEB. REV. STAT. § 21-2901 (2007 & Supp. 2009).	Must contain "limited cooperative association" or "their" abbreviation." NEB. REV. STAT. § 21-2906 (2007 & Supp. 2009).	Same as ULCAA § 102(16). See NEB. REV. STAT. § 21-2903(15) (2007 & Supp. 2009).	A member may lend money to and transact other business with the LCA. See NEB. REV. STAT. § 21-2911 (2007 & Supp. 2009).	Similar to ULCAA § 1102 but somewhat different wording. See NEB. REV. STAT. § 21-2983 (2007 & Supp. 2009).	Similar to ULCAA § 1101 but somewhat different wording. See NEB. REV. STAT. § 21-2982 (2007 & Supp. 2009).	Similar to ULCAA § 1002 but somewhat different wording; omits "labor" as a form of contribution yet includes "services performed or to be performed." NEB. REV. STAT. § 21-2978 (2007 & Supp. 2009).
Utah "Uniform Limited Cooperative Association Act" UTAH CODE ANN. § 16-16-101 (Supp. 2009).	Same as ULCAA § 111. See UTAH CODE ANN. § 16-16-111 (Supp. 2009).	Same as ULCAA § 102(16). See UTAH CODE ANN. § 16-16-102(17) (Supp. 2009).	Same as ULCAA § 115. See UTAH CODE ANN. § 16-16-115 (Supp. 2009).	Same as ULCAA § 1102. See UTAH CODE ANN. § 16-16-1102 (Supp. 2009).	Same as ULCAA § 1101. See UTAH CODE ANN. § 16-16-1101 (Supp. 2009).	Same as ULCAA § 1002. See UTAH CODE ANN. § 16-16-1002 (Supp. 2009).
Oklahoma <sup>811</sup> "Uniform Limited Cooperative Association Act" OKLA. STAT. § 18-440-101 (West Supp. 2009).	Same as ULCAA § 111. See OKLA. STAT. § 18-440-111 (West Supp. 2009) (effective Jan. 1, 2010).	Same as ULCAA § 102(16). See OKLA. STAT. § 18-440-102(16) (West Supp. 2009) (effective Jan. 1, 2010).	Same as ULCAA. See OKLA. STAT. § 18-440-115 (West Supp. 2009) (effective Jan. 1, 2010).	Same as ULCAA § 1102. See OKLA. STAT. § 18-440-1102 (West Supp. 2009).	Same as ULCAA § 1101. See OKLA. STAT. § 18-440-1101 (West Supp. 2009).	Same as ULCAA § 1002. See OKLA. STAT. § 18-440-1002 (West Supp. 2009).
ULCAA	Must contain "limited cooperative association," "limited cooperative," "LCA," "L.C.A.," or use specified abbreviations for "limited," "cooperative" and "association." ULCAA § 111(a)(b).	"Member." ULCAA § 102(16).	Member may lend, transact business with LCA. See ULCAA § 115 (similar to ULPA § 113 (2001)).	Follows general unincorporated law; no book-up, no required statutory payout unless the association causes a dissolution. Member becomes a transferee. See ULCAA § 1102.	Follows general unincorporated law. Board of Directors may expel if there has been a transfer of all member's financial rights, member has been adjudicated incompetent, or for reasons under organic rules. See ULCAA § 1101(d)(4).	Very broad; e.g., tangible or intangible property, any other benefit, labor or services performed or to be performed. See ULCAA § 1002(a).

<sup>811</sup> See *supra* note 749.

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