

HOUSE BILL REPORT

SSB 6038

As Reported by House Committee On:
Judiciary

Title: An act relating to limited cooperative associations.

Brief Description: Concerning limited cooperative associations.

Sponsors: Senate Committee on Law & Justice (originally sponsored by Senators Pedersen and Padden; by request of Uniform Law Commission).

Brief History:

Committee Activity:

Judiciary: 2/15/18, 2/22/18 [DPA].

**Brief Summary of Substitute Bill
(As Amended by Committee)**

- Adopts the Washington Limited Cooperative Association Act, a new chapter of law governing the formation, organization, governance, operation, and dissolution of limited cooperative associations.

HOUSE COMMITTEE ON JUDICIARY

Majority Report: Do pass as amended. Signed by 13 members: Representatives Jinkins, Chair; Kilduff, Vice Chair; Rodne, Ranking Minority Member; Graves, Assistant Ranking Minority Member; Goodman, Haler, Hansen, Kirby, Klippert, Muri, Orwall, Shea and Valdez.

Staff: Edie Adams (786-7180).

Background:

Washington law allows any number of people to join together for the creation of a cooperative association where members participate in the cooperative's business for the mutual benefit of all the members. Under the Cooperative Associations Act, a cooperative association may be formed to advance any lawful business, including any agriculture, dairy, mercantile, mining, manufacturing, or mechanical business. Cooperative associations are

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formed by the filing of articles of incorporation with the Office of the Secretary of State (SOS). They consist of the members of the cooperative association and are governed by a board of directors and officers.

Cooperative associations may also be formed under the Nonprofit Miscellaneous and Mutual Corporations Act (NMMCA), which allows a business to organize for any lawful purpose, including mutual, social, cooperative, fraternal, or other purposes. A corporation organized under the NMMCA is formed by filing articles of incorporation with the SOS. The corporation is governed by the articles of incorporation and the bylaws adopted by the board of directors. The corporation is managed by a board of directors and officers and may have members or shareholders. A corporation organized under the NMMCA may elect to be governed by provisions of the Cooperative Association Act.

The Uniform Law Commission (ULC) is an organization that authors and promotes enactment of uniform state laws in areas of law where national uniformity is desirable and practical. The ULC promulgated the Uniform Limited Cooperative Association Act (ULCAA) with a stated purpose of providing states with a framework for creating an unincorporated form of business entity with a flexible organizational structure that combines traditional cooperative values with modern financing mechanisms by allowing for voting investor members in addition to patron members. The ULCAA has been adopted in six states and the District of Columbia.

Summary of Amended Bill:

The Washington Limited Cooperative Association Act (LCAA) is adopted. The LCAA contains requirements and default rules governing the formation, organization, governance, operation, and dissolution of limited cooperative associations.

General Provisions.

A limited cooperative association is an unincorporated association of persons united to meet their mutual interests through a jointly-owned enterprise that they control. The LCAA permits the combining of ownership, financing, and receipt of benefits by members with separate investments in the association by investor members who may receive returns on their investments and a share of control. A limited cooperative association may be organized for any lawful purpose except for the purpose of generating, purchasing, selling, marketing, transmitting, or distributing electric energy.

A limited cooperative association is an entity distinct from its members. The relations between a limited cooperative association and its members are consensual and any matter concerning the relations among the members and between the association and its members may be provided in the organic rules unless otherwise limited or prohibited by the LCAA. Matters that may be varied only by the articles of incorporation and matters that may be varied only by the organic rules are specified.

Definitions of terms are provided, including definitions for "patron member" and "investor member." A patron member is a person who has made a contribution to a limited cooperative

association and is either entitled or required to conduct patronage with the association in order to receive the member's interest. An investor member is a member that has made a contribution but is not required or permitted by the organic rules to conduct patronage with the association in order to receive the member's interest. A person may have both a patron member's interest and an investor's interest in a limited cooperative association.

Organization of Limited Cooperative Associations.

A limited cooperative association is formed by the filing of articles of organization with the Office of the Secretary of State (SOS). The articles must include certain information and may contain other specified matters. Procedures are established for initial directors to adopt bylaws and accept members. Bylaws of a limited cooperative association must include specified information, if not stated in the articles of organization, including the capital structure of the association, the method of admission of members, voting and other governance rights, and the manner in which profits and losses are allocated and distributions made.

Amendment of Organic Rules.

The articles of organization and bylaws are the organic rules of the limited cooperative association. With some exceptions, a limited cooperative association may amend the organic rules only at a meeting of the members. An amendment of the organic rules may be proposed by a majority of the board of directors or greater percentage if required in the organic rules or by petition of at least 10 percent of the patron members or 10 percent of the investor members.

Generally, an amendment to the articles of organization must be approved by at least two-thirds of the voting power of members present and at least a majority of the votes cast by patron members. An amendment to the bylaws generally must be approved by a majority vote of all members present and a majority of the votes cast by patron members.

Amendments to the bylaws affecting certain matters require the same voting requirement as an amendment to the articles of organization. To amend its articles of organization, an association must deliver to the SOS for filing an amendment or restatement of the articles of organization.

Members.

A limited cooperative association must have at least two patron members to begin business unless the sole member is a cooperative. A person becomes a member as provided under the organic rules, with the affirmative vote or consent of all members, or as the result of a merger or conversion. A member is not an agent of the association solely by reason of membership. A member is not personally liable for a debt, obligation, or other liability of the association solely by reason of being or acting as a member or director.

Requirements are established regarding a member's right to inspect and copy records that a limited cooperative association is required to maintain, including procedures for obtaining the records and restrictions that an association may impose on access to records.

A limited cooperative association must hold an annual meeting of members, and special meetings of members may be called by the board of directors or by members under some

circumstances. Requirements for notice and conduct of the meetings are specified as well as standards for taking action without a meeting of the members.

Each patron member has one vote unless the organic rules allocate voting power among the patron members on another basis. Patron member voting power may be allocated by districts or class. Investor members each have one vote unless the organic rules provide otherwise. Investor member voting power may be allocated by class, classes, or any combination of classes. Voting requirements are established for an association that has both patron and investor members, including a requirement that any action must receive a majority of votes cast by patron members. Rules are also established for proxy voting, formation of districts of patron members, and delegate voting.

Member's Interest.

A member's interest in a limited cooperative association is personal property and consists of governance rights, financial rights, and the right or obligation to do business with the association. A member's interest may be in certificated or uncertificated form. Governance rights include the right to vote on matters such as election of directors, amendments to the organic rules, dissociation, and conversions or mergers. Financial rights include the right to share in allocations or distributions of profits and losses and distributions upon dissolution.

A member's interest, other than financial rights, is not transferrable unless the organic rules provide otherwise. The organic rules may restrict the ability of a member to transfer the member's financial rights. Any transfer of financial rights does not confer member status on the transferee unless the transferee is admitted as a member.

Directors and Officers.

A limited cooperative association must be managed by, or under the direction of, a board of directors, which may adopt policies not in conflict with the organic rules. An individual is not an agent for the association solely by being a director and is not personally liable for an obligation of the association solely by reason of being a director.

Directors must be individuals who are members, or an individual designated by a member that is not an individual, unless nonmember directors are authorized in the organic rules. Unless the organic rules establish a greater number, at least one-third of the directors must be patron members and a majority of the board of directors must be elected exclusively by patron members. The organic rules may allow for nomination and election of directors by districts or classes of members. Procedures are established governing resignation of a director, filling a vacancy on the board, removal of a director by the members, and suspension of a director for cause by the board of directors.

Standards under the Washington Business Corporation Act (WBCA) relating to conflicts of interest between a director and entity and a director's standard of conduct and liability are applicable to directors of limited cooperative associations. In considering the best interests of a limited cooperative association, the board of directors may consider interests of employees, customers, and suppliers as well as the local, state, national, or world community, the environment, and other cooperative principles.

A limited cooperative association has officers as designated in the organic rules or as appointed by the board of directors. One officer must be designated to prepare and authenticate the records required to be maintained by the association.

Contributions, Allocations, and Distributions.

Standards are established governing member contributions, allocations of profits and losses, and distributions to members. Unless addressed in the organic rules, member contributions may consist of property, services, or another benefit provided to the limited cooperative association, and the board of directors may establish the amount, manner, and valuation of member contributions.

The organic rules may establish standards for the allocation of the profits and losses of the limited cooperative association. Unless otherwise provided in the organic rules, all profits and losses must be allocated to patron members and losses must be allocated in the same proportion as profits. If the association has investor members, the allocation of profits to patron members may not be less than 50 percent of profits. A portion of the profits may be set aside to create a capital reserve and reserves for specific purposes. Standards are provided for apportioning profits or losses between groups entitled to receive allocations and the allocation of apportioned amounts within the group's members.

Unless otherwise provided in the organic rules, the board may authorize distributions to members, which may be in any form, including money, capital credits, allocated patronage equities, revolving fund certificates, or securities. A limited cooperative association may not make a distribution if the association would not be able to pay its debts as they become due or the association's total assets would be less than its total liability plus a sum that would be needed to satisfy preferential rights if the association were to dissolve. A director may be personally liable for assenting to an unlawful distribution in violation of the standard of care, and a member may be personally liable for accepting a distribution knowing it was unlawful.

Dissociation of Members.

A member may dissociate from a limited cooperative association, rightfully or wrongfully, at any time. Circumstances under which a member is dissociated are provided, including circumstances under which a member may be expelled. A dissociation is wrongful only if: it is a breach of an express provision of the organic rules; or it occurs before termination of the association and the person is expelled as a member, or in the case of a member that is not an individual, trust, or estate, the person is expelled or dissociated because it dissolved or terminated in bad faith. A person who wrongfully dissociates is liable to the association for any damages caused by the dissociation, unless the organic rules provide otherwise.

Dissolution.

A limited cooperative association may be dissolved upon the occurrence of an event or at a time specified in the articles of organization or after the dissociation of a member results in the association having one patron member and no other members. An association may be voluntarily dissolved by recommendation of the board of directors and member approval of a resolution of dissolution. In addition, an association may be dissolved through judicial or administrative proceedings. Standards for the process of winding up a dissolved association are provided, including requirements for the handling and disposition of claims against the

association, distribution of the association's assets, and court assistance in providing security for contingent and unknown claims.

Disposition of Assets.

With exceptions, a sale, lease, exchange, license, or other disposition of the assets of a limited cooperative association requires approval of the members if the disposition leaves the association without significant continuing business activity. Member approval is not required for an association to: sell, lease, exchange, license, or otherwise dispose of assets in the usual and regular course of business; or mortgage, pledge, or encumber assets of the association whether or not in the usual and regular course of business. A disposition of assets that requires member approval must be submitted to the members at a members' meeting and must be approved by at least two-thirds of the voting power of members present and at least a majority of the votes cast by patron members, unless the organic rules require a greater vote by patron members.

Conversion and Merger.

A qualifying entity may convert to a limited cooperative association by adopting a plan of conversion. A qualifying entity means a domestic entity formed under the Cooperative Association Act (CAA) or a domestic entity formed under the Nonprofit Miscellaneous and Mutual Corporations Act (NMMCA) that operates on a cooperative basis and has elected to be governed by provisions of the CAA. Requirements are provided for the approval and effectiveness of a conversion and for amendment or abandonment of a conversion.

One or more domestic limited cooperative associations may merge with one or more cooperative associations organized under the LCAA, the CCA, or the NMMCA, or with one or more foreign cooperative associations. Two or more foreign cooperative associations may merge into a domestic limited cooperative association. Requirements are provided for contents of a plan of merger, the approval and effectiveness of a merger, and the amendment or abandonment of a merger.

Voting requirements for the approval of a plan of conversion or merger are provided. The board of directors must approve the plan and recommend it for adoption by the members. A plan generally must be approved by two-thirds of the voting power of members present and, if the association has investor members, at least a majority of the votes cast by patron members.

Other.

Indemnification and advancement of expenses for an individual who has incurred liability or is a party to an action based on the performance of an activity on behalf of the limited cooperative association are governed by the standards under the WBCA.

A member of a limited cooperative association may maintain a derivative action against the association in the same manner as a shareholder may maintain a derivative action against a corporation under the WBCA.

Limited cooperative associations are subject to the Washington Uniform Business Organizations Code (UBOC), and provisions of the UBOC and other entity statutes are amended to incorporate limited cooperative associations.

Amended Bill Compared to Substitute Bill:

The substitute bill takes effect October 1, 2018.

Appropriation: None.

Fiscal Note: Available.

Effective Date of Amended Bill: The bill takes effect on October 1, 2018.

Staff Summary of Public Testimony:

(In support) This act will provide a new alternative with a more modern and flexible approach for Washington cooperative businesses. Washington is home to two of the largest cooperatives in the nation. This bill was born out of frustration experienced by Recreational Equipment Incorporated operating under the current law. Recreational Equipment Incorporated has millions of members, and it is difficult to administer the business under the current act. Over the years, the Legislature has had to craft fixes to make the current act work for these cooperatives. The new Limited Cooperative Association Act (LCAA) will provide a better alternative. The LCAA will enable cooperatives to access capital beyond the initial fee that the patron members pay. Patron liability is limited just as in traditional cooperatives and investor liability is limited as in a limited liability company. It provides an important alternative, but does not replace traditional cooperatives.

(Opposed) None.

Persons Testifying: Senator Pedersen, prime sponsor; and Michael Hutchings.

Persons Signed In To Testify But Not Testifying: None.