

***NEW GENERATION CO-OPS:  
ALBERTA'S NEWEST OPTION FOR AGRICULTURE BUSINESS***

Prepared for  
ALBERTA AGRICULTURE,  
FOOD AND RURAL DEVELOPMENT

Corbett Smith Bresee LLP  
Barristers and Solicitors  
10056- IOIA Avenue  
Edmonton, AB T5J 0C8  
Telephone: (780) 424-1800  
Facsimile: (780) 428-1107  
Brian Kaliel, BA, LLB  
Gayle M. Kelly, BA, LLB  
Rose Schlegl, BA, MLIS

## **DISCLAIMER**

The purpose of this paper is to provide a general overview of Alberta law to persons interested in New Generation Cooperatives. The views expressed in this paper may not apply to a specific fact situation or problem and is not intended to provide legal advice or opinions for this purpose. If you require specific advice or an opinion, you should contact legal counsel. Neither Her Majesty the Queen in Right of the Province of Alberta, Corbett Smith Bresee LLP, or their respective employees, partners, or agents will be responsible for the result of any actions taken on the basis of the information in this article or for any errors or omissions.

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**A. INTRODUCTION**

Cooperatives have been used as a form of business structure for a very long time. One of the earliest cooperatives was established in the village of Fenwick, Scotland, in 1769.<sup>1</sup> Cooperative principles were outlined by a group known as the Rochdale Society of Equitable Pioneers in 1844. In Canada, traditional cooperatives have played a crucial role in the agricultural sector of our economy, especially in the processing and marketing of grains and oil seeds, milk and dairy products, poultry, honey, maple products, fruits and vegetables, and livestock.<sup>2</sup> In Alberta, the role of cooperatives in the agricultural economy has been particularly strong. A 1996 study, for example, revealed that 61.1% of Alberta cooperatives were involved in either the supply, marketing, or production of agricultural products or the provision of services to rural Alberta, compared to 24.6% in Saskatchewan and 16.2% for the rest of Canada.<sup>3</sup>

Cooperatives legislation has been in place in Alberta since the enactment of *The Co-operative Associations Act* in 1913.<sup>4</sup> The Alberta Government introduced new cooperatives legislation in the Spring of 2001. The *Cooperatives Act*, S.A. 2001 c. C-28.1 received Royal Assent.

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<sup>1</sup> C.S. Axworthy, "Consumer Co-operatives and the Rochdale Principles Today" (1977) 15:1 *Osgoode Hall L.J.* 137 at 138.

<sup>2</sup> Cooperative Secretariat: Government of Canada – "Cooperatives in Canada (1996 Data)", July 1998.

<sup>3</sup> *Ibid.* In Alberta, agriculture accounted for 4 of 19 supply cooperatives, 17 of 18 marketing cooperatives, 81 of 83 production cooperatives and 306 of 497 service cooperatives. Rural electric, natural gas, water and seed cleaning cooperatives were included in the category of service cooperatives for the purpose of this analysis. Of the total of 667 Alberta Cooperative. 408 were either agriculture or rural based. Although housing coops comprise the largest single type of cooperative on a national basis. Alberta only has 60 housing coops.

<sup>4</sup> *The Co-operative Associations Act*, chapter 12, Statutes of Alberta. 1913.

on May 31, 2001 and was proclaimed April 1 2002 (*'Cooperatives Act'* or the "Act").<sup>5</sup> The new Act has specific provisions dealing with New Generation Cooperatives.<sup>6</sup>

This paper reviews the New Generation Cooperative model and examines issues relevant to those involved in the establishment of New Generation Cooperatives in Alberta.

## **B. WHAT IS A COOPERATIVE?**

### **1. Traditional Cooperatives**

A traditional cooperative has been defined by W.B. Francis as:

- - a voluntary democratically controlled association of persons who operate an enterprise for the purpose of supplying themselves with commodities or services, on the basis that they share any surplus created in carrying on the enterprise substantially in proportion to the use they make of the association.<sup>7</sup>

A traditional cooperative has the following features:

- It is a form of corporation and is a separate legal entity from its members.
- Members enjoy “limited liability”.
- It exists for the benefit of its members.
- Each member has one vote regardless of the size of the member’s investment.
- As a general rule the membership is open to anyone who may use the services

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<sup>5</sup> The new *Cooperatives Act*, S.A. 2001 c.C-28.1 replaces the *Co-operative Associations Act*. R.S.A. 1980. c.C-24. Section 474 of the *Cooperatives Act* provides that the Co-operative Associations Act will be repealed on March 31, 2005.

<sup>6</sup> See Part 18 Division 4 of the *Cooperatives Act*, supra note 5.

<sup>7</sup> W.B. Francis. *Canadian Co-operative Law* (1959). 1.

of the cooperative.<sup>8</sup>

- Surplus funds are distributed by way of patronage dividends to members.

- Services are primarily provided for members.

## 2. New Generation Cooperatives

Although new to Alberta, New Generation Cooperatives (“NGCs”) have been in existence elsewhere for some time. In response to socio-economic changes facing American producers during the 1970’s, a new cooperative movement emerged in the midwest, primarily in the area of value-added agricultural processing and marketing. Similar factors have been at play in the Canadian agricultural economy, and several provinces have enacted legislation enabling the establishment of this “hybrid” cooperative model.<sup>9</sup> The emergence, success, and essential features of NGCs have been the subject of a good deal of research and commentary.<sup>10</sup>

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<sup>8</sup> In his article, *Management and Membership in Canadian Cooperatives* [1975] Volume XIII, Alta. L. Rev. 412 at 421, Daniel Ish points out that although open membership is one of the founding principles of cooperatives, no Canadian legislation (to that point) contained a requirement that membership be open. It should be noted that subsequent legislative changes both at the federal level and at some provincial levels now address the requirement of open membership.

<sup>9</sup> All three prairie provinces now have cooperative legislation under which NGCs can be formed; see *The Cooperatives Act*, C.C.S.M. C. C223; *New Generation Cooperatives Act*, S.S. 1999 c. N-4.001.

<sup>10</sup> Stefanson, Fulton and Harris, *New Generation Co-operatives: Rebuilding Rural Economies*. September, 1995, Centre for the Study of Co-operatives, University of Saskatchewan; Report of the COPAC International Technical Meeting, *Capital Formation in Agricultural Cooperatives*, Rome, November 1995, at p.8; Morris, *Legal & Financial Aspects of New Generation Cooperatives: Legal Implications*, April, 1996, University of Wisconsin Center for Cooperatives’ website; Cropp, *New Generation Cooperatives Defined*, April, 1996. University of Wisconsin Center for Cooperatives website; Lawless, Cropp and Harris. *Cooperative Ownership Compared to Other Business Arrangements for Multi-Family Dairy Operations*, April, 1996. University of Wisconsin Center for Cooperatives website. at p. 3; Nilsson *New Generation Farmer Co-ops*, April 1997, ICA Review, Volume 90; Stefanson and Fulton, *New Generation Co-operatives, Responding to Changes in Agriculture*, September, 1991. Centre for the Study of Co-operatives, University of Saskatchewan; Harris, Fulton, Stefanson and Lysyshyn, *Working Together: The Role of External Agents in the Development of Agriculture-Based Industries*, The Centre for the Study of Co-operatives and the Department of Agricultural Economics, The University of Saskatchewan (ch. 8. *New Generation Co-operatives*, at p.120); Dr. Michael Cook, *Experience of the Cooperatives Sector in the United States and Europe, Symposium on Agri-Food Co-operatives into the Next Millennium*. Government Conference Centre, Ottawa, Ontario, February 23/24, 1998; Royer, *Financial Market Innovations: Implications for Farmer Cooperatives*, November. 1996, Presentation to University of Wisconsin Center for Cooperatives, at p 4; Jorgensen, *Cooperative Principals Still Work for New Generation Cooperative*.

## C. FEATURES OF NGCS

New Generation Cooperatives retain some key cooperative principles. Although the one member, one vote” principle is retained, the **Cooperatives Act** affords NGCs (and other cooperatives) the ability to give investors voting rights and some control over the activities of the cooperative (discussed in more detail below). NGCs also permit distribution of excess earnings to members as patronage returns. While there are a number of similarities between traditional cooperatives and NGCs, there are also a number of fundamental differences which make NGCs a unique business model:

- **Restricted or Closed Membership**

One feature of traditional cooperatives is open membership” to all persons who can use the services of the cooperative. American NOCs restricted membership to producers who could participate in that undertaking and have the capital to do so. The “closed” membership option is closely connected with the need for high equity investment among members in NGCs and the creation of a business organization which is focused on viability and profitability for its members in a competitive agricultural economy. Closed membership serves to foster a higher degree of member commitment.<sup>11</sup> It also ensures that the cooperative has a stable, quality supply of producer product.<sup>12</sup> Although section 2(1)(a) of the *Alberta Cooperatives Act* provides that cooperative membership must be:

...available to persons who can use the services of the cooperative and who are willing and able to accept the responsibilities of and abide by the terms of

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<sup>11</sup> See discussion in Stephanson, Fulton and Harris article, *New Generation Co-operatives: Rebuilding Rural Economies*, September, 1995, Centre for the Study of Co-operatives.

<sup>12</sup> See commentary in Forming a New Generation Cooperative in Manitoba at <http://www.umanitoba.ca/afs/agric/economies/MRAC>; and New Generation Cooperatives: A Primer for Missouri Agricultural Producers, AG Innovation Guide at <http://www.aginnovationcenter.org>.

membership,

section 2(2) provides that this requirement may be:

...subject to any restrictions set out in the articles so long as the restrictions are consistent with applicable laws with respect to human rights.

Alberta NGCs may therefore have closed membership, so long as the restrictions do not violate human rights legislation.

- **Greater Capital Investment**

Unlike traditional cooperatives, NGCs generally require a substantial capital investment from their members at the outset. The literature indicates that a minimum capital contribution in the range of 35% to 50% by the organizing members is required.” The amount of contribution by way of investor equity is dependent on the overall cost of the project to be undertaken by the cooperative, as well as how much of the project will be financed by debt. The new Alberta Act affords considerable flexibility to NGCs to raise capital from both members and non-members. These are discussed in more detail later in this paper.

- **Delivery Rights**

Delivery rights are a primary feature of NGCs. Members generally receive the right (as well as the obligation) to deliver product to, or acquire services from, the cooperative, often in proportion to the number of shares held or the units of investment contributed. A delivery rights contract may be entered into between the member and the cooperative

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<sup>13</sup> See Patrie, Bill. Creating “Co-op Fever” A Rural Developer’s Guide to Forming Cooperatives. USDA Service Report 54, July 1998; see New Generation Co-operatives. Centre for the Study of Co-operatives, University of Saskatchewan article at <http://coop-studies.usask.ca/NGC/NGC.html>; and Equity Drive commentary in Forming a New Generation Cooperative in Manitoba at [http://www.umanitoba.ca/afs/agric\\_economies/MRAC](http://www.umanitoba.ca/afs/agric_economies/MRAC) and, Waner, Jennifer. *New Generation Cooperatives and the Future of Agriculture: An Introduction*. Illinois Institute for Rural Affairs Available Online at [www.iira.org](http://www.iira.org); see Stetanson Fulton and Harris, *New Generation Cooperatives- Rebuilding Rural Economies*, *Supra*, at Page 13; Minnesota Association of Cooperatives - *Financing New-Wave Cooperative Ventures* at Page 4, [www.mncoop.org/publicatlonns-financing.html](http://www.mncoop.org/publicatlonns-financing.html) Nilsson, *New Generation Farmer Cooperatives - (1997)*, *Supra*, Page 2.

which may provide for: (a) the quantity, quality and delivery of the product to the cooperative; (b) the price to be paid to the producer for the product: and (c)



remedies in the event of non performance by either the producer/member or the cooperative.<sup>14</sup> If membership is restricted and the cooperative is successful, these delivery/service rights may (at least in theory) increase in value (like quota), as well as being a valuable adjunct to the member's agricultural operation.

**D. HOW DOES A NEW GENERATION COOPERATIVE WORK?**

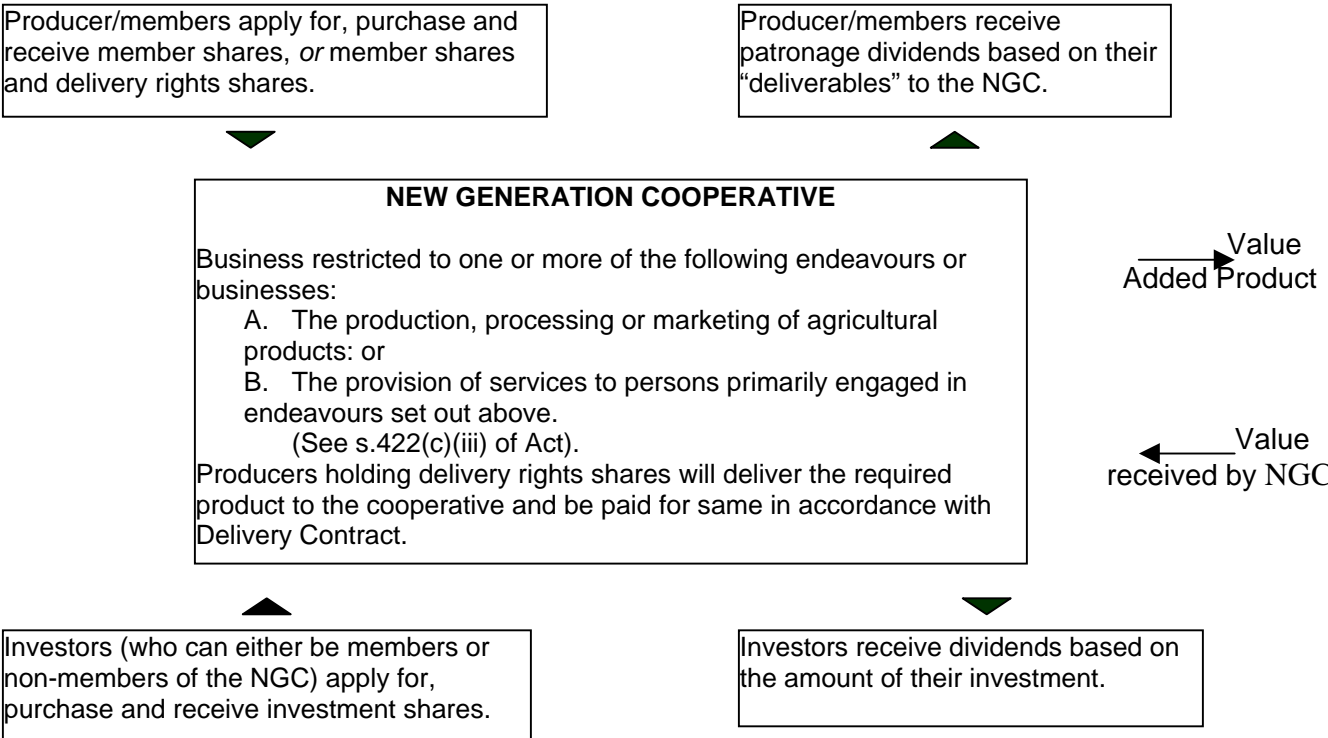


Figure 1: Basic Structure of an NOC.

<sup>14</sup> Section 429 of the *Cooperatives Act*, *supra* note 5, provides that a NGC's bylaws may contain provisions to be included in delivery rights contracts.

**E. THE ADVANTAGES/ DISADVANTAGES OF NGCS AS A BUSINESS STRUCTURE FOR VALUE-ADDED AGRIBUSINESS**

Alberta producers have a number of business organization models to choose from

including:

- Sole proprietorships
- Business corporations
- Partnerships
- Joint ventures
- Associations
- Cooperatives

Each business model has its own advantages and disadvantages.<sup>15</sup> The “cooperative” approach may be attractive in the following situations:

- capital: when participants need substantial amounts of capital for their investment and have the opportunity to raise capital from producers who may use the products and services of the cooperative;
- value-added returns: when participants wish to own and control the marketing and processing of their products to increase profits and increase their markets;
- control: when participants wish to have decision making controlled by the member producers (based on “one member, one vote”) rather than by investors (based on the amount of the investment);
- diversification/innovation: when participants are seeking new opportunities for innovation and diversification, in particular where there is a lack or inadequacy with respect to established businesses involved in providing the goods or services

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<sup>15</sup> A good discussion of advantages and disadvantages of various business structures can be found in the article entitled Forming a New Generation Cooperative in Manitoba, which can be located at the following website: [http://www.umanitoba.ca/afs/agric\\_economics/MRAC](http://www.umanitoba.ca/afs/agric_economics/MRAC).

- required;
- rural development: when participants are interested in seeking community support and fostering local economic growth.

The main drawback of the NGC model is the issue of control and whether control should be lodged in the members or investors. The issue may be influenced by the need for capital and which model is best suited to raise the capital required.

## **F. SHARE CAPITAL AND FINANCE / MEMBER AND INVESTOR CONTROL**

### **1. Introduction**

A number of writers have suggested that the lack of adequate access to capital is one of the greatest challenges facing traditional cooperatives.<sup>16</sup> While “ordinary” cooperatives may incorporate with or without membership shares, NGCs must be incorporated with membership shares.<sup>17</sup>

New Generation Cooperatives have the ability to issue the following types of shares, each of which is discussed in more detail below:

- Membership shares with or without a par value.<sup>18</sup>

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<sup>16</sup> See: Report of the COPAC International Technical Meeting, *Capita! Formation in Agricultural Cooperatives*, Rome, 1995; Johnson, *Cooperatives: A Tool For Community Economic Development* (see c. 7, Financing Cooperatives)

<sup>17</sup> See *Cooperatives Act*, *supra* noteS, s.424(1).

<sup>18</sup> New Generation Cooperatives must be incorporated with membership shares. The following sections of the *Cooperatives Act supra* note 5, deal with membership shares: s. 1(1)(gg) - Defines membership share; s. 101 provides that a Cooperative that issues membership shares must have at least one class of membership share; s. 102 discusses the requirements of the issuance of membership shares to members; and s. 104 provides that membership shares may be issued with or without par value.

- Section 427 Investment Shares (‘Designated Shares’) without par value.
- Investment shares without par value.<sup>20</sup> These shares can be issued to both members and non-members of the cooperative.

A member may hold membership shares as well as investment shares.

Cooperatives also have the ability to issue options or rights to acquire securities, including membership shares at a future date.<sup>21</sup>

## **2. Membership Shares**

A member of a cooperative is someone who can use the services of the cooperative and who is willing and able to accept the responsibilities of membership (s. 2(s))<sup>22</sup>. NGCs are, by definition, restricted to production, processing, or marketing of agricultural products or the provision of services to persons engaged in this activity (s. 422(c)). The members of an NGC should be individuals who can use the type of agricultural services provided by the cooperative.

Membership shares may be issued with or without a par value (s. 104). The articles must indicate whether or not membership shares are par value or non par value and any limit on the number of membership shares (ss. 104(2) and (3)). Members have an equal right to receive dividends on their shares. Subject to the articles, the holders of membership shares also have a right to receive the remaining property of a cooperative on dissolution. The cooperative's articles may indicate how the holders of membership shares rank in preference to other shareholders in this regard.

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<sup>19</sup> See *Cooperatives Act*, *supra* note 5, s. 427. These shares are unique to New Generation Cooperatives. They are issued to members of an NGC who want to have delivery rights to the cooperative. Holders of these shares must also hold membership shares.

<sup>20</sup> See *Cooperatives Act*, *supra* note 5, s. 108 and s. 109(l)

<sup>21</sup> See *Cooperatives Act*, *supra* note 5, s. 124.

<sup>22</sup> All bracketed references in this section are to the *Cooperatives Act*, *supra* note 5

Membership shares may also be redeemed or transferred. The articles may specify the time within which and the terms on which membership shares may be redeemed by the member and the cooperative (ss. 101(5) and (7) and s. 424). If there is any limitation on the transfer of a

membership share in an NGC, it must be set out in the bylaws (s. 426).

In an NGC, the right to vote attaches to membership shares; however, no member is entitled to more than one vote (s. 424). Subject to the Act, all directors must be elected by members (s. 52(5)). However, the Act permits that a class or classes of investment shareholders may have the right to elect not more than 20% of the directors (s. 108(4)) and that up to 20% of the directors may be appointed as the representatives of an “entity, government or any other person or organization having an interest in the activities of the cooperative, but who are not members of the cooperative” (s. 51(3)). The minimum number of directors that members may elect to the Board is, therefore, 60%.

### **3. “Designated” Shares**

New Generation Cooperatives may issue a type of investment share called a “designated” share (s. 427)<sup>23</sup> These shares may be issued only to members and carry no right to vote. The articles may be drafted to give designated shareholders the right to participate:

- in the surplus of the cooperative by the payment of patronage dividends or bonus payments (i.e., based on the amount of business they do with the cooperative); and
- in any reserve of the cooperative by payment of dividends.

In theory, therefore, it would be possible to attach both patronage (i.e., division of surplus based on the amount of business done by a member) and traditional dividends (based on the number of shares held) through designated shares. Members who purchase designated shares may

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<sup>23</sup> Our general comments with respect to investment shares also apply to designated shares.

also purchase the right to deliver a specified quantity of product to the cooperative at a preferred price, or in guaranteed amounts.

### **4. Investment Shares**

Cooperatives may also issue investment shares. Investment shares:

- may be issued to members or non-members (ss. 108(a) and 117);
- may be issued in different classes and series (ss. 108(c) and 110(1));
- may have special preferences, restrictions and limitations, which may vary from class to class and which must be specified (s. 108(d));
- may be given a right to vote a fixed number or percentage of directors which must not exceed 20% of the total number of directors (ss. 108(4) and (5));
- may provide for cumulative dividends (s. 110(2));
- may provide for pre-emptive rights (s. 110);
- may provide for cumulative voting (s. 115(3)).

The articles may authorize the Board to issue future classes of investment shares in one or more series and also authorize the Board to fix the number of investment shares and determine the designation, rights, privileges, restrictions and conditions attached to the investment shares of each series (s. 110(1)).

#### **G. SECURITIES ACT COMPLIANCE**

Now that cooperatives are able to raise capital via different types of share issuance, compliance with the *Securities Act*, R.S.A. 2000, c. S-4, as amended, is a fundamental concern. When the *Cooperatives Act* was enacted, concurrent amendments were made to the *Securities Act* to exempt membership shares in an amount prescribed by the regulations from the registration requirements of the *Securities Act*. As of the date of this paper, regulations have

not been passed prescribing this amount (*Securities Act*, s. 87(h.1)). A similar exemption has also been enacted for investment shares on “prescribed conditions”; however, no conditions have to date been prescribed and this exemption does not in any event apply to investment shares issued by an NGC (*Securities Act*, s. 87(h.2)).

NGCs (as well as other cooperatives under the new Act) are currently governed by the same securities provisions that apply to business corporations and other issuers. Incorporators must be mindful of the provisions of the *Securities Act* and ensure that they fully comply with existing securities legislation. In some cases exemptions may be available and in others a full prospectus may be required; it is very much a case by case analysis.

On March 31, 2002, the Alberta Securities Commission adopted Multilateral Instrument 45-103 Capital Raising Exemptions and companion policy 45-103CP wherein new exemptions for registration and prospectus filing are established.

A number of exemptions are established by this Instrument, including an 'Offering Memorandum Exemption', which applies, among other things, if a purchaser's aggregate acquisition cost does not exceed \$10,000.00 or the purchaser is an "eligible investor" whose net assets exceed \$400,000.00 or whose net income before taxes exceeded \$75,000.00 (for individuals) or \$125,000.00 (combined with a spouse) for a prescribed period. An Offering Memorandum (which is less onerous than a prospectus) is required. A signed Risk Acknowledgement is also required. The authors have found this exemption useful with respect to NGCs. Incorporators are cautioned that each cooperative's share offering will be unique and that professional advice should be obtained on a case by case basis.

## **G. RETURN ON INVESTMENT**

Surplus funds arising from a cooperative's operations are to be used as follows:

- to develop the cooperative's business;
- to provide or improve common services to members;

- to provide for reserves or the payment of interest on member loans or dividends on shares;
- for community welfare or the propagation of cooperative enterprises; and/or
- as a distribution among its members as a patronage return.<sup>24</sup>

The Act defines a “patronage return” as:

...an amount that the cooperative allocates among and credits or pays to its members or to its member and non-member patrons based on the business done by them with or through the cooperative, and includes patronage dividends or bonus payments issued to members who hold investment shares issued by a cooperative referred to in Part 18, Division 4 [i.e., Designated Shares of an NGC]<sup>25</sup>

The *Cooperatives Act* provides that a cooperative (which includes an NGC) must limit interest on member loans to a maximum percentage fixed in the articles, and must limit dividends on any membership share to a maximum percentage fixed in the articles.<sup>26</sup> Cooperatives are not required to limit the rates of return for investment shares (which includes

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<sup>24</sup> See *Cooperatives Act*, *supra* note S, s2(g).

<sup>25</sup> See *Cooperatives Act*, *supra* note 5, s. 1(1)(kk).

<sup>26</sup> See *Cooperatives Act*, *supra* note S, s- 2(1)(d) and (e). Sections 5(1)(j) and (k) require the articles of incorporation of the cooperative to include any provision for a maximum rate of return that may be paid on member loans as well as the maximum dividend that may be paid on membership shares. Although the restriction on the rate of return on member interests is a traditional cooperative principle, the authors have a concern that these provisions may not allow for the full distribution of a cooperative’s surplus based on patronage/use in cases where only membership shares are issued .

delivery rights shares of an NGC) in its articles of incorporation.<sup>27</sup> In all cases, however, provision must be made in the bylaws of a cooperative for the distribution of any surplus funds,<sup>28</sup> Ordinary cooperatives are required to calculate patronage returns in accordance with a special formula set out in the *Cooperatives Act*.<sup>29</sup> In contrast, an NGC has the ability to deviate from this formula by providing so in its bylaws.<sup>30</sup>



The patronage returns allocated by an NGC to those members holding Designated Shares may be declared either as:

- Patronage Dividends; or
- Bonus Payments.

These patronage returns may be based on the number of Designated Shares held by the designated shareholder in addition to the business done by him or her with or through the cooperative.<sup>31</sup>

## H. TRANSFERABILITY OF MEMBERS' SHARES AND RIGHTS

The members of ordinary cooperatives, as well as NGCs, may have a substantial investment in their cooperative. NGC members may also have rights associated with a delivery rights contract". If the cooperative is successful, a member's rights may increase in value and become a tradeable commodity, especially if membership is restricted or closed. Delivery rights may acquire values similar to production quotas.

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<sup>27</sup> In the authors' opinion, this ensures greater flexibility for a cooperative to distribute surplus funds of a cooperative.

<sup>28</sup> See *Cooperatives Act Regulation* AR 55/2002. s.45(g).

<sup>29</sup> See *Cooperatives Act*, *supra* notes, s. 137.

<sup>30</sup> See *Cooperatives Act*, *supra* note 5, s. 428(2).

<sup>31</sup> See *Cooperatives Act*, *supra* note 5, s. 428(1).

Section 48 of the *Cooperatives Act* addresses the transfer of member interests (which include designated shares of an NGC) whether as a result of the death of a member or during a member's lifetime. A transfer of a member interest is valid if:

- a) it is approved by the Board of Directors of the Cooperative;
- b) the transferee meets the requirements of the articles and bylaws of the

- Cooperative; and
- c) if applicable, the transferee becomes a party to any unanimous agreement of the members of the cooperative.<sup>32</sup>

The bylaws of a cooperative must contain provisions as to whether member interests may be transferred or assigned and any conditions or restrictions that apply to such transfer.<sup>33</sup> There is a special provision for NGCs regarding the transfer of member interest It provides that the Board of Directors' approval of a transfer of member interests is subject to any limitations which may be set out in the NGC's bylaws?<sup>34</sup>

## I. REDEMPTION RIGHTS

Redemption rights arise in the event of either a voluntary withdrawal or termination of a person having an interest in the cooperative. The nature of the departing persons interest will dictate the redemption rights. The *Cooperatives Act* contains specific provisions regarding the redemption of member interests as well as investment shares,

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<sup>32</sup> See *Cooperatives Act supra* notes, s. 48(2). According to s. 102(5), a transfer of membership shares is only valid if it complies with s. 48(2) of the Act.

<sup>33</sup> See *Cooperatives Act Regulation AR 55/2002*, s. 45(e).

<sup>34</sup> See *Cooperatives Act, supra* notes, s.426. This is a very important section, in that it ensures that the directors are provided with certain criteria to govern their approval of transfers of membership. For example, the interests of a member should be transferable when the member sells a farm or business, or when the member retires or dies.

A cooperative may at any time redeem any of its membership shares, provided the cooperative is in a financial position to do so.<sup>35</sup> Par value membership shares are redeemed for the price set out in the articles and non-par value shares are redeemed in accordance with the price or formula set out in the cooperative's articles. In the event no such price or formula is set out in the articles then these shares are to be redeemed at fair market value.<sup>36</sup> The articles

must set out the price or formula to be used for the redemption of redeemable investment shares.<sup>37</sup>

In the case of a voluntary withdrawal, unless the bylaws provide otherwise, a cooperative must, no later than one year after the effective date of such notice, redeem all of the member's membership shares and repay all of the members loan and other amounts held to the withdrawing members credit. The directors do have the discretion to delay the redemption and/or repayment if:

- the directors believe on reasonable grounds that the redemption or payment would affect the financial well-being of the cooperative; or
- the directors believe on reasonable grounds that the cooperative, after payment of these debts, would be unable to pay its liabilities as they become due or would render the cooperative insolvent.<sup>38</sup>

Similar provisions are made in the Act for the redemption of the shares and loans made by a terminated member.<sup>39</sup>

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<sup>35</sup> See *Cooperatives Act supra* note 5, s. 128(1). Membership shares can be redeemed as long as such redemption does not result in fewer than three members in a cooperative (secs. 307 of the Act).

<sup>36</sup> See *Cooperatives Act, supra* note 5, S. 128(1).

<sup>37</sup> See *Cooperatives Act, supra* note 5, s. 5(1)(m).

<sup>38</sup> See *Cooperatives Act supra* note 5, s. 37(2).

<sup>39</sup> See *Cooperatives Act. supra* note 5, s.41.

In the case of NGCs, the redemption of membership shares or the repayment of loans by the cooperative no later than one year may be extended in the bylaws.<sup>40</sup>

## **J. CONTINUANCE**

A cooperative established under the *Co-operatives Associations Act* has until March 31,

2005 to continue under the *Cooperatives Act* or it will be dissolved.<sup>41</sup> The procedure for continuance is set out in Part 19 of the *Cooperatives Act*.

Cooperatives and other types of business organizations may also consider continuing as an NOC under the new Act. For example, the ability of societies to “continue” themselves as NGCs could be particularly useful in a number of situations:

- Grazing associations presently incorporated as societies (but really carrying on business), which need capital or may wish to give control to their members based on the “one member, one vote” principle.
- Groups of producers who wish to conduct feasibility study on a “non-profit” basis and are required to incorporate for the purpose of doing so. They would have the option of incorporating a society and then converting the society to a cooperative if the venture seems profitable.

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<sup>40</sup> See *Cooperatives Act*, *supra* note 5, s. 425. Some protection must be afforded to cooperatives from the consequences of the withdrawal of member shares and loans. It is reasonable to give cooperatives the ability to determine the level of requisite protection in their bylaws. The time required to replace withdrawn capital may depend upon the nature of the cooperative’s enterprise

<sup>41</sup> See *Cooperatives Act*, *supra* note 5, s.432 and s. 434(1).

- Trade associations and other groups which have incorporated themselves as societies but which, through changing circumstances, are involved, or want to become involved, in carrying on a business for the benefit of their members.
- Any existing cooperative which has, or may have, requirements for significant capital

investment.

## **K. HOW TO SET UP A NEW GENERATION COOPERATIVE**

### **1. Getting Started**

The initial step in any new business venture is identifying a business opportunity. A key group of producers will normally formulate the initial business plan and determine the level of community interest. From there a formal business plan should be prepared to assess the viability of the proposed business.<sup>42</sup> A working committee made up of individuals from the producer group might be selected. These individuals must be prepared to commit time to the set up of business and may need to consult with institutional lenders since the lender's requirements may impact on the business plan. It is important for the incorporators to define an effective equity program.<sup>43</sup> The incorporators should seriously consider hiring a paid organizer to avoid volunteer "burn-out". Professional advisors (*i.e.*, agronomists, business advisors, accountants, lawyers) should also be consulted at this stage.

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<sup>42</sup> Although a feasibility study was required to be filed at the time of an incorporation of a cooperative under the *Co-operatives Associations Act*, this is no longer required under the new act. Notwithstanding this, it is highly recommended that a business plan be prepared. A number of authors have emphasized the need for a business plan. Patrie. Bill. Creating Co-op Fever. A Rural Developer's Guide to Forming Cooperatives. supra @ p.14; Stephanson, B., Fulton.M. and Harris, A. New Generation Cooperatives: Rebuilding Rural Economies, supra @p.12.

<sup>43</sup> For an excellent article discussing equity capital and redemption issues see Cropp. R., Tretcher, D., Cottingham, J. and Berends, P., Equity Redemption Practices: A Study of Wisconsin Cooperatives. UWCC Occasional Paper No. 12, September 1998 at <http://www.wisc.edu/uwcc/info/ocpap/occas12.html>.

### **2. Raising Seed Money**

Seed money will be required in order to finance the initial start-up costs, such as the business plan and other pre-incorporation matters. In some cases grant money may be available; however, in most cases the initial start-up costs will be financed by those who are involved directly with the new venture. If the venture proceeds, these initial cash contributions

can be treated as loans or later converted to shares.

### 3. Incorporation

Once the business plan has been prepared and it has been determined that the project is viable, the incorporation of the NGC can proceed. Three or more persons who intend on becoming members of the NGC are required to apply to the Director of Cooperatives for incorporation. The following documentation is required for the incorporation and must be filed with the Director along with the prescribed fee:<sup>44</sup>

- Articles of Incorporation in the prescribed form;
- Notice of the registered office in the prescribed form;
- Notice of the names and addresses of directors in the prescribed form;
- Declaration signed by one or more of the incorporators that, after incorporation, the cooperative will be organized and operated and will carry on business on a cooperative basis. A statement to this effect is also required to be included in the Articles of Incorporation<sup>45</sup>
- A declaration signed by one or more incorporators that after incorporation the cooperative will comply with the specific provisions in the Act dealing with NGCs; and

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<sup>44</sup> See *Cooperatives Act, supra* note 5,s.4. The fee for incorporation is \$100.00; see Schedule 1 of the *Cooperatives Act Regulation, AR 55/2002*.

<sup>45</sup> See *Cooperatives Act, supra* note 5, a. 5(1)(g).

- NUANS name search<sup>46</sup>.

Before issuing the Certificate of Incorporation, the Director must be satisfied: (a) that the articles of incorporation comply with the Act and regulations; (b) that the proposed cooperative will carry on business on a cooperative basis; and (c) in the case of an NGC, that the cooperative will comply with the specific provisions dealing with NGCs in Part 18, Division 4 of the Act.<sup>47</sup>

When preparing Articles of Incorporation, every NGC should consider:

- indicating whether membership shares are par value or non par value;
- if membership shares are par value, state the amount and (if applicable) the number of par value shares issued;
- indicating whether or not dividends may be paid on membership shares and whether these dividends will be paid in preference to other dividends;
- whether redemption provisions will apply to membership shares.

Careful consideration should be given to who will be allowed to hold membership shares, remembering that each member will have the same vote to elect directors. Incorporators may wish to restrict the control of the cooperative to only those who are active producers or who have made a substantial investment.

#### **4. Capitalization Issues**

An NGC should consider creating a series of designated shares. Paying out surplus through patronage dividends creates an income flow through direct to the producer and creates taxable income in the hands of the producer, rather than the cooperative. This may be to the cooperative's advantage.

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<sup>46</sup> See *Cooperatives Act Regulation*, AR 55/2002 s.16(j). Section 16(1)(a) provides that a cooperative must have the word "cooperative", "Co-operative", "coop", "co-op", "united" or "pool" or another grammatical form of any of those words as part of its name. New Generation Cooperatives, however, in accordance with s. 423 of the *Cooperatives Act* may request an exemption from the requirement to have any of the words referred to in section 16(1)(a) as part of its name.

<sup>47</sup> See *Cooperatives Act*, *supra* note 5, S. 7(3).

An NGC should also consider the various groups from which it will wish to raise funds and may wish to tailor a class of investment shares for each group. An NGC might, for example, wish to create a class of voting investment shares for members from whom it expects a significant investment. Attention must also be paid to *Securities Act* requirements; perhaps issuing a series tailored for investors under the \$10000.00 "limit" should be considered. An NGC may also wish to consider using shares carrying conversion or option privileges to reward "seed capital" investors who provided the high-risk start-up funding required to set up the NGC.

If protecting the rights of a major investor is important, the NGC may wish to do so through a Unanimous Agreement. Other rights can also be protected. Be careful before agreeing to contractual commitments, as they will impair the cooperative's flexibility and member control,

## **5. Post Incorporation**

Once the NGC has been incorporated, the first directors will be in a position to actively sign up members/shareholders in the cooperative. In order to do so, it is recommended that a subscription package be prepared which would include a membership application, disclosure documentation regarding the nature of the investment (it may include an Offering Memorandum), and a form of delivery rights contract.

The directors who were listed in the incorporation documents serve as directors until the first meeting of members. These directors will also be required to hold an organizational meeting.<sup>48</sup> At that meeting the directors may:

- adopt the forms of security certificates and of cooperative records;
- admit persons to membership in the cooperative and issue or authorize the issuance of membership shares and arrange for member loans;

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<sup>48</sup> See *Cooperatives Act*, *supra* note 5, s. 55 and 56.

- appoint officers;
- appoint an auditor to hold office until the close of the first meeting of members;"
- make financial arrangements for the cooperative; and
- transact any other business necessary to organize the cooperative.

After holding the organizational meeting, the directors will be required to call a meeting of the members. This meeting must be called within 180 days from the date of incorporation of the cooperative.<sup>50</sup> At their first meeting, the members will be required to:



- adopt the bylaws for the cooperative.<sup>51</sup> The bylaws are to be filed with the Director of Cooperatives within 60 days of the date that they come into effect;<sup>52</sup>
- elect or appoint directors; and
- appoint an auditor unless the appointment is dispensed with in accordance with the Act.

## L. CONCLUSION

New Generation Cooperatives have proven to be successful business models for the revitalization of rural agricultural economies in the mid-western United States.<sup>53</sup> As one US economist has succinctly stated:

New Generation Cooperatives are the best way for farmers to get a bigger slice

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<sup>49</sup> According to section 235 of the *Cooperatives Act*, the members of a cooperative must, at the first meeting of members and at each subsequent meeting thereafter, appoint an auditor to hold office. In some cases, the cooperative may resolve not to appoint an auditor (see s.236(1)).

<sup>50</sup> See *Cooperatives Act Regulation*, AR 55/2002. s. 18.

<sup>51</sup> The proposed by-laws should be carefully reviewed to ensure that NGC aspects are accommodated and that long term needs of the cooperative are met.

<sup>52</sup> See *Cooperatives Act*, *supra* note 5, s. 13(2).

<sup>53</sup> See the discussion of case studies of the Dakota Growers Pasta Company, Northern Plains Premium Beef, North American Bison Cooperative and United Spring Wheat Processors in Michelle Bielick's article [New Generation Cooperatives on the Northern Plains](#), *supra*, which can be found at: [http://hwww.umanitoba.ca/afs/agric\\_economics/ardi/casestudies.html](http://hwww.umanitoba.ca/afs/agric_economics/ardi/casestudies.html)

of the economic pie.<sup>54</sup>

The success of the NGC south of the border has sparked the interest of both government, which sees NGCs as a way of enhancing rural development, and producers, who see NGCs as a way in which they may raise capital and participate in value-added ventures.

The diversification of agriculture and the development of value-added processing and marketing is critical to the viability and continued growth of Alberta's agricultural economy. The *Cooperatives Act* provides an alternative framework for the development of competitive cooperative agribusiness in Alberta.

- <sup>54</sup> Sutton, R.W. New Generation Cooperatives. April 11, 2001 Department of Agricultural and Applied Economics, Clemson University. South Carolina at <http://lcherokee.agecon.clemson.edu/mmm407.html>

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NEW GENERATION CO-OPS; ALBERTA'S NEWEST  
OPTION FOR AGRICULTURE BUSINESS

- B. Kaniel, BA. LLB.  
- G. Kelly. BA. LLB.

SEMINAR OUTLINE- DECEMBER 3, 2002  
"GENERAL LEGAL ISSUES"

- A. CHOOSING THE RIGHT ORGANIZATIONAL MODEL FOR AGRI-BUSINESS IN ALBERTA
- B. GETTING ORGANIZED - PRE-INCORPORATION STEPS
- C. INCORPORATION
- D. POST-INCORPORATION DOCUMENTS (THE SUBSCRIPTION PACKAGE) - RAISING THE CAPITAL
- E. POST-INCORPORATION - COMPLETING CAPITALIZATION TO FIRST MEETING OF MEMBERS
- F. DELIVERY RIGHTS CONTRACTS
- G. CONTINUANCE
- H. GOVERNANCE/CONTROL ISSUES

A. CHOOSING THE RIGHT ORGANIZATIONAL MODEL FOR AGRI-BUSINESS IN ALBERTA

- 1. Business Models
  - Business Corporations
  - Partnership/Joint Venture
  - New Generation Cooperatives

**2. Be Objective and Dispassionate About Choosing a Model - Pick the Model Which Makes the Best Business Sense**

- De-politicizing NCGs/The Corporate Name Issue (eg: “NCG,” “Group,” “Association,” rather than Co-op or Limited).

**3. NCG vs. Business Corporation  
NCG vs. Partnership/Joint Venture**

The Key Issues:

- Control: - Producer/Members or Investors  
- “One Member One Vote is not the end of the story
- Raising Capital: - Whether an NCG, or a business corporation or a partnership/joint venture is best will depend on the circumstances in each case
- Tax Issues: - E.g. Is patronage flow through an issue?

**2. NCG vs. Traditional Co-op**

NCGs better suited if:

- Limited Membership/Producer Control an Issue
- High Capital Contribution Per Member Required
- Delivery Rights Contracts Involved
- Increase/Maintenance in Share Value/Investment an Issue
- Producers wish to pool/raise capital to aggressively pursue a business opportunity which will yield additional profits to their individual operations; and are interested in an investment which may increase in value.

**5. “Legal” Differences Between NCGs and Traditional Co-ops**

**NCGs:**

- Agricultural Use Only
- Must Issue Member Shares and Shares for Patronage Rights - Shareholder Value Tied to Share Capital

- Name Flexibility
- Ability to Issue ‘Designated’ Shares Connected With Delivery Rights/Patronage Dividends
- More Flexibility for Redemption Rights/Share Transfer Rights Through Bylaws

***The main difference is in how NCGs are used.*** The *Cooperatives Act* gives all Cooperatives the ability to restrict membership (different than Saskatchewan, Manitoba and Canada legislation).

## 6. Prime NCG “Situations”

- Capital:
  - Where the ability/need to raise significant amounts of capital from producer members is an issue.
  - Where community support to raise capital for a “rural development project” is an issue.
- Value Added Projects/Producer Control:
  - Where producers wish to control marketing and processing of their products and receive value added returns.
- Diversification/Innovation:
  - Where there is no existing business or service to meet producer needs, and producers wish to pool resources to create new markets or ventures.

## B. GETTING ORGANIZED - PRE-INCORPORATION STEPS

### 1. The Organizational Personnel

- Organizing Committees
- Paid Organizers and Consultants
- Key Issues:
  - Avoid “Burn Out” and Loss of Focus
  - Qualified and Knowledgeable Management

### 2. The Business Plan



- The Crucial Question - Knowing Exactly How the Project is Going to Make Money For You.
- Consultants/Feasibility Studies and Your Particular Project.
- May be Required for Offering Memorandum and Due Diligence.

### **3. Consider the Use of A Society For Pre-Incorporation Steps**

- Government Funding.
- Society Documents Should Provide For Transfer of Assets to NCG.

### **4. Determine Capital Requirements**

- Minimum Approximately 50%
- How Much?
- From Whom? Define Your Potential Investors
- How - What Type of Share Capital (eg: Membership; Investor; Designated; How Many Classes; Conversion Rights; Redemption Rights; Options; Preferences; Returns; etc.)?
- Is RRSP eligibility an issue?

### **5. Determine Seed Capital Requirements**

- How much?
- What Mechanism (eg: Loans, Convertible Shares, etc.)?
- Seed Capital Agreement

### **6. Financing Requirements**

- Ensure Financing Will be Available if Capital Raised.
- Discuss Lending Terms. Consider Setting A Conditional Commitment.

### **7. Governance and Control Issues**

- What model is best suited to the proposed members/shareholders/investors.
- Is Producer Control Essential?

- Will Other Investors Require Control Based on Amount of Investment?

## **8. Timing Issues**

- Develop a Time Line for the Project

## **9. Legal and Tax Advice**

## **10. The Last Step: Choose the Organizational Model Which Best Suits The Project**

- Be Prepared to Be Flexible. It's Okay to Change Your Mind.

## **C. INCORPORATION**

### **1. The Incorporation Documents**

- Articles of Incorporation
  - name
  - registered office and business address
  - names and addresses of incorporators (at least 3)  
(important:
    - first directors: sign initial corporate documents, offering memorandum, etc.)
  - minimum and maximum number of directors
  - restrictions on business (NCGs - agriculture)
  - objects and purposes of cooperatives
  - restrictions on powers of directors

- "Cooperative" basis
  - capitalization [VERY IMPORTANT]
  - maximum interest rate on member loans
  - restrictions on transfer of member interest
- Notice of Registered Office
  - Notice of Names & Addresses of Directors
  - Incorporators' Declaration re: Section 2 (Cooperative Basis)
  - Incorporators' Declaration re: Part 18 Division 4 (NCG Provisions)
  - NUANS name search
  - Filing Fee (\$100.00)

## 2. The Result

A body corporate with a Board of Directors (the original incorporators) who can carry through with the important remaining steps.

**NOTE: STEPS TO BE TAKEN NEXT WILL VARY WITH EACH PROJECT**

## **D. POST-INCORPORATION DOCUMENTS (THE SUBSCRIPTION PACKAGE) - RAISING THE CAPITAL**

### **1. Subscription Agreement/Membership Application**

- Securities Compliance
- Types and Numbers of Share Capital Applied For
- Covenants

### **2. Offering Memorandum/Prospectus**

### **3. Risk Acknowledgment**

### **4. Delivery Rights Contract**

- See Section F

## 5. Unanimous Agreement

- A Unanimous Agreement may require a greater number of votes for directors or members, or investment shareholders, to effect an action, than is required by the Act. s. 5(3)

## 6. Proposed Bylaws

- General Conduct of Business: - Use of corporate seal; fiscal year; execution of instruments; business to be conducted by Board; information .
- Directors: - Number of directors, election of directors, apportionment of directors, quorum, qualifications, removal, vacancies, electronic meetings, written Resolutions; notice time and place of meeting, officers, votes to govern, conflict of interest.
- Committees and Officers: - Powers and duties, terms of employment, auditor, bonding requirements.
- Duty of Care and Protection of Directors and Officers:
  - honesty, skill, insurance, indemnity
- Shares, Membership and Transfers:
  - Qualifications, classes of shares, applications for membership, right to refuse membership, transfer and transmission of share, duty of members, withdrawal of members, termination of membership, redemption of shares
- Allocation of Revenues:
  - Disposition of surplus, patronage dividends, borrowing, purchase of share capital
- Delegates: - Right to vote through delegates
- Meetings of Members:

- Annual meeting, notice, place and time, voting procedure, special meetings

**E. POST-INCORPORATION - COMPLETING CAPITALIZATION TO FIRST MEETING OF MEMBERS**

- 1. Has the Capitalization Threshold (and Other Conditions) Been Met?**
  - Release of Capital
- 2. Share Issue**
  - Directors Review and Accept/Reject Share Subscriptions
- 3. Financing/Project Acquisition Issues**

**4. First Meeting of Member Shareholders (180 Days)**

- Adopt Bylaws
- Elect First Board (Minimum 60%)

**5. First Meeting of Investor Shareholders**

- Elect Directors (Maximum 20%)

**F. DELIVERY RIGHTS CONTRACTS**

**1. Checklist of Common Issues**

- Sale/Purchase Obligations:
  - Amount (units) member entitled to sell/NCG obligated to purchase
  - Relationship to number of designated" Shares held
  - 
  - Type of units
  - 
  - Quality/Standards
  - 
  - Compliance with Production Protocols (eg: for specialty markets such as EU.)

- Dates and frequency of sales (timing may be important for producers and NCG to meet processing/marketing objectives)
- Delivery:
  - Transportation costs
- Ability to Make Additional Deliveries:
  - In addition to Pre-Contracted Sales
  - Terms
- Acceptance/Rejection:
  - Right to Inspect
  - Right to Reject Product Not Up To Standard
  - Removal of Rejected Product
- Payment:
  - May Be Fixed to Published Rates
  - May be Split
  -
- Damages/Remedies for Non-Delivery:
  - Right to Replace Delivery Shortfalls From Other Sources
  - Liability For Losses
- Obligation to Accept Delivery:
  - Define When Obligation to Accept Delivery Excused (eg: Events Beyond NCG's Control)
  - Remedy for Non-Acceptance
- Dispute Resolution:
  - Arbitration/Mediation re: ice/Grades. etc.
- Termination:
  - Notice Provisions
- Assignment:
  - With Approved Transfer of "Designated" Shares

## 2. Legal Issues

- Not Enforceable Unless Clear (Certainty of Terms), Must be in Writing,

Signed.

**3. Business Issues**

- As Clear, Short and Simple As Possible
- Understandable by Both Parties
- Fair to Both Sides
- Economically Attractive to Producer
- Must Permit Long Term Viability of NCG:
  - With this Guaranteed Supply of Product Will the NGC meet expenses and make money?

**3. Patronage Dividends/Reserves (Bylaws)**

- "Profit" to Members Based on Sales/designated Shares Held
- Provision for Reserves
- Provision for Loans

**G. CONTINUANCE**

**1. General**

- Existing Cooperatives Must Apply For Continuance Under the New Act by March 31, 2005.
- Cooperatives Which Do Not Continue Will Be Dissolved.

**2. Continuance Procedure**

- Submit Application to Cooperatives' Director Containing the Following:
  - Articles of Incorporation Under New Act



- Directors' Declaration That Cooperative Will Be Organized, Operated and Carry On Business on a Cooperative Basis
- If Continued as an NCG, a Directors' Declaration That It Will

Comply with Part 18, Division 4 of the Act (the NCG Division)

No Fee is Required

- On Acceptance of Application a Certificate of Continuance Will Be Issued

### **3. Post-Continuance**

- The Continued Cooperative Must, Within One Year of the Certificate of Continuance, or By the Next Annual Members' Meeting, Pass New Bylaws Which Comply With the New Act and Regulations

## **H. GOVERNANCE/CONTROL ISSUES**

### **1. The Role of the Board of Directors**

- all management decisions, subject to bylaws and unanimous agreement

### **2. Member Elected Directors (Minimum 60%)**

- one member on vote

### **3. Investor Elected Directors (Maximum 20%)**

- vote number of shares held

**4. Appointed Directors (Maximum 20%)**

- significant “partners”, community groups, investors, etc.

**5. Using Unanimous Agreements**

- can be used to fundamentally change control of the NCG.  
Be careful.

**6. Because Members Usually “Control” the Management of NCG by Electing the Board**

- consider restricting members to only those producers who:
  - (a) make a significant financial contribution through acquisition of ‘designated’ shares,
  - (b) are clearly able to meet delivery obligations.
- consider affording others (broader community) ability to participate through acquisition of investor shares.
- carefully consider who you want to control the Board (eg: producers or investors); be mindful of potential issues arising from dilution of membership.