MEMORANDUM

TO: Moscow Food Co-op, Inc.
121 East 5th Street, Moscow, Idaho 83843

FROM: David P. Swanson
~~Kelsey J. Dolven~~

DATE: ~~January 5,~~May 12, 2017

RE: Collaborative Arrangements, Store Expansion and Funding Options and Reorganization Structures for Idaho Natural Foods Co-operatives Organized as Nonprofits

Moscow Food Co-Op, Inc., an Idaho nonprofit corporation (the "Co-op") is considering (1) potential collaborative arrangements with other co-ops to improve their competitive position, (2) a new store expansion into the state of Washington to improve purchasing power and margins, and (3) a reorganization from the Idaho Nonprofit Corporation Act to the Idaho cooperative law in order to eliminate potential uncertainties as to whether the nonprofit act permits dividends to be paid on preferred equity issued by the Co-op to its members. This memorandum discusses options for the Co-op pursuant to each of the above items.

A. COLLABORATIVE ARRANGEMENTS

Several natural foods co-ops have been studying alternatives to collaborate or combine operations in order to improve their competitive position in the market relative to larger competitors, such as Whole Foods, Fresh Thyme and Trader Joe's. We have identified the following three business combination or collaboration options:

(i) a co-op services model under which each co-op maintains its separate governance structure and balance sheet but combines purchasing and services in a single new co-op;

(ii) a holdco model pursuant to which a parent co-op is created and has ultimate control over the participating co-ops; and

(iii) a merger or consolidation model, which would result in a ~~compete~~complete combination of the participating co-ops.

This section discusses these alternative structures, as well as the pros and cons of each alternative.

I. Co-op Services Model

In the co-op services model, a new services co-op would be formed as either a cooperative or an LLC with cooperative allocation of costs. The participating co-ops would then become the members and customers of this service co-op. Each of the participating co-ops

would enter into service agreements with the service co-op, but the members of the participating co-ops would retain their current memberships and the co-ops would continue to have separate boards. The service co-op could provide shared management, branding[1], joint purchasing of inventory and supplies and other services to the participating co-ops.

One important consideration in this model is the degree of commitment the participating co-ops would make to utilize services of the service co-op. Generally, the greater the commitment the participating co-ops make, the better the ability to achieve the goals of efficiency and to compete with investor owned natural foods stores. Thus, it is imperative to define the degree to which the participating co-ops will be expected to commit to shared management services, shared purchasing, etc., both as to the volume of services and purchases that must be made through the service co-op, and as to the length of term of these commitments.

The primary advantage of the service co-op model is that it would be less disruptive than the other models, and less expensive to establish. It could also be done without the need for approvals from the members of the participating co-ops. The boards of the participating co-ops should have authority cause the co-ops to become members of the service co-op without the need for member approvals. But, particularly if the co-ops are making long-term and substantial contractual commitments to the service co-op, the co-op boards may be uncomfortable approving the new member agreement without a member approval, even if not legally required.

Another advantage is this model may be viewed as a natural first step toward a complete combination, giving the participating co-ops a chance to decide from experience if a more complete combination works for them. If it does not work, it is much simpler to terminate than the other models. It would also be scalable, i.e., relatively easy to bring in additional participating co-ops.

The primary disadvantage is this model would not achieve the full benefits of a complete business combination. In particular, it would not result in much (if any) balance sheet strengthening and the related benefits that a strong balance sheet can bring – i.e., improved financing strength to expand, make investments in or otherwise support local suppliers, survive negative events or operating environments, etc.

II. Holdco Model

The holdco model involves creation of a new “holding company” co-operative. The holdco would basically operate as the only member of each participating co-op, and have “control” over major decisions relating to the participating co-ops’ operations. Major decisions would be defined as part of the transaction documents (i.e., the articles and bylaws of the holdco and new articles and bylaws for the participating co-ops) and would likely include approval of the annual operating and capital budgets and plans (if not, the maximum benefits of the combination would not likely be achieved, and there may be accounting issues with consolidation of the balance sheets). Although the holdco would be the only member of the operating co-ops, the operating co-ops’ members could be given the right to maintain some

[1] If shared branding is desired, potential application of franchise laws should be reviewed. If the service coop does common marketing and brand or trademark marketing, and there is a payment made for the use of this service, it could be treated as a franchise. Some state franchise laws have exemptions for cooperatives, but many do not. The main effect of franchise status is an obligation to comply with disclosure requirements for members (which adds expense) and limits on the ability to terminate members.

supervisory role over local operations, and separate profit and loss sharing through use of separate allocation pools.

The members of the participating co-ops would become voting members of the holdco co-op and patron members of one or more of the local co-ops. The boards of the local co-ops will have a lot of discretion to develop a board election system. The patron members of each local co-op could be given a right to elect directors from amongst the local co-op's patron members~~,~~ to form the holdco board, or the members of holdco could elect directors directly, either at large throughout the membership or by local voting districts (e.g., based on a member's primary store) .

The holdco would provide management, administrative and purchasing services for each of the participating local co-ops, and some or all of the employees of each local co-op would become employees of the holdco co-op, depending on whether all management and operating services are provided by the holdco, or only specified shared management and operating services are provided.

The primary advantage of the holdco model is it should permit consolidation[~~1~~2] of the balance sheets, and improved financing strength to open new stores, make investments in suppliers, survive significant negative events, etc. Another advantage is that this model should facilitate scalability, i.e., adding additional local co-ops to the combined entity or creating new stores as additional local co-ops . This model may also work to avoid the potential issues created by the varying capital structures which may well exist among the participating local co-ops—each local co-op could have its own preferred share and member loan and patronage equity structure without creating conflict. Another advantage is each local co-op could keep its own identity and name (although this is not likely to create a significant advantage over the complete combination model).

The primary disadvantage of the holdco model is complexity. The transaction would be more difficult to ~~easily~~ explain to the co-op members, and it would likely be more expensive~~. It~~ to establish than the other models. Briefly, it would involve mergers of each of the existing co-ops into new single member co-ops created by the new holdco co-op. Some additional detail about the holdco model is included in Appendix 1.

III. Merger or Consolidation Model

A merger generally means one of the participating co-ops would be identified as the survivor, and the other participating co-ops would merge into it. A consolidation generally means a new co-op would be formed, and the participating co-ops would essentially consolidate into the newly formed co-op as the survivor. State laws governing the participating co-ops would need to be reviewed to determine if and to what extent a merger or consolidation is permitted. Cooperative laws vary from state to state, but most of them allow mergers and consolidations if approved by the members in a member vote. Some state coop laws have limits on mergers with out-of-state coops.

The legal effect of a merger and a consolidation is basically the same. In each case, all of the assets, rights and obligations of all participating co-ops would become—by operation of law—assets, rights and obligations of the consolidated co-op. Membership is automatically

[~~1~~2] If there is interest in pursuing this holdco model, it would be important to confirm the viability of achieving accounting consolidation. We are aware of one agriculture cooperative that has used this model for 20 years with a consolidated balance sheet including three operating coop "subsidiaries".

transferred to the surviving co-op. In a merger, even though only one of the co-ops is selected to be the survivor, the name of the surviving co-op can be changed via the merger documents (basically a plan of merger and articles of merger). The bylaws and membership and board structure can also be changed via the merger documents.

However, the member reaction to merger v. consolidation can be very strong. It would likely sound very different to members if the consolidation approach is used, because it does not sound as much like one co-op is "acquiring" the other. If the merger approach is used, members are more likely to have a negative reaction that the transaction is a take-over and loss of community identity.

As a result, a consolidation would likely be the best approach to a complete combination of the operations and membership of the participating co-ops.

Although a consolidation may sound better to the members, in some cases a merger format may be advisable if there are important permits or contracts in place that would require approvals from the permit agency or contract party that may present difficulties. In this case, a merger format may be easier to accomplish because the surviving co-op may be able to avoid obtaining the problematic approvals. I would not expect that to be an important factor for combining most natural food co-ops.

The primary benefit of a merger or consolidation is that the operations and membership of the combined co-op are completely integrated and centrally managed. This arguably creates the best structure to achieve the potential benefits of combining the operations of two or more co-ops, because it brings centralized management functions and centralized decision-making over investment activities, and a stronger balance sheet that would better facilitate quick movement on expansion opportunities and better ability to weather tough operating periods or losses.

This is accomplished in a merger or consolidation with relatively simple legal documentation. The most complex and sensitive part of a merger or consolidation is often educating members as to the underlying rationale. A merger or consolidation can also likely be done in a way that it is eligible for tax-free reorganization status (which means no income tax expense for the combined co-ops or the members).

The primary negative aspect of a merger or consolidation is that all of the obligations (known and unknown) of all participating co-ops are assumed by the combined co-op[~~2~~3]. In addition, the centralized management feature of a merger or consolidation could be viewed by members as a negative—loss of local control and loss of community identity.

B. Expansion into Washington and Funding Implications

It is our understanding that the Co-op is also interested in developing a new store in the state of Washington. This would be best accomplished in one of three ways: (1) opening a store in Washington through the existing Co-op (the "one co-op" approach); (2) forming a parent co-operative (the holdco model); or (3) forming a Washington co-operative that will enter into a

[~~2~~3] If one of the participating co-ops has a known or unknown liability or risk, an asset transaction may be more appropriate because in some cases, the combined co-op can avoid assuming the risks and uncertainties associated with a known or unknown obligation by transferring assets. Documentation for a transfer of assets is more complex, and can involve additional tax expense (such as deed transfer taxes or sales taxes).

services agreement with the existing Co-op. We describe these three expansion options under Section I below.

In order to fund a new store or a store expansion, the Co-op will likely seek to issue preferred stock or subordinate member notes. Different exemptions to registration of these interests will be available depending on which of the three expansion approaches the Co-op utilizes. These exemptions are discussed under Section II below.

I. Expansion into Washington

a. The ~~Existing~~One Co-op Approach

Under the existing co-op approach, the Co-op would not form an additional co-operative. Instead, it would open a store in Washington under the umbrella of the ~~existing Co-op~~ Co-op (and on the same balance sheet as the existing store in Moscow). This is the approach that most natural foods co-ops have used in establishing second and third stores. While this may seem like the simplest approach, it may limit the ability of the new store to solicit members to raise funds, as discussed under Section B.II below.

b. The Parent Cooperative Approach

The parent co-operative approach mirrors the holdco model address under A.II above. It similarly involves the creation of a new "holding company" co-operative, which would only have two members – the Co-op and a newly formed co-operative in Washington. ~~These~~The members of the two member co-ops would become patron members of their respective member co-~~op~~ops. As discussed above, the parent co-operative would have "control" over major decisions relating to the two participating co-ops' operations. The two member co-operatives could be given the right to maintain some supervisory role over local operations, and separate profit and loss sharing through use of separate allocation pools. The parent co-op would provide administrative and purchasing services for both of the member co-ops, and some or all of the employees of each member co-op would become employees of the parent co-op, depending on whether all management and operating services are provided by the parent, or only specified shared management and operating services are provided.

c. Two Separate Cooperatives Approach

In the two separate co-operatives approach, a Washington co-operative would be formed separate ~~of~~from the existing Co-op. The ~~two~~existing Co-op and the new co-~~ops~~op would then enter into a services agreement, whereby the existing ~~co~~Co-op would operate as the service co-op, similar to the co-op services model discussed under A.I above. The two co-ops would have separate memberships and boards.

II. Funding Implications

In order to raise capital by issuing ~~interests~~shares or notes in the Co-op, the Co-op would generally be required to register such interests with the SEC and / or state securities regulators. Registering securities is a complicated process and involves providing the investors with a great deal of information and on-going regulatory compliance. There are, however, several exemptions on the state and federal level that allow ~~businesses~~co-ops to bypass registration. The Co-op will need to secure exemptions on both the state and federal level in

order to avoid ~~registered any interests~~registering shares or notes it offers pursuant to a ~~funding~~capital campaign. Three of these exemptions are discussed below.

a. Exemption for Co-operatives and Rule 504

The Co-op could simultaneously employ (i) both Idaho and Washington's exemption for securities being offered by a co-operative and (ii) the federal exemption pursuant to Regulation D's Rule 504. *These exemptions would work with any of the three expansion approaches above*. These exemptions would permit an offering to members in both Idaho and Washington but it would create limitations on the ability of the Co-op to advertise to solicit member investments.

Under Section 21.20.320(16) of the Washington Statutes, the Co-op would be exempt from registering any securities if such securities (a) represent a contribution of capital to the association by a person who is or intends to become a member or patron of the association and (b) are nontransferable. If the Co-op uses general advertising or public solicitation, it would first need to file a notice of claim of exemption with the Secretary of State of Washington, which would then have ten days to deny the exemption. Similarly, pursuant to Section 30-14-201(8) of the Idaho Statutes, any membership interests in the Co-op are exempt from registration. These exemptions can be used by a co-operative formed in any state and would relate to securities sold to residents of each state respectively.

Using Rule 504 of Regulation D, the Co-op would secure an exemption from the registration requirements of the federal securities laws so long as it offered and sold less than $1,000,000 of its securities in any 12-month period. Unfortunately, the Co-op would not be able to employ general solicitation or public advertising, unless the interests were sold to accredited investors alone[~~3~~4]. It can also be an entity that is owned entirely by accredited investors. This limitation on advertising could hinder the Co-op's ability to successfully raise funds because it limits the ability of the Co-op to advertise to solicit member investments.

b. Exemption for Co-operatives and Intrastate Exemption

The Co-op could use the state exemptions for co-operatives discussed above, as well as the federal intrastate exemption to avoid registration; however, *this method would only work with the two separate co-operatives approach* (i.e., the Idaho co-operative could use the Idaho co-operative exemption and the intrastate exemption to offer securities to residents of Idaho and the Washington co-operative could use the Washington co-operative exemption and the intrastate exemption to offer securities to residents of Washington). It likely would not work with the parent co-operative model given the business requirement discussed below.

The federal intrastate exemption is available to (a) corporations that ~~are organized in the state where the securities are being offered, (b)~~ carry out at least 80% of its business in the state in which the securities are being offered and (~~c~~b) make offers and sales only to residents of that state. A person is deemed a resident of a state if it is an individual who has his or her primary residence in such state ~~and~~or if it is a corporation that has its principal office within ~~such~~the state. General advertising is allowed to persons that are residents of that state. If ~~interest~~general solicitation is employed, the Co-op must (x) limit access to information to

[~~3~~4] An "accredited investor" is defined as an individual with a net worth of at least $1,000,000 (excluding the value of one's primary residence) or income of at least $200,000 for each of the last two years. There are also proposals to increase the net worth and income thresholds. So an accredited investor only offering is not likely to be attractive for the Co-op.

persons who confirm they are residents of the relevant state and (y) provide a disclaimer and restrictive legend clarifying "that the offer is limited to residents of the relevant state under applicable law."

c. Crowdfunding

Finally, the Co-op could utilize crowdfunding laws to conduct its offering. *This approach would work with the two separate cooperative model alone*. This option is likely to increase transaction costs but it would permit advertising or general solicitation to residents of both Washington and Idaho (and it would allow non-members to invest).

Section 4(a)(6) and Regulation CF govern the federal crowdfunding exemptions. In order to qualify under federal law, the following requirements must be met:

- Less than $1,000,000 may be raised over any 12-month period;
- Any individual investor may only contribute $2,000 or, if that individual meets certain income and net worth thresholds, $100,00 in any 12-month period to *any* crowdfunding offerings (not just the crowdfunding offerings conducted by the Co-op);
- The offering must take place through an intermediary registered with the SEC;
- The Co-op would need to file a Form C with the SEC, which requires lengthy disclosure and includes two years of financial statements;
- The Co-op would need to file annual reports with the SEC; and
- The Co-op would not be able to advertise the terms of an offering, except for providing notice to potential investors directing them to the intermediary.

The federal requirements described above are mirrored under Section 21.20.880 of the Washington Statutes and Section 30-14-203 of the Idaho Statutes, with some additional requirements. Under the Washington crowdfunding law, the issuer must be organized and doing business in the state of Washington and each investor must provide evidence of residency in Washington. Similarly, the; no out-state investors may be included. In Idaho, the crowdfunding exemption is established in a 2012 Department of Finance Order made under Section 30-14-203 of the Idaho Statutes. The Idaho exemption requires a filing with the Idaho Department of Finance prior to launch and it is only available for Idaho corporations and securities may only be issued to Idaho residents. UnderIn Idaho, the thresholds are higher ($2,000,000 may be raised by an issuer and $2,500 may be invested by an investor); however, in order to maintain the federal exemption, the federal thresholds would take precedent.

C. Reorganization of Moscow Food Co-op to an Idaho or Washington Cooperative to eliminate uncertainty about the ability of a Nonprofit to pay Dividends on Preferred Equity

I. Ability to Pay Dividends or Interest on Preferred Equity or Member Loans

The Co-op is organized under Idaho law as nonprofit corporation. The Idaho Nonprofit Corporation Act does not restrict a co-operative's ability to distribute net income as cash patronage refunds or as retained patronage, or to issue preferred equity or to provide a distribution to its members upon liquidation. So the Idaho Nonprofit Corporation Act accommodates cooperative operation. (Many state non-profit laws are more restrictive.)

Section 30-30-905 of this law does prohibit a nonprofit cooperative from paying any interest or dividends on ~~a~~ "capital furnished by its members". This means that the Co-op may not pay any interest on a member's capital account (i.e., retained patronage equity). However, it is not as clear that Section 30-30-905 prohibits the payment of interest or dividends on preferred equity or subordinate member notes that are issued to members as an investment rather than as a "capital credits" or retained patronage equity as required for "cooperative operation".

We believe there are very good arguments that preferred equity and member notes issued to members (or others) as an investment (as opposed to as a required consequence of a member's patronage) should not be subject to the prohibition on payment of dividends or interest on member capital. The way Section 30-30-905 is written makes it clear that it is intended to apply only to retained patronage equity rather than to cash investments such as paid-in owner equity, preferred equity and subordinate member notes. The language in this Section is clearly designed for consumer electric cooperatives. The use of the terms "capital furnished by members" and "capital credits" in this Section is language used nearly universally by consumer electric coops across the country to describe patronage or cooperative operation in their bylaws and articles. This fact strongly supports the conclusion that the reference to "capital furnished by members" is intended to apply only to retained patron's equity.

Further, this statute states that, in the event of liquidation, "after all outstanding indebtedness of the corporation has been paid, outstanding capital credits must be retired without priority on a pro rata basis before any payments are made on account of the property rights of a member." It would be problematic for member preferred equity if it must be liquidated pro-rata with retained patron's equity. But again, there are very strong arguments that the liquidation clause in 30-30-905 should not be read as applying to both patron's equity and member investment in preferred equity or member notes. This position is strongly supported by the fact that "capital credits" in cooperative parlance is almost always intended to refer to patron's equity rather than paid-in capital.

Although we believe the verbiage in Section 30-30-905 should not be read to preclude payment of dividends on preferred equity or interest on member loans, the language is not crystal clear. It could be read both ways. So there is some uncertainty if the Co-op issues preferred equity or member loans to members. But we believe the better position on this issue is clearly that payment of dividends or interest on preferred equity or member loans is permitted. We also believe this uncertainty can be minimized by disclosing this issue in the Co-op's offering documents and stating the Coo-op's position is that Section 30-30-905 does not preclude payments of dividends or interest to members.

An option to eliminate this potential risk is to reorganize Moscow Food Co-op under the Idaho or Washington cooperative statutes. Neither of these cooperative statutes creates any uncertainty about the ability to pay dividends on preferred equity purchased by members. This is covered in the next Section ~~C.II~~.

II. Paths to Conversion to a Cooperative Statute

There are basically two ways to reorganize the Co-op to bring it under a cooperative statute: (1) transfer all of the assets of the Co-op to a new co-op formed under the Idaho or another state's cooperative law[~~4~~5], or (2) merge the Co-op into a new co-op formed under the Idaho or another state's cooperative law. The documentation and conversion process, as well as some pros and cons of these two paths, are discussed below.

(a) Merger. This option would mean forming a new co-op and merging the existing nonprofit Co-op into the new co-op. The effect of the merger is all of the members and member interests of the existing Moscow food Co-op will ~~be~~ automatically (by operation of law) be transferred to the new Moscow Food Co-op, and all of the assets and all of the rights and obligations of the existing Moscow Food Co-op automatically (by operation of law) become assets and rights and obligations of the new Moscow Food Co-op once merger papers are filed with the Secretary of State. In effect, nothing would change except the statute under which the Co-op is incorporated.

A merger would require both board approval, and holding a member meeting and a member vote. The Idaho nonprofit law says that a merger requires yes votes of 2/3 of the members who vote (so if an eligible member fails to vote, it is not a "no" vote), or, if less, a majority of the total number of members. The documentation would include a (a) "plan of merger" document, (b) a member meeting notice, (c) an explanation for members of the reasons for the merger, (d) a ballot and (e) meeting details and voting instructions.

The plan of merger document would be relatively short and simple, basically saying that all rights and benefits of members stay the same. The plan of merger would also include adoption of the articles and bylaws in their current form for the existing Moscow Food Co-op, with technical changes to reflect the fact that a cooperative statute governs. (It would also be possible to amend the articles and bylaws as part of the merger. So, for example, if the proposed bylaw updates have not yet been completed and approved by the members, that approval could be included as part of the merger vote.)

One benefit of a merger is the legal documentation is simpler than in an asset transfer (but not significantly simpler). A merger may also minimize the potential that state or local sales or property transfer taxes could arise (e.g., sometimes transfers to real property triggers a deed transfer tax, where a merger would not), and that state and local license transfer approvals are required to be obtained (e.g., a state or local operating permit may not require state or local agency approval in merger, although it would require state agency approval in an asset transfer).

~~(b)~~ (b) Asset Transfer. The primary benefits of an asset transfer are (a) it leaves open the potential to have the newly merged co-op not assume specified liabilities of the existing co-op, and (b) it *may not* require a member vote and the expenses associated with the vote.

The documentation for an asset transfer would be somewhat more complex than that for a merger (but not likely significantly more complex). The primary document would be a short

[~~4~~5] If you decide to convert to a cooperative law, we can recommend the best option. It would make sense to look at both the Idaho and Washington cooperative statute as options and identify pros and cons of both of them. Both should work. One advantage of using the Washington cooperative statute is that it creates an exemption from the Washington state tax (called the B&O tax). If Moscow Food Co-op expands into Washington, using the "separate cooperatives approach", it could be very valuable to choose Washington as the state of incorporation.

asset transfer document. As noted above, an asset transfer could result in property transfer taxes or the need to obtain consents of third parties such as government permit and license issuers or major contract parties, that may not need to be obtained in a merger.

The ability not to assume all liabilities is a common reason why business sales are done as asset transfers rather than mergers. But the ability to avoid assuming liabilities is difficult to achieve ~~in this situation~~to achieve with certainty when a complete merger of businesses is involved, because there are many exceptions to the general rule that liabilities do not have to be assumed in an asset transfer and it would not likely apply to a conversion merger.

We say an asset transfer *may not* require a member vote, because a member vote is required by Section 30-3-107 only if the asset sale is not in the "regular course of activities" (in this case, a simple majority of the votes cast – or if less, a majority of the total number of members – is required for approval). Section 30-3-106 requires only a board approval if the transaction is in the "usual and regular course of activities". An asset transfer to the new Moscow Food Co-op could easily be defended as usual and regular on the grounds the only real change being made is to change the incorporation statute and to remove uncertainty about whether dividends on member preferred equity is permitted. But proceeding without a member vote could be challenged as inappropriate by members. So unless there is a strong desire to look into converting without a member vote, we recommend a merger as the better option.

Appendix 1 – Holdco Model Details

Transaction Structure

- A new Holdco co-op would be formed under a state cooperative law (likely by representatives of each of the participating co-ops)
- The Holdco would form "consolidation subsidiaries", one for each participating coop
- The participating co-ops and the Holdco would sign a transaction agreement approved by the boards but not the members
- The participating co-ops would merge into the companion consolidation subsidiary, resulting in 100% ownership by the Holdco of the participating coops as "local subsidiaries" (this could also be done as an asset transfer, but that would likely be more complicated)
- The members of each participating co-op would automatically be made voting members of the Holdco and would remain as patron members of the local subsidiaries (in some states dissenters rights could apply, which complicates things because it would give members a right to "cash out" in lieu of accepting this change)
- The Holdco bylaws would create separate allocation units (profit / loss pools) for each participating co-op for purposes of allocating patronage income and distribution of cash rebates and patron equities (either as nonvoting shares or as non-stock patron equity) – economics would be allocated to the local subsidiary patron members based on their patronage of the local store(s)
- The local subsidiary economics would flow to the Holdco and be allocated to patron members based on the local economics
- Member economic rights (member stock, patron equity, preferred stock / member loans) would become economic rights in the Holdco (likely economic rights in a financially stronger and more diversified coop)
- The Holdco and local subsidiary bylaws could establish local supervisory boards with authority to address local operations
- The participating co-ops' bank loans could remain at the local subsidiary level or be consolidated at the Holdco level, depending on the lenders' desires and whether there is an opportunity to obtain better pricing terms on a consolidated basis

- Supply and service contracts could remain at the local subsidiary level or be consolidated at the Holdco level
- Employees could remain at the local subsidiaries or move to the Holdco, or there could be a combination of both – the Holdco and the local subsidiaries would enter into "management agreements" for the Holdco to provide services to the local subsidiaries

Member Voting on the Holdco Formation

- To form a Holdco model, there would need to be a vote by both the board and the members of all the participating co-ops
- The member approval would cover (1) changes in the co-op's articles and bylaws to reflect the change in governance and ownership to the Holdco, and (2) the merger of the participating co-op with the companion local subsidiary
- The member voting requirement will be based on the participating co-op's bylaws and state law – e.g., a Minnesota coop would need to obtain approval of 2/3 of those members voting
- An information packet would be developed and made available to all of the voting members
- Owners of preferred stock or member loans would most likely not have a voting right – I have never seen that requirement as part of a member capital program, but it is going to depend on the terms of each co-op's member capital program (sometimes preferred shares can be called if there is a change of control)

Scalability

- The Holdco could add additional cooperatives as local subsidiaries by board action, without a member vote at the Holdco level, unless there are limits on this included in the Holdco bylaws
- The additional co-op would need both board and member approval to become part of the Holdco system

Director Election

- The Holdco board can be elected locally or at-large across the co-op
- One model would be for the Holdco members to elect directors in regional elections based on the participating co-ops' membership or geographic locations – e.g., if there are 3 participating co-ops, you could have a 9 member board with 3 directors each elected by the patron members of each participating co-op

- Another model would be to have the patron members of each local subsidiary elect a local supervisory board and then have the supervisory board elect directors from among them to the Holdco board
- Yet another model would be to have the patron members of each local subsidiary appoint nominees and have the entire membership vote on some or all of the directors
- The co-ops involved in forming a Holdco will have a lot of freedom to develop an appropriate director election method and board composition plan

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