

## MEMORANDUM

TO: The Members of Federated Co-Ops, Inc.

FROM: The Board of Directors

DATE: March 8, 2017

RE: Amending the Articles of Incorporation and By-Laws of Federated Co-Ops, Inc.

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### **I. Summary**

After conducting a review of our Articles of Incorporation and By-Laws, we found that there were some differences between the procedures described by the Articles and By-Laws and how Federated works with its members in practice. We also discovered some provisions that potentially could adversely affect the operation of the cooperative. We've updated our Articles of Incorporation, which had been last amended in 2006 (the "2006 Articles"), and current By-Laws, which had also been adopted in 2006 (the "2006 By-Laws"), to correct those issues, improve the drafting, eliminate errors, and make them easier to read. This memo describes our changes and summarizes the reasons that we made the revisions.

### **II. Changes to the Articles of Incorporation**

Our most significant change from the 2006 Articles is the deletion of sections describing capital stock, as Federated does not govern itself based upon outstanding stock and has not done so for over three decades. Article II, Section 1, Section 2, and Section 3, were deleted, leaving only the old Section 4 on membership rights, which was modified to remove the Board's power to refuse membership to properly qualified persons. Lastly, we clarified Article VI to indicate that, while net income from patronage sources would be distributed on the basis of patronage, non-patronage net income may not necessarily be distributed in that manner.

### **III. Changes to By-Laws: Stock and Membership Rights**

The 2006 By-Laws were similarly amended to remove the concept of capital stock. We have removed references to "stock" and "stockholders" and paragraphs of the By-Laws discussing stock and stockholders. Under Federated's current governance regime, to become and stay a member, a person must conduct sufficient patronage business or hold a certain amount of equity in Federated. The Proposed By-Laws now state that a member must conduct either \$500 in business with Federated annually or hold \$500 in equity (from retained patronage dividends over the years), which is consistent with our current practice. Article I, Section 3 and Article II, Section 1 were also deleted because they were only related to stock, and the numbering of all of the other sections of Articles I and II changed as well.

#### **IV. Qualifications to be a Board Member**

We changed the maximum number of directors on the Board from seventeen to twelve and took out the term limit of a maximum of three, three year terms. We also clarified in the Proposed By-Laws that the Board of Directors may continue to operate until a subsequent member meeting even if an unexpected act occurred that caused the number of producer-directors on the Board of Directors to fall below the required 2/3<sup>rd</sup>s threshold. The 2006 By-Laws required 2/3<sup>rd</sup>s of the board members to be Producers but did not explain what would happen if a Producer board member resigns, passes away or is disqualified. Our new language clarifies that if a Producer leaves the Board of Directors and Producers no longer make up 2/3<sup>rd</sup>s of the directors, the Board of Directors can still continue to act until the next member meeting, at which point a new Producer board member will be elected.

#### **V. Committees**

Currently, Federated only has one committee, the Executive Committee, which is described in the 2006 By-Laws. The Proposed By-Laws leave in place the Executive Committee and all of the its responsibilities, but also allow the Board of Directors to create other committees that it feels are necessary to best operate Federated. This gives the Board of Directors flexibility to operate in a way that will best serve its members. The Proposed By-Laws also reference a nominating committee that would identify interested and qualified members to run for election for open seats on the Board.

#### **VI. Distributions**

The Distribution section of the By-Laws has been revised and improved significantly, but we believe the core economics remain the same. Changes were made to Article V (Distributions) to (i) clarify how income and expenses will be shared between capital reserves and the members doing business with different divisions of Federated, (ii) streamline language and use consistent terminology to make the By-Laws easier to read, and (iii) eliminate references to capital stock. The 2006 By-Laws description of the capital reserve has been simplified to show which sources of income may be retained by Federated and the amount of income must be distributed to the members.

Further, under the Proposed By-Laws, the Board may establish a minimum amount of a patronage dividend payment each year (the 2006 By-Laws set a \$20 minimum, but the Board has authorized a minimum payment of \$50 for 2017). The Board works to maximize distributions to all members, but small dividend payments are not cost effective due to the administrative burden on Federated and tax complications for members receiving these small payments.

Article V, Section 5 also spells out how expenses shared between divisions of the association will be treated. Finally, the Proposed By-Laws more consistently use similar and appropriate terms to reduce ambiguity.

#### **VII. Other Housekeeping Changes**

You will see other moderate changes throughout the By-Laws that create consistency and sharpen the text. For example, references to Federated in the By-Laws were not consistent: sometimes “cooperative” was used and in other places “association.” In the Proposed By-Laws, every reference to Federated has been changed to “association.” In Article III, Section 14 of the 2006 By-Laws, there was a reference to Section 3 without clarifying which Article had been referenced, and we have now included the correct reference. Article IV in the 2006 By-Laws was deleted because it did not actually contain any information, and Articles V through XIII have been renumbered accordingly. You will find other small changes along these lines.

#### **VIII. Summary**

We hope you will agree that the revisions to the 2006 Articles and 2006 By-laws do not reflect a significant departure from our current governance and organization and that they generally preserve the economic relationship between Federated and its members. We trust these improvements will avoid potential legal pitfalls in the future and keep the cooperative operating and competitive. If you have any questions about the Proposed By-laws, please feel more than free to contact our chief executive officer, Michael McMahon at (763) 389-2582 or email at [mmcmahon@federatedcoops.com](mailto:mmcmahon@federatedcoops.com).

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