A worker cooperative is a democratic corporation, owned and controlled by the people who work in the company - a firm that applies the principle of democracy to the legal structure of the workplace. Simply put, it is a business where the people who work in the company own and control the business on a democratic basis of one person, one vote. In a worker cooperative, ownership and control of the business are derived from working in the company, rather than from simply investing capital in it.
The company (and thus the value of the shares) increases. Were a co-op to use this structure, as the firm succeeded, it would make it increasingly difficult for new workers to afford to buy a share and become members.

The plywood worker co-ops of the Pacific Northwest, clearly the most financially successful worker co-ops that have ever existed in this country, were all eventually sold off from the workers exactly because of this issue. While democracy is at the heart of a co-op, the other key element is creating an inter-generational firm that provides a steady source of income for current and future worker-owners.

The Membership Share

The innovation of the Mondragon Cooperative and the ICA Model By-Laws is to issue membership shares and shift the function of carrying the net worth of the company away from the shares and into the internal capital accounts. Thus in a co-op, you do not have capital shares, but rather capital accounts.

KEY ELEMENTS OF THE MEMBERSHIP SHARE

1. Can only be owned by worker
2. Monetary value does not change
3. Entitles holder to one vote
4. Right to an internal capital account
5. Non-transferable
6. Is redeemed when member leaves

A membership share does not increase or decrease in value like a share in a standard corporation. It is the internal capital accounts that increase in value, not the membership shares. At any given time, members may have differing membership shares, and the role of the membership share is not clearly spelled out in your governing documents. It is important that in reality, your firm’s value is tracked using capital shares. This could lead to litigation in a co-op that has succeeded when members leave.

For this reason, ICA strongly recommends that firm’s use the ICA Model By-Laws as a template for your co-op and be sure to only engage legal advice from people who clearly understand this issue.

STRUCTURE & CONTENT OF THE ARTICLES:

To create a corporation, all states require the “filing of the articles” and a filing fee with the state government — usually, the Corporations Division of the Secretary of State’s office. Most people choose to define the corporate purposes broadly and keep the articles brief. Amendments to the Articles require shareholder voting and the filing of Articles of Amendment and a fee to the state.

The specific form of the articles will vary depending upon your state laws and your choice of incorporation statute, however, the provisions on the following page are standard for most states and for most LLC registrations.

Typical Elements of Articles of Incorporation

CORPORATE NAME

This section sets the official name of your business. Be sure to check whether the name you choose is available and if there are requirements or restrictions, i.e. whether you can use the word cooperative.

PURPOSE

This provision of the Articles communicates the basic purposes of the corporation, but should also be broad enough to allow for flexibility.

AUTHORISED STOCK

A stock corporation can only issue shares of stock if the number and type of shares is authorized in the Articles. In a co-op, the membership shares are the “common” stock and have a residual claim on corporate earnings & assets. While LLCs do not technically issue shares, the ICA Model By-Laws for an LLC mirror this structure for ease of understanding and consistency. This section is also used to authorize other classes of shares. If you are issuing non-member shares, be sure it is permitted under your selected incorporation statute.

RELATIVE RIGHTS OF DIFFERENT CLASSES OF STOCK

If you intend to issue non-member shares, this section defines the relative voting, dividend, redemption, and dissolution rights of the classes. This provision must be drafted with care, in consultation with legal counsel.

RESTRICTION ON THE TRANSFER OF STOCK

In a worker co-op, the transfer of stock shares is restricted so that only the members can hold membership shares and that membership shares can only be sold back to the company. Check your applicable state law to determine if such restrictions, if any, are required to appear in the Articles.

OTHER LAWFUL PROVISIONS

This is an open-ended section for any additional provisions. While nothing may be necessary, the election of the worker cooperative statute can appear in this section. In many states, certain authority of the Board of Directors or certain corporate powers are available only if authorized in the Articles.

ARTICLE I: CORPORATE AFFAIRS

This section includes the basic information on the firm, such as its name, fiscal year end date, and the corporate purpose. If you’re going to have a social mission listed in your by-laws, this is the place to put it.

ARTICLE II: MEMBERS AND SHAREHOLDERS

This section lays out the powers of the various shareholders, a fundamental element of how power flows through a firm. It determines who the members (worker-owners) are, what powers they have, how they’ll vote on issues, and if there are non-working shareholders, what powers they have.

ARTICLE III: INTERNAL CAPITAL ACCOUNT SYSTEM

This section lays out how money flows through the company and how the company’s value will be calculated. In a worker co-op, the net value of the firm is not reflected in the value of the stock, but rather in the values in the internal capital accounts (i.e. capital accounts versus capital shares).

ARTICLE IV: MEETINGS OF MEMBERS

The members (or shareholders) hold at least one annual meeting to elect the Board of Directors. This section outlines when this meeting will happen, what issues should be addressed, and how notice related to these meetings should be dealt with.

ARTICLE V: THE BOARD OF DIRECTORS

The Board of Directors set policy in a firm, therefore, how they are selected and what power they hold is essential. This section outlines who is eligible to serve on the Board of Directors, how they are selected, what their term of office will be and how often they will meet.

ARTICLE VI: OFFICERS

The Officers of the firm are responsible for the operations of the firm, entering into contracts and maintaining the records of the company. This section lays out who the officers of the firm (President, Treasurer, Secretary, etc.) are and what their roles and responsibilities are. If you are a benefit corporation, this is where the role of the Benefit Officer is laid out.

ARTICLE VII: AMENDMENTS

The by-laws also need to determine how they can be changed. This section lays out how changes...
to the by-laws will be made, what percentage of members need to vote, what components are set in stone, which can be changed, and who has the power to change them.

ARTICLE VIII: OPERATING RULES

What are the rules you’ll set up as a firm? This section allows the Board to set its own operating rules. We recommend that this section be left vague to allow the firm to set its own policies. If you want to specify that the members should vote on, how the firm will conduct meetings, or issues related to employment policies, you can specify them here. It’s best to leave your by-laws simple and easy to understand. Specifying too much detail is a sure way to make sure members don’t read and understand the business they own.

CUSTOMIZING YOUR BY-LAWS OR OPERATING AGREEMENT

The ICA Model By-Laws & Articles of Incorporation are designed to be used with minimal support from an attorney. Every company is slightly different, however, so we’ve developed the following questions broken off, to help you identify the areas you need to change to reflect your co-op’s culture.

Many worker cooperatives diverge from a “pure” cooperative form, while still maintaining a commitment to democratic work. These firms cope with complex business and financial attributes.

ICA’s model by-laws are designed so a worker co-op is able to qualify for the preferential tax treatment co-ops enjoy under Subchapter T of the IRS code. However, using this incentive is a business decision, not a requirement. For instance, under subchapter T, outside investor’s dividend rate is limited to 8%. Some investors or selling owners might want voting rights, profit participation, or guaranteed board seats and a strong business rationale might warrant such arrangements. Worker co-ops are permitted to forego a situation where one group of owners benefits off the labor of another group of workers.

What will the Membership Fee cost?

The membership fee can be set at virtually any level, although it should be within reach of the people who work at the firm. Some co-ops set the fee low - $50 or $100 to make membership open to everyone. Others set the fee higher, anywhere from $1,000 to $15,000 to ensure that only those really committed to ownership join. Still others don’t charge any fee, but gift the membership share to workers after completing a probationary period.

What are the rights of outside shareholders?

There is a risk in giving voting power to individuals or organizations that do not work at the firm and generally, outside shareholders are issued preferred shares that pay a dividend but do not provide any voting rights or other powers.

However, using this incentive is a business decision, which can be changed, and who has the power to change them.

The model by-laws require a provision for a startup loss account, although some firms use this approach which enables them to amortize startup losses over time by reducing the balance in that account before charging those losses to the other internal capital accounts. Such an account would be a sub-account of the retained earnings account. For more information on the startup loss account see the ICA publication: Internal Capital Accounts.

What will your redemption schedule for paying out amounts in the internal capital accounts be?

The model by-laws leave it up to the board of directors to determine the redemption schedule. However, some firms specify in their by-laws the time period during which all written notices of allocation will be redeemed. One way to think about internal capital accounts is that they enable members to invest their share of the profits back into the company for a time. The longer that investment, the more return the co-op can realize. Therefore, establishing a long redemption period (15 years or at retirement, for instance) can have significant long term benefits. At any rate, we recommend that the redemption period be at least 3 years.

ARTICLE IV: MEETINGS OF MEMBERS

How often will the membership meet?

The model by-laws call for an annual meeting, the main purpose of which is to elect the board of directors. The membership meeting is different than a staff meeting, which will likely be held much more frequently.

How much notice will members be given prior to a membership meeting?

The model by-laws require written notice be given to each member at least 10 days prior to the meeting. You may want to require more time.

ARTICLE V: BOARD OF DIRECTORS

The Board of Directors is critical for any democratic firm, it is the representative of the membership.
and the body responsible for setting policy for the business, including establishing the operating rules. Therefore determining who will be able to serve on the Board, what responsibilities they hold, and how they will be elected is essential. The model by-laws make recommendations, however, this is an area to be negotiated amongst the founders of a firm. Questions to consider include:

How many years should the Directors serve?

It is common practice for Board members to serve staggered terms of one, two or three years.

Will the co-op allow non-members or others from outside the firm to serve?

The model by-laws allow non-members to serve on the board. This allows you to include community partners or industry experts that may add value to the firm.

How many Directors will the firm have?

The model by-laws call for 5 board members, however, if you are planning on having non-members sit on the board, it may be advantageous to increase this number. Similarly, if you are a startup with fewer than 5 members, you may need fewer. In any event, having an odd number to avoid ties is a good practice.

What is the process for removing Directors from office?

The model by-laws allow both the membership and the Board to remove members of the board. If you have a good rationale, however, you may want to restrict who can remove Directors.

Are there specific issues the Board should engage in that should be discussed amongst the founders of a firm?

The model by-laws leave all policy matters to the Board of Directors. However, there may be some issues that you require a membership vote for. If you elect to adapt this policy, it should be specified in the operating rules section. For more detail on the appropriate role of the board versus membership see the ICA publication Democratic Governance.

ARTICLE VI: OFFICERS

This section is quite straightforward, although if you are going to have a benefit corporation, many B-Corporations do, this is where you specify their role.

In most states with a benefit corporation statute, the Benefit Officer cannot be the same person as any other officer.

ARTICLE VII: AMENDMENTS

What elements of the by-laws should be able to be amended and which parts should be set in stone?

The model by-laws do not allow issues regarding the trust share or indivisible reserves to be amended. They are set in stone to ensure that the power to sell the company is restrained indefinitely.

ARTICLE VIII: OPERATING RULES

The by-laws allow the board and the members to establish operating rules they can use in running the firm. Operating rules could be the method that meetings are run, employment issues, or certain financial issues. It's good practice to have your by-laws be simple, so in general you should provide leeway for the firm to set its own policy outside the by-laws. If there are specific issues you want to be spelled out, however, this is where they go.

CHOOSING YOUR LEGAL STRUCTURE

When starting or converting a democratic firm, you have to choose what legal structure your business should take. There are five main types of firms: C-Corporation, Cooperative Corporation, Limited Liability Company, Non Profit Corporation, or S-Corporation. Each form carries with it, certain benefits and drawbacks.

ICA has developed model by-laws and articles of incorporation for all the corporate structures outlined above except the LLC, although the C-Corp by-laws could be easily adjusted. But how exactly should you choose which form is right for your particular business?

Choose a C-Corp or Cooperative Corporation if the worker owners are clearly employees, if you have a need to retain significant earnings to fuel business growth and stability, and you are willing to commit to regular meetings.

Choose an LLC if the workers are clearly partners in a business and not employees. This model is used regularly by co-ops in industries like housecleaning, where the individual member acts kind of like an independent business. This is also a good option if you are likely going to seek outside investment from a variety of sources and do not wish to authorize multiple forms of stock. Take care that you don’t choose this option to skirt employment issues, not only is this possibly illegal, it doesn’t support workers.

Choose a Non-Profit corporation if you have a clear charitable mission and do not need to access capital markets to raise funds.

DESCRIPTION OF LEGAL FORMS

C-Corp:

A ‘traditional’ stock corporation where the entity is taxed separately from its owners. In this way, the C-Corp is subject to ‘double taxation’ where profits are taxed at the corporate level and then again when they are distributed to owners. Subchapter T, cooperatives incorporated as a C-Corp can avoid this double taxation for dividends paid out to members. While corporations can have an unlimited number of classes of stock, they require the authorization of share classes in the articles—which requires a state filing—and equal treatment of each share within a class. Worker-owners at a C-Corp are considered employees for purposes of employment law.

Cooperative Corporation:

A form of stock corporation that specifies that shareholders are members and the corporation operates for the benefit of its members. In states with a worker co-op statute modeled after the Massachusetts Law, the fact that the company is calculated at book value and member’s share of that value is recorded in an internal capital account is specified. In states with a cooperative statute, you likely cannot have the word cooperative in your name unless your business incorporates under the statute. In states where the state income tax mirrors Subchapter T, it may be necessary to incorporate under the state’s cooperative statute to realize that benefit. Worker-owners in a cooperative corporation are considered employees for purposes of employment law.

Limited Liability Companies (LLC):

LLCs are not taxable entities, but rather pass through entities, where the income from the business passes through to the owners (who are called members, even in non-cooperatives). The member then pays personal employment and income tax on their portion of the profits. In most cases LLCs can have unlimited classes of shares and an unlimited number of members. LLCs are also highly flexible vehicles for accepting investment, the terms of each new investment can be easily tailored without reference to a class of securities—and without amending the articles.

Most LLCs taxed in the same way as partnerships, therefore to retain earnings and not have members have to pay personal taxes, an LLC has to elect to be taxed as a C-Corporation (a more complex workaround is to establish a separate subsidiary corporation whose sole purpose is to retain earnings). LLCs electing to be taxed as C-Corps can retain up to $250,000 in retained earnings. In most cases, worker-owners at an LLC electing to be taxed as a C-Corp would be considered employees for purposes of employment law.

In LLCs taxed as partnerships it is not assumed that members are employees. As such, “non-resident aliens” can be worker-owners of an LLC without violating any employment law. This non-employment status can have both advantages and disadvantages — careful attention must be paid to ensure you are in compliance with applicable employment law. Furthermore, non-employees are not eligible for social safety net protections such as unemployment.

LLCs also have far less rigorous requirements for shareholder meetings and record keeping. While this simplifies certain things, a democratic corporation should hold regular (at least quarterly) board meetings and at least annual membership meetings. Despite not being a ‘corporation’ owners of an LLC retain the corporate shield against personal liability for corporate debts and liabilities.

Net-for-Profit:

Many worker cooperatives organize as non-profits. In fact, the ICA Group is organized as a cooperative structured nonprofit. The employees are the members of the firm, new members are approved by the existing members, and the staff as members elect the Board of Directors on a one person/one vote basis. Nonprofits that want a 501c(3) status must have a charitable mission and cannot pay out profits to their members, although staff can receive bonuses as compensation for labor. Nonprofits have a number of advantages: (1) corporate income is tax exempt, excepting unrelated business income; (2) all retained earnings are permanently reinvested in the firm (allowing business growth and income stabilization); and, upon dissolution, (3) all assets are protected by the state for distribution to another not-for-profit, such as for the purpose
of worker cooperative development. Non-profits cannot usually access capital markets for growth

S-Corp:
S-Corps are not taxed separately from their owners, and thus avoid ‘double taxation.’ The S Corp has a number of limitations: the corporation cannot have more than 100 shareholders (except in the case of an ESOP), there can be only one class of stock, and all shareholders must be individuals or simple trusts. Moreover, all corporate net income or loss is taken into account each year by the shareholders, without regard to actual distributions. Thus, if the corporation needs to retain substantial earnings, the worker-owners might face tax liability with no cash proceeds to pay the tax. A corporation operating on a cooperative basis in compliance with Subchapter T has much more flexibility to shift the tax burden among the corporation and the members, even while retaining corporate earnings and avoiding double taxation. Owners of an S Corp retain the corporate shield against personal liability for corporate debts and liabilities.

RESOURCES TO HELP YOU SUCCEED
ICA has developed a series of best in class materials designed to help worker co-ops and other democratic firms succeed.

The Democratic Corporation: The ICA Model By-Laws:
This publication provides a comprehensive introduction to worker cooperatives and includes a compendium of model by-laws for stock corporations, LLCs, or non-profits.

Democratic Governance:
Worker co-ops are built on a framework of democracy, but without an effective means to put this into place, it does worker very little good. This guide walks you through establishing an effective mechanism to ensure you are creating a democratic culture that works with your business.

The Internal Capital Account System:
Value in a worker co-ops is tracked using a system of internal capital accounts. This guide covers the basics of co-op finances, including the difference between capital shares and capital accounts, tax treatment for worker co-ops, and how to deal with financial losses.

Ensuring Your Legacy – Succession Planning & Democratic Ownership:
Many business owners look to employee ownership as a way to cement their legacy, yet the process can be confusing and perceived as risky. This report walks owners through the process of converting to a democratic firm and helps owners address whether this is the right next step.

A Comparison of Employee Ownership Models:
This publication provides a basic overview of the key differences between worker cooperatives, ESOPs, and hybrid models. It walks through the details of the various forms to help business owners weigh the financial and tax impacts of a sale.

Business Valuation Basics:
Determining the value of a closely held company is a difficult and imprecise science. This publication walks you through the basics of how a firm’s value is determined, and provides a checklist of what information is necessary to complete the process.

For more information visit our websites:
www.icagroup.org
www.workercooplaw.org
www.altstaffing.org