



The Secret Legal Life of Co-ops

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Disclaimer

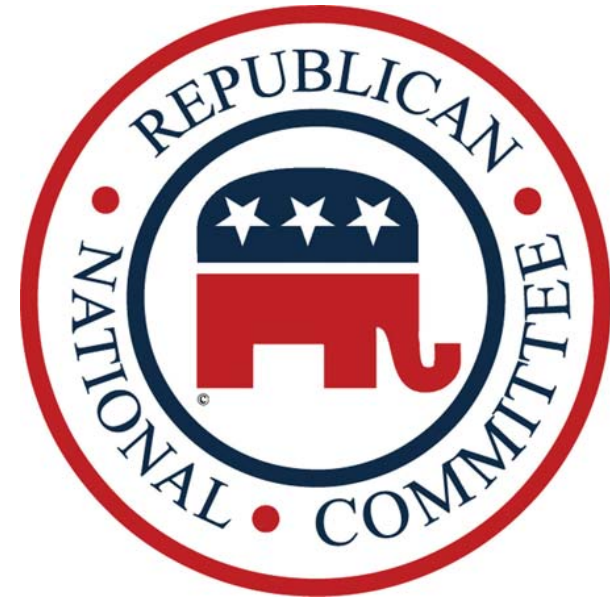


I am a lawyer . . . but I'm not
your lawyer.

Seven Days,

“Good for Business?” Issue, July 7

- Jeffrey Hollander, Chairman of Seventh Generation: “[B]usiness is basically a vehicle for transferring money from the poor to the rich.”
- Bill Carris of Carris Reels: Definition of “socially responsible” business is “all over the place” but he “knows it when he sees it.”



An autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise.

The Cooperative Principles

- Voluntary and open membership
- Democratic member control
- Member economic participation
- Autonomy and independence
- Education, training and information
- Cooperation among cooperatives
- Concern for community

What's a corporation?

- Chartered by a state
- Limited liability
- Perpetual life
- Can sue and be sued
- “Personhood,” see, e.g., *Citizens United v. Federal Election Commission*, 130 S.Ct. 876 (2010)
- Three major flavors

Old fashioned business corporation

- One share, one vote
- Obligated to maximize return on shareholder investment, especially if publicly traded
- Profits taxable, sometimes twice
- Various mutations: C Corps, LLCs, B Corps, L3Cs . . . ULCA?

501(c)(3) Nonprofits

- No shares – supposedly owned by the community
- Obligated to meet IRS's notion of charitable purpose
- Tax-exempt
- Donations generally tax-deductible to donors

Co-ops – best of both worlds



- Real democracy – one member one vote
- Unfettered by obligation to profit-maximize or be “charitable”
- Free to be entrepreneurial

Co-ops under Vermont Law

- Four types
 - Rural Electric Cooperatives, 30 V.S.A. Ch. 81
 - Cooperative Housing, 11 V.S.A. Ch. 14
 - Worker Cooperatives, 11 V.S.A. Ch. 8
 - Credit Unions, 8 V.S.A. Chs. 220-226
 - None of the above, 11 V.S.A. Ch. 7



Rural Electric Cooperatives

- “Cooperative” not defined, but structure specified
- Vermont RECS may be organized “for the purpose of creating or supplying energy, cable television, telecommunications, interactive media and internet access and facilitating and extending the use thereof, and in addition, any other lawful business not inconsistent with this chapter which utilizes the electric distribution facilities of the cooperative.”

Use of revenues specified

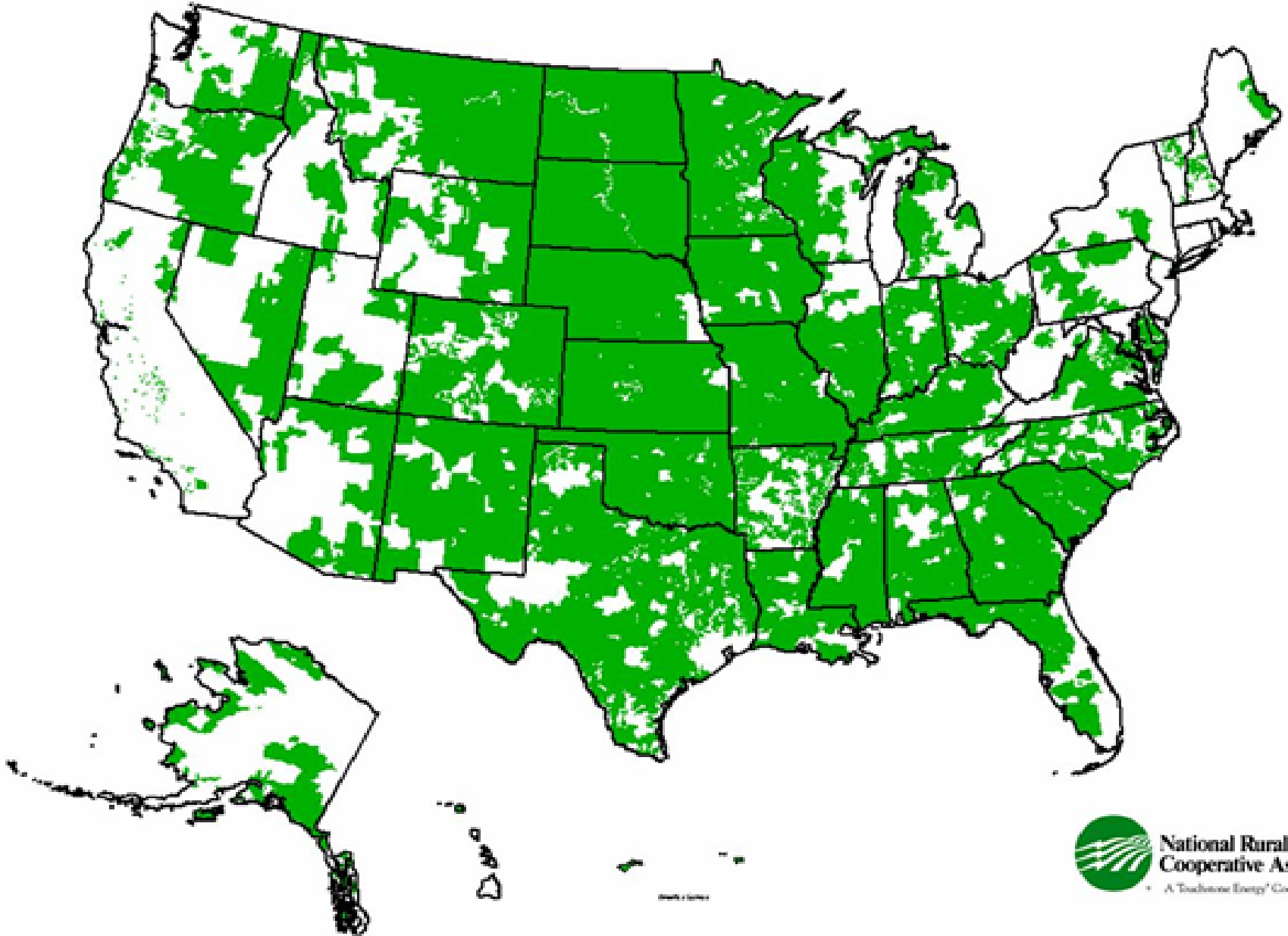
First use revenues:

- (1) For operation and maintenance,
- (2) To pay interest and principal obligations,
- (3) To finance additional facilities to the extent determined by the board of directors,
- (4) To provide a reasonable reserve for working capital,
- (5) To provide a reserve for the payment of indebtedness,
- (6) To provide a “[cooperative education fund](#),” for education in cooperation and for the dissemination of information concerning the effective use of energy and other services, goods or products made available by the cooperative,

And from what’s left over after that:

unless otherwise determined by a vote of the members, be distributed to members as [patronage refunds](#).

America's Electric Cooperative Network



Vermont Cooperative Housing Ownership Act

- Members must be residents
- One member, one vote for “limited equity” housing co-ops
- One third of board may be nonmembers
- Statute designed to create clarity for purposes of attracting mortgage lenders
- Members get a “proprietary lease”

What's a "limited equity" housing cooperative?

- "To fulfill the public purpose of providing and preserving housing for persons and households of low and moderate income at the time that they purchase their memberships."
- Cooperative interests may be sold at no more than a transfer value determined by a limited equity formula contained in the articles. That value shall be consistent with the object of maintaining long-term affordability of cooperative interests for persons or households of low and moderate income.
- Upon dissolution, any assets remaining after retirement of corporate debts and distribution to members shall be distributed to a 501(c)(3) nonprofit or another housing co-op
- Member/owners can sublease their units but rent can't exceed 110% of what the member pays under her "proprietary lease."

Vermont Worker Cooperatives

- Any Vermont corporation may elect to be governed as a worker co-op.
- Members must be employees and 50.1 percent of employees must be members.
- “‘Patronage’ means the amount of work performed as a member of a worker cooperative.”
- Net earnings declared as patronage allocations apportioned “in accordance with the ratio which each member's patronage during the period involved bears to total patronage by all members during that period.”
- Demutualization by majority vote.

11 V.S.A. §1081(a)

- An internal capital account cooperative is a worker cooperative whose entire net book value is reflected in internal capital accounts, one for each member, and a collective account, and in which no persons other than members own capital stock. In an internal capital account cooperative, each member shall have one and only one vote in any matter requiring voting by stockholders.



Vermont Chapter 7 Cooperatives

You can call yourself a co-op if:

- Each shareholder has only one vote
- Annual interest or dividend does not exceed six percent
- You set aside annually not less than ten percent of the net profits of the corporation for a reserve fund until there is accumulated a fund of not less than fifty percent of the paid up capital stock;
- Remaining earnings distributed by a uniform annual dividend upon the amount of purchases or sales, or the amount of raw material furnished to, or business done through, the corporation by the shareholders
- No member owns more than 10 percent of the stock

More about Chapter 7 co-ops

- Specific provisions related to agricultural (and handcraft) marketing co-ops and consumer co-ops
- Co-ops incorporated in other states may do business in Vermont if organized under “generally similar” laws of another state
- The bylaws may allow one or more directors to be appointed by any public official or commission or by the other directors selected by the members or their delegates. Such directors shall represent primarily the interest of the general public and need not be members. They can't number more than one-fifth of the entire board.

Uniform Limited Cooperative Association Act (ULCAA)

- National Conference of Commissioners on Uniform State Laws
- Chair of drafting committee = Middlebury's own Peter F. Langrock, Esq.
- Wyoming, Tennessee, Iowa, Minnesota, Wisconsin, Nebraska, Utah, Oklahoma
- House Bill 109 in 2010 – adopted by House, but not Senate

Limited Cooperative Associations

- Designed to attract investment capital
- User (patron) members *and* nonuser (investor) members
- User members must be allocated at least half of net profits (or losses)
- At least 1/3 of board must be user members
- User members must elect majority of board
- Major organizational changes require two-tier voting – majority or supermajority of members present plus majority of user members
- LCAs do *not* have to adopt one-member one-vote as to either class of member



Not
everything
that looks
like a
cooperative
is a
cooperative.

Federal Taxation of Co-ops

- Rural Electric Co-ops are 501(c)(12)s
 - No charitable purpose required
- Credit Unions are 501(c)(14)s
 - No charitable purpose required
- Section 501 exempt organizations must file Form 990
- Read them at www.guidestar.org

Federal Taxation of Co-ops



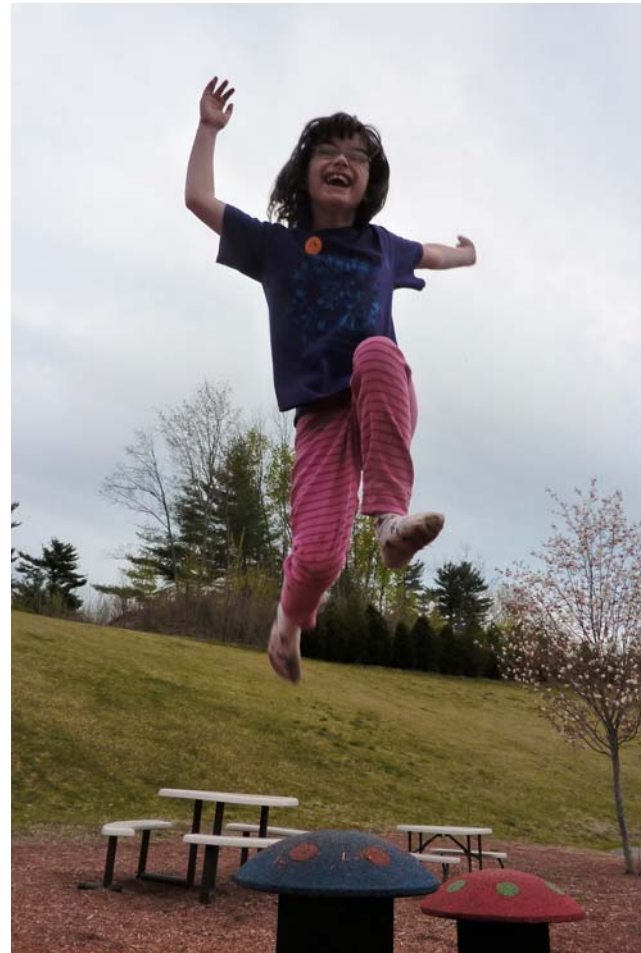
- Dividends paid by Agricultural Co-ops exempt per Section 521 of the Internal Revenue Code
- Subchapter T (26 U.S.C. §§ 1381-1388) of Subtitle a, Chapter 1 of the Internal Revenue Code

Subchapter T, Oversimplified

- Patronage refunds not taxable income *to the cooperative* if paid in cash to members
- Retained earnings allocated to members
 - Either “qualified” or “unqualified”
- Qualified allocations not taxable income *to the cooperative*
 - Allocation must be redeemable or members must have consented to tax liability – see your bylaws!
- Non-qualified allocations taxable to the cooperative.

26 U.S.C. § 1385(b)

- “[T]he amount of any patronage [refund] . . . shall not be included in gross income to the extent that such amount . . . is attributable to personal, living, or family items.”



Capper-Volstead Act (1922)



- 7 U.S.C. §§ 291-292
- Exempts from antitrust law cooperatives of agricultural producers, marketing their products on a cooperative basis

Securities Law – the Abyss

- *United Housing Foundation v. Forman*, 421 U.S. 837 (1975)
 - Co-op memberships are not subject to federal securities regulation, even if the co-op issues “stock”
- But member loan programs, preferred shares, etc. may be subject to state registration as securities.
- Offering in more than one state = registration with SEC in Washington = ugh!
- Contact CFNE, www.cooperatiefund.org . . . ?



Questions?

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