

LOW-INCOME & IMMIGRANT WORKER COOPERATIVE FORMATION

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I. WHAT IS A COOPERATIVE?

Cooperatives are member-based organizations, governed by democratic ownership principles where each member has one vote. They are governed by elected boards of directors, and often run by professional managers. Directors are elected by voting members. Cooperatives exist to provide some economic advantage to members or patrons. Typically all members are patrons, but not all patrons have to be members.

In cooperative businesses, capital is subordinated to labor. That means that control is shared based on membership and profits are allocated based on one's patronage of the co-op. Dividends are not allocated based on capital invested. In this regard cooperatives are dissimilar to typical corporate entities. This structure assures that the contribution of labor to the enterprise is put on par with capital contributions.

In general, members all contribute the same amount of capital through purchasing a membership share. The cooperative will set the cost of the membership share which remains constant. The membership share is not like a typical corporate share since it generally cannot be freely sold, its value does not fluctuate based on the value of the cooperative, and it can only be held by a member.

A. WORKER/ LABOR COOPERATIVE

In a labor cooperative, the commodity is not a tangible good; it is the labor of the individual. Patrons contribute their labor to the cooperative and are rewarded at the end of the year by a patronage refund if the cooperative earns a profit. Patronage refunds are apportioned based on the number of hours worked by the individual patron divided by the total number of hours that all patrons worked.

Notable examples of successful worker co-ops include Cooperative Home Care Associates in the South Bronx, Equal Exchange, the coffee and chocolate producer, and Rainbow Grocery in Oakland, California.

¹ For more information, visit <http://cdp-ny.org>.

II. HOW COOPERATIVES GET FORMED?

Cooperative businesses, like most businesses, are either launched around a unique idea or to fill a market gap, or come into existence from an existing, successful business.

A. START-UPS

Whether started in a garage, college dorm room, or elsewhere, at some point all businesses have to launch. The distinction between co-op start-ups and other business start-ups is the recognition early on among the founders that capital shall be subordinate to labor. For the most part this is a cultural decision.

The decision to do co-op is reflected by first asking key questions, such as: how do I want to operate my business? how do I want to live my life? what role, if any, will my work have in other areas of my life?

An important benefit of the co-op form is wealth creation for patron workers. In the typical capitalist paradigm the founders get rich when they sell their equity in an idea, which is represented by equity shares in a company, to a wealthy investor or to the public. In a cooperative, the goal is not for founders or management to "cash out," but for workers to build up equity over time and retire with money in the bank.

One current example of a start-up co-op is found in Cleveland. The goal of the Evergreen Cooperative Laundry, a newly-launched industrial laundry business in Cleveland's impoverished greater university circle area, for instance, is not just to make money, but also to provide jobs. The workers who patronize the laundry with their labor have jobs that will allow them to eventually build family wealth.²

The idea of the co-op start-up is therefore consistent with capitalist economics. The difference, however, is to create more capitalists, not fewer.

In addition to a stake in wealth creation, members also enjoy the right to control in governance decisions. Not only do members select the board of directors, but the slate of candidates for director positions are mostly members themselves. This means that members have more access to decisions that affect their work on a day-to-day basis.

B. SUCCESSION PLANNING & CONVERSION (CO-OPS VS. ESOPs)

Another opportunity for co-op creation is in succession planning. That is, when a business owner decides to retire without an heir to take over the business there is an opportunity to create a worker-owned cooperative or Employee Stock Ownership Plan (ESOP). Section 1042 of the Internal Revenue Code permits owners who sell 30% or more of the stock in their company to their workers through a worker cooperative to get the same deferral of taxes on the

² Alperovitz, Gar, Thad Williamson and Ted Howard, *The Cleveland Model*, *The Nation*, February 11, 2010, available at: <http://www.thenation.com/article/cleveland-model>.

capital gain on the sale as they would have if they sold to an ESOP.³

The first worker cooperative roll-over occurred at Select Machine in Ohio. John Logue from the Ohio Employee Ownership Center has written an in-depth case study of the Select Machine conversion analyzing the process for converting to a co-op.⁴

In addition, co-ops may be formed when a business owner announces the closure of a business. It's useful to note that the New York State Department of Labor has limited funds available for feasibility studies to explore the possibility of converting closing plants into worker co-ops. A feasibility study is often the first step in assessing whether a cooperative conversion is possible given the particular business and market conditions.

II. WHAT COOPERATIVE BUSINESS FORMS ARE AVAILABLE TO LOW-INCOME & IMMIGRANT WORKERS?

Low-income & immigrant workers considering forming worker co-ops have several entity options to consider. New York State has a Cooperative Corporations Law that contains some free-standing provisions, but refers to the Business Corporation Law and Not-for-profit Corporation Law depending on the specific type of cooperative for much of its default statutes. Other entity options include limited liability company or partnership structures.

A. NEW YORK STATE COOPERATIVE CORPORATIONS LAW (CCL)

"It is the declared policy of this state, as one means of improving the **economic welfare of its people**, particularly those who are producers, marketers or consumers of food products, to encourage their effective organization in cooperative associations for the rendering of **mutual help and service**." § 2 of the CCL (emphasis added).

The CCL permits the formation of four types of co-ops: (1) agricultural, (2) general, (3) membership, and (4) worker. Generally, the membership and worker types are most relevant in an urban pro bono microenterprise practice. However, where food production is the primary activity, clients should consider the agricultural or general types. For the purposes of this presentation we shall focus on the membership and worker cooperative corporations.

1. Membership Cooperative Corporation

§ 3(k) of the CCL defines a membership cooperative as "a non-stock cooperative which admits only natural persons to membership, which provides services only to members and which makes no distribution of net retained proceeds other than to its member on the basis of their patronage." § 5 states that the Business Corporations Law applies to cooperative corporations,

3 Britton, Eric D., Mark C. Stewart, *Selling to Your Employees through a Worker Cooperative – and Sheltering Your Capital Gain*, Ohio Employee Ownership Center, available at:

<http://dept.kent.edu/oeoc/OEOCLibrary/Coop1042Rollover.htm>.

4 Logue, John, *The 1042 roll-over cooperative in practice: A case study of how Select Machine became a co-op*, Ohio Employee Ownership Center, January 2006, available at:

http://www.usworker.coop/system/files/1042_rollover_co-ops_case_study_0.pdf.

except that membership cooperative corporations are governed by the Not-for-profit Corporation Law (NPCL) and are type D not-for-profit corporations.

2. Worker Cooperative Corporation

§ 80 of the CCL states that a worker cooperative is a cooperative incorporated under Article 5A of the CCL. It is democratically controlled and operated by its members. Note that unlike a membership, or other type of cooperative corporation, a worker cooperative corporation in New York may be formed for any lawful business purpose and may be conducted for profit. CCL § 13.

Also, no worker cooperative shall be classed as a non-profit or not-for-profit corporation. CCL § 83. This classification of a worker co-op as for profit might be a slight misclassification since the purpose of the worker co-op is not to generate a profit for the co-op itself, but for its members as patrons.

B. LIMITED LIABILITY COMPANIES OR PARTNERSHIPS OPERATED AS COOPERATIVES

Cooperatives may also be formed using limited liability company or partnership vehicles. Note, however, that only cooperative corporations may use the word "cooperative" or the abbreviation "co-op" in their legal name. In fact, § 3(j) of the CCL permits a cooperative corporation to seek injunctive relief to prevent the prohibited use of the word "cooperative" by a non-cooperative corporation. This same provision states that such prohibited use is a misdemeanor punishable by a fine not more than \$500.

Rarely does the CCL make any noteworthy news. However, recent announcements by the clothing retailer Barneys Co-op that it would open a store in Brooklyn's Cobble Hill neighborhood was met with some talk about Barneys Co-op using the co-op name in a manner prohibited by the New York Cooperative Corporations Law. Joe Holtz, general manager of the Park Slope Food Co-op, said "[i]t's a new thing having a co-op in Brooklyn that's not a co-op. ... There's something wrong with that."⁵ Mr. Holtz was referring to the prohibited use provisions of § 3(j) of the CCL.

There have also been at least two opinions issued by the state Attorney General's office regarding the appropriate interpretation of the prohibited use of the word "cooperative."⁶ These opinions were generated following requests from cooperative corporations to file certificates of incorporation with the Secretary of State. Once such opinion dealt with an entity that was permitted to file with the word "co-op" in its legal name because its use of "co-op" was geographic, as in "Co-op City Auto Repair, Inc." However, non-geographic use of "cooperative" or an abbreviation was deemed prohibited use by the Attorney General's office.

New York is not the only state with a cooperative corporations law. Other states, typically with large agricultural industries, have more comprehensive laws governing

⁵ Murrow, Lauren, *Barneys Co-op Draws Ire for Its Name*, New York Magazine, April 15, 2010, available at: http://nymag.com/daily/fashion/2010/04/barneys_co-op_draws_ire_for_it.html.

⁶ See NYS Attorney General Opinion No. 283, 1938; see also NYS Attorney General Opinion No. 31, 1970.

cooperative formation. Ohio, for instance, has taken the approach of creating free standing cooperative laws. That is, co-op laws that do not refer or incorporate by reference other non-co-op corporate laws.

III. ISSUES IN FORMING COOPERATIVES

The first step in counseling cooperative businesses is selecting the appropriate entity and drafting the organic documents. The principle organic documents, like any other corporate entity, are the certificate or articles of incorporation and the by-laws. Choice of entity will be governed by some of the considerations discussed above:

A. DRAFTING THE CERTIFICATE/ ARTICLES OF INCORPORATION

While § 11 states what must be included in the certificate of incorporation for a cooperative corporation, the CCL is silent concerning the purposes of the membership cooperative corporation. Since membership cooperative corporations are governed by the NPCL, the Secretary of State, Division of Corporations, has been filing certificates that have purposes clauses that state the specific activities of the cooperative corporation, like any other not-for-profit corporation. This is in contrast to worker cooperatives corporations which can be formed for any legal purpose.

B. DRAFTING BYLAWS

Cooperatives have unique needs and cultures. Governance procedures are therefore important to defining how co-ops shall make decisions.

Model by-laws for membership cooperatives are available from the presenter upon request. Although, it is important for attorneys advising co-op clients to spend significant time discussing governance procedures with the members who will eventually have to live by those by-laws. One size does not necessarily fit all.

IV. WHAT SUPPORT ORGANIZATIONS ARE AVAILABLE TO ASSIST COOPERATIVES OR ATTORNEYS IN DEVELOPING OR OPERATING COOPERATIVES?

Within the cooperative movement are a variety of support organizations, both for attorneys representing co-ops, and co-ops themselves. Note that co-ops operate according to seven internationally-accepted principles.⁷ These principles govern how co-ops operate fundamentally. They also create a sense of support among co-ops.

Here is a brief list of organizations, broken into several categories, from which attorneys representing co-ops can seek assistance in representing their clients:

⁷ International Co-operative Alliance, *Statement on Co-operative Identity*, available at: <http://www.ica.coop/coop/principles.html>.

A. EXISTING COOPERATIVES (6TH PRINCIPLE OF COOPERATIVES: COOPERATION AMONG COOPERATIVES, 7TH PRINCIPLE OF COOPERATIVES: CONCERN FOR COMMUNITY)

There are several well-known, successful co-ops in New York State. Cooperative Home Care Associates⁸ is the largest, by number of workers, worker cooperative in the country. Examples of community-based co-ops include Si Se Puede, Women's Cooperative, We Can Do It,⁹ a women's housecleaning co-op in Brooklyn.

B. REGIONAL & NATIONAL & INTERNATIONAL NETWORKS/ LENDERS

Networks at all levels have formed to support co-op development. At the regional level, there are networks like the NYC Network of Worker Cooperatives,¹⁰ and Valley Alliance of Worker Co-ops (VAWC).¹¹ There is a national federation called the U.S. Federation of Worker Co-ops,¹² and the International Co-operative Alliance.¹³

Beyond attempts to create a federal employee ownership bank, lenders such as credit unions, and co-op development funds exist to provide loans to encourage worker ownership opportunities.

There are also additional resources available online.¹⁴

8 www.chcany.org.

9 www.wecandoit.coop.

10 www.nycworker.coop.

11 wiki.valleyworker.coop.

12 www.usworker.coop.

13 www.ica.coop.

14 Go.Coop, available at: <http://www.go.coop/>. Worker Cooperative Toolbox: In Good Company: A Guide To Cooperative Employee Ownership, Northcountry Cooperative Foundation, 2006, available at: http://www.community-wealth.org/_pdfs/articles-publications/coops/report-lund-et-al.pdf