

LEGAL STRUCTURE OF COOPERATIVES

Forming any type of corporation limits the individual liability of those associated with the incorporated firm.

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A. Legal Status of Cooperatives

1. Incorporation

To conduct its business effectively, a cooperative must exist as a legal entity separate from its members. Incorporation is necessary to achieve such status.

Like other corporations, cooperatives obtain significant advantages from incorporation. The primary one is limited liability. Under incorporation, the personal liability of the individual owner/ members for the co-op's losses are limited to the amount of equity each member has invested in the co-op.

All states have statutes pertaining specifically to cooperatives (in Wisconsin, cooperatives are governed by Chapter 185). The documents necessary to incorporate a co-op are the articles of incorporation and the bylaws (see below for instructions on preparing these documents). Filing the articles of incorporation creates the co-op as a legal entity; while the bylaws provide the co-op with guidelines for conducting business. It is advisable to obtain legal counsel to review the articles of incorporation and bylaws.

Government is not an enemy or a friend, but a tool in the conduct of business that is necessary to ensure fair play. It is not expected to be responsible for saving us.

Bill Patrie
North Dakota Assn. of
Rural Electric Co-ops

2. Capper-Volstead Act

Around the beginning of the 20th century, the U.S. Congress passed anti-trust laws designed to break up powerful corporate monopolies which controlled a number of industries. This legislation did not acknowledge, however, that many farmers had been collectively marketing their products together for decades. Thus, additional legislation was needed to enable farmers to continue doing so without violating anti-trust laws.

The Capper-Volstead Act of 1922 exempted farmer cooperatives from anti-trust legislation. The Act enabled members of co-ops to collectively market their products and to exchange pricing information among them. Note that cooperatives must meet certain criteria in order to qualify for exemptions under Capper-Volstead. It is advisable to seek legal counsel to determine if your cooperative is qualified to receive them.

B. Legal Documents Pertaining to Cooperatives

In order to exist legally and function effectively, a new cooperative must develop the following legal documents:

1. articles of incorporation
2. bylaws
3. membership application
4. marketing agreement

These documents form the legal and operational basis for the co-op. They should provide a solid foundation on which to build a new business, and should be developed with care and legal counsel.

Each document is discussed separately below.

1. Articles of Incorporation

The articles of incorporation are filed with the state when the co-op incorporates. They should be the first document the co-op develops.

In Wisconsin, a cooperative exists as a legal entity when articles are filed and accepted by the state. The Department of Financial Institutions (Secretary of State) has copies of the proper articles to file. The Articles of Incorporation set out the basic characteristics of the cooperative, including its name, address, and type of business. The specific information required by law is described in the state statute. Note that articles of incorporation are legally binding; all subsequent documents adopted by the co-op must be consistent with the articles. Articles can be amended by procedures established in most cases by state statute.

A copy of the cooperative articles of incorporation form for Wisconsin appears in the Appendix. Although these may be used as a model to draft articles for your co-op, we strongly suggest that a qualified co-op lawyer review your draft articles before adopting them.

Articles of Incorporation for Cooperatives*

Incorporation is usually the best method of organizing. Each State has special enabling laws under which cooperatives may incorporate. It may be preferable to incorporate under the state's general corporation enabling act, but structure bylaws to operate as a cooperative.

Incorporation gives the cooperative a distinct legal standing. Members generally are not personally liable for the debts of an incorporated organization beyond the amount of their investment. The articles indicate the nature of the cooperative business. The articles should specify rather broad operating authority when incorporating even though services may be limited at the beginning.

These articles usually contain the name of the cooperative, principal place of business, purposes and powers of the association, proposed duration of the association, names of the incorporators (in most States), and information about the capital structure. In some States, the names of the first officers of the association must be included.

Filing the articles of incorporation (usually with the Secretary of State) activates the cooperative corporation. After the organizing committee approves the articles, the attorney files for the corporation charter and includes the recording fees. Once chartered by the State, the cooperative should promptly adopt bylaws.

[SEE APPENDIX D](#) FOR ARTICLES OF INCORPORATION FORMS.

*From Galen Rapp and Gerald Ely, "How to Start a Cooperative," Cooperative Information Report 7. Washington DC: United States Department of Agriculture, Rural Business-Cooperative Service. Revised September 1996.

2. Bylaws

The co-op's bylaws provide a more detailed description of the cooperative's internal structure and operations. They are a set of written rules for how the co-op will function and govern itself. Bylaws are not usually filed with the state in which the co-op will operate, but they are considered legally binding on the cooperative and its members.

If you draft the bylaws yourself, we strongly recommend that you have a lawyer who is knowledgeable about cooperatives review your bylaws before presenting them to the membership for approval. This will ensure that no aspect of your draft is in conflict with the articles of incorporation or your state's statutes.

An outline of the major topic areas that the bylaws should cover appears below.

Membership

Identifies the qualifications for eligibility and procedures for joining the cooperative, including requirements for purchase of stock, if any. Describes the procedure by which membership may be ended, either voluntarily or involuntarily.

Meetings of Cooperative Members

Identifies the date for the annual meeting; how and when any special meetings may be held; requirements for notice of upcoming meetings; procedures for voting and requirements for a quorum; order of business at the annual meeting.

Directors and Officers

Specifies the number and qualifications of directors; procedures for electing directors and length of terms; election of officers by the board; frequency of board meetings and requirements for notice of board meetings; any special meetings; compensation of board members and requirements for a quorum.

Duties of Directors

States the director's specific powers and responsibilities, including: guiding the cooperative and articulating its mission, goals, and policies and periodically reviewing those goals. Authorizes directors to employ a manager, define the manager's duties, determine his or her compensation and evaluate his or her job performance. Specifies the director's responsibility to maintain an appropriate accounting system and have the co-op's books audited or reviewed annually. This section also specifies the board's responsibility to indemnify directors, officers and management against liability.

Duties of Officers

Specifies the duties of the president, vice president, secretary, and treasurer. Also describes the terms of officers and excused absences from board meetings.

Membership Capital Contributions

Specifies the required equity contribution by members and the method by which the co-op will collect the contribution; what type of stock the cooperative has the authority to issue; and any requirements regarding the co-op's stock certificates.

Profits and Losses

Specifies how the co-op's profits, if any, will be distributed based on each member's patronage with the co-op. In addition, any losses experienced by the co-op must be allocated across the membership.

Equity Redemption

Gives the board authority to determine at what time and in what manner the cooperative will redeem members' equity in the cooperative.

Nonmember Business

Specifies how the cooperative will distribute the benefits, if any, resulting from business with non-members.

Dissolution

Identifies a procedure for dissolving the cooperative, and specifies the distribution of any remaining assets.

Amending the Bylaws

Specifies a straightforward method by which the bylaws may be amended.

...prospective members must have enough trust in the individuals associated with the cooperative and confidence that the projected member benefits will be delivered to them, to write that check for their investment in the new cooperative and make the commitment to join.

Brian Henehan
Cornell University

3. Membership Application

This document is used to apply for membership in the cooperative, and should include the prospective members name, address, telephone, and signature, as well as a statement that the individual agrees to abide by the co-op's bylaws and meets all membership qualifications.

It also specifies the equity contribution required (the number of shares of stock being purchased or the amount of the membership fee if it is a non-stock co-op), which is often submitted at the same time as the application.

This application, approved by the board of directors and signed by the co-op president, is the primary legal proof that the individual is a member of the co-op. However, a stock certificate can also serve to recognize that the person has been accepted as a member of the cooperative. Careful records should be kept of membership agreements, stock sales and other transactions between the member and the cooperative for tax purposes.

Please see the combined membership/marketing agreement on the next page.

A couple hours of a lawyer's time up front could save the co-op a great deal of money later on.

4. Marketing Agreement

The marketing agreement, used primarily by agricultural marketing co-ops, is a contract between each individual member and the co-op's membership as a whole. It is intended to benefit both the member and the co-op by setting out the respective obligations of both parties in terms of product delivery, sale, and payment.

As a contract, the membership agreement should carefully specify the production commitment of the producer (measured in either volume or acres), and the specific products to be marketed; describe how the value of the producer's goods will be determined and when s/he will be paid for them; specify any actions that are considered in breach of the contract; and include an Act of God statement that releases both parties from their commitments to the contract in the event of a natural disaster which substantially harms the producer's crop.

It is highly recommended that the co-op seek a knowledgeable lawyer to review the marketing agreement draft before putting it to use. A couple hours of a lawyer's time up front could save the co-op a great deal of time and money down the road.

COMBINED MEMBERSHIP/MARKETING AGREEMENT

Membership Application for Cooperatives, including a Sample Outline*

This form has five main parts: applicant's statement asking to become a member of the cooperative, signature of the applicant, statement of cooperative acceptance of applicant, signatures of the president and secretary, and a statement of the duty and intent of the member.

The application, signed by the member and approved by the board of directors, is the legal proof that a patron is a member. A cooperative should have a completed membership application on file from every member. Membership and the amount of business done with members and nonmembers are important factors for certain antitrust and taxation provisions.

Membership Application and Marketing Contract

THIS AGREEMENT between the _____, Inc., hereinafter referred to as the Association, and the undersigned Producer, witnesseth:

The Producer

1. Applies for membership in the Association, and if accepted as a member, agrees to be

bound by its articles of incorporation, bylaws, rules, and regulations as now or hereafter adopted.

2. Appoints the Association as agent to sell all the _____ of marketable quality produced on any farm in control of or operated by the Producer, except that required for consumption on the farm.

3. Will deliver such products at such times and to such places in unadulterated form under such conditions as may be prescribed by proper authorities.

4. Will notify the Association of any lien on the products delivered hereunder, and authorizes the Association to pay the holder of said lien from the net proceeds derived from the sale of such products before any payment is made to the Producer hereunder.

5. Will provide capital in such amounts and in such a manner as may be provided in the bylaws.

The Association:

1. Accepts the application of Producer for membership in the Association.

2. Agrees to act as agent for the marketing of products of Producer as herein provided.

3. Will dispose of Producer's products in a manner deemed to be most advantageous for its members.

4. Will account to the Producer in accordance with this contract for all amounts received from the sale of products as herein provided.

5. Will reflect in an appropriate capital account the capital received from each patron.

*From Galen Rapp and Gerald Ely, "How to Start a Cooperative," Cooperative Information Report 7. Washington DC: United States Department of Agriculture, Rural Business-Cooperative Service. Revised September 1996.

The Producer and the Association mutually agree that the Association shall have the power:

1. To establish various plans for making returns to the Producer.

2. To blend or pool proceeds from sales of products of the Producer with the proceeds of the sales of products of other Producers, and to account to or settle with Producer therefore in accordance with established plans.

3. To process or cause to be processed products of the Producer and dispose of the same in the manner deemed most advantageous to its members.

4. To collect from buyers of products the purchase price therefore and to remit the same to Producer under a plan authorized by this contract after making uniform deductions deemed adequate for all necessary expenses and for capital purposes.

In case of a breach of this contract by the Producer, the actual damage to the Association and other producers cannot be determined. Therefore, Producer agrees to pay to the Association as liquidated damages for such breach, the sum of _____ dollars () per _____ on all products that would have been delivered had the Producer not breached the said contract.

And the Association shall further be entitled to equitable relief by injunction or otherwise

to prevent any such breach or threatened breach thereof and the payment of all costs of litigation in connection with the exercise of any or all of the remedies available to the Association.

This contract shall remain in effect for an initial term of () years from the date hereof. Following the initial term, the contract may be cancelled by notice given in writing by either party to the other within ten (10) days after any yearly anniversary date, and such cancellation shall become effective on the last day of the second calendar month following the month during which such notice is given.

Date _____
Producer's signature _____ (_____) _____
Address _____
Social Security No. _____ - _____ - _____ County _____
Accepted this day of _____, 19_____. _____, Inc.
By _____, President By _____,
Secretary

(Some State laws provide for filing or recording cooperative marketing contracts in a county recorder's office to give notice to third parties that the contract exists. And acknowledgment if the contract is to be filed or recorded.)

Membership Certificate

This certifies that _____ of _____ is a member of _____ Association and is entitled to all of the rights, benefits, and privileges of the Association.

Date _____

(President)

Because the directors are also member/users of the co-op, they have a personal investment in making sure that it is successful.

D. Cooperative Board of Directors

(adapted from "Liability of Directors" by Robert Guenzel, Nebraska Cooperative Council)

A director of a cooperative has a special fiduciary relationship with that co-op and with its members. Cooperative directors have a duty to conduct the co-op's affairs in the members' interests; they are trustees of the members' property.

It is the duty of the board to hire and evaluate the performance of the cooperative's manager. If the manager fails to perform adequately, the board has a responsibility to the members to respond effectively.

Directors should always use their best business judgment in conducting the co-op's affairs, making decisions as reasonably prudent people would. Directors should use reasonable care and skill to obtain knowledge useful to them in making such decisions. They must be willing to ask questions, even if such questions are inconvenient for co-op management. They must be willing to take steps to obtain sufficient appropriate information to make good decisions.

This does not mean, however, that the directors can ensure that the cooperative will be financially successful. Directors are required to use their best judgment; if the members feel that a director has not done so and one consequence is that the co-op has not made money, they can exercise their right to elect a different director.

A person nominated for a director's position should carefully consider the responsibilities inherent in that position. Directors may be liable for damages if they are found to have exercised less than their best judgment.

Criteria for Separating Cooperative Board and Executive Decision Areas

There is no fine line of distinction between the executive's and the board's authority for specific action. The following ten criteria may be helpful in distinguishing board and executive decision areas.

Criterion 1

Ultimate accountability to stockholders or members is vested in the board of directors, who may subsequently grant certain authority to officers, agents, and employees as permitted under the corporate charter, bylaws, and applicable laws. The executive or general manager, in turn, is accountable to the board and initiates action within the boundaries of authority granted by the board.

Criterion 2

The board of directors is primarily concerned with idea decisions; executives are primarily concerned with action decisions.

Criterion 3

Decisions on overall objectives, policies, and goals of the company are the responsibility of the board.

Criterion 4

Decisions related to attaining objectives and goals are the responsibility of executives.

Criterion 5

Decisions involving long range and consequential commitment of resources, which include facilities, finances, or manpower, are the board's responsibility.

Criterion 6

Decisions involving long range and consequential commitment of resources, which include facilities, finances, or manpower, are the board's responsibility.

Criterion 7

Decisions related to the assurance of capable executive succession by providing for executive depth and training are the board's responsibility.

Criterion 8

Decisions specifying the ideal pattern or model of board behavior and performance, and the review of and perpetuation of this ideal through indoctrination and training of directors, are the board's responsibility.

Criterion 9

Control over the executive and of board performance, decisions involving long range and substantial financial commitments and financial structure, objectives and policies, and public and member relations are the board's responsibility.

Criterion 10

Control over operations and over subordinate managers and employees, decisions involving budgets, procurement, production, and marketing plans, and industrial and employee relations programs are the responsibility of executives.

The following are some decision areas that are often performed by the board, management or shared.

Board Decisions Solely

1. Defining corporate objectives, policies, and goals (but with opportunity for management participation and recommendations for setting goals).
2. Long range financial commitments, including sources and type of financing.
3. Selection of chief executive (manager) and his salary.
4. Defining duties of chief executive.
5. Filling board vacancies.
6. Employing corporate auditing firm (unless bylaws provide for membership approval).
7. Retaining board legal counsel.
8. Basic changes in financial structure.

9. Approval of major plans and commitments.
10. Matters where stockholder or member decisions are due.
11. Selection of banking, insurance, and related entities.
12. Approval of employee retirement and benefit programs.
13. Basic affiliations with suppliers.

Management Decisions Primarily

1. Defining operating or management level objectives, goals, and policies within constraints of corporation-wide decisions.
2. Short run commitments of resources.
3. Preparation of budgets, production plans, and market plans for approval by board.
4. Defining duties of division and department heads.
5. Administration of employee benefits program and salary determination (consistent with salary scales approved by board for key management people).
6. Selection of employees.
7. Short run decisions on sources of supply that do not modify basic board decisions.
8. Selection of management's legal counsel.
9. Employee working conditions.
10. Measurements of employee performance.

Shared Decision Areas

The following were identified by respondents in a survey by the Agricultural Cooperative Service. There is some difference from the above list.

1. Relations with government, industry, and general public.
2. Insurance requirements (but not the source selection).
3. Amounts and sources of working capital
4. Engaging professional services.
5. Employee benefits plans.
6. Selections of depositories
7. Appraisal of cooperative's performance
8. Distribution of earnings.
9. Financial relationships with affiliates.
10. Employee bonding..
11. Changes in basic organizational structure
12. Issuing capital instruments.
13. Authorizing facility construction, expansion, etc.

	<u>BOARD</u>	<u>MANAGEMENT</u>
ACCOUNTABILITY	To Members	To Board
AREAS OF CONCERN	Idea Decision , Judge Ends/Purpose	Action Decisions, Manage Means/Activities
COMMITMENT OF RESOURCES	Determine Values Long-Range, Consequential Set limits, Monitor	Intermediate and Short-Range Organize and Control Resources
GOALS, POLICIES	Determine Set Policies Regarding Results to be Achieved and Limitations on	Implement
MANAGEMENT EVALUATION	Activities Monitor Progress Toward Results Monitor Compliance with Limits	Provide Information for Monitoring
OPERATIONS	Determine Values and Goals Set Limits Monitor	Conduct
PERPETUATION	Assurance of Capable Management and Board Succession	Support, Participate
BOARD PROCESS	Determine Structure, Behavior, Performance Evaluation, Calendar and Agenda	None

Adapted from Leon Garoyan and Paul O. Mohn, "The Board of Directors of Cooperatives." Davis, CA: University of California (1976).