

Building Commonwealth:

A guide to building a sustainable, equitable cooperative business in Kentucky.

Version 2

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Prologue: About this Guide

The creators of this guide are very excited about your interest in cooperatives. We truly believe co-ops offer great benefits to strengthen local economies and give community members autonomy from the institutions in the place where they live. Co-ops come in a variety of forms, operate in a myriad of industries, and each one is different according to the needs of its founders and membership. Therefore, this guide is not exhaustive, as it could not possibly anticipate, or accommodate, all of the different interests people may have in starting a co-op. What this guide is meant to do, however, is to provide a framework and considerations to help direct you as someone who is considering starting a co-op, in Kentucky specifically. Throughout this document, we will refer to the Kentucky Revised Statutes (KRS), these are the state laws that include provisions governing cooperatives and they can be found online here: <http://www.lrc.ky.gov/statutes/index.aspx>. **This document does not constitute legal advice**, it only provides some helpful information to aid in starting a co-op. We highly encourage you to consult an attorney when you begin the journey of building your cooperative company. We hope you find this guide helpful in getting started.

I. Co-op Basics

What Exactly is a Co-op?

The International Cooperative Alliance defines a cooperative as, “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.”¹ Cooperatives are owned, governed and operated by their participating members on the democratic principle of one member, one vote. In a traditional corporation, voting power is vested with stockholders who seek to maximize the value of stock and company profits. Voting power is often tied to the stockholder’s level of monetary investment in the company. In a cooperative, the patron- or worker-owners of the business share voting power on an equal basis.² As a business form, co-ops allow individuals and businesses to allocate responsibility, risk, expense, and rewards through a shared-governance business model. At their core, these types of businesses are about cooperation among owners, hence the name “cooperative.” Cooperatives generally possess a number of core principles:

- Open membership. Anyone can join, or certain requirements can be established by the cooperative for joining.
- Democratic control. Traditionally this means one-member, one vote.
- Economic participation by members on an equitable and democratic basis.
- Education and training for members, directors, and managers. Many cooperative owners consider it an essential responsibility to foster an understanding of cooperative values and business and board management.
- Cooperative autonomy. The cooperative remains independent to achieve its function, it has a social purpose in addition to generating a profit and, the benefit of its patrons and workers is an imperative concern.³

All cooperatives, in accordance with their name, operate by the principle of shared, or cooperative, ownership. They can, however, take many different forms in terms of function and purpose. A cooperative may be a “worker-owned business,” where the employees working in

¹ Margaret Lund. Cooperative Equity and Ownership: An Introduction. Available at: <http://community-wealth.org/content/cooperative-equity-and-ownership-introduction> (2013)

² Id.

³Charles T. Autry, & Ronald Felton Hall. The Law of Cooperatives. (2009)

the company are its owners. Or, when the people buying the goods or services of the company are the owners, such as with a grocery store, it is known as a consumer cooperative. A farmer's market owned by local farmers who bind their efforts to sell their goods is an example of a producer cooperative. Producer cooperatives involve people cooperating to manufacture and market goods, and a purchasing cooperative is a collaboration among buyers to enhance their combined purchasing power.⁴

The cooperative business model is used for a variety of reasons. Co-ops are a tool that can respond to market forces and promote economic development in traditionally underserved areas. When services are unavailable in a specific area, a community can band together to meet their need by forming a cooperative. Examples include electricity and utility cooperatives in rural areas where large for-profit companies often do not consider it gainful to provide services. In urban areas, housing co-ops can provide affordable housing options by pooling individuals' money and enhancing buyer power. Worker cooperatives allow individuals to market their labor collectively in a way that generates wealth through gaining equity in the company.⁵ Farmers have been some of the most successful with creating profitable and efficient cooperatives with national examples such as Ocean Spray, Sunkist, and Blue Diamond.⁶ The Mondragon corporation, a federation of worker cooperatives in the Basque region of Spain, employs over 70,000 people. Founded in 1967, the Federation of Southern Cooperatives seeks to retain black-owned lands and use cooperatives for land-based economic development in the Southeast United States. These are just a few of the numerous co-ops you can look to for direction as you begin to develop your own business idea.

The Benefits of a Cooperative

Generating Wealth

Cooperatives generate wealth for communities and individuals in a variety of ways. As previously mentioned, they can provide goods and services to underserved areas that are deemed to have less profitable markets.⁷ Because local residents are often the patron- or

⁴ Democracy Collaborative, Overview Cooperatives. Accessed January 14, 2015 at: <http://community-wealth.org/strategies/panel/coops/index.html>

⁵Autry, Charles T. and Hall, Ronald Felton. *The Law of Cooperatives*. (2009)

⁶Id

⁷Democracy Collaborative, Overview Cooperatives. Accessed January 14, 2015 at: <http://community-wealth.org/strategies/panel/coops/index.html>

worker-owners of a cooperative, these types of businesses can create jobs for community members and business profits tend to remain in the community.⁸ These attributes make cooperatives a local solution to filling gaps in a community's economic life. Further, through collaboration among multiple parties, purchasing and producer cooperatives can help small, local businesses be competitive in markets with larger, national-scale goods and service providers.⁹

Favorable Tax Treatment

Correctly organized cooperatives benefit from favorable tax treatment. The IRS treats specific kinds of cooperatives, such as mutual or cooperative telephone companies, rural electric cooperatives, mutual ditch or irrigation companies, benevolent life insurance companies of a purely local character, and others that are "like entities" as a nonprofit entity exempt from federal taxes under section 501(c)(12) of the Federal Tax Code.¹⁰ Also, with their long and rich history of operating as a sort of quasi-nonprofit, it is well established that money distributed to a cooperative's "patrons," is not subject to double taxation, as a standard corporation would be, as long as they are truly operated on a cooperative basis.¹¹ Subchapter T of the Federal Tax code governs how co-ops may avoid taxation on patronage dividends. Also, traditional business owners are also rewarded for selling a business to employees who want to make it a cooperative with deferments on corporate gains through section 1042 of the Federal Tax Code.¹² The tax implications of a cooperative are discussed in more detail later in this document and you are highly encouraged to seek out the advice of an accountant familiar with co-ops who can help you understand the ins and outs of cooperative taxation.

Outperform traditional business

Cooperatives are a proven, viable business entity, shown to outperform traditional businesses in many ways.¹³ Survival rates exceed those of regular firms, and cooperatives

⁸Id.

⁹Id.

¹⁰ Charles T. Autry, & Ronald Felton Hall. *The Law of Cooperatives*. (2009)

¹¹ Id.

¹² Britton, Eric D. & Stewart, Mark C. *Selling to Your Employees through a Worker Cooperative - and Sheltering Your Capital Gain*. (2001). Available at: <http://dept.kent.edu/oeoc/oeoclbrary/Coop1042Rollover.htm>.

¹³ John Logue & Jacquelyn Yates. *Productivity in Cooperatives and Worker Owned Entities: Ownership and Participation Make a Difference*. (2005)

often offer creative benefit packages for employees.¹⁴ Aside from this, cooperatives benefit from management with an incentive to support the long-term health of the organization and who have strong ties to the community. Co-ops are valuable to local economies because they keep a larger percentage of local money in local pockets.¹⁵

How it Works

Cooperatives group together people interested in working toward a common goal and provide a structure to accomplish that goal. Cooperatives are not formed to generate a dividend for investors and do not make a fortune for their owner, but instead work to equitably distribute wealth to all of the member-owners. In a cooperative, financial profits and benefits accrue to members based on patronage and not based on investment in the business. The cooperative is a business entity whereby members receive the benefits of patronage through a shared, collective action model.

The collective action model of a cooperative creates a different framework for decision-making, differentiated from companies owned by shareholders who often have little interest in the day-to-day activities of the company. While a corporate restaurant may pay servers the server minimum wage, a worker-cooperative restaurant will only do so if all the owners, including the servers, agree this is the fair rate. Corporate owners see compensation hundreds of times greater than the wage of the bottom-rung workers. Cooperatives bring this pay disparity down to what makes sense for all those involved.

As mentioned, a key concept in the operation of cooperatives is the idea of patronage. Simply put, patronage is the business a user or member provides to a cooperative, and how patronage is measured depends on the type of cooperative. User-oriented cooperatives pay their patrons based on how much the patron uses the cooperative. Let's say there is a cooperative formed to market spring mix from micro-farms. Each member provides the spring mix they produce and the cooperative accounts for this contribution based on a formula agreed to by members. At the end of an accounting period, each member is paid a dividend from the cooperative that is based on the percentage of spring mix provided by members. If one person contributed 55 percent, another 35 percent, and another 15 percent of the product, then the money divided at the end of the year would be distributed according to the same percentages. Worker cooperatives work in a similar fashion, but patronage becomes slightly more abstract.

¹⁴ Id.

¹⁵ Id.

Workers patronize a worker cooperative by providing their service to the cooperative. They are therefore paid patronage dividends based on the percentage of the total hours they work in the organization per period.

Final Note

It is important to celebrate the history of cooperatives as a disruptive force that are a sturdy and viable alternative to traditional, business structures that seek to maximize shareholder profit. Not only are cooperatives radical and subversive in the modern business context, they are also a proven method for building a business that can compete on its own merits. After all, who better to manage a business than the people it serves?

II. Formation

Before a cooperative is formed, the owners need to ask themselves a series of questions about what type of business the cooperative will be, how they want the cooperative to function, what purpose it will serve, and how it will be managed. This section delves into the two basic documents needed to form a cooperative, and highlights important points to consider in developing those documents. In order to create these documents, a series of meetings should take place to help think through issues of governance, management, and day-to-day business operations related to cooperative ownership. In addition, the new owners of cooperatives may want to host or seek out trainings for its leaders and members on topics such as finance, record-keeping, how to run a board meeting, general operating principles for business, and marketing to name a few.

Strangely enough, in KY a cooperative organized under KRS 272 is not allowed to call itself a 'cooperative' or any abbreviated version in its official business name unless it is a rural electric or telephone cooperative.¹⁶ A limited cooperative formed under KRS 272A can use the word 'Limited Cooperative Association' or certain specified abbreviation options.¹⁷ The limitation, however, does not apply to assumed name. A cooperative, in other words, can file with a name that complies with the rule and then file an assumed name certification with their preferred name. The co-op then will need to be careful on leases and contracts to make sure it is clear what their

To form a cooperative the two initial documents you will need are the articles of incorporation, to be filed with the Secretary of State, and bylaws that outline how the cooperative is governed. A cooperative can be formed as a cooperative corporation specifically, or may be a corporation or limited liability company that operates using cooperative principles. This document focuses on forming a cooperative corporation under Kentucky's Cooperative Statute found in Chapter 272 of the Kentucky Revised Statutes. Kentucky's cooperative statute is organized with a general cooperative statute followed by specific provisions for agricultural cooperatives and livestock protective associations. Electric and telephone cooperatives can organize under Chapter 279

More recently, in 2012, Kentucky passed the "Kentucky Uniform Limited Cooperative Association Act," found in Chapter 272A of the Kentucky Revised Statutes. These types of

¹⁶ KRS 14A.310.

¹⁷ Id.

cooperatives increase flexibility for investment in the cooperative and may also be referred to as “New Generation Cooperatives.” Kentucky law provides a greater amount of specificity, including greater direction on bylaws and membership rules for patrons and investors, in the provisions in its Limited Cooperative Association Act. This entity type is a response to a national trend toward cooperatives that require a large capital investment to start. A cooperative association is defined as, “an autonomous unincorporated association of persons united to meet their mutual interest through a jointly owned enterprise.”¹⁸ The discussion of articles of incorporation below focuses on Kentucky law and rules defining cooperative corporations under KRS 272.¹⁹ You are highly encouraged to consult with an attorney in developing your articles to make sure they adhere to the legal requirements established by Kentucky law.

The Articles of Incorporation is the simpler, less customized document needed to form the legal entity that is the cooperative. The cooperative corporation must be organized by no less than three (3) residents of the state to, “conduct any agricultural, dairy, mercantile, mining, manufacturing, mechanical, service, or other lawful business, except organizations subject to any of the provisions of the banking laws of this state.”²⁰ The articles create the legal form that shields worker- and patron-owners from personal liability for business activities. Under KRS 272,²¹ the articles must include:

- The name of the corporation
- The purposes for which the organization is formed
- The mailing address of the principal office
- The name and street address of the initial registered office and registered agent
- The name and mailing address of each organizer
- If the association is to exist for a time period other than perpetuity; the term for which the corporation will exist.
- The shares or memberships for ownership of the cooperative

A cooperative can chose to be subject to standard cooperative limitations on voting, ownership and control by filing a declaration signed by the president and secretary swearing the company had a majority vote affirming their intention to be bound by those provisions.²²

¹⁸ Kentucky Revised Statutes. 272A.1-040 Nature of limited cooperative association

¹⁹ There are some differences between KRS 272 and 272A that should be noted. For example, under 272A, the articles of incorporation do not need to identify cooperative stock but, it is a requirement that should be included in the bylaws.

²⁰ KRS 272.020(1),

²¹ KRS 272.020

²² KRS 272.040.

As a cooperative corporation, the owners will need to decide if the business will be organized with shares or with memberships. This is one of the major decisions that will need to be made from the beginning of the cooperative formation. If the cooperative company issues stock, the articles must designate the number of shares that will be issued and, if there is more than one class of shares, the articles must set forth the preferences, limitations, and rights for each class. More information regarding stock can be found in the financing section of this document.

Bylaws

In addition to the articles of incorporation, the bylaws are another essential document to form a cooperative. The bylaws are an integral document in the formation of a cooperative corporation because they delineate the “membership, governance, capital structure, allocation of profits, stock valuation and repurchase practices, dissolution, and management,” of the cooperative.²³ The bylaws are the operating document for the cooperative and detail how it will be governed and the rules and procedures for its functioning and administration as a company. Appendix B is a bylaws template to review, however, you are highly encouraged to seek out the assistance of an attorney who can help draft bylaws and develop the appropriate language to fit your needs. The information below describes some, but not all, of the different articles and sections most commonly found in cooperative bylaws, listed in no particular order.

- **Purpose**

If your articles of incorporation sufficiently outline the specific objectives of the coop, this section may be excluded from the bylaws. If it is included, it should adequately address the purpose for which the coop has been formed.

- **Membership**

This section of the bylaws outlines the details of the membership of the cooperative and includes, but is not limited to, who is eligible to be a member of the cooperative, the terms of application and acceptance into cooperative, any required membership fees, the different

²³ Frank T. Adams & Gary B. Hansen, “Putting Democracy to Worker: A Practical Guide for Starting Worker-owned Businesses.” (1991).

classes and privileges afforded to different classes of membership, and how membership may be terminated.

Generally speaking, you will want to define the qualifications for membership in the cooperative in a way that achieves the established mission and stated purpose of the co-op. At a minimum, this section of the bylaws should include a general statement that persons who support the purposes of the cooperative, and are not adverse to its interests, are eligible for membership. If you are establishing an agricultural co-op specifically, Kentucky law promulgates specific rules about who is a permissible member in KRS 272.191. It reads, “an association may admit as members (or issue voting stock to) only persons engaged in the production of agricultural products, including tenants and landlords who receive any part of the crops raised on the leased premises, or one or more association of producers.” This is precisely why it is important to be familiar with the specifics of the cooperative statute under which you are organizing the co-op in Kentucky.

It also important to identify if there are different classes of members in the cooperative and to detail the requirements of each of those classes. For example, if the cooperative will be a grocery store, you might want to include a section in the bylaws listing the requirements of its employee members and its consumer members. You may even consider having an additional class of investor members who will help capitalize the grocery store.

If the cooperative charges an initial membership fee to join, or imposes a membership fee upon its patrons, those fees must be articulated in the cooperative bylaws as well. Identifying how ownership will operate in the company bylaws is critical. In membership-based cooperatives that do not issue stock, capital can be raised through the sale of “revolving-fund certificates,” also referred to as certificates of interest or certificates of investment. If the cooperative is structured as stock cooperative, you can avoid having to register the stock if only members of the co-op are allowed to purchase stock. You should also include a clause as to the non-transferability of membership interests in the cooperative to keep a tighter reign on the ownership of the co-op. Finally, you will most likely want to consult an attorney to help weigh the pros and cons of the different options for structuring the membership classes and ways to draft this section of the bylaws.

- **Board of Directors**

Creating a strong board that mirrors the purpose and shares the vision of the direction of the cooperative is a critical component in the success of the business. This portion of the bylaws

identifies the number of members on the board, how those board members will be elected, and how long they will serve on the board. You may want to consider staggering the election of board members, so when the time comes to replace board members, there will not be an entirely new board responsible for leading the cooperative.

In addition, the board of directors section of the bylaws identifies any board composition requirements and also outlines leadership positions within the board along with the duties required of each position. Under KRS 272.020(4), “[t]here shall be a president, one (1) or more vice presidents, and a secretary and treasurer, or secretary treasurer, elected annually by and from the directors.”²⁴ There are no similar officer requirements under KRS 272A, however, sections .8-010 through .8-.220 promulgates very specific requirements for boards of directors that should be reviewed if the cooperative is being formed under the newer statutory provision.

Thinking through board composition and the requirements of board members is critically important to achieving the purpose of the cooperative. If your board requires 7 members, you may want to establish some type of requirement that 5 of the 7 directors live within a 10 mile-radius of the neighborhood where the cooperative is located. This would be a way to maintain community control of the business and is just one example of a requirement that you could consider in developing the co-op board. Once again, the advice of an attorney can help guide you through this process.

- **Stock**

Whether or not to organize a cooperative with capital stock is a decision owners will need to make. There are a number of considerations to make in determining whether or not to issue stock. Keep in mind, however, that in adhering to the democratic model of cooperatives, a member or stockholder will only receive one vote at business meetings, irrespective of how many shares the member may own. One benefit to having a cooperative with a stock structure is the flexibility it provides in capitalizing the company. The People’s Food Cooperative of La Crosse, Wisconsin requires the purchase of two different types of stock in the cooperative. Members may purchase only one share of Class A stock, entitling the member to vote and democratically participate in the affairs of the co-op. Members are also required to purchase three shares of Class B stock, which has a par value of \$25 and carries no voting rights. This scheme allows the cooperative to operate on a one-member, one-vote basis, and the second

²⁴ Kentucky Revised Statute, KRS 272.020(4)

class of stock allows some flexibility for the co-op to adjust equity requirements by member type, independent of voting rights.²⁵

- **Voting**

Kentucky law places particular restrictions on voting in a cooperative corporation. First, the standard “one vote per shareholder or member,” a hallmark of a cooperative, is codified in the revised statute.

The bylaws should indicate what constitutes a quorum at a meeting of the shareholders or members but there are limitations. A quorum should not consist of less than one-third ($\frac{1}{3}$) of the stockholders or members with voting power in a corporation that allows for both proxies and voting trusts.²⁶ This limitation exists because proxy voting, where some members can delegate their voting power to other members, and voting trusts, where votes are given to a trustee, can take away from the democratic governance principles of a cooperative. Alternatively, in a corporation that prohibits both proxies and voting trusts there may not be a quorum “set lower than one-tenth ($\frac{1}{10}$) of the stockholders or members entitled to vote or twenty (20) such stockholders or members entitled to vote, whichever is less.”²⁷ Quorum, if not set in the bylaws defaults to a simple majority under Kentucky Law.²⁸

Kentucky law does not allow cooperatives to distribute votes based on patronage, so only a one member one vote plan is possible.²⁹ Non-members, however, can buy preferred stock in the cooperative (assuming the sale does not violate securities law discussed in the financing section below). Traditionally, stock would not be sold to outside investors, but instead would only be issued to members with an ability to pay and would grant no additional rights to the member.³⁰ If stock is sold outside the cooperative, as has successfully been done in some cases, the sell should not grant voting rights to the nonmember shareholder.³¹

- **Income Allocations**

²⁵ <http://www.uwcc.wisc.edu/pdf/Cooperative%20Equity%20and%20Ownership.pdf> & <http://www.pfc.coop/>

²⁶ KRS 272.020(7). A “voting trust” is an arrangement whereby the shares in a company of one or more shareholders and the voting rights attached thereto are legally transferred to a trustee, usually for a specified period of time (the “trust period”). They may be used to form a block of votes or for numerous other reasons in corporate governance. (Wikipedia. Voting Trusts. Accessed January 15, 2015).

²⁷ KRS 272.020(7)

²⁸ Id.

²⁹ KRS 272.020(5).

³⁰ Janelle Orsi. *Practicing Law in the Sharing Economy: Helping People Build Cooperatives, Social Enterprise, and Local Sustainable Economies.* (2013)

³¹ Charles T. Autry, & Ronald Felton Hall. *The Law of Cooperatives.* (2009)

Patronage dividends have tax consequences, and building the obligation to pay patronage dividends into the bylaws or articles of the cooperative can help the cooperative avoid double taxation. Establishing a pre-existing obligation to pay patronage dividends is a clear requirement in order to receive the tax benefits found under Subchapter T. Taxation is discussed further later in this document.

Alternatives to Forming a Cooperative as a Corporation

Cooperatives can form as any type of business except for a sole proprietorship. If you start operating with another person without filing any paperwork on a cooperative basis, you are working under Kentucky law as a partnership. Filing with the Secretary of State as an LLC is another possibility for having a cooperative if the company functions based on cooperative principles outlined in the foundational documents. You are eligible for the tax benefits defined in the federal cooperative tax code provided you adhere strictly to cooperative principles in organizing documents and day to day practice.

There are, though, great reasons for organizing your cooperative as something other than a cooperative. In most states, including Kentucky, a cooperative is defined in the cooperative statute as a corporation. This imposes governance requirements on the organization, requiring a board of directors. It may also trigger labor law consequences in situations where members are not entitled to decision-making autonomy that gives them a large say in how the business is managed. Labor law will be briefly discussed below. Also, a cooperative planning to ask for tax deductible contributions, should organize as a nonprofit corporation and seek 501(c)(3) status from the federal government.³²

This guide provides guidance on formation and examples of formation documents. Our documents are drafted based on the Kentucky Cooperative Corporation statute. Your cooperative will probably not find our templates exactly fits your vision. Cooperatives attract idealistic people, and there is no need to restrict the group's most innovative ideas about management. However, as you edit based on your cooperative's vision, pay attention to provisions necessary for recognition as a cooperative by state and federal authorities. When in doubt, don't hesitate to seek professional advice.

³² Janelle Orsi. *Practicing Law in the Sharing Economy: Helping People Build Cooperatives, Social Enterprise, and Local Sustainable Economies.* (2013)

III. Governance

Governance is how decisions are made, and also the principles guiding decision-making. It involves identifying and adhering to processes and rules controlling business operations. To achieve effective governance, the importance of developing cooperative leadership cannot be underemphasized. As stated previously, the founders of a cooperative may want to strongly consider hosting retreats and trainings to develop the leadership skills and business management acumen needed to run a company. Additionally, as a rule of thumb, preserve the governance practices for your co-op in writing. Bylaws are one type of document where you can identify how the cooperative will be controlled and operated, but there are other documents that will help the cooperative conduct business from day-to-day. A list of a few of them are included below.

In terms of thinking through governance, Sherwood and Scholl identify Four Pillars with the unified goal of, “steering cooperatively owned enterprises toward economic, social, and cultural success.”³³ They identify the Four Pillars, operating at all levels from board officers to membership, as Teaming, Accountable Empowerment, Strategic Leadership, and Democracy. Teaming includes defining expectations clearly and having a shared understanding of the necessary work to make the cooperative function smoothly. Accountable Empowerment is a framework where responsibility is assigned, there is clarity in roles, and accountability occurs.

Although this document has consistently referred to the democratic principle of one member, one vote- the hallmark of a co-op; Democracy, within the context of the Four Pillars, also entails meaningful participation in the business. Democratic principles in terms of cooperative governance means that, “all owners have the right to participate in the cooperative... and are entitled to information, voice, and representation.”³⁴ Lastly, Strategic Leadership requires planning in accordance with the cooperative’s purpose to ensure proper record-keeping to monitor progress and adequate resources to achieve the co-op mission. While the Four Pillars is not the only framework for cooperative governance, it is a helpful way to think about what is required to govern a cooperative.

Board of Directors

³³ Marilyn Scholl and Art Sherwood. Four Pillars of Cooperative Governance, a new model grounded in the cooperative difference. *Cooperative Grocer* (Jan./Feb. 2014), pg. 18

³⁴ Marilyn Scholl and Art Sherwood. Four Pillars of Cooperative Governance, a new model grounded in the cooperative difference. *Cooperative Grocer* (Jan./Feb. 2014), pg. 19

Directors set policy and management goals and are responsible for the management of the cooperative.³⁵ They are responsible for making sure the organization is run effectively and according to the organization's articles of incorporation and bylaws. They are protected under the “business judgment rule” from liability to other shareholders as long as they are acting in good faith and paying reasonable attention to business affairs. You do not have to be a great business mind to serve on a board of directors, but you are committing yourself to making sure the books are in order and everything is on the up-and-up.

In smaller cooperatives, all co-op members serve on the board of directors.³⁶ However, in cooperatives with large memberships, members may be better served by electing a board of directors to efficiently choose between conflicting visions for the organization and represent the larger body of members. Making board development a priority for the cooperative cannot be underemphasized. Seeking out opportunities to gain the knowledge, expertise, and skills needed to manage a business and participate in company leadership would benefit the overall health and vitality of the cooperative.

Other Documents

Depending on the type of cooperative you establish, there are a number of additional documents you may want to develop in order to detail the operation and governance of the coop in writing. The following list is presented in no particular order and is not exhaustive, but highlights a few of the types of documents specific cooperatives may need.

- **Membership Agreement.** The membership agreement details the qualifications of members, the terms of their membership, and the rules they must adhere to as a member in the cooperative.
- **Marketing Agreement.** In a producer’s cooperative, the marketing agreement records the rights and duties of the members and of the cooperative in marketing the member’s products. Statutory requirements for marketing agreements in Limited Cooperatives can be found in Kentucky law under KRS 272A.7.010-.7.040.
- **Membership Application.** This form is for interested parties to apply to become members of the cooperative.

³⁵Charles T. Autry, & Ronald Felton Hall. *The Law of Cooperatives*. (2009)

³⁶Janelle Orsi. *Practicing Law in the Sharing Economy: Helping People Build Cooperatives, Social Enterprise, and Local Sustainable Economies*. (2013)

- **Director's Handbook.** A handbook to acclimate directors of the cooperative to the policies and procedures helps set clear guidelines for the management of the co-op.

IV. Labor & Employment Issues

Let's say your business is a grocery cooperative. In the beginning of the business, it might make good sense to only use the labor of co-owners. However, as the business grows, it is likely cooperative members will want to hire staff, such as produce buyers and clerks to run registers. It is important to budget for employees if your cooperative plans to use help from people who are not owners or independent contractors. Employees are generally not allowed to volunteer to work in for-profit organizations, including cooperatives.³⁷ This rule cannot be waived by the employee, and there is no exception even for businesses that are socially conscious.

If employees are used in a cooperative, they must be paid the greater of state or local minimum wage, in Kentucky that is \$7.25. Lexington and Louisville, however, have recently enacted ordinances that already have increased this minimum and will continue to do so in the future. Cooperatives founded in these cities should familiarize themselves with the statutes enacted and stay abreast of when the minimum wage increases. Violations are zealously policed by state authorities and prosecution does not depend on employee reporting. The consequences for violation include requiring the business to pay an employees back wages as a lump sum.

Business owners do, however, make use of their own free/ discounted labor.³⁸ If you and a partner decide to start a sandwich shop, you and your partner will clearly only compensate each other if the business is a success. If you and your partner loses money, no one gets paid. Minimum wage will not apply. The same applies in a three member LLC with equal decision making power shared among the owners. Each owner is directly investing in the value of the business they own. They are not guaranteed a minimum wage from their labor, are not subject to the Americans with Disabilities Act, and are not protected by Family and Medical Leave Act (FMLA) regulations.

Generally, the closer the person working is to receiving a 1:1 financial reward from their efforts the more likely it is there is no violation of labor laws.³⁹ The exact test, from a Supreme Court case asking the Court to decide if the American's with Disabilities Act applies to

³⁷ Janelle Orsi. *Practicing Law in the Sharing Economy: Helping People Build Cooperatives, Social Enterprise, and Local Sustainable Economies.* (2013)

³⁸ *Id.*

³⁹ *Id.*

shareholders in a small professional corporation, determines if shareholders of a corporation (or owner/workers of a cooperative) are exempt from labor laws by looking at the following factors:

1. The entity's ability to regulate an individual's work and fire or hire them
2. If the entity supervises the individual's work and how closely they do so
3. If the individual reports to someone higher up in the entity.
4. The extent of an individual's influences on the organization
5. If the parties intend for the individual to be an employee in their written agreements
6. If the individual has a share of the entity's profits, losses, and liabilities.⁴⁰

A background assumption when you start a corporation, including a cooperative corporation, is that co-owners are employees.⁴¹ This assumption is a major reason why some founders of cooperatives chose to organize under an LLC or Limited Partner as the entity despite the sacrifice of using "cooperative" as a selling point. A small cooperative, however, created in such a way as to give control over management to everyone who is working there is controlling the terms under which they work will likely be able to argue no employer/ employee relationship exists.⁴² Here are some factors to consider as you are thinking about structuring your cooperative to prevent labor laws from acting in expensive and unexpected ways:⁴³

- Firing co-owners: generally it should take more than a simple majority, and certainly more than a single person's opinion in a situation where individuals are truly sharing management of a company.⁴⁴
- Size of company: A large group is not determinative, what really matters is democratic management.⁴⁵
- Control over company: the more control co-owners have over a business, the clearer it is they are not workers. Some courts have focused on factors like the amount a partner has invested, their exposure to liability, ownership of firm assets, and right to vote.⁴⁶ Other courts, including the Supreme Court have looked more directly at the actual ability of a partner to control management decisions in the firm.⁴⁷
- Entity Choice: some jurisdictions have leaned toward the assumption shareholders of corporations are employees when they work for their corporation.⁴⁸ The Supreme Court,

⁴⁰ Clackamas Gastroenterology Assocs., PC v. Wells, 538 U.S. 440 (2003) *quoting* EEOC's factors. (Paraphrased for clarity.)

⁴¹ Janelle Orsi. *Practicing Law in the Sharing Economy: Helping People Build Cooperatives, Social Enterprise, and Local Sustainable Economies.* (2013)

⁴² *Id.*

⁴³ Adapted from *Id.*

⁴⁴ *Simpson v. Ernst & Young*, 100 F.3d 436 (6th Cir. 1996)

⁴⁵ *Wheeler v. Hurdman*, 825 F.2d 257 (10 Cir. 1987)

⁴⁶ *Id.*

⁴⁷ Janelle Orsi. *Practicing Law in the Sharing Economy: Helping People Build Cooperatives, Social Enterprise, and Local Sustainable Economies.* (2013)

⁴⁸ *Id.*

however, rejected the presumption. However, since this is up in the air, caution is required.

Cooperative founders are also not going to be able to take advantage of the free labor of interns. Cooperatives would provide a great learning environment, and there are probably a lot of people who would be willing to do some of the work for free, but misusing interns can expose a business to serious labor law problems. An intern does not work for the benefit of the business, or do work that is normally reserved for employees, but instead is there for the intern's benefit. If an intern is displacing an employee the company needs to operate, then the company is probably violating labor law by using an intern instead.⁴⁹

Once an employee is hired, the relationship of that employee to the cooperative is presumed to be "at-will".⁵⁰ The cooperative may fire an employee for any lawful reason at any time without notice, and the employee may quit for any reason at any time without notice. However, if a term of employment is specified, however, either orally or in writing. If the term of the employment contract is going to take longer to perform than a single year, say an employment contract for a two year term, then the agreement has to be in writing.⁵¹ Cooperative owners should consult with an attorney if they are planning to create an employer-employee relationship intended to last for longer than a year because doing so creates enforceable rights.

There are, however, several exceptions⁵² to the at-will employer-employee relationship that are worth mentioning:

- Employees are allowed to assert their collective bargaining rights, or rights to unionize.
- Employees may not be fired for asserting a worker's compensation claim.
- Employers cannot fire or discriminate against an employee who exercises rights under Kentucky's Occupational Safety and Health of Employees (OSHA) law.
- Employees must be allowed to take time off to vote.
- Employers are not allowed to fire an employee because the employee's wages are being garnished.
- Employees must be allowed to serve on jury duty, or appear in court when required.

⁴⁹ U.S. Wage and Hour Division. Fact Sheet #71: Internship Programs Under the Fair Labor Standards Act. (2010). Available at: <http://www.dol.gov/whd/regs/compliance/whdfs71.pdf>.

⁵⁰ Wyatt, Tarrant & Combs. Kentucky Forms and Transactions. Section 18:2. (Continuously updated)

⁵¹ KRS 371.010(7)

⁵² This list is not meant to be exhaustive, but instead lists several limitations on the right to fire employees that may not be widely known.

- Employees must be allowed a leave of absence for National Guard or active military duty.
- Maybe goes without saying, but an employer may not fire an employee for refusing to break the law, or when the employee is exercising a right granted by a well-established legislative enactment.
- Employees may not be fired for observing religious sabbaths.
- Smokers may not be discriminated against.
- Employees may also not be fired if they have relied and taken action based on a promise made by an employer.⁵³

Another easy to overlook requirement imposed by Kentucky is mandatory Workers' Compensation insurance. Cooperatives that hire workers are almost without exception required to obtain workers' compensation insurance.⁵⁴ Employers obtain coverage from a Workers' Compensation insurance carrier. This carrier will report proof of insurance to State authorities and afterward will be required to update the same authorities if there is any change or lapse in coverage. The carrier will also issue a notice to post in the workplace informing employees of the coverage. Workers injured on the job will be covered by the cooperatives workers' compensation, making the coverage a potentially valuable protection for a business. Policies will be priced based on how dangerous the cooperatives work is.

⁵³ Wyatt, Tarrant & Combs Kentucky Forms and Transactions. Section 18:4

⁵⁴ Commonwealth of Kentucky Department of Workers' Claims. Guidebook to Workers' Compensation. (2011).

V. Financing the Co-Op

Start Up Capital

The level of sophistication in a cooperative's management structure and the type of business the cooperative will be influences the amount of start up capital a cooperative requires. A simple way to structure a fair cooperative is to require all members to pay the same amount into the cooperative and give all members an equal vote. Keeping the cooperative small means everyone who is a member is also a director. However, what if you want to start a large grocery buying cooperative and need to finance modifications to an old store, buy coolers, and stock an initial inventory? It may be a good idea to seek outside contributors. Kentucky allows a cooperative corporation to sell preferred stock,⁵⁵ or non-voting stock that generally pays a fixed dividend (less than 8 percent) and carry a preference over the share of ordinary stock required to become a member.⁵⁶ , so it is possible in this state to sell to members and non-members who buy a monetary, as opposed to managerial interest in the business.⁵⁷ However, a typical cooperative will obtain little capital through the sell of preferred stock to non-members.⁵⁸

New Generation cooperatives, sometimes called Limited Cooperative Associations, are an attempt to allow co-ops that require large capital investments to get their footing.⁵⁹ These cooperatives are authorized in Kentucky under KRS 272A.⁶⁰ New generation cooperatives raise only a small percentage of their money from member contributions and raise the rest from selling dividend-bearing stock to non-members that grants limited voting rights to nonmember shareholders.⁶¹ These investors need to be motivated to support their community since federal tax law places an 8 percent limitation on dividends paid.⁶²

There are many tools available to people interested in raising capital for their cooperative venture. Banks loan money, selling shares (discussed below) can bring in community involvement, and using creative methods to engage people with a little extra wealth are ways

⁵⁵ KRS 272.040; KRS 272.010(1)(a).

⁵⁶Charles T. Autry, & Ronald Felton Hall. *The Law of Cooperatives*. (2009).

⁵⁷ KRS 272.040

⁵⁸ Charles T. Autry, & Ronald Felton Hall. *The Law of Cooperatives*. (2009).

⁵⁹ Janelle Orsi. *Practicing Law in the Sharing Economy: Helping People Build Cooperatives, Social Enterprise, and Local Sustainable Economies*. (2013).

⁶⁰ KRS 272A.1-050

⁶¹ Id.

⁶²Charles T. Autry, & Ronald Felton Hall. *The Law of Cooperatives*. (2009).

cooperatives have raised money in places with thriving cooperative economies.⁶³ All of them require serious commitment by cooperative members.

Accounting

Like any other business, cooperatives need to keep accurate books and records, but cooperatives need careful records because patrons are going to receive returns. People with a financial interest in the organization need to know how the money is managed, and failure to keep accurate records can mean the business cannot accurately file taxes and misses its bottom line. Cooperatives have the added complexity of being required by their foundational agreements to pay dividends based on member patronage. This means the records are going to have to accurately include enough information that when the time comes, everyone whose sweat and blood went into the year's operations will agree they are being paid fairly based on their initial agreement.

The bottom line of this discussion is that a cooperative should seek the assistance of a CPA or other tax expert so they can begin with their records on the right track for tax purposes. While finding a CPA with experience working with the cooperative structure is going to be a challenge here in Kentucky, it is important the cooperative not saddle itself with tax obligations and no way to repay. Taxes are discussed in greater detail below.

Financing a cooperative can be as simple as raising a couple hundred dollars from all the members, but it can also be as complex as selling stock on the New York exchange. In between is borrowing money from rich members, relatives, or banks. No matter what scale your vision is, you should be ready to think about ways to raise additional capital so your cooperative can grow with your vision and need accurate records to see who is owed what along the way.

Banks

Looking to banks for loans is a real possibility. There are many credit unions across the state, themselves cooperatives, which would be willing to extend credit to the right cooperative. A key factor is the equity to debt ratio the cooperative brings to the bank. Banks are usually only going to loan money to a business if there is a substantial investment committed by the business owners.⁶⁴ Not only does this decrease financial risk to the bank, but it also

⁶³Janelle Orsi. *Practicing Law in the Sharing Economy: Helping People Build Cooperatives, Social Enterprise, and Local Sustainable Economies.* (2013).

⁶⁴Charles T. Autry, & Ronald Felton Hall. *The Law of Cooperatives.* (2009).

demonstrates owners have a clear interested stake in the success of the endeavor. To reiterate from earlier, it is key to make sure members are paying enough equity into the cooperative that they will have a vested interest in making good, long-term decisions on behalf of the entity.

Crowdfunding

Another possibility is the use of crowdfunding. Since investors do not expect a return (assuming the incentives aren't too valuable), there is no regulation to make sure you aren't duping investors. Remember, though, that a business must pay taxes on money donated to the organization through crowdfunding. If the cooperative is organized as an LLC or unincorporated entity, this means the owners will pay taxes on their personal returns at the end of the year.

Gift Certificates

A gray area in current law is selling gift certificates with large denominations to expand a business.⁶⁵ For example, a coffee shop might sell \$200 gift certificates to loyal customers. The shop uses the money to expand operations, and customers have prepaid their coffee for the year. Here though, the business should not offer the gift certificate as at a significant discount, since there is the expectation of a return on investment being sold to the customer.⁶⁶

Selling Stock

Entrepreneurs with serious ideas, though, should not be afraid to offer stock certificates. Federal tax law caps dividends on cooperatives at eight percent, meaning the investment will be modest compared to other investment opportunities with higher rates of return. Cooperatives, however, are directed more towards community buy-in and allow socially conscious people a chance to invest in their community. Cooperatives also help get the word out that Kentuckians are building the progressive and unique business climate we deserve.

The authors do not seriously believe this guide is likely to find its way into the hands of anyone willing to take their idea to the New York Stock Exchange, but it is important to understand what triggers a requirement to register when selling company stock. The definition of what is a security is broad, and securities regulations can be triggered by circumstances much more commonplace than Google offering a million shares. In fact, many of the apps we

⁶⁵ Janelle Orsi. *Practicing Law in the Sharing Economy: Helping People Build Cooperatives, Social Enterprise, and Local Sustainable Economies*. (2013).

⁶⁶ *Id.*

use on our phones and in businesses and a substantial number of land developments, are financed by selling investment opportunities. An example can be found in Louisville's own Portland Neighborhood where Gil Holland's plan to rehabilitate 100 properties is being paid for through socially conscious investors who will receive only a modest return on their investment.⁶⁷

This section builds from a very quick description of what forces a business to register their offering with the Federal and state government, to the exceptions in federal securities law that allow small community oriented projects to raise millions of dollars. It is important to recognize there are federal and state laws that regulate how people are allowed to raise money for their businesses because regulators are serious about violations of these laws. As a business owner, you are expected to do better in your defense than "I didn't know that." To avoid personal liability you need to make sure you thoroughly understanding of the laws governing your company's stock offerings. When in doubt, it is always safe to send a Request a Letter of No Action to either Federal or State authorities (or both).

Securities law creates complexity for social entrepreneurs trying to raise money because it defines a security broadly.⁶⁸ Securities are basically any offering of an investment opportunity that is primarily about earning a return on that investment through other people's efforts.⁶⁹ As it is, state and Federal securities acts provide for exceptions that are far less costly and time consuming than all out registration for companies traded on national stock exchanges. These exceptions allow practically any of the everyday businesses you can see looking around the state to finance themselves by accepting investments, as long as the rules are followed closely. If you and your friends need to raise money for your small business, there is likely an exception that can be used.

Exemption One: Selling to Members

Only selling voting stock in the cooperative to its member managers is the most straightforward of the exceptions. Membership and voting stock are expressly exempted from registration with Kentucky regulators when a cooperatives organized under Kentucky's

⁶⁷ Personal communication, Stephanie Kaufmann, assistant to Gill Holand. (January 21, 2015).

⁶⁸ SEC v. W.J. Howly Co. 328 US 293 (1946)

⁶⁹ Janelle Orsi. Practicing Law in the Sharing Economy: Helping People Build Cooperatives, Social Enterprise, and Local Sustainable Economies. (2013). Our state court system has adopted the federal Hawley definition: Courts look to whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others. (

cooperative statute sells them.⁷⁰ This enactment is a direct response to the background assumption shares of a corporation are securities.

Additional member capital in a traditional cooperative can be harnessed by selling a non-voting class of stock or, in the case of a nonstock cooperative issuing capital certificates. Since the people are going to be making the decisions that determine success or failure of the cooperative, there is no need to protect investors from being scammed by management.⁷¹ They are management! It is important, though, that all members making this investment are actually actively involved in management, for example sitting on the board of directors.⁷²

Financing your cooperative in this way also ensures that only people who share the vision of the cooperative are involved with managing it. People who invest more are not given greater control of the cooperative as a regular stock corporation or some LLCs, but are rather giving the cooperative a loan that will be repaid at the occurrence of a predetermined event like the passage of time, or, usually when the member leaves the cooperative.⁷³ This structure may provide the best of both worlds for a fledgling organization. People with more resources can support the cause without squeezing out people who need to make use of the service but may not be able to pay the outright per person division of the cooperative's finances.

The argument for issuing preferred stock to members becomes more tenuous argument, however, as the scale of the cooperative increases and management becomes more complex. It is also essential to note that this type of transaction is not specifically exempted from Kentucky securities regulations.⁷⁴

Telephone, electric, and agricultural cooperatives organized under the appropriate state statutes are exempt from registration with State authorities.⁷⁵ Under Federal Securities regulations, farmer's cooperatives are exempt from securities registration if they are:

1. exempt from income taxation under section 521 of the Internal Revenue Code of 1924,
2. or described under 501(c)(16) and exempt under 501(c)(2) of the Code,

⁷⁰ KRS 292.400(13).

⁷¹ Janelle Orsi. *Practicing Law in the Sharing Economy: Helping People Build Cooperatives, Social Enterprise, and Local Sustainable Economies*. (2013). Paying out exiting members frequently is important to ensure the owners are the current users of the cooperative.

⁷² *Id.*

⁷³ Janelle Orsi. *Practicing Law in the Sharing Economy: Helping People Build Cooperatives, Social Enterprise, and Local Sustainable Economies*. (2013)..

⁷⁴ Jay H. Knight & Garrett P. Baker. *Kentucky Blue Sky Law*. *Northern Kentucky Law Review*. Volume 34, Issue 3, Page 485. (2007).

⁷⁵ Jay H. Knight & Garrett P. Baker. *Kentucky Blue Sky Law*. *Northern Kentucky Law Review*. Volume 34, Issue 3, Page 485. (2007)..

3. or described in section 501(c)(2) and exempt under 501(a) of the Code and organized exclusively for holding title to hold title to a property, collect income from the property, and turn the entire amount less expenses also exempt from registration under federal securities law.⁷⁶

LLCs Operating with Cooperative Principles

LLC investments are also generally considered to be securities, but courts again determine whether they must meet the requirements of state and federal securities law based on the extent to which the owners of interests in the LLC exercise control over the business⁷⁷. Factors to consider include whether all the members intend to profit from the joint efforts of all the members, whether any of the investors are passive members, and whether the transfer of ownership interests are easily transferable.⁷⁸ In Kentucky, there is a safe harbor provision in State Securities Regulations that applies if there are no more the 35 members of the LLC and one of the following is met:

1. Each member is actively engaged in the management of the company or,
2. The articles of organization or the operating agreement of the organization vests management in a manager who is a member and the organizing document provides that a majority vote can cause the manager to be removed and replaced by another member or,
3. Each member is authorized to bind the organization under applicable law or the organizing document.⁷⁹

Exception Two: Offering Stock Only to Kentuckians

A little nonsensical in Louisville, but keeping stockholders only on this side of the Ohio means a cooperative will only have to contend with the securities law of Kentucky. The reason for this exception is that as Federal law, Federal Securities Regulations apply only to interstate securities sales.⁸⁰ But won't some of the stock end up in the hands of people in another state

⁷⁶ Janelle Orsi. *Practicing Law in the Sharing Economy: Helping People Build Cooperatives, Social Enterprise, and Local Sustainable Economies*. (2013).

⁷⁷ Jay H. Knight & Garrett P. Baker. *Kentucky Blue Sky Law*. *Northern Kentucky Law Review*. Volume 34, Issue 3, Page 485. (2007).

⁷⁸ *id.*

⁷⁹ 808 Kentucky Administrative Regulations (KAR) 10:360

⁸⁰ Janelle Orsi. *Practicing Law in the Sharing Economy: Helping People Build Cooperatives, Social Enterprise, and Local Sustainable Economies*. (2013).

when it's just across the pedestrian bridge? Understanding the practical impossibility of completely controlling the flow of stock, the safe harbor provision of federal securities law recognizes the difficulty in making sure everyone lives in your state. A company may qualify under this exception if:

- The company is organized in Kentucky;
- 80 percent of the company's revenue is earned in the state
- 80% of the company's assets are located in KY at the end of the most recent semi-annual fiscal year,
- The money goes to fund operations, purchases of land, or rendering services in Kentucky.
- The Company's principal office is in KY.
- None of the stock can be offered or sold to anyone outside the state for nine months from the last date the stock was sold by the Company.
- For the same nine months, any sell of the stock can only be to Kentuckians.
- The Company shall:
 - Put a legend on the certificate saying:
 - it is not registered under the Securities Act
 - that also alerts people the limitations on resale.
 - And also:
 - Send stop transfer instructions to the Company's transfer agent (if one is used)
 - Or make notations in the Company's records of the sale.
- The Company shall disclose in writing every time it "offers to sell, offers for sale or sales" stock under the rule the limitations on resale that imposed by the rule.⁸¹

This exception, however, does not also provide an exception to Kentucky law. A seller of securities within the state will have to qualify for one of the Kentucky exceptions or follow the requirements outlined in KRS 279.

Exception Three: Private Offerings

Though maybe a long-shot for socially conscious, democratically oriented business owners, no one should judge if business owners choose to raise capital by only offering their

⁸¹ 17 CFR Sec. 230.147

shares privately to people with significant personal wealth. Private offerings allow businesses to raise large sums of money from people who are not going to “lose the farm” if they lose their investment capital with no limits on the maximum amount to be raised.

The private offering to securities law is vague, so for practical reasons private offerings will usually be structured to qualify for the safe harbor found in Rule 506.⁸² Access to safe harbor protection is granted to companies that only sell to 35 or fewer people who do not qualify as accredited investors because of the investor's net worth. Accredited investors are:

- Business development companies
- Entities with \$5 million in assets
- A principle (the boss) of issuer
- People with \$1 million in net worth excluding primary residence
- People with \$200k or more in yearly income
- A trust with \$5 million in assets
- Or an entity composed of accredited investors.⁸³

When you determine whether a person or entity is an accredited investor, you are not required to personally confirm the person qualifies. Instead, you create a statement for potential investors to sign affirming they qualify for accredited investor status.⁸⁴ You also have to limit resale of stock certificates to other accredited investors. This is done with a notation on the stock certificate that prohibits resale of stock to people who do not qualify as accredited investors. If you sell to people who are not accredited investors, you have to comply with disclosure requirements specified in Regulation D, 17 CFR 230.502(b), which can be onerous and prevents frequent use of private offerings to investors that do not qualify for accredited investor status.⁸⁵

To comply with Kentucky regulations, companies selling private offering securities need to meet the following conditions:

⁸² Janelle Orsi. *Practicing Law in the Sharing Economy: Helping People Build Cooperatives, Social Enterprise, and Local Sustainable Economies*. (2013); 17 CFR Sec. 230.147. (This is very loosely paraphrased for clarity. It captures the gist, but the regulation is very complex and should be consulted carefully before offering to sell stock in Kentucky. (Jay H. Knight & Garrett P. Baker. *Kentucky Blue Sky Law*. *Northern Kentucky Law Review*. Volume 34, Issue 3, Page 485. (2007).)

⁸³ Janelle Orsi. *Practicing Law in the Sharing Economy: Helping People Build Cooperatives, Social Enterprise, and Local Sustainable Economies*. (2013).

⁸⁴ Janelle Orsi. *Practicing Law in the Sharing Economy: Helping People Build Cooperatives, Social Enterprise, and Local Sustainable Economies*. (2013).

⁸⁵ *Id.*

1. No advertising to the general public and no general solicitation of the public.
2. The issuer must believe that buyers have an investment intent, meaning they are not going to turn around and sell the security. The stock certificate has to indicate that the private offering stock is not freely transferable, or issuers need to have buyers sign a document agreeing the purchase is for investment and not immediate resale.
3. Additionally, one of the following three requirements must be met:
 - a. Each purchaser has access to all the material facts necessary for valuing the securities because the purchaser is actively involved or involved with the management of the organization, or because the purchaser has a family relationship with a person actively involved or involved in the management of the organization;
 - b. there are no more than 15 purchasers in Kentucky (excluding accredited investors)
 - c. the aggregate offering price of the securities including securities sold outside Kentucky does not exceed \$1 million, the total number of purchasers (excluding, again, accredited investors) does not exceed 35, and each purchaser who is not an accredited investor received all material facts relevant to the offering or is a purchaser described in (a) above.⁸⁶

To qualify for the safe harbor rule under both a State and Federal regulations, Form D must be used to report the offering to the SEC⁸⁷ and Kentucky Department of Financial Institutions Division of Securities.⁸⁸

Since the Kentucky regulation for private offerings does away with the federal requirement of onerous disclosures to investors that are not accredited, this could be a useful exception to Kentucky securities registration requirements if. For example, if you are selling shares to 30 family members of cooperative owner patrons who all live in Kentucky, the private offering exemption may cover

Exception Four: Crowdfunding Act

The Crowdfunding Act, Title III of the JOBS Act, makes it possible for small businesses to raise money from anyone, not just accredited investors, on internet payment portals

⁸⁶ Jay H. Knight & Garrett P. Baker. Kentucky Blue Sky Law. Northern Kentucky Law Review. Volume 34, Issue 3, Page 485. (2007).

⁸⁷ Janelle Orsi. Practicing Law in the Sharing Economy: Helping People Build Cooperatives, Social Enterprise, and Local Sustainable Economies. (2013).

⁸⁸ Public Protection Cabinet. Securities Registration and Exemptions. Accessed January 14, 2016 at: <http://www.kfi.ky.gov/industry/Pages/registrations.aspx>.

registered with the SEC.⁸⁹ The final regulations were released on October 30, 2015.⁹⁰ There are currently several equity crowdfunding portals on the internet a co-op might consider.

⁸⁹ Jeffrey W. Rubin. The JOBS Act: An Overview—What Every Business Lawyer Should Know. Business Law Today. (May 2012) Available at: http://www.americanbar.org/publications/blt/2012/05/01_rubin.html.

⁹⁰ U.S. Securities and Exchange Commission. SEC Adopts Rules to Permit Crowdfunding. Accessed January 14, 2016 at: <http://www.sec.gov/news/pressrelease/2015-249.html>.

VI. Tax Considerations

A cooperative, like any other business, will have to pay taxes every year. As mentioned above, accounting is essential in a cooperative, and with technical distinctions like patron and non-patron dividends in complex cooperatives, it is important to have competent accounting help. Not only will accurate records be essential to maintain a transparent cooperative, but they will also be indispensable for determining tax obligations. Many accountants will provide a free consultation to a new business in hopes of handling the business' taxes at the end of the year for a fee. Consulting with an accountant is an important part of starting a cooperative, and a step that should not be taken lightly. When starting a cooperative, it is important to ask the accountant whether they have any experience with the type of entity. If they do not, a good follow up is finding out if they are willing to understand the tax implications of an organization choosing to work on a cooperative basis.

Subchapter T operates as a default provision for entities organized as a business corporation or trade association to operate as a cooperative for federal tax purposes.⁹¹ Simply put, you could organize as a cooperative, or a corporation, or a limited liability company, and still receive the benefits of Subchapter T if you follow the guidelines that would qualify your business as a cooperative under it. While not all patrons must have an ownership interest, the ownership of the cooperative is vested in the persons who are patrons of the co-op. Additionally, cooperatives only return earnings to their patrons in proportion to their patronage.

Subchapter T delineates what counts as taxable income for a cooperative and provides information on how income should be computed. Subchapter T allows a cooperative to avoid double taxation on patronage dividends.⁹² Although it is possible for the cooperative to avoid paying taxes on patronage dividends, the patrons of the cooperative will pay income tax on all the amounts received as a patronage refund. Once again, the rules applying to a cooperative are complex and an accountant should be consulted to help assist the cooperative in making the correct computations.

Under Subchapter T, the payment of patronage dividends can avoid double taxation through receiving a deduction at the level of the cooperative. Patronage dividends are defined by the IRS as follows:

⁹¹ http://www.dsbcpas.com/faqtechnical/0001_subt.html

⁹² <http://www.co-oplaw.org/worker-co-op-resources/worker-cooperatives-and-tax/>

- paid to the co-op member on the basis of the quantity or value of the business done with or for such patron member.
- distributed under a pre-existing obligation to pay such an amount and the obligation existed before the organization received the amount paid, and
- are calculated based on earnings derived from the co-op's business done with its members.⁹³

When filing federal tax returns, the amount of patronage dividends issued by a cooperative may be deducted from its gross income in that year.⁹⁴ Identifying the income that can be distributed as a patronage dividend and calculating those dividends to qualify for the tax deduction is complex. There also tax provisions specific to Farmer's Cooperatives under section 521 of the Internal Revenue Code (IRC). In order to establish the exemption as a farmer's cooperative, Form 1028 must be filed. In addition, associations that are exempt under IRC section 521 complete income tax returns using Form 990-C. Cooperative owners are encouraged to seek out the advice of a tax professional to help complete these forms and to stay up to date with the IRS requirements.

⁹³ <http://www.co-oplaw.org/worker-co-op-resources/worker-cooperatives-and-tax/>

⁹⁴ <http://www.dmlp.org/legal-guide/taxation-cooperatives-and-patronage-dividends>

Appendix A: Articles of Incorporation

SAMPLE ARTICLES OF INCORPORATION

About This Form: This sample Articles of Incorporation is meant to serve as a drafting tool for individuals organizing their entity under Kentucky law, specifically KRS chapter 272, and the attorneys who represent them. This form includes the option for both a non-stock and stock cooperative. The sample is annotated with explanatory footnotes that include citations to applicable laws. It is important to consider the footnote explanations to help determine, preferably with consultation from an attorney, what choices will best serve one's business entity depending on the activities and membership of the cooperative.

Disclaimer: This form should not be construed as legal advice. This form's endnotes discuss relevant provisions of the law as of January 13th, 2015 and have not been updated to reflect changes in the law. Please contact an attorney for legal advice about your organization's specific situation. This form should not be used "as is" but should be modified after careful consideration of the explanations and alternative wording choices in the text of the articles and footnotes.

**ARTICLES OF INCORPORATION OF
[NAME OF COOPERATIVE]⁹⁵**

Article 1. Name

The name of this Corporation is [Name of Cooperative], Inc.⁹⁶

Article 2. Purpose

This Corporation is a cooperative corporation organized under the provisions of Kentucky revised Statute Chapter 272.⁹⁷ The purpose of this Corporation is to engage in any lawful act or activity for which a corporation may be organized under such law.⁹⁸

Article 3. Powers⁹⁹

This cooperative shall have the following powers¹⁰⁰:

- a. To engage in those activities outlined in Article 2
- b. To borrow money without limitation as to amount of indebtedness, and to make advances to members and others.
- c. To buy, lease, hold and exercise all privileges of ownership, over such real or personal property as may be necessary or convenient for the conduct and operation of the business of the association, or incidental to it.

Article 4. Principal Place of Business and Agent

⁹⁵ Remember to take a look at KRS14A.3-010. Your cooperative can't call itself a cooperative in the articles of association. The Secretary of State website contains information about filing an assumed name certificate.

⁹⁶ Please note, if a cooperative corporation is organized with shares, it will be governed by the provisions of KRS 271B, that promulgates rules for Kentucky business corporations. Alternatively, a membership-based cooperative corporation, operated on a nonprofit basis, falls under the provisions of 273.161 to 273.390 for nonstock, nonprofits in Kentucky. If you chose to organize as an association under 272A, this document will be titled "Articles of Association"

⁹⁷ Keep in mind, there are other statutes you can use to formally organize your cooperative. For example, a Limited Cooperative Association can be formed under KRS 272A and carries its own specific legal requirements.

⁹⁸ Here, the purpose of the cooperative can be detailed with specificity.

⁹⁹ You may also want to include any limitations on the power of the cooperative in this Article. For example, a producers cooperative may want to add stipulations on the marketing of products from non-members of the co-op.

¹⁰⁰ You may not want to include all of these powers, choose which ones are most relevant to your cooperative. Some of these powers will not apply based on the type of cooperative you are forming.

The cooperative's initial street address is [Location of Business]. The Corporation's initial mailing address is [Mailing Address].

The name and address in the state of Kentucky of this cooperative's initial agent is: [Address of the Agent for Service]

Article 5. Term

The cooperative shall begin its corporate existence upon receipt of its charter from the Secretary of State, and its existence shall be perpetual from that time.

Article 6. Voting

The voting rights of each member of the Corporation are equal, and each member is entitled to one vote. The proprietary interests of each member of the Corporation are unequal and the rules by which the proprietary interests are determined shall be proscribed by the bylaws of the Corporation.

Article 7. Directors

Here you will list the names and addresses of the initial directors of the corporation.

Article 8. Membership

The cooperative shall have no authority to issue capital stock, but shall admit applicants to membership upon such uniform conditions as may be prescribed in its bylaws.¹⁰¹

Article 9. Capital Stock¹⁰²

Section 1. Authorized amount, Classes.¹⁰³

¹⁰¹ Whether or not the corporation wishes to issue stock must be outlined in the articles of incorporation. As mentioned previously, a membership-based cooperative operated on a nonprofit basis is governed by the Kentucky law provisions that apply to nonstock, nonprofit cooperatives. You should not use this Article in conjunction with the following Article outlining a cooperative that is able to issue capital stock.

¹⁰² This section should not be used if the cooperative will not issue stock, these provisions are for cooperatives that issue stock. Keep in mind also, cooperative corporation issuing shares are subjected to KRS 271B that details the rules for business corporations. If it is an agricultural cooperative, KRS 272.201 explains the requirement for a membership certificate issued by stock cooperatives.

¹⁰³ The stock structure should be based on the capitalization needs of the cooperative.

The capital stock of the cooperative shall consist of insert number amount shares, divided into insert number amount, of common stock of the par value of \$ insert dollar amount per share, and insert number amount shares of preferred stock of the par value of \$ insert dollar amount per share, resulting in a total capitalization of insert amount based on number of shares x dollar amount.

Section 2. Common stock

The common stock of this cooperative may be purchased, owned, or held only by identify name for individuals who may own common stock (1) who patronize the cooperative in accordance with uniform terms and conditions prescribed by it, and (2) who have been approved by the board of directors.

Each member shall hold at least one share of common stock and each eligible holder of common stock shall be entitled to only one vote in any meeting of the membership¹⁰⁴. In the event the board of directors of the cooperative shall find, following a hearing, that any of the common stock of the cooperative has come into the hands of any person who is not eligible for membership, or that the holder thereof has ceased to be an eligible member¹⁰⁵, such holder shall have no rights or privileges on account of such stock, or vote or voice in the management of affairs of the cooperative other than the right to participate in accordance with law in case of dissolution. The cooperative shall have the right, at its option, (a) to purchase such stock at its book or par value, whichever is less as determined conclusively by the board of directors; (b) to require the transfer of any such stock to convert it into shares of preferred stock of equal value.

¹⁰⁶

The common stock of the cooperative may be transferred only with the consent of the board of directors of the cooperative and on the books of the cooperative, and then only to persons eligible to hold it; and no purported assignment or transfer of common stock shall pass to any person not eligible to hold it any rights or privileges on account of such stock, or vote or voice in

¹⁰⁴ This is how to maintain the democratic principle of one member, one vote.

¹⁰⁵ Here, you may also want to include a stipulation on a time limit for failing to transact business with the cooperative that would disqualify someone from having privileges and rights on the stock.

¹⁰⁶ Language taken from: <http://www.uky.edu/Ag/apes/materials/Item4-XYZArticlesofIncorporation.pdf>

the management of the affairs of the cooperative. The cooperative shall have a lien on all of its issued common stock for all indebtedness of the holders thereof to the cooperative.

Dividends, noncumulative, may be paid on common stock, annually when earned and not in excess of six (6) percent, and when declared by the board of directors, but no such dividends shall be paid in any year unless and until six (6) percent dividends shall have been declared and paid on all preferred stock outstanding.

Section 3. Preferred Stock.

The preferred stock of the cooperative may be issued to any person, corporation, partnership or other organization. It shall carry no voting rights. Noncumulative dividends of not-to-exceed six (6) per cent per annum may be paid on such preferred stock when, if, and as declared by the board of directors.¹⁰⁷

Preferred stock may be transferred only on the books of the cooperative, and may be redeemed in whole or in part on a pro-rata basis at par plus any dividends declared thereon and unpaid, at any time on thirty (30) days notice by the cooperative, provided said stock is redeemed in the same order as originally issued by years. All such preferred stock so redeemed shall be paid for in cash at par value thereof, plus any dividends declared thereon and unpaid and such stock shall not bear dividends after it has been called for redemption.

Upon dissolution or distribution of the assets of the cooperative, the holders of all preferred stock shall be entitled to receive the par value of their stock, plus any dividend declared thereon and unpaid before any distribution is made on the common stock of the cooperative.

Article 10. Amendments

These Articles of Incorporation may be amended at any regular meeting or any special meeting of the members called for that purpose. An amendment must first be approved by two-thirds of the directors and then adopted by a vote representing a majority of all the members of the cooperative. Procedures for filing and recording shall be the same as for these original Articles of Incorporation as required by law.

¹⁰⁷ Dividends in Kentucky may be up to the federal cap of eight (8) percent.

Article 11. Dissolution

Upon dissolution and winding up the affairs of the cooperative, the net assets remaining after payment of all debts, both secured and unsecured, shall be distributed as follows: first, payment for all preferred stock at par value, plus any dividend declared thereon and unpaid; second, payment for all common stock at par value or book value whichever is less, plus any dividend declared thereon and unpaid, third; the payment of any other individual equities, however represented in the records, and; fourth, the remaining unassigned net assets shall be divided on a pro-rata basis among the patrons of the last five years immediately preceding the dissolution of the cooperative, according to volume of patronage.

[Name], Incorporator

Appendix B: Bylaws

About This Form: These sample Bylaws are meant to serve as a drafting tool for individuals organizing their entity under Kentucky law and the attorneys who represent them. This form most closely embodies a non-stock cooperative, managed by a board of directors, with different membership classes. You may not want to have different classes of membership and therefore should amend this to fit your needs. It is highly recommended that you consult an attorney to draft your bylaws. This sample is annotated with explanatory footnotes that include citations to applicable laws. It is important to consider the footnote explanations to help determine what choices will best serve one's business entity depending on the activities and membership of the cooperative.

Disclaimer: This form should not be construed as legal advice. This form's endnotes discuss relevant provisions of the law as of January 13th, 2015 and have not been updated to reflect changes in the law. Please contact an attorney for legal advice about your organization's specific situation. This form should not be used "as is" but should be modified after careful consideration of the explanations and alternative wording choices in the text of the articles and footnotes.

Name of the Cooperative

Bylaws

Article I Name

The name of the cooperative association shall be name of the cooperative, incorporated in the Commonwealth of Kentucky under the provisions of the Kentucky Revised Statutes, Title XXII, Chapter 272, subsection 272.101 to 272.345 to be operated on a cooperative basis for the mutual benefit of its members in the Commonwealth of Kentucky.

Article II Purpose

The purpose of the name of the cooperative is describe the purpose for which your cooperative is being formed.

Article III Membership

Membership in the cooperative is restricted to detail who is eligible to be a member of the cooperative. Membership in the name of the cooperative is granted only upon Board approval under guidelines established by the full Membership. Any person or organization may apply for membership under the class of membership that applies to them as specified below.¹⁰⁸ All members must meet the requirements as specified in the membership agreement and abide by the rules and policies set forth by the board of directors to maintain membership in the Berea Farmers Market.

1. Membership Categories and Qualifications

Name of the cooperative is operated on a cooperative basis for the mutual benefit of its members as producers. Members are encouraged to include any details you would like to specify regarding membership i.e., membership in a particular professional or trade association, purchase from a specific retailer with certain specifications such as fair trade practices.

¹⁰⁸ The reference to classes of membership only applies if your cooperative will, in fact, have classes of membership.

A. Member “1”¹⁰⁹

Here you would outline the characteristics and attributes of this particular class of members. You would address what qualifies someone to be in this class of membership and enumerate it in this section.

Member 1s are considered in Good Standing when approved by the Board and all fees and dues are current and paid in full.

B. Member “2”

Here you would outline the characteristics and attributes of this particular class of members. You would address what qualifies someone to be in this class of membership and enumerate it in this section.

Member 2s can promote to Member 1s in Good Standing at any time through approval and payment of any balance of annual dues.¹¹⁰

C. Associate Members:

Associate members shall be limited to non-producer charitable organizations, firms and organizations which have related local and community goals, such as trade associations, colleges and universities, and professional organizations which are sympathetic to and interested in supporting the purposes and activities of the name of the cooperative.

2. Rights:

In this section you can delineate the rights and privileges of different member classes.

3. Termination or Refusal of Membership:

The Board may by a simple majority vote refuse or terminate the membership of any current or member applicant upon violation of these Bylaws or for such other cause as the Board may deem deleterious to the name of the cooperative's reputation or financial

¹⁰⁹ Throughout these bylaws you will see references to

¹¹⁰ Adding in this language is not required. It is optional to allow certain classes of members to become other classes through specific acts or by meeting particular requirements.

condition or for violation of law. Prior to termination of membership, the member shall be given notice and a reasonable opportunity to be heard. The action of the Board thereon shall be final.

4. Reinstatement.

A former member desiring to be reinstated must reapply for membership in the proper membership classification.

Article IV Membership Meetings and Voting

1. Membership Meetings:

Membership meetings for all categories will be held quarterly, with the fall meeting serving as the Annual meeting. The first quarter (Q1) meeting will serve to present and approve the closed financials from the previous year, budget and work plan for the upcoming year and the conduct of any further business that the Members or Board deems appropriate. Only *Member 1s* in Good Standing have voting rights (see IV.5). The date, time, and location shall be determined by the board of directors.

2. Annual Meeting:

The fall membership meeting is considered the annual meeting of the *name of the cooperative*. The Annual meeting serves to present and approve the election of directors as set forth herein, and the conduct of any further business that the Members and Board deems appropriate. The date, time, and location shall be determined by the board of directors.

3. Special Meetings:

Special meetings of the membership may be called at any time by the board of directors or upon written request of at least twenty percent (20%) of the *Member 1s* in Good Standing listed on the current membership list and specifying the business to be undertaken at such meeting. No business shall be undertaken at such special meetings except that specified in the written request.

4. Notice of Meetings:

Notice shall be provided for all regular and special membership meetings no less than 10 days before such meeting. Forms of notification shall include, but not limited to, written and/or electronic means. Such notice shall state the business to be transacted, the date, time and place of the meeting.

5. Voting Rights:

Only a *Member 1* in Good Standing shall have and/or exercise the right to vote as a member. Voting rights shall be equal among members, with only one vote per membership.

Members shall be eligible to vote at both scheduled and any other special membership meetings. A membership list will be maintained by the *name of the cooperative* to track voting rights.

Member 1s in Good Standing shall vote on recommendations and proposals put forth by the Board, including, but not limited to: market rules, policies, annual workplan and budget and other decisions affecting the Members.

6. Quorums:

A quorum shall consist of Twenty-five percent (25%) of the *Member 1* members in good standing for the annual membership meeting and any properly called special membership meeting. Voting electronically or by proxy will be allowed as set forth in the Board policy.

Article V Membership Dues

1. Fees:

The *name of the cooperative* will collect fees and dues from members to provide for *include brief statement as to why dues will be collected.* Upcoming calendar year dues and fees are to be approved on an annual basis at the annual membership meeting for all classes of membership. The annual fee (dues) will be due to the *name of the*

cooperative no later than the 15th of January of the following year. Installment payments and hardship cases can be approved by the Board and documented in the Producer member agreement. Any day fees will be collected as approved by the Membership and specified in the membership agreement.

Annual dues are not prorated and a full annual fee must be paid to be considered in Good Standing. Current *Member 1s* in Good Standing who have documented good history of timely installment payments, may be considered in Good Standing with no interruption, for the subsequent year.

2. No Refund of Dues.

No dues shall be refunded to any member whose membership terminates for any reason.

Article VI Board of Directors

1. Duties and Authority

The affairs of the cooperative shall be managed by the Board. The Board may exercise all the powers of the Association subject to any restrictions imposed by law, the Articles of Incorporation or these Bylaws.

The Board of Directors serves the membership and is responsible for the efficient and effective operations and management of the *name of the cooperative*.

The Board is responsible for developing and proposing to the membership for discussion and voting:

- the annual work plan and budget
- cooperative rules
- policies
- other decisions that affect the membership

The Board may appoint such committees as set forth under Article VII.5 as may be necessary to further the business of the cooperative, including an executive committee for such exigencies as may require immediate action.

2. Board Composition and Qualifications:

The *name of the cooperative* shall have a Board of Directors with minimum five (5) and maximum seven (7) voting members¹¹¹: with the majority of whom are *here you may delineate specific requirements for your board members i.e., must live in the community served by the cooperative*¹¹².

To be eligible to serve as a voting director, a person must be a *Member 1* in Good Standing as set forth in Article III. The board may appoint advisors to the board (ex-officio board members) that have no voting rights but can contribute to the discussion.

3. Election of Directors:

A nominating committee shall be appointed by the Board. The duties of the nominating committee will be to prepare a slate of directors for the annual elections to be held at the fall Annual meeting of the association.

Board members shall be elected by a majority vote of the *Member 1s* in Good Standing. There will be a minimum of five (5) and maximum seven (7) seven Directors elected by the members. New directors shall be prepared to assume the responsibilities of the office at the annual meeting.

At the initial election of directors, board members will be elected to staggered terms.¹¹³

For 5 directors: Two directors (2) will be elected to serve three (3) year terms. Two (2) directors will be elected to serve two (2) year terms. One director (1) will be elected to serve one (1) year terms.

¹¹¹ The number of the board of directors is flexible and you should determine it based on the needs of the cooperative you are establishing.

¹¹² The board composition and requirements of your board should be determined based on the needs of your cooperative. It is highly encouraged that you do establish some requirements

¹¹³ It is not required that board members be elected to staggered to terms but, it is highly encouraged. Once again, this will be based on the needs of your cooperative.

If 7 directors: Three directors (3) will be elected to serve three (3) year terms. Two (2) directors will be elected to serve two (2) year terms. Two directors (2) will be elected to serve one (1) year terms.

Terms will be drawn for by lot. After the initial election of directors, all directors will serve three (3) year terms, with no limits on number of terms. The immediate past President may serve as an ex officio non-voting member of the Board as well.

4. Board Vacancies:

Whenever a vacancy occurs on the board of directors, other than from an expiration of term, the remaining directors shall temporarily fill the empty spot by majority vote until the next annual meeting of members or until an election is held in a Special meeting, where members will elect a permanent replacement to fill the rest of the term.

5. Board Meetings:

In addition to the meetings mentioned above, regular meetings of the Board of Directors shall be monthly, or at such times and at such places as the Board may determine. A quorum of current directors must be present physically or virtually to conduct business. A written summary of the meeting including financials and discussions affecting the membership and decisions made should be made available to all *Member 1s* in Good Standing through forwarding electronically.

6. Quorum:

Three (3) directors, with the majority present being *Member 1s* shall constitute a quorum. For example, if three (3) directors are present, at least two (2) must be *Member 1s* to constitute quorum. If four (4) directors are present, at least three (3) must be *Member 1s* to constitute quorum. If five (5) directors are present, at least three (3) must be *Member 1s* to constitute quorum. Board meetings may be held by conference telephone call and board members may call in via telephone to vote at in-person board meetings (if available) in order to constitute quorum.

Voting by proxy will be allowed as set forth in the Board policy.

7. Special Meetings:

A special meeting of the Board of Directors shall be held whenever called by the President or by a majority of the directors. The President may call a special board meeting at any regularly scheduled board meeting, or via telephone, letter, electronic mail, or facsimile. Each call for a special meeting by the Board of Directors shall be in writing (letter, facsimile or electronic mail), signed by the person or persons making the same, addressed and delivered to the Secretary, and shall state the time and place of such meeting. On the signing of a waiver of notice of a meeting by all directors, a meeting of the Board of Directors may be held at any time. At all meetings, the presence of a majority of the members of the Board then in office shall be necessary to constitute a quorum for the transaction of business.

8. Removal of Directors:

Whenever any director fails to meet the qualifications described in Section 2. of this Article or fails to attend three (3) consecutive board meetings, either regular or special, without just cause and provided that notice of such meeting has been given in accordance with these bylaws, then the Board of Directors can remove said director and fill the vacancy in according with Section 4. of this Article. Board members may also be removed in accordance to KRS Chapter 272.460(1).

The *Member 1s* may remove any director for cause by an affirmative two-thirds (2/3) vote of the *Member 1s* in Good Standing present at any regular or special meeting of the Membership

9. Volunteers.

Directors shall not receive any compensation for services but shall be eligible to receive reimbursement for any expenses that they may incur in the performance of their duties and obligations as a member of the Board, under policies adopted by the Board for such purpose from time to time. No director, *Member 1s*, *Member 2s*, *Associate Member* or member of the immediate family of a director, *Member 1s* or *2s* or associate member shall occupy any paid position in the *Name of the Cooperative*.

Article VII Duties of the Directors

The duties of the Board of Directors shall be to assure the smooth transaction of all business of the association.

1. Management of the Business:

The Board of Directors shall have general supervision and control of the business and the affairs of the name of the cooperative and shall make all rules and regulations not inconsistent with law, the articles of incorporation and bylaws for the management of the business and the guidance of the members, officers, employees and agents of the name of the cooperative. The Board of Directors shall have the power to enter into contracts with individuals or organizations to secure management and operational services.

Operational responsibility includes¹¹⁴:

- a. Financial, such as paying all expenses of the association, seeking and applying for funding from outside sources, maintaining proper financial records, establishing membership and market stall fees, developing an annual budget for approval by the general membership
- b. Administrative, such as maintaining all records of the association including membership rolls, sales tax records (as applicable), Kentucky Secretary of State Forms, and any other records deemed necessary by the Board of Directors
- c. Hear and rule on grievances
- d. Supervise any staff or contractors

2. Depository:

The Board of Directors shall have the power to select one or more banks to act as depositories of the funds of the name of the cooperative and to determine the manner of receiving, depositing, and disbursing the funds of the name of the cooperative. All monies collected will be deposited into a bank account in the name of name of the cooperative. Any checks written or other withdrawals from this account will require the signatures of two officers or appointees. The board of directors shall have the power to change such banks and the persons signing such checks and the form thereof at will.

¹¹⁴ These responsibilities should be specific to the needs of your cooperative.

3. Bonds and Insurance:

The Board of Directors may require any member to maintain any policy or policies of insurance as the Board of Directors in its discretion deems to be necessary to further the purposes of the name of the cooperative. Further, the Board of Directors may maintain insurance to protect itself and each person, association, corporation, partnership or other entity, which is or was a director or officer of the Association.

4. Accounting System and Audits:

The Board shall keep correct and complete books and records of account and shall also keep minutes of the meetings of the Board of Directors and committees of the Board of Directors. All books and records of the name of the cooperative may be inspected by any director, or his or her agent or attorney, for any purpose at any reasonable time. An audit, review or compilation of the accounts of the Association shall be made annually after the end of each fiscal year. Such report shall be made available to the members at the Annual meeting.

5. Committees:

The Board of Directors may at its discretion establish and disband committees as it deems appropriate and may at its discretion appoint and remove members of committees as it deems appropriate. Committees can include members and also community non-members, but must include at least one board member as a liaison.

Article VIII Duties of the Officers:

1. Designation of Officers

The officers of the name of the cooperative shall be a President, Vice-President, Secretary and Treasurer. Officers shall be elected from the directors at the first Board of Directors meeting following the annual meeting by simple majority vote. Terms start January 1st and run to December 31st. Only one vote is permitted per board member, even though any two (2) or more offices may be held by the same person, except that the same person shall not be both President and Secretary.

a. **The President** shall call and preside over meetings as outlined in Article VI, develop the agenda for regular board meetings, appoint committees, perform duties in the interest of the association and sign all membership cards and such other papers of the name of the cooperative as s/he may be authorized or directed to sign, including without limitation, all checks, contracts and other instruments in writing on behalf of the name of the cooperative. The President shall perform such other duties as may be prescribed by the Board of Directors.

b. **The Vice President** shall perform duties of the President in his/her absence or disability. The Vice-President will act as ex-officio member of all committees.

c. **The Secretary** shall keep a complete record of all meetings of the name of the cooperative and of the Board of Directors and shall have general charge and supervision of the books and records of the name of the cooperative.

S/he will be responsible for monthly reporting to the *Member 1s* in Good Standing of monthly Board meetings as specified in Article VI.5.

S/he shall sign all papers pertaining to the name of the cooperative as s/he may be authorized or directed to sign by the Board of Directors. S/he shall serve all notices required by law and by these bylaws and shall make a full report to the members of all matters and business pertinent to the office at the annual meeting. He or she shall keep complete membership records. S/he shall make all reports required by the name of the cooperative or the Board of Directors. Upon the election of a successor, the Secretary shall turn over to the successor all books and other property belonging to the name of the cooperative that are in his or her possession.

d. **The Treasurer** shall perform duties with respect to the finances of the Berea Farmers Market as prescribed by the Board of Directors including:

1. collect and hold all association money in bank accounts and pay all bills consistent with the approved budget. The association's checking account will require the signature of two members of the Board of Directors, the treasurer and any one other member. The Treasurer shall present the books and records

annually to the auditing committee consisting of a minimum of two members appointed by the President. The Treasurer shall keep complete financial records and present a report at each meeting of the association.

2. S/he shall present a detailed year-end report to the Board of Directors and is responsible for preparing a preliminary budget for the upcoming year.

Article IX Capital Stock:

The *name of the cooperative* shall operate as a non-stock cooperative.

Article X Operation at Cost and Members' Capital:

1. Operation at Cost:

The *name of the cooperative* shall at all times be operated on a cooperative service-at-cost basis for the mutual benefit of its members.

2. Margin Allocation:

In order to induce patronage¹¹⁵ and to assure that the *name of the cooperative* will operate on a service-at-cost basis in all its transactions with its members, *name of the cooperative* is obligated to account on a patronage basis to all members on an annual basis for all amounts received from business conducted with members on a patronage basis, over and above the cost of providing such services and making reasonable provisions for reserves. The allocation of such amounts shall be based on length of membership in months and number of market participation days.

3. Dividends:

No dividends shall be paid on any capital.

4. Fiscal Year:

The fiscal year of the Association shall commence on the first day of January and end on the last day of December.

¹¹⁵ In order to get the benefits of subchapter T, you will need to include a statement about the allocation of patronage.

Article XI Dissolution:

Should the association dissolve or become inoperative, any remaining money shall be disposed after all debts and liabilities have been paid of according to the recommendation of the Board of Directors with the approval of the membership and consistent with applicable laws.

Article XI Amendments:

The Bylaws may be amended at any meeting of the cooperative by a two-thirds vote of the members in Good Standing present, provided due notice of such proposed amendments be mailed or emailed by the Secretary to the entire membership not less than fifteen (15) days prior to the said meeting. Electronic and proxy voting is permitted under the policy as set forth by the Board.

Article XII Indemnification:

The Association shall indemnify its officers, directors, employees and agents to the fullest extent possible under the laws of the Commonwealth of Kentucky, as they may be amended from time to time.