

Serial Number _____

ICA MODEL BYLAWS FOR A WORKER COOPERATIVE
VERSION III (1995)

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ICA MODEL BYLAWS FOR A WORKER COOPERATIVE
VERSION III (1995)

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ICA MODEL BYLAWS FOR A WORKER COOPERATIVE
VERSION III (1995)

A. PREFACE

We are pleased to introduce Version III of the ICA Model Bylaws for a Worker Cooperative. The Industrial Cooperative Association — now The ICA Group — developed the original Model Bylaws with extensive annotations in the late 1970s. The last significant revision was published as Version II in 1983. During the past decade and a half, these model documents have provided guidance to hundreds of enterprises throughout the United States and helped to inform statutory changes in a number of states.

This Version III reflects the cumulative experience of the ICA, its clients, and other cooperative business participants and advisors since the earlier publication. It also accounts for changes in the laws governing worker cooperatives and anticipates tax and accounting challenges faced by cooperative enterprises. One significant addition is more detailed attention to the use of hybrid structures and outside investment by a worker cooperative, with resulting variations in governance and corporate finance.

Another change, we trust, is that this package is more user friendly than previous versions. The Bylaws have been streamlined and the annotations made more precise. New ancillary materials in the Appendix add practical forms and background articles. And the Bylaws are now available on computer disk.

Version III reflects the hard work of many people and lessons from a number of cooperative enterprises. We thank them here, although we cannot name them all. We give particular thanks to David Ellerman from whose original work much of this revision was built; to Janet Saglio for distilling the experience of a number of operating enterprises; to Robert Estes, James Steiker, David Kirkpatrick, and Kathryn Sedo for their expert advice; to Linda Enoma for producing the final product; and to James Megson and The ICA Group for commissioning the development of the ICA Model Bylaws for a Worker Cooperative: Version III.

Peter Pitegoff
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B. INTRODUCTION

This publication presents legal forms and guidelines for creating a worker cooperative corporation. A worker cooperative is a special type of business corporation and, in many ways, resembles a conventional business. It differs, however, in three primary respects.

First, a worker cooperative is structured as a membership organization, with eligibility for members limited essentially to the core workforce. Second, a worker cooperative is governed democratically by its members, ordinarily giving members the right to elect a majority of the board of directors and to vote on selected other issues on a one-person/one-vote basis. Third, a portion of corporate earnings are allocated to members on the basis of their relative investment of work rather than simply on the basis of capital investment. These basic elements might vary somewhat in their application to different enterprises, especially in cooperatives that include non-member investors. Nonetheless, they constitute the core "cooperative attributes" that distinguish a worker cooperative from other business enterprises.

As a corporation, a worker cooperative is chartered under state law and is required to file articles of incorporation with state officials in order to form the corporate entity. Its legal structure is defined essentially in the articles of incorporation and, with more detail, in the bylaws. At the end of this Introduction is "A Guide to the Articles of Incorporation," followed by a model form of bylaws for a worker cooperative and extensive annotations. Ancillary materials in the Appendix include sample documents, selected background articles, and descriptions of alternative organizational forms.

IMPORTANT NOTE: This publication and its model documents are designed without specific reference to the laws of any particular state. Each state has its own corporate law and some states have special worker cooperative statutes as well. The governing law for a worker cooperative will differ from state to state. We recommend that you consult with a lawyer familiar with the corporate law of the state in which you plan to incorporate. Moreover, any offer or sale of corporate stock is governed by securities regulations, although the burden of compliance can be reduced in smaller companies including many worker cooperatives. Your local counsel should guide you through the maze of securities law compliance.

This publication is not designed as a substitute for competent legal advice, although it can be a helpful tool in your consultations with local counsel. With respect to taxation, a corporation structured and operating in accordance with these Model Bylaws is likely, but not guaranteed, to qualify for the cooperative tax benefits of Subchapter T of the federal Internal Revenue Code. We recommend that you also consult with a lawyer or accountant familiar with cooperative taxation to select the appropriate organizational form for tax purposes and, if organized on a cooperative basis, to assure that your enterprise is in compliance with all Subchapter T requirements.

1. What is a Worker Cooperative?

A worker cooperative is a democratic corporation, owned and controlled by the people who work in the company. The workers are "members" of the cooperative, subject to certain eligibility requirements. Members hold basic rights: (1) voting rights on selected issues, including the right to elect a majority of the board of directors, which in turn selects management, and (2) rights to share in the net earnings of the company, allocated according to relative amount of work performed.

Each member has an equal vote in shareholder voting, in accordance with the democratic principle of one-person/one-vote. The extent of issues on which members vote, however, varies from cooperative to cooperative. In practice, the board may decide many issues without voting by members, and managers make many day-to-day decisions without any voting at all.

In legal terms, a worker cooperative is a particular type of closely-held corporation. As such, the board of directors retains the primary authority and responsibility for managing the affairs of the corporation. In organizational terms, though, a worker cooperative is analogous to a democratic community. The citizens are the people who work in the company. The articles of incorporation serve as a charter or constitution, and the bylaws define rules, rights, and responsibilities. The board of directors, like a legislature, is elected by the people it represents — citizens in a political community, worker-members in a cooperative.

A town or city is a democratic community of people with the common purpose of living in a certain geographical area. People qualify to vote in the town or city elections by residing within that area. A worker cooperative is also a democratic community, but it is a community of work, not a residential community. It is a business, a place to make a living by producing and selling a meaningful and useful product or service. Unlike many conventional businesses, however, a worker cooperative is controlled by the members who qualify to vote by working in the firm.

Theoretically, then, membership rights in a worker cooperative are personal rights attached to the functional role of working in the firm, rather than property rights that can be bought and sold. In contrast, ownership rights in a conventional corporation — voting rights and the rights to capital dividends — are property rights which may be bought and sold as capital shares, subject to any transfer restrictions in the articles of incorporation. A worker cooperative applies the principle of democracy to the legal structure of the workplace. [See Appendix 6 for a more detailed discussion of the theoretical foundations of the worker cooperative legal structure.]

Rights give rise to responsibilities. Voting rights in a town, city, state, or nation come together with responsibilities, such as paying taxes. A corresponding responsibility in a cooperative is to pay the membership fee. In corporate terms, a membership fee is a contribution to capital, representing a member's initial portion of the net worth of the company and consideration for a share of common stock defined as a "membership share." Legally, since the membership fee is an investment of equity capital, the member risks losing his or her investment if the corporation experiences an investment of losses.

2. Worker Cooperative Capital Structure

The capital structure reflected in the Model Bylaws is adapted from the successful cooperatives of Mondragon, in the Basque region of Spain. [See Appendix 7.] In this cooperative form, the corporation's net worth is reflected in a system of internal capital accounts. Each member has an individual capital account to reflect the value of the member's relative equity in the corporation. A member's capital account keeps track of his or her portion of the corporation's net worth and of the amount of money eventually distributed to the member if not reduced to cover corporate losses.

A portion of the cooperative's positive net income or profit (if any) is allocated to each member's account each year. These amounts are called "patronage dividends," a term derived from Subchapter T of the federal Internal Revenue Code, a tax provision for cooperatives. [See Appendix 4 for discussion of Subchapter T.] In the event of negative net income or losses by a cooperative in a given year, these losses can be allocated to members' accounts, thereby reducing their account balances.

In a conventional corporation, dividends are distributed according to each shareholder's capital investment and number of shares, so they are called "capital dividends." In a cooperative, dividends are allocated according to "patronage" so they are called "patronage dividends." Patronage is defined differently in different types of cooperatives. In an agricultural marketing cooperative, for instance, patronage is the value of the crops sold through the cooperative. In a consumer cooperative, patronage is the value of the member's purchases. In a worker cooperative, patronage is the amount of work (measured by hours or pay) that the member performs.

Patronage dividends in a worker cooperative differ from capital dividends in a number of ways: (1) they represent a return on labor patronage rather than a return on capital investment, (2) payment of patronage dividends (unlike capital dividends) is ultimately tax deductible by the corporation if the requirements of Subchapter T of the Internal Revenue Code are met, and (3) a corporation may allocate a patronage dividend partially or entirely on paper, and retain the profits for a period of time to use for any corporate purposes. The patronage dividends retained in a worker cooperative are credited to each member's internal capital account in proportion to his or her labor patronage for that year and redeemed for cash in the future. Cooperatives can and often do pay a portion of patronage dividends initially in cash to the members.

This model capital structure differs substantially from the capital structure in a conventional business corporation. The net worth of a conventional corporation is reflected in the stock shares. If the company succeeds and retains earnings, the net worth of the company (and thus the value of the shares) increases over time. If such stock shares are used as membership shares in an employee-owned company, then their appreciated value might make them too expensive for new members to purchase. Historically, use of such capital shares has led to the demise of democratic structure in a variety of employee-owned firms. In some cases, the members sold the entire company to a conventional investor to cash in on their share of

equity. In other cases, the members have hired non-member employees or members with lesser rights, in either case causing destructive tension in the firm.

In a worker cooperative using these Model Bylaws, the function of carrying the net worth of the company is essentially shifted away from the shares and into the internal capital accounts. Increases in net worth will increase the balance in members' accounts, due back to them eventually in cash. Thus the older members still get the value of the fruits of their labor, paid by the corporation over a period of time. The shares, however, remain at a reasonable value, enabling new members to pay an affordable membership fee when they join. At any given time, members may have differing claims on the company's net worth, but they all have the same membership rights and only one membership share each. This worker cooperative structure is designed to sustain the democratic corporate structure over time.

One limitation of this capital structure with internal capital accounts is that it is based on book value. The valuation of each member's equity thus reflects corporate performance only to the extent of retained earnings or losses. During the life of the corporation, however, the member foregoes any claim on the market value of the corporation in excess of book value. This limitation on the upside return in an "internal capital account cooperative" is moderated by dissolution provisions in the bylaws that allow for the sale of the corporation and distribution of market price proceeds to all current and recent members on the basis of their relative patronage. The limitation on market value return can be moderated further by interim measures, such as severance packages, wage bonuses, and salary or benefit adjustments.

3. Hybrid Structures & Alternative Legal Forms

The Model Bylaws embody a democratic corporate structure, in terms of member voting for the board of directors and other issues, and in terms of equitable allocation of earnings on the basis of labor patronage. It is important to note, however, that corporate structure alone cannot make a company democratic. Worker ownership and control as shareholders may be a necessary but not sufficient element for a democratic workplace. For this reason, many worker cooperatives supplement the ownership or legal structure with other mechanisms for employee involvement and influence.

Management and board policies can reinforce a participatory system, and programs may be established for shopfloor participation and other shared decision-making in operational matters. Operating rules, separate from the bylaws, can encompass many of these policies and programs. Contracts — e.g., shareholder agreements, employment contracts, or collective bargaining agreements — often supplement the basic legal structure of the worker cooperative corporation. The bottom line, though, is that a democratic corporate culture depends substantially on informal norms of behavior and on shared values that reflect mutual respect.

Many worker cooperatives diverge from a "pure" cooperative form, while still maintaining a commitment to democratic work. The result is a wide range of "hybrid" legal forms that couple core cooperative attributes with more conventional artifacts of business and finance. Various contracts as noted above can alter the legal and financial relationships

significantly. Notably, as well, worker cooperatives often issue a second class of stock in addition to membership shares.

a. Worker Cooperative with Two Classes of Shares

"Class B" stock, as designated in Version III of the Model Bylaws, can enable a cooperative to raise needed equity capital by issuing stock to outside investors or to institutions willing to assist in the cooperative acquisition or start-up. Outside equity carries with it some risk of undermining the democratic structure of the cooperative or reducing the return to members on the basis of labor patronage. In order to maintain a legal structure with core cooperative attributes such as member control and return based on patronage, the voting and capital rights of such non-member shares are ordinarily quite limited. In fact, some state laws governing cooperatives, as well as eligibility for cooperative tax advantages under Subchapter T, require limitations on return to holders of capital stock and on their voting rights. **NOTE:** Before issuing non-member shares, be sure to determine whether and to what extent such shares are permitted by the state law under which your enterprise is incorporated.

Legal constraints aside, though, the use of non-member shares suggests that an enterprise can be more or less of a cooperative; i.e., that the cooperative nature of a corporation is a matter of degree. A worker cooperative can, in fact, "put aside" many of the legal constraints on issuing multiple classes of shares, if it incorporates under a state's general business corporation law, does not use the term "cooperative" in its corporate name, and foregoes any claim for tax deductions under Subchapter T of the Internal Revenue Code. At some point along the hybrid spectrum, of course, the enterprise no longer can legitimately be described as a democratic worker cooperative.

This version III of the Model Bylaws presumes a corporate structure with two classes of stock — Class A membership shares and Class B preferred shares — since experience has shown the need for two classes of shares in many worker cooperatives. A second set of Model Bylaws, with only one class of shares (membership shares) is included as Part C.2 in this package as a simpler alternative, although the annotations generally refer to the 2-class model.

b. Employee Stock Ownership Plans (ESOPs)

A popular hybrid form for worker ownership involves business corporations with ESOPs. The 1980s witnessed the formation of a dramatic number of ESOPs, or employee stock ownership plans, by business corporations. [See Appendix 9 for a discussion of ESOPs.] Most of the more than 11,000 companies with ESOPs bear little resemblance to a worker cooperative. Most ESOPs, instead, are simply employee benefit plans that give some company stock to the employees and provide a tax-favored financing mechanism for the employer.

Some ESOPs, however, have been designed to provide for majority ownership and control by the workforce. A detailed discussion of ESOPs is outside the scope of this publication. It is important to understand, though, that the cooperative attributes reflected in the

Model Bylaws can be translated into the more complex legal form of a business corporation with a "democratic ESOP." This option can be useful and important in worker acquisitions of existing businesses and in circumstances where substantial financing is required. ESOPs also require valuation of workers' equity shares on the basis of market value, in contrast to the more modest book value formula in a worker cooperative using internal capital accounts. And, ESOPs can offer a member of significant tax benefits.

Certain thresholds of enterprise scale and transaction cost must be considered before selecting an ESOP as the vehicle for a democratic corporation. We recommend that you consult with The ICA Group or other ESOP experts regarding the ESOP option.

c. S Corporations and Limited Liability Companies (LLCs)

Small worker cooperatives might consider two other legal forms that provide significant tax advantages. One, commonly known as an "S Corp," is a small business corporation that elects to be taxed under Subchapter S of the Internal Revenue Code. The other is a limited liability company, or "LLC," a new legal form available in most states.

The primary advantage of both an S Corp and an LLC is the elimination of corporate tax and thus the avoidance of "double taxation" of enterprise earnings, i.e., taxation of earnings at both the corporate level and, upon distribution, at the individual level. Like a partnership, the tax liability for all the corporation's net income or loss is passed through to the owners. Unlike a partnership, owners of an S Corp or an LLC retain the corporate shield against personal liability for corporate debts and liabilities. Many of the cooperative attributes reflected in the Model Bylaws can be built into an S Corp or LLC, without the need for administrative and substantive compliance with Subchapter T.

The S Corp, however, has a number of limitations. Subchapter S election is not available if the corporation has more than 35 shareholders. The corporation can have only one class of stock, and all shareholders must be individuals or simple trusts. Moreover, all corporate net income or loss is taken into account each year by the shareholders, without regard to actual distributions. Thus, if the corporation needs to retain substantial earnings, the worker-owners might face tax liability with no cash proceeds to pay the tax. A corporation operating on a cooperative basis in compliance with Subchapter T has much more flexibility to shift the tax burden among the corporation and the members, even while retaining corporate earnings and avoiding double taxation.

The LLC holds more promise than the S Corp as an alternative vehicle for worker ownership. Unlike an S Corp, most LLCs can have multiple classes of shares and more than 35 shareholders. Owners are even designated as "members." Although LLC owners (like S Corp owners) face the impact of pass-through tax liability without regard to distributions, LLC statutes generally offer more flexibility than Subchapter S. Since a favorable ruling by the Internal Revenue Service in 1988, allowing certain LLCs to be taxed like partnerships, almost all states have enacted statutes authorizing LLCs.

The primary drawback in using an LLC for a cooperative business is a risk that the IRS will deny the right to single or "partnership" taxation, unless the business foregoes certain corporate characteristics. Essentially, the LLC needs to look more like a partnership than a corporation, with provisions that may limit the corporation's "continuity of life," "free transferability of interests," or "centralized management." As of the mid-1990s, the LLC remains novel and its tax treatment uncertain. Over time, it may very well become the preferred form for many small businesses, including worker cooperatives. [See Appendix 10 for further discussion of LLC's.]

4. Role of the Articles of Incorporation and Bylaws

All corporations operate according to their governing documents, primarily the articles of incorporation and the bylaws. To create a corporation, all states require the filing of the articles of incorporation and a filing fee with the state government — usually, the Corporations Division of the Secretary of State's office. A corporation's existence ordinarily begins when the articles of incorporation are accepted by state officials.

The articles of incorporation, in some states termed the "articles of organization" or "certificate of incorporation," are often referred to informally as the articles and are designated hereinafter as the "Articles." They include basic information, such as: (1) corporate name and address, (2) corporate purpose, (3) authorized stock, (4) restrictions on the transfer of stock, and (5) other details such as a list of initial directors. Some of this information will reflect basic cooperative attributes — in particular, corporate purposes and capital structure. [See "A Guide to the Articles of Incorporation," below, and Appendix 1 for Sample Articles of Incorporation.]

Most incorporators choose to define the corporate purposes broadly in the Articles and to keep the Articles relatively brief in order to avoid constraining corporate activity unnecessarily. Many provisions relating to operation of a corporation may properly be placed in either the Articles or the bylaws or both. More detail about the cooperative structure is ordinarily reflected in the bylaws, which are not usually filed with state officials and are thus easier to amend. Amendments to the Articles require shareholder voting and the filing of Articles of Amendment and a fee to the state.

The bylaws of a corporation are usually adopted by the incorporators and/or at the first meeting to the board of directors after incorporation. The bylaws include provisions primarily regarding governance, such as shareholder meetings, election and meetings of the board of directors, duties of officers, voting rights and procedures, relationships among the shareholders and various other participants, and related corporate affairs. The Model Bylaws also define in Article III the capital structure and operation based on a system of internal capital accounts.

The purpose of the ICA Model Bylaws and sample Articles is to create a democratic cooperative structure within a legal shell incorporated under an appropriate corporation statute. Fortunately, most general business corporation statutes are flexible enough to use in creating a democratic worker cooperative. Some cooperative corporation statutes can also be used. Many existing cooperative statutes, however, are designed primarily for agricultural cooperatives, include troublesome limitations, and are essentially inappropriate for this model of a worker cooperative. You should examine the statutory framework in your state, and with local legal counsel choose the most appropriate incorporation statute.

A number of states have a special statute exclusively for worker cooperatives, including Massachusetts, New York, Vermont, Connecticut, Maine, Ohio, and others. Most of these special worker cooperative statutes were modeled on the Massachusetts statute, drafted in the early 1980s by the ICA. Where such a law exists, a worker cooperative should incorporate under the worker cooperative statute, and the Model Bylaws will closely track the statutory guidelines. In other states, a worker cooperative may incorporate under the business corporation law or under the general cooperative corporation law, subject to any particular state law restrictions.

The Model Bylaws will, in effect, convert a normal business corporation or cooperative corporation to a unique type of democratic worker cooperative with internal capital accounts.

5. A Guide to the Articles of Incorporation

The form for articles of incorporation will vary, depending upon your state laws and your choice of incorporation statute. This description tracks the requirements for Massachusetts business corporations organized under MGL ch. 156B, which is also used for worker cooperative corporations under MGL ch. 157A.

Appendix 1 includes sample articles of incorporation for a worker cooperative. The sample Articles in Appendix 1 and the following guidelines for worker cooperative Articles can be adapted to your state law and requirements. We recommend that you consult local counsel before filing articles of incorporation, since specific state law requirements differ from state to state.

The Articles contain a list of the names and addresses of the "incorporators." In most cases, the incorporators will be one or more of the initial organizers of the cooperative corporation. The incorporators meet to adopt Articles and bylaws, select initial directors and officers, and take any other action which might be taken by members or shareholders after the Articles become effective. The Articles ordinarily become effective when approved by the Secretary of State or other appropriate state official. Once the corporation is formed, the initial board of directors holds its organizational meeting, to ratify the actions of the incorporators and take whatever action is required to activate the corporation.

Following are standard provisions for the Articles of Incorporation.

(1) Name

When choosing a name for the corporation, be sure to check the applicable state incorporation statute for requirements or restrictions. Some cooperative statutes, for instance, require use of the word "cooperative" in the name. Many business corporation statutes, on the other hand, prohibit use of the word "cooperative" (or any variant) but require a term such as "Incorporated," "Corporation," "Limited," or some derivation of those terms in the name.

The corporate name must not duplicate that of any other existing corporation in the state. In order to avoid delay in state approval of your Articles, you can first call or write the Corporations Division of the Secretary of State's office (or other appropriate official) to check for the availability of a particular name. With an appropriate filing and small fee, you can reserve your preferred corporate name for a period of time preceding incorporation.

(2) Purpose

This provision of the Articles should communicate the basic purposes of the corporation, but should also be broad enough to allow for flexibility. At a minimum, the purpose provision should include a general statement such as item (a) below. In fact, your lawyer might suggest that you include that purpose alone, without other listed purposes that might give rise to restrictions on corporate activity.

- (a) A general statement of any lawful purpose; for example: "To conduct any business or other activity which lawfully may be conducted by a corporation organized under the _____ corporation law of the state of _____, whether or not related to those purposes described in the following paragraph."

Founders and members of some cooperatives prefer to use the Articles to establish certain basic cooperative attributes or corporate purposes that are intentionally difficult to change. Thus, you might consider items (b) and (c) below as well.

- (b) A description of the general business purpose of the corporation; for example: "To conduct the business of selling data processing consulting services; to buy, lease, sell, exchange and otherwise deal in computer programs and software; to enter into relationships with others for any of these purposes; and to do all other things necessary, appropriate, or incidental to the accomplishment of these purposes."
- (c) A statement of democratic structure of organization; for example: "To operate as a corporation controlled democratically by the members, as defined in the Bylaws." Or, in states with worker cooperative statutes modeled on Massachusetts' MGL chapter 157A, a more specific provision as follows is appropriate: "To operate on a cooperative basis in accordance with [cite worker cooperative law]."

Finally, this portion of the Articles is often used to make reference to statutory powers of the corporation, and to assure that enumeration of purposes does not unduly limit the power of the corporation. [See Appendix 1 for sample language.]

(3) Authorized Stock

A corporation can issue shares of stock to shareholders only if the number and type of shares is authorized in the Articles. In a conventional business corporation, at least one class of stock is "common stock," with a residual claim on corporate earnings and assets. In a worker cooperative, the core common stock shares are the membership shares, and this section of the Articles is used to authorize membership shares to be issued to the members. This section is also used to authorize Class B shares or other classes of stock if the worker cooperative intends to

issue non-member shares. Again, if you intend to issue non-member shares, be sure that it is permitted under your selected incorporation statute.

A corporation can issue several different "classes" of stock with different rights attached to each class. Some classes are termed "preferred" stock which might be entitled to get dividends before holders of other classes of shares and, in the event of dissolution or bankruptcy, might get cashed out before other classes of shareholders. Ordinarily, preferred shares have a fixed dividend rate and only limited voting rights. Other classes are termed "common stock" which, in the event of dissolution or bankruptcy, gets cashed out last. Since common stock is most at risk, it usually carries the right to substantial return in dividends or dissolution proceeds if the corporation is successful. At least one class of common stock always carries voting rights.

In a worker cooperative as envisioned in the ICA Model Bylaws, the corporation would authorize a class of common stock defined as "membership shares" and a second class of stock termed "Class B Shares," defined as either common stock or preferred stock. [See Part C.2. below for alternative Model Bylaws with a single class of membership shares.] The initial Articles should authorize a sufficient number of shares to cover anticipated future issues of stock. Otherwise, the later addition of new members or Class B shareholders would require an amendment to the Articles, which includes a filing and a fee to the state.

The upper limit of authorized shares is related to the fee structure for incorporation. In Massachusetts, for instance, the filing fee is one cent a share, with a minimum fee of \$150. Thus, up to 15,000 shares can be authorized without increasing the \$150 filing fee — any more would increase the cost of filing, although there is no legal limit to the number of shares. This explanation assumes the authorization of stock "without par value" or with par value of one cent. Stock can be authorized with a designated par value, in which case the filing fee is a percentage of total par value.

We suggest the authorization of "no par" stock or "penny par" stock. Although the meaning of par value may be more historical than practical, a minimal par value may be preferable to no par value under some state laws. Consult with a local attorney with respect to the par value issue in your state.

(4) Relative Rights of Different Classes of Stock

This section is not applicable if the Articles authorize only membership shares as the single class of stock. If, however, you intend to issue non-member shares, this section defines the relative voting, dividend, redemption, and dissolution rights of the different classes of shares. This provision must be drafted with care, in consultation with legal counsel, since it establishes basic governance and financial rights among shareholders. This provision should be consistent with any disclosure document distributed to prospective members and shareholders and with any investment contracts or shareholder agreements.

(5) Restrictions on the Transfer of Stock

In a worker cooperative, the transfer of stock shares is severely restricted so that only the members can hold membership shares and so that any non-member shareholders can sell their shares only back to the corporation. The terms of any such restrictions may appear in the Articles, and may anticipate such events as death, bankruptcy, attempted attachment, or other legal directives. (Check your applicable state law to determine if such restrictions, if any, are required to appear in the Articles.)

At a minimum, language such as the following should appear in the Articles with respect to all shares:

"No share of any class or interest therein may be sold, assigned, or otherwise transferred, voluntarily or involuntarily, by operation of law or otherwise, except for a transfer to the corporation."

In addition, you might include the following provision in the Articles with respect to membership shares:

"Class A Shares may be held only by persons eligible as members in accordance with the Bylaws, and no person may hold more than one (1) Class A Share. Upon termination of his or her employment in the corporation, a holder of a Class A Share must transfer his or her share back to the corporation at redemption terms determined in accordance with the bylaws."

(6) Other Lawful Provisions

This is an open-ended section for any additional provisions. A simple answer would be "none," but there may be reasons for including other provisions. In some states, for instance, election of the worker cooperative statute can appear in this section rather than in the "purposes" section. In any state, you may use this section to reinforce basic cooperative attributes by including such provisions as:

"Each member shall be entitled to one and only one vote on any subject that requires voting by members." And, "The net earnings and losses of the corporation shall be apportioned and distributed in accordance with the Bylaws."

In many states, certain authority of the Board of Directors or certain corporate powers are available only if authorized in the Articles. In Massachusetts, for instance, the following two provisions should appear in the Articles: "The corporation may be a partner in any business enterprise which the corporation would have power to conduct by itself;" and, "The directors may amend the Bylaws except as limited by law or the Bylaws." Some states require designation of an agent for service of process, such as the corporate secretary, or designation of the Secretary

of State as agent for service, with an address at which the corporation would be notified. Thus, state officials or private litigants know where to find the corporation and whom to serve with legal papers in the event of litigation or other required notice. Check with local counsel or with state officials to learn what additional provisions should be in the Articles in your state.

(7) Other Details

The remainder of the Articles ordinarily is limited to basic information not treated as a permanent part of the Articles. Changes in these initial facts usually appear in annual reports or other filings, but do not require amending the Articles. Such information may include: the initial address of the principal office of the corporation, duration, registered agent, names and addresses of initial directors and officers, fiscal year, and date of the annual meeting of shareholders. Such information should be consistent with parallel provisions in the bylaws.

In most states, bylaws are adopted by the Board of Directors at the organizational meeting after incorporation, but some states require that the incorporators adopt the bylaws before filing the Articles of Incorporation.

After the Articles are approved by the Secretary of State or other appropriate official, they are filed with the state records and a filing receipt is sent to whomever the incorporators choose. For an additional fee in most states, it is useful at the outset to request a certified copy of the Articles. The filing receipt and certified copy constitute evidence of corporate formation and should be kept on file by the secretary of the corporation, along with other filings, bylaws, and corporate records.

The procedure for amending the Articles is governed by state law. Amendments ordinarily require the filing of Articles of Amendment and the payment of a filing fee to the Secretary of State. Amendments to the Articles require a shareholder vote. State law may require a supermajority vote of shareholders for certain amendments to the Articles and/or a vote by each class of shareholders whose shares are affected by the amendment. Given these requirements, the Articles are not likely to be amended except when absolutely necessary.

C.1

ICA MODEL BYLAWS

FOR A WORKER COOPERATIVE

VERSION III (1995)

[One Class of Shares]

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ARTICLE I

CORPORATE AFFAIRS

1. **NAME.** The name of the corporation is _____ (hereinafter, the "Corporation").
2. **FISCAL YEAR.** The fiscal year of the Corporation shall end on the last day of [month] in each year.
3. **EXECUTION OF INSTRUMENTS.** All deeds, leases, transfers, contracts, notes, bonds, and other obligations authorized to be executed on behalf of the Corporation shall be signed by the President or the Treasurer except as otherwise determined from time to time by the Board of Directors.
4. **CORPORATE RECORDS.** Copies of the following documents shall be kept at the principal office of the Corporation or at the office of the Secretary, but need not all be kept at the same office: (a) the Articles of Incorporation and Bylaws, (b) records of all meetings of Incorporators, Directors, and Members, and (c) the stock and transfer records containing the names and record addresses of all Members.
5. **ARTICLES OF INCORPORATION.** The purposes of the Corporation shall be as set forth in the Articles of Incorporation (hereinafter, the "Articles"). In the event of any inconsistency between the Articles and these Bylaws, the provisions of the Articles shall be controlling.

ARTICLE II

MEMBERS AND SHAREHOLDERS

1. **MEMBERSHIP ORGANIZATION.** The Corporation shall operate on a cooperative basis, with earnings and losses allocated on the basis of patronage and with voting by Members in accordance with the Articles and Bylaws.
2. **MEMBERS AND MEMBERSHIP SHARES.** The Corporation has a single class of common voting stock (hereinafter, "Membership Shares"), and holders of Membership Shares are designated hereinafter as Members.
 - 2.A. **MEMBER ELIGIBILITY.** Members shall be limited to natural persons who:
 - (1) patronize the Corporation through provision of their labor on a full-time or part-time basis;

- (2) have been approved by the Board of Directors or its designees;
- (3) have paid a Membership Fee as hereinafter defined; and,
- (4) have been employed by the Corporation for a period of at least ____ months, except as otherwise determined by the Members from time to time.

2.B. MEMBERSHIP SHARES. Each Member shall own one and only one Membership Share.

- (1) Only Members may own Membership Shares, except that, in the event of the death of a Member, his or her estate may hold the Membership Share pending repurchase by the Corporation.
- (2) The cost and terms of a Membership Share shall be determined by the Board of Directors from time to time, and such cost is designated as the "Membership Fee."

2.C. MEMBERSHIP TERMINATION. Upon voluntary or involuntary termination of a Member's employment by the Corporation, except for temporary layoffs or absences, his or her membership shall be terminated and the Corporation shall redeem his or her Membership Share for consideration determined in accordance with Article III.

3. TRANSFER RESTRICTIONS. No share or interest therein may be sold, assigned, or otherwise transferred, voluntarily or involuntarily, by operation of law or otherwise, except for a transfer to the Corporation.
4. CERTIFICATES FOR SHARES. Each Member is entitled to a certificate representing his or her share in such form as prescribed by the Board of Directors. The certificate shall be signed by the President and the Treasurer when it is issued. Each share shall set forth conspicuously on the face or back of the certificate either the full text of the restrictions prescribed in section 3 of this Article, or a statement that such restrictions exist and that the Corporation will furnish a copy of such restrictions to the Shareholder upon written request and without charge. In case of the loss, destruction, or mutilation of a share certificate, a duplicate certificate may be issued in its place, upon such terms as the Board of Directors may prescribe.

ARTICLE III

INTERNAL CAPITAL ACCOUNT SYSTEM

1. INTERNAL CAPITAL ACCOUNTS. The Corporation shall have a system of Internal Capital Accounts as equity accounts to reflect its net worth, to reflect the allocation of net worth among the Members, and to determine the redemption value of Membership Shares and Written Notices of Allocation as hereinafter defined. The Internal Capital Accounts consist of Individual Capital Accounts and a Retained Earnings Account. The sum of the balances of the Internal Capital Accounts is the net worth of the Corporation.
 - 1.A. INDIVIDUAL CAPITAL ACCOUNTS. The Corporation shall maintain for each Member an Individual Capital Account that reflects the value of the Member's relative equity in the Corporation.
 - (1) The balance in any Individual Capital Account results from and is increased by: (a) the initial Membership Fee, plus any other paid-in capital from or on behalf of the Member in excess of the Membership Fee, and (b) the amount of any Written Notices of Allocation issued to the Member.
 - (2) The balance in any Individual Capital Account is decreased by: (a) any losses allocated to the Individual Capital Accounts, and (b) the redemption, in cash or notes of indebtedness, of a Written Notice of Allocation previously issued to the Member and recorded in the Member's Individual Capital Account.
 - 1.B. RETAINED EARNINGS ACCOUNT. The Corporation shall maintain an unallocated retained earnings account (hereinafter, "Retained Earnings Account") that reflects the portion of net worth not allocated to Individual Capital Accounts.
 - (1) The balance in the Retained Earnings Account results from and is increased by: (a) that portion of retained earnings not allocated to Individual Capital Accounts, and (b) any gifts or grants to the Corporation, unless otherwise allocated to Individual Accounts.
 - (2) The Retained Earnings Account balance is decreased by any losses allocated to the Retained Earnings Account.
 - (3) The Corporation shall maintain a Retained Earnings Account balance with reference to a target amount for business purposes, in accordance with section 2.C of this Article III.
2. ALLOCATION OF NET INCOME. The positive or negative Accounting Net Income of the Corporation shall be allocated annually among the Internal Capital Accounts, after payment of corporate tax, dividends on capital stock, and the cash portion of Patronage Dividends.
 - 2.A. DEFINITIONS. The following definitions shall apply to terms used herein.

- (1) "Accounting Net Income" is the book net income for the fiscal year computed in accordance with Generally Accepted Accounting Principles (GAAP).
- (2) "Patronage" is the total number of hours worked for the Corporation by Members and non-members during the fiscal year. "Member Patronage" is the total number of hours worked for the Corporation by Members during the fiscal year.
 - (a) "Patronage Income" is that portion of Accounting Net Income resulting from the Member Patronage and is calculated by multiplying the Accounting Net Income (minus any Ancillary Income) by the ratio of Member Patronage to Patronage.
 - (b) "Non-member Patronage Income" is that portion of Accounting Net Income resulting from the Patronage of non-members.
 - (c) "Ancillary Income" is that portion of Accounting Net Income resulting from transactions that do not facilitate the primary business of the Corporation and do not result from Member Patronage.
- (3) "Patronage Dividend" is the positive amount of Patronage Income allocated to the Members in proportion to their relative Member Patronage during the fiscal year and may consist of any combination of cash and Written Notices of Allocation.
- (4) "Written Notice of Allocation" is the certificate issued to each Member specifying the amount, if any, of the Patronage Dividend allocated to the Member and retained by the Corporation.

2.B. PATRONAGE ALLOCATIONS. Patronage Net Income, after reductions in accordance with section 2.C shall be allocated as Patronage Dividends to the Members on the basis of their relative Patronage within 8 1/2 months after the end of the fiscal year.

- (1) In any proportions determined by the Board of Directors, Patronage Dividends may be paid in cash, in Qualified Written Notices of Allocation, or in Non-qualified Written Notices of Allocation as defined in Subchapter T of the Federal Internal Revenue Code of 1986, as amended from time to time (hereinafter, "Subchapter T").
- (2) The amount of any Written Notice of Allocation issued to a Member shall be credited to the Member's Individual Capital Account and the amount thus retained by the Corporation may be used for any and all corporate

purposes. Written Notices of Allocation are non-transferable unless otherwise approved by the Board of Directors.

- (3) By becoming a Member of the Corporation, each Member shall be deemed to have consented to include in his or her taxable income the amount of any Qualified Written Notices of Allocation and to pay tax thereon in accordance with Subchapter T.
 - (4) The Corporation shall issue annually to each Member an Individual Capital Account Statement that discloses his or her account balance and any changes since the previous Statement.
- 2.C. UNALLOCATED RETAINED EARNINGS. From time to time, the Board of Directors shall establish an overall target amount for unallocated retained earnings on the basis of stated business purposes and needs. Annually, the Board of Directors shall make allocations of retained earnings to the Retained Earnings Account with reference to the target amount and business purposes and needs. Such allocations shall be from: (1) Ancillary Income and Non-member Patronage Income, and (2) if necessary for business purposes, from Patronage Net Income.
- 2.D. LOSSES. If the Corporation incurs a net loss in any fiscal year, such net loss shall be charged against the balances in the Internal Capital Accounts as determined by the Board of Directors.
3. CAPITAL DISTRIBUTIONS TO MEMBERS. Membership Shares and Written Notices of Allocation shall be redeemed by the Corporation in accordance with this section.
 - 3.A. REDEMPTION OF WRITTEN NOTICES OF ALLOCATION. All Written Notices of Allocation credited to a Member's Individual Capital Account shall be redeemed by the Corporation in accordance with their terms and procedures as determined by the Board of Directors.
 - 3.B. REDEMPTION OF MEMBERSHIP SHARES. Upon termination of Membership in accordance with the Bylaws, the Membership Share held by the terminated Member shall be transferred to the Corporation for the consideration defined herein.
 - (1) After year-end adjustments, the Member's Individual Capital Account balance other than Written Notices of Allocation shall be paid to the terminated Member as consideration for the Membership Share in cash, promissory notes, or other property as determined by the Board of Directors.
 - (2) If there is no positive balance in the terminated Member's Individual Capital Account other than Written Notices of Allocation, then the

Membership Share shall be returned to the Corporation for no consideration.

- (3) Written Notices of Allocation, if any, shall be redeemed in accordance with section 3.A.

3.C. **DISSOLUTION DISTRIBUTIONS.** Upon liquidation, dissolution, or sale of all the assets of the Corporation, any assets left after payment of all debts and Individual Capital Account balances shall be distributed to all persons who were Members during the immediately preceding ten (10) years, or to their heirs, in proportion to the Members' relative Patronage during that period. No distribution need be made to any person who fails to acknowledge the receipt of notice of liquidation in a timely manner. Said notice shall be deemed sufficient if sent by certified mail, at least 30 days before distribution of any residual assets, to the person's last known business or residence address.

ARTICLE IV

MEETINGS OF MEMBERS

1. ANNUAL MEETING. The Annual Meeting of Members shall be held on the first Friday in [month] of each year, except as otherwise determined by the Board of Directors, at a time and location fixed by the Board of Directors or by the President. The Annual Meeting shall be held for the purpose of electing the Board of Directors, and for any other lawful purposes that are specified by the President, by the Board of Directors, by at least ten percent (10%) of the Members. If the Annual Meeting is omitted on the day specified herein, a special meeting may be held in its place and any business transacted shall have the same effect as if transacted at the Annual Meeting.
2. REGULAR MEETINGS. Regular meetings of Members may be held without call or formal notice at such places and at such times as the President or a majority of the Members may from time to time determine, provided that each Member shall be given notice of the schedule of regular meetings.
3. SPECIAL MEETINGS. Special meetings of Members may be called at any time by the Board or the President, or upon written application of at least ten percent (10%) of the Members. Special meetings may be called for any lawful purpose.
4. NOTICE OF MEETINGS. A written notice of each Annual Meeting or special meeting of Members stating the time, place, and purpose shall be given by the Secretary or by the officer calling the meeting, at least ten (10) days before the meeting, to each Member either: (1) in person; (2) by leaving the notice at his or her residence or usual place of business; or (3) by mailing it to his or her address as shown on the records of the Corporation. Notice need not be given to any Member who, before or after the meeting, executes a written waiver of notice that is filed with the records of the meeting. Each Member shall notify the Corporation of his or her current mailing address.
5. QUORUM. A majority of Members shall be required to constitute a quorum at any meeting of Members.
6. VOTING AND PROXIES. Members shall vote on a one vote per person basis on any matter requiring voting by Members at meetings of Members. Voting by proxy shall not be permitted, except in accordance with procedures for voting by proxy or absentee ballot adopted by the Board of Directors.
7. ACTION AT A MEETING. The President, Chair, or other designee, as determined by the Board of Directors, shall preside at meetings of Members. When a quorum is present at a meeting of Members, a majority of the Members present and entitled to vote shall decide any matter to be voted upon, except if a larger vote is required by law, the Articles, or Bylaws. A secret ballot is required if requested by any Member present at the meeting. The Corporation shall not directly or indirectly vote any share of its stock. Any

decision to sell substantially all of the Corporation's assets, or to merge, consolidate, or liquidate the Corporation, shall require the approval of two thirds of the Members.

8. **ACTION WITHOUT MEETING.** Any action to be taken by Members may be taken without a meeting if all Members entitled to vote on the matter consent to the action in writing. Such written consent shall be filed with the records of the Corporation, and shall be treated for all purposes as a vote at a meeting.

ARTICLE V

THE BOARD OF DIRECTORS

1. **POWERS.** The Board of Directors (hereinafter, the "Board") may exercise all the powers of the Corporation, including the power to issue stock, except as otherwise provided by law, by the Articles, or by these Bylaws. In the event of a vacancy on the Board, the remaining Directors may exercise the powers of the full Board until the vacancy is filled, except as otherwise provided by law.
2. **ELECTION AND SIZE.** The Members shall fix the number of Directors and elect as nearly as possible one half of the Directors for two-year terms at each Annual Meeting or special meeting held in its place. A Director need not be a Member.
3. **VACANCIES.** Any vacancy on the Board may be filled for a remainder of the term by a majority vote of the Directors then in office, or by a majority vote of the Members, in accordance with procedures adopted by the Board.
4. **TENURE.** Except as otherwise provided by law, the Articles, or the Bylaws, each Director shall hold office until the second Annual Meeting of Members following his or her election or until his or her successor is elected. Any Director may resign by delivering his or her written resignation to any officer or to a meeting of the Board, effective at the time specified therein.
5. **REMOVAL.** A Director may at any time be removed from office for cause or without cause by a vote of a majority of the Members. A Director may at any time be removed for cause by a majority of the Directors then in office. A Director may be removed for cause only after reasonable notice and opportunity to be heard before the body proposing to remove the Director.
6. **MEETINGS.** Regular meetings of the Board may be held at such places and times as the Board may from time to time determine. Special meetings of the Board may be called at any time by the President, or by the Secretary at the request of three or more of the Directors.
7. **NOTICE OF MEETINGS.** Notice of the time, place, and purposes of any meeting of the Board shall be given to each Director by an Officer or by one of the Directors calling the

meeting. Notice shall be given to each Director in person or by telephone or by telegram sent to his or her last known address not less than 24 hours before the meeting, or by written notice mailed to such address at least 72 hours before the meeting. Notice need not be given to any Director if a written waiver of notice, executed by the Director before or after the meeting, is filed with the records of the meeting or to any Director who attends the meeting without protesting the lack of notice.

8. **QUORUM.** At any meeting of the Board, a majority of the Directors then in office shall constitute a quorum. Directors may participate in a meeting of the Board by means of which all participants can hear each other at the same time, and such participation shall constitute presence at the meeting for purposes of voting and quorum requirements.
9. **ACTION AT A MEETING.** If a quorum is present, the Directors present may take any action on behalf of the Board of Directors, by majority vote, unless a larger number is required by law, the Articles, or the Bylaws, and on a one vote per Director basis.
10. **ACTION BY CONSENT.** Any action by the Board may be taken without a meeting if all Directors then in office consent to the action in writing and the written consents are filed with the records of the Corporation. Such consent shall be treated as a vote of the Board for all purposes.
11. **COMMITTEES.** The Board may establish committees and may delegate thereto some or all of their powers except those which they are prohibited from delegating by the law, the Articles, or the Bylaws. Except as the Board may otherwise determine, any such committee may make rules for the conduct of its business.

ARTICLE VI

OFFICERS

1. **ELECTED OFFICERS.** The Officers of the Corporation shall be the President, Treasurer, Secretary, and such other Officers as the Board may determine from time to time, including a Chair of the Board. The Board shall elect Officers annually at the first Board meeting following the Annual Meeting of Members or special meeting held in place thereof.
2. **TENURE.** Except as otherwise provided by law, the Articles, or the Bylaws, the term of office of the Officers shall be determined by the Directors. Any Officer may resign by delivering to any Director his or her written resignation, effective upon receipt or at some later time specified.
3. **REMOVAL.** The Board may remove any Officers with or without cause. If an Officer is removed for cause, he or she is entitled to reasonable notice and an opportunity to be heard by the Board.

4. **VACANCIES.** If any office becomes vacant for any reason, the Board may elect a successor or successors, who shall hold office for the unexpired term, except as otherwise provided by law, the Articles, or the Bylaws.
5. **PRESIDENT.** The President shall be the chief executive officer of the Corporation and, subject to the supervision and direction of the Board, shall have administrative authority and responsibility for the operations of the Corporation. The President shall have such other duties and powers as the Board shall determine from time to time.
6. **TREASURER.** Subject to the supervision and direction of the Board, the Treasurer shall keep or cause to be kept accurate books of account for the Corporation, which shall be the property of the Corporation. If required by the Board, the Treasurer shall give a bond for the faithful performance of his or her duty.
7. **SECRETARY.** The Secretary shall keep at his or her office or at the principal office of the corporation those documents described in section 4 of Article I of the Bylaws and such other documents as the Board shall determine, and shall have such other duties and powers as determined by the Board. In the absence of the Secretary at a meeting, a temporary secretary designated by the person presiding at such meeting shall perform the duties of the Secretary.

ARTICLE VII

INDEMNIFICATION

1. **INDEMNIFICATION.** The Corporation shall indemnify and hold harmless each person who serves or has served in the past as an Officer or Director of the Corporation, or in any capacity with respect to an employee benefit plan of the Corporation, against all liabilities and expenses incurred by him or her in connection with the defense or disposition of any action, suit, or other proceeding (whether civil or criminal) in which he or she may be involved, while in office or thereafter, by reason of having been such an Officer or Director; except with respect to any matter as to which he or she shall have been adjudicated not to have acted in good faith in the reasonable belief that his or her action was in the best interests of the Corporation, or with respect to any matter as to which he or she shall agree or be ordered by any court of competent jurisdiction to make payment to the Corporation. This indemnification shall be in addition to any other right which any such person may have or obtain and shall inure to the benefit of the heirs of any such person.

2. **INSURANCE.** The Corporation may purchase insurance to cover any liability or expense reasonably incurred by employees, Members, Officers, or Directors by reason of their having acted in such positions.

ARTICLE VIII

AMENDMENTS

1. **BY MEMBERS.** The Members shall have the power to make, amend, or repeal these Bylaws, by a majority vote of the Members present at a meeting of Members, provided that the notice for such meeting indicated a change in the Bylaws was to be considered.

2. **BY DIRECTORS.** The Board shall have the power to make, amend, or repeal these Bylaws by a vote of a majority of Directors, provided that:
 - 2.A. The Board may not make, amend, or repeal any provision of these Bylaws which alters:
 - (1) the procedure for making, amending, or repealing the Bylaws;
 - (2) the provisions for removal of Directors;
 - (3) the terms of Member eligibility; or,

- (4) any other provision which by law, the Articles, the Bylaws, shareholders agreement, or other applicable written agreement requires an action by the Members.
- 2.B. Not later than the time of giving notice of the meeting of Members next following the adoption, amendment, or repeal by the Board of any Bylaw provision, notice thereof stating the substance of such adoption, amendment, or repeal shall be given to all Members.
- 2.C. Any amendment by voting of Members, in accordance with the Bylaws, shall be controlling in the event of an inconsistent amendment by the Board.

ARTICLE IX

OPERATING RULES

- 1. **OPERATING RULES.** Written rules, separate from these Bylaws, may be established by the Members or by the Board. These Operating Rules may be added to, amended, or repealed at any meeting of the Members or the Board. The Operating Rules shall be binding on all Members and Directors, unless inconsistent with the law, the Articles, the Bylaws, shareholder agreements, or other applicable written agreements. A current copy of the Operating Rules shall be maintained by the Secretary, and a copy shall be available to any Member requesting a copy.

ICA MODEL BYLAWS
FOR A WORKER COOPERATIVE
VERSION III (1995)
[Two Classes of Shares]

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ARTICLE I

CORPORATE AFFAIRS

1. NAME. The name of the corporation is _____ (hereinafter, the "Corporation").
2. FISCAL YEAR. The fiscal year of the Corporation shall end on the last day of [month] in each year.
3. EXECUTION OF INSTRUMENTS. All deeds, leases, transfers, contracts, notes, bonds, and other obligations authorized to be executed on behalf of the Corporation shall be signed by the President or the Treasurer except as otherwise determined from time to time by the Board of Directors.
4. CORPORATE RECORDS. Copies of the following documents shall be kept at the principal office of the Corporation or at the office of the Secretary, but need not all be kept at the same office: (a) the Articles of Incorporation and Bylaws, (b) records of all meetings of Incorporators, Directors, and Shareholders, and (c) the stock and transfer records containing the names and record addresses of all Members and Shareholders, and the stock held by each Member and Shareholder.
5. ARTICLES OF INCORPORATION. The purposes of the Corporation shall be as set forth in the Articles of Incorporation (hereinafter, the "Articles"). In the event of any inconsistency between the Articles and these Bylaws, the provisions of the Articles shall be controlling.

ARTICLE II

MEMBERS AND SHAREHOLDERS

1. MEMBERSHIP ORGANIZATION. The Corporation shall operate on a cooperative basis, with earnings and losses allocated on the basis of patronage and with voting by Members and Shareholders in accordance with the Articles and Bylaws. The Corporation has two classes of stock: (a) Class A common stock as defined in section 2 of this Article II; and (b) Class B preferred stock as defined in section 3 of this Article II. Holders of Class A common stock and Class B preferred stock, collectively, are designated hereinafter as "Shareholders."

2. MEMBERS AND MEMBERSHIP SHARES. The Corporation has a class of common voting stock (hereinafter, "Membership Shares" or "Class A Shares"), and holders of Membership Shares are designated hereinafter as Members.
 - 2.A. MEMBER ELIGIBILITY. Members shall be limited to natural persons who:
 - (1) patronize the Corporation through provision of their labor on a full-time or part-time basis;
 - (2) have been approved by the Board of Directors or its designees;
 - (3) have paid a Membership Fee as hereinafter defined; and,
 - (4) have been employed by the Corporation for a period of at least ____ months, except as otherwise determined by the Members from time to time.
 - 2.B. MEMBERSHIP SHARES. Each Member shall own one and only one Membership Share.
 - (1) Only Members may own Membership Shares, except that, in the event of the death of a Member, his or her estate may hold the Membership Share pending repurchase by the Corporation.
 - (2) The cost and terms of a Membership Share shall be determined by the Board of Directors from time to time, and such cost is designated as the "Membership Fee."
 - 2.C. MEMBERSHIP TERMINATION. Upon voluntary or involuntary termination of a Member's employment by the Corporation, except for temporary layoffs or absences, his or her membership shall be terminated and the Corporation shall redeem his or her Membership Share for consideration determined in accordance with Article III.
3. CLASS B SHARES. The Corporation has a class of preferred stock (hereinafter "Class B Shares"), and holders of Class B Shares are designated as "Class B Shareholders." The Corporation can sell Class B Shares to any individual or organization for such consideration and on such terms as the Board of Directors determines from time to time in accordance with law, the Articles, the Bylaws, and any shareholder agreements or other applicable agreements approved by the Board of Directors.

4. **TRANSFER RESTRICTIONS.** No share of any class or interest therein may be sold, assigned, or otherwise transferred, voluntarily or involuntarily, by operation of law or otherwise, except for a transfer to the Corporation.
5. **CERTIFICATES FOR SHARES.** Each Shareholder is entitled to a certificate representing his or her shares in such form as prescribed by the Board of Directors. The certificate shall be signed by the President and the Treasurer when it is issued. Each share shall set forth conspicuously on the face or back of the certificate either the full text of the restrictions prescribed in section 4 of this Article, or a statement that such restrictions exist and that the Corporation will furnish a copy of such restrictions to the Shareholder upon written request and without charge. In case of the loss, destruction, or mutilation of a share certificate, a duplicate certificate may be issued in its place, upon such terms as the Board of Directors may prescribe.

ARTICLE III

INTERNAL CAPITAL ACCOUNT SYSTEM

1. **INTERNAL CAPITAL ACCOUNTS.** The Corporation shall have a system of Internal Capital Accounts as equity accounts to reflect its net worth, to reflect the allocation of net worth among the Members and Class B Shareholders, and to determine the redemption value of Membership Shares, Class B Shares, and Written Notices of Allocation as hereinafter defined. The Internal Capital Accounts consist of Individual Capital Accounts, a Retained Earnings Account, and any Shareholder Accounts. The sum of the balances of the Internal Capital Accounts is the net worth of the Corporation.
 - 1.A. **INDIVIDUAL CAPITAL ACCOUNTS.** The Corporation shall maintain for each Member an Individual Capital Account that reflects the value of the Member's relative equity in the Corporation.
 - (1) The balance in any Individual Capital Account results from and is increased by: (a) the initial Membership Fee, plus any other paid-in capital from or on behalf of the Member in excess of the Membership Fee, and (b) the amount of any Written Notices of Allocation issued to the Member.
 - (2) The balance in any Individual Capital Account is decreased by: (a) any losses allocated to the Individual Capital Accounts, and (b) the redemption, in cash or notes of indebtedness, of a Written Notice of Allocation previously issued to the Member and recorded in the Member's Individual Capital Account.

- 1.B. SHAREHOLDER ACCOUNTS. For each person who holds Class B Shares issued by the Corporation, the Corporation shall maintain a Shareholder Account that reflects the value of such shares as a portion of the equity of the Corporation. The balance in any Shareholder Account is determined in accordance with the terms by which the Corporation issued the Class B Shares and with the Articles and Bylaws.

- 1.C RETAINED EARNINGS ACCOUNT. The Corporation shall maintain an unallocated retained earnings account (hereinafter, "Retained Earnings Account") that reflects the portion of net worth not allocated to Individual Capital Accounts or Shareholder Accounts.
 - (1) The balance in the Retained Earnings Account results from and is increased by: (a) that portion of retained earnings not allocated to Individual Capital Accounts nor Shareholder Accounts, and (b) any gifts or grants to the Corporation, unless otherwise allocated to Individual or Shareholder Accounts.
 - (2) The Retained Earnings Account balance is decreased by any losses allocated to the Retained Earnings Account.
 - (3) The Corporation shall maintain a Retained Earnings Account balance with reference to a target amount for business purposes, in accordance with section 2.D of this Article III.

2. ALLOCATION OF NET INCOME. The positive or negative Accounting Net Income of the Corporation shall be allocated annually among the Internal Capital Accounts, after payment of corporate tax, dividends on capital stock, and the cash portion of Patronage Dividends.
 - 2.A. DEFINITIONS. The following definitions shall apply to terms used herein.
 - (1) "Accounting Net Income" is the book net income for the fiscal year computed in accordance with Generally Accepted Accounting Principles (GAAP).
 - (2) "Patronage" is the total number of hours worked for the Corporation by Members and non-members during the fiscal year. "Member Patronage" is the total number of hours worked for the Corporation by Members during the fiscal year.
 - (a) "Patronage Income" is that portion of Accounting Net Income resulting from Member Patronage of Members and is calculated by

multiplying the Accounting Net Income (minus any Ancillary Income) by the ratio of Member Patronage to Patronage.

(b) "Non-member Patronage Income" is that portion of Accounting Net Income resulting from the Patronage of non-members.

(c) "Ancillary Income" is that portion of Accounting Net Income resulting from transactions that do not facilitate the primary business of the Corporation and do not result from Member Patronage.

(3) "Patronage Dividend" is the positive amount of Patronage Income allocated to the Members in proportion to their relative Member Patronage during the fiscal year and may consist of any combination of cash and Written Notices of Allocation.

(4) "Written Notice of Allocation" is the certificate issued to each Member specifying the amount, if any, of the Patronage Dividend allocated to the Member and retained by the Corporation.

2.B. PATRONAGE ALLOCATIONS. Patronage Net Income, after reductions in accordance with sections 2.C and 2.D, shall be allocated as Patronage Dividends to the Members on the basis of their relative Patronage within 8 1/2 months after the end of the fiscal year.

(1) In any proportions determined by the Board of Directors, Patronage Dividends may be paid in cash, in Qualified Written Notices of Allocation, or in Non-qualified Written Notices of Allocation as defined in Subchapter T of the Federal Internal Revenue Code of 1986, as amended from time to time (hereinafter, "Subchapter T").

(2) The amount of any Written Notice of Allocation issued to a Member shall be credited to the Member's Individual Capital Account and the amount thus retained by the Corporation may be used for any and all corporate purposes. Written Notices of Allocation are non-transferable unless otherwise approved by the Board of Directors.

(3) By becoming a Member of the Corporation, each Member shall be deemed to have consented to include in his or her taxable income the amount of any Qualified Written Notices of Allocation and to pay tax thereon in accordance with Subchapter T.

- (4) The Corporation shall issue annually to each Member an Individual Capital Account Statement that discloses his or her account balance and any changes since the previous Statement.

- 2.C. **DIVIDENDS ON CLASS B SHARES.** Dividends, if any, on Class B Shares shall not exceed 8% annually of the book value of the underlying shares and shall be paid in accordance with the terms by which the shares were issued. Such dividends shall be paid pro rata from Patronage Income and the sum of Non-member Patronage Income and Ancillary Income in proportion to relative Member Patronage and Non-member Patronage.

- 2.D. **UNALLOCATED RETAINED EARNINGS.** From time to time, the Board of Directors shall establish an overall target amount for unallocated retained earnings on the basis of stated business purposes and needs. Annually, the Board of Directors shall make allocations of retained earnings to the Retained Earnings Account with reference to the target amount and business purposes and needs. Such allocations shall be from: (1) Ancillary Income and Non-member Patronage Income, and (2) if necessary for business purposes, from Patronage Net Income.

- 2.E. **LOSSES.** If the Corporation incurs a net loss in any fiscal year, such net loss shall be charged against the balances in the Internal Capital Accounts as determined by the Board of Directors.

- 3. **CAPITAL DISTRIBUTIONS TO MEMBERS.** Membership Shares and Written Notices of Allocation shall be redeemed by the Corporation in accordance with this section.
 - 3.A. **REDEMPTION OF WRITTEN NOTICES OF ALLOCATION.** All Written Notices of Allocation credited to a Member's Individual Capital Account shall be redeemed by the Corporation in accordance with their terms and procedures as determined by the Board of Directors.

 - 3.B. **REDEMPTION OF MEMBERSHIP SHARES.** Upon termination of Membership in accordance with the Bylaws, the Membership Share held by the terminated Member shall be transferred to the Corporation for the consideration defined herein.
 - (1) After year-end adjustments, the Member's Individual Capital Account balance other than Written Notices of Allocation shall be paid to the terminated Member as consideration for the Membership Share in cash, promissory notes, or other property as determined by the Board of Directors.

- (2) If there is no positive balance in the terminated Member's Individual Capital Account other than Written Notices of Allocation, then the Membership Share shall be returned to the Corporation for no consideration.
 - (3) Written Notices of Allocation, if any, shall be redeemed in accordance with section 3.A.
- 3.C. REDEMPTION OF CLASS B SHARES. The Corporation shall redeem Class B Shares in accordance with their terms.
- 3.D. DISSOLUTION DISTRIBUTIONS. Upon liquidation, dissolution, or sale of all the assets of the Corporation, any assets left after payment of all debts, Shareholder Account balances, and Individual Capital Account balances shall be distributed to all persons who were Members during the immediately preceding ten (10) years, or to their heirs, in proportion to the Members' relative Patronage during that period. No distribution need be made to any person who fails to acknowledge the receipt of notice of liquidation in a timely manner. Said notice shall be deemed sufficient if sent by certified mail, at least 30 days before distribution of any residual assets, to the person's last known business or residence address.

ARTICLE IV

SHAREHOLDER MEETINGS

1. ANNUAL MEETING. The Annual Meeting of Shareholders (including Members and Class B Shareholders) shall be held on the first Friday in [month] of each year, except as otherwise determined by the Board of Directors, at a time and location fixed by the Board of Directors or by the President. The Annual Meeting shall be held for the purpose of electing the Board of Directors, and for any other lawful purposes that are specified by the President, by the Board of Directors, by at least ten percent (10%) of the Members, or by at least ten percent (10%) of the holders in interest of Class B Shares. If the Annual Meeting is omitted on the day specified herein, a special meeting may be held in its place and any business transacted shall have the same effect as if transacted at the Annual Meeting.
2. REGULAR MEETINGS. Regular meetings of Shareholders may be held without call or formal notice at such places and at such times as the President or a majority of the Members may from time to time determine, provided that each Shareholder shall be given notice of the schedule of regular meetings.

3. **SPECIAL MEETINGS.** Special meetings of Shareholders may be called at any time by the Board or the President, or upon written application of at least ten percent (10%) of the Members or of at least ten percent (10%) of the holders in interest of Class B shares. Special meetings may be called for any lawful purpose.
4. **NOTICE OF MEETINGS.** A written notice of each Annual Meeting or special meeting of Shareholders stating the time, place, and purpose shall be given by the Secretary or by the officer calling the meeting, at least ten (10) days before the meeting, to each Member and Class B Shareholder either: (1) in person; (2) by leaving the notice at his or her residence or usual place of business; or (3) by mailing it to his or her address as shown on the records of the Corporation. Notice need not be given to any Shareholder who, before or after the meeting, executes a written waiver of notice that is filed with the records of the meeting. Each Member and Class B Shareholder shall notify the Corporation of his or her current mailing address.
5. **QUORUM.** A majority of Members and a majority of holders in interest of Class B Shares shall be required to constitute a quorum at any meeting of Shareholders; except that a majority of Members shall constitute a quorum if all Class B Shareholders execute a written waiver of attendance before or after the meeting.
6. **VOTING AND PROXIES.** Members shall vote on a one vote per person basis on any matter requiring voting by Members at meetings of Shareholders. Class B Shareholders shall vote as a separate class on a one vote per share basis at meetings of Shareholders, on such matters and in such manner as defined in the Articles, in these Bylaws, in shareholder agreements, or in other written agreements approved by the Board of Directors and in accordance with law. Voting by proxy shall not be permitted, except in accordance with procedures for voting by proxy or absentee ballot adopted by the Board of Directors.
7. **ACTION AT A MEETING.** The President, Chair, or other designee, as determined by the Board of Directors, shall preside at meetings of Shareholders. When a quorum is present at a meeting of Shareholders, a majority of the Members present and entitled to vote shall decide any matter to be voted upon, except if a larger vote is required by law, the Articles, or Bylaws, or if Class B Shareholders are entitled to vote as a class in accordance with the terms of Class B Shares. A secret ballot is required if requested by any Member present at the meeting. The Corporation shall not directly or indirectly vote any share of its stock. Any decision to sell substantially all of the Corporation's assets, or to merge, consolidate, or liquidate the Corporation, shall require the approval of two thirds of the Members and of two thirds of holders in interest of the outstanding Class B Shares, if any, voting as separate classes.

8. **ACTION WITHOUT MEETING.** Any action to be taken by Shareholders may be taken without a meeting if all Shareholders entitled to vote on the matter consent to the action in writing. Such written consent shall be filed with the records of the Corporation, and shall be treated for all purposes as a vote at a meeting.

ARTICLE V

THE BOARD OF DIRECTORS

1. **POWERS.** The Board of Directors (hereinafter, the "Board") may exercise all the powers of the Corporation, including the power to issue stock, except as otherwise provided by law, by the Articles, or by these Bylaws. In the event of a vacancy on the Board, the remaining Directors may exercise the powers of the full Board until the vacancy is filled, except as otherwise provided by law.
2. **ELECTION AND SIZE.** The Shareholders shall fix the number of Directors and elect as nearly as possible one half of the Directors for two-year terms at each Annual Meeting or special meeting held in its place. A Director need not be a Member.
3. **VACANCIES.** Any vacancy on the Board may be filled for a remainder of the term by a majority vote of the Directors then in office, or by a majority vote of the Members or Class B Shareholders entitled to elect a Director for such position, in accordance with procedures adopted by the Board.
4. **TENURE.** Except as otherwise provided by law, the Articles, or the Bylaws, each Director shall hold office until the second Annual Meeting of Shareholders following his or her election or until his or her successor is elected. Any Director may resign by delivering his or her written resignation to any officer or to a meeting of the Board, effective at the time specified therein.
5. **REMOVAL.** A Director may at any time be removed from office for cause or without cause by a vote of a majority of the Members, except that a Director elected by Class B Shareholders may be removed from office without cause only by a vote of a majority of holders in interest of Class B Shares. A Director may at any time be removed for cause by a majority of the Directors then in office. A Director may be removed for cause only after reasonable notice and opportunity to be heard before the body proposing to remove the Director.
6. **MEETINGS.** Regular meetings of the Board may be held at such places and times as the Board may from time to time determine. Special meetings of the Board may be called at any time by the President, or by the Secretary at the request of three or more of the Directors.

7. NOTICE OF MEETINGS. Notice of the time, place, and purposes of any meeting of the Board shall be given to each Director by an Officer or by one of the Directors calling the meeting. Notice shall be given to each Director in person or by telephone or by telegram sent to his or her last known address not less than 24 hours before the meeting, or by written notice mailed to such address at least 72 hours before the meeting. Notice need not be given to any Director if a written waiver of notice, executed by the Director before or after the meeting, is filed with the records of the meeting or to any Director who attends the meeting without protesting the lack of notice.
8. QUORUM. At any meeting of the Board, a majority of the Directors then in office shall constitute a quorum. Directors may participate in a meeting of the Board by means of which all participants can hear each other at the same time, and such participation shall constitute presence at the meeting for purposes of voting and quorum requirements.
9. ACTION AT A MEETING. If a quorum is present, the Directors present may take any action on behalf of the Board of Directors, by majority vote, unless a larger number is required by law, the Articles, or the Bylaws, and on a one vote per Director basis.
10. ACTION BY CONSENT. Any action by the Board may be taken without a meeting if all Directors then in office consent to the action in writing and the written consents are filed with the records of the Corporation. Such consent shall be treated as a vote of the Board for all purposes.
11. COMMITTEES. The Board may establish committees and may delegate thereto some or all of their powers except those which they are prohibited from delegating by the law, the Articles, or the Bylaws. Except as the Board may otherwise determine, any such committee may make rules for the conduct of its business.

ARTICLE VI

OFFICERS

1. ELECTED OFFICERS. The Officers of the Corporation shall be the President, Treasurer, Secretary, and such other Officers as the Board may determine from time to time, including a Chair of the Board. The Board shall elect Officers annually at the first Board meeting following the Annual Meeting of Shareholders or special meeting held in place thereof.
2. TENURE. Except as otherwise provided by law, the Articles, or the Bylaws, the term of office of the Officers shall be determined by the Directors. Any Officer may resign by

delivering to any Director his or her written resignation, effective upon receipt or at some later time specified.

3. **REMOVAL.** The Board may remove any Officers with or without cause. If an Officer is removed for cause, he or she is entitled to reasonable notice and an opportunity to be heard by the Board.
4. **VACANCIES.** If any office becomes vacant for any reason, the Board may elect a successor or successors, who shall hold office for the unexpired term, except as otherwise provided by law, the Articles, or the Bylaws.
5. **PRESIDENT.** The President shall be the chief executive officer of the Corporation and, subject to the supervision and direction of the Board, shall have administrative authority and responsibility for the operations of the Corporation. The President shall have such other duties and powers as the Board shall determine from time to time.
6. **TREASURER.** Subject to the supervision and direction of the Board, the Treasurer shall keep or cause to be kept accurate books of account for the Corporation, which shall be the property of the Corporation. If required by the Board, the Treasurer shall give a bond for the faithful performance of his or her duty.
7. **SECRETARY.** The Secretary shall keep at his or her office or at the principal office of the corporation those documents described in section 4 of Article I of the Bylaws and such other documents as the Board shall determine, and shall have such other duties and powers as determined by the Board. In the absence of the Secretary at a meeting, a temporary secretary designated by the person presiding at such meeting shall perform the duties of the Secretary.

ARTICLE VII

INDEMNIFICATION

1. **INDEMNIFICATION.** The Corporation shall indemnify and hold harmless each person who serves or has served in the past as an Officer or Director of the Corporation, or in any capacity with respect to an employee benefit plan of the Corporation, against all liabilities and expenses incurred by him or her in connection with the defense or disposition of any action, suit, or other proceeding (whether civil or criminal) in which he or she may be involved, while in office or thereafter, by reason of having been such an Officer or Director; except with respect to any matter as to which he or she shall have been adjudicated not to have acted in good faith in the reasonable belief that his or her action was in the best interests of the Corporation, or with respect to any matter as to

which he or she shall agree or be ordered by any court of competent jurisdiction to make payment to the Corporation. This indemnification shall be in addition to any other right which any such person may have or obtain and shall inure to the benefit of the heirs of any such person.

2. **INSURANCE.** The Corporation may purchase insurance to cover any liability or expense reasonably incurred by employees, Members, Officers, or Directors by reason of their having acted in such positions.

ARTICLE VIII

AMENDMENTS

1. **BY SHAREHOLDERS.** The Shareholders shall have the power to make, amend, or repeal these Bylaws, voting by separate classes, by a majority vote of the Members and a majority vote of the holders in interest of Class B Shares present at a meeting of Shareholders, provided that the notice for such meeting indicated a change in the Bylaws was to be considered.
2. **BY DIRECTORS.** The Board shall have the power to make, amend, or repeal these Bylaws by a vote of a majority of Directors, provided that:
 - 2.A. The Board may not make, amend, or repeal any provision of these Bylaws which alters:
 - (1) the procedure for making, amending, or repealing the Bylaws;
 - (2) the provisions for removal of Directors;
 - (3) the terms of Member eligibility; or,
 - (4) any other provision which by law, the Articles, the Bylaws, shareholders agreement, or other applicable written agreement requires an action by the Members or Class B Shareholders.
 - 2.B. Not later than the time of giving notice of the meeting of Shareholders next following the adoption, amendment, or repeal by the Board of any Bylaw provision, notice thereof stating the substance of such adoption, amendment, or repeal shall be given to all Shareholders.

- 2.C. Any amendment by voting of Shareholders, in accordance with the Bylaws, shall be controlling in the event of an inconsistent amendment by the Board.

ARTICLE IX

OPERATING RULES

1. **OPERATING RULES.** Written rules, separate from these Bylaws, may be established by the Members or by the Board. These Operating Rules may be added to, amended, or repealed at any meeting of the Members or the Board. The Operating Rules shall be binding on all Members, Shareholders, and Directors, unless inconsistent with the law, the Articles, the Bylaws, shareholder agreements, or other applicable written agreements. A current copy of the Operating Rules shall be maintained by the Secretary, and a copy shall be available to any Member or Shareholder requesting a copy.

D. ANNOTATIONS TO THE MODEL BYLAWS

Following is a section-by-section guide to the ICA Model Bylaws for a Worker Cooperative, Version III. The particular needs will vary from company to company, and the governing law will vary from state to state. These Model Bylaws can be adapted accordingly. We recommend that you consult with a local lawyer when adapting these Bylaws to your Corporation. Terms defined in the Model Bylaws are capitalized hereinafter.

ARTICLE I: Corporate Affairs

The Model Bylaws begin with standard information about the Corporation, such as name and fiscal year. Some of these items will be duplicated in the Articles of Incorporation, but they enable the Bylaws to present a more complete picture of corporate governance and should appear in both documents. Later, if you amend overlapping items in the Articles, be sure also to amend the Bylaws accordingly. If any Bylaw provisions are inconsistent with the Articles, initially or by later amendment, the Articles will override the Bylaws. This is stated in SECTION 5 of the Bylaws and reinforces the Corporation law notion that the Articles serve as the fundamental "constitution" of the organization, providing a framework for the more specific operational "laws" of the Bylaws.

The law requires that the Corporation's purposes appear in the Articles. Some cooperatives choose to repeat in the Bylaws the full text of the purposes. For guidance in drafting Articles of Incorporation, see the section above entitled, "Guide to the Articles of Incorporation," and sample Articles in Appendix 1.

When choosing a Corporation name (SECTION 1), check the applicable state incorporation statute for requirements or restrictions. Many states, for instance, prohibit use of the word "cooperative" in the name, unless the Corporation is incorporated under the state "cooperative" statute. For further explanation of the choice of a corporate name, see section 1 of the "Guide to the Articles of Incorporation" above.

Your choice of fiscal year (SECTION 2) has important tax and accounting implications. The most common fiscal year is the calendar year. Your accountant or lawyer might suggest that a different fiscal year would be appropriate for your Corporation. A later change of fiscal year is possible, requiring appropriate filings with state and federal authorities and amendment of the Bylaws.

A natural person (rather than a legal entity) must sign contracts and other instruments on behalf of the Corporation. SECTION 3 authorizes the President or Treasurer to so act on behalf of the Corporation, subject to any limitation, delegation or expansion directed by the Board.

This ensures a degree of order and coordination of corporate commitments, while retaining some flexibility for the Board to alter the normal routine.

Maintenance of corporate records (SECTION 4) is extremely important. Articles and bylaws are useless if unavailable; stock records define who has the rights and responsibilities of Members and Shareholders; and records of meetings provide a written account of corporate decisions. In the event of disputes or litigation, corporate records serve as crucial evidence. Failure to comply with corporate formalities can lead to the unraveling of external contracts or internal relationships or, in rare cases, loss of the corporate shield against personal liability of directors and officers. On a more positive note, a clear record of activities and relationships within the Corporation can help in orderly planning and communication.

Article I contains basic items of corporate affairs. You might choose to include additional items. For instance, some bylaws describe a corporate seal, usually a circular stamp with the name of the Corporation and state. In some states, a seal is useful in execution of contracts or opening bank accounts. Check your state law for any requirement or advantages of a seal, which can be purchased at most legal stationery stores.

ARTICLE II: Members and Shareholders

This portion of the Model Bylaws establishes the foundation for creating a Membership organization within a corporate shell. Whether you begin with the legal form of a business Corporation or a statutory cooperative, Article II defines Membership criteria and characterizes a class of capital stock ("Class A Shares") as non-transferable "Membership Shares". The result is a corporate structure designed for democratic control by its worker-Members.

Different capital stakes for different Members may be implemented through an Internal Capital Account System (see Article III), without compromising the basic democratic structure. Article II also envisions a second class of stock ("Class B Shares") in addition to Membership Shares. Holders of Class A Shares ("Members") and holders of Class B Shares are designated, collectively, as the "Shareholders."

The provision for "Class B" stock enables the Corporation to issue Shares to outside investors to raise needed equity capital. This second class of Shares has proven useful, as well, for giving institutional promoters or supporters a mechanism for financing and assisting in the development of cooperative enterprises. For instance, a nonprofit community development organization can provide an enterprise with valuable risk capital, while also exercising limited shareholder rights to protect its investment and to encourage cooperative attributes or a commitment to community interests.

Hereinafter, the Annotations presume a corporate structure with two classes of Shares — Class A Membership Shares and Class B preferred Shares — and thus refer to the Model Bylaws

authorizing two share classes (Part C.1, above.) If you select a structure and bylaws with only Membership Shares (Part C.2, above), simply ignore references in the annotations to Class B Shares and assume that all shareholder rights are rights of the Members. If you decide to authorize more than one class of Shares, be sure to determine whether and to what extent your cooperative can issue non-Member Shares under your selected state incorporation law.

SECTION 2 defines Class A Membership Shares as common stock, which ordinarily carries controlling voting authority in a Corporation and the residual claim on corporate net worth after payment of all other claims. SECTION 3 defines Class B Shares as preferred stock, which ordinarily has limited voting rights and some type of financial preference — e.g., payment of a regular fixed dividend before any dividends to holders of common stock, or payment upon corporate liquidation before any payment to common Shareholders.

SECTIONS 2 and 3 are flexible with respect to the relative rights of Class A and Class B Shares. In consultation with local counsel, you might decide to define more specifically the voting rights of Members and Class B Shareholders in Article IV and the financial rights and preferences in Article III. In that context, you might also decide that Class B Shares should be a second class of common stock rather than preferred. With or without substantial change from the Model Bylaws, specific definition of stock terms should appear in the Articles of Incorporation and most likely in shareholder agreements and the Corporation's agreements with investors.

Beware that issuing non-Member Shares carries some risk of undermining the democratic structure of the cooperative or reducing the return to Members. Thus, voting and capital rights of non-Member Shares are ordinarily quite limited in a worker cooperative. Be sure that any non-Member Shares are authorized consistently with the corporate law governing your cooperative, for many cooperative statutes limit the voting and dividend rights of capital stock. Moreover, eligibility for tax deductions under Subchapter T of the federal Internal Revenue Code requires a Corporation to maintain certain core cooperative attributes or, in the language of the tax law, to "operate on a cooperative basis."

Operation on a cooperative basis, as defined in Puget Sound Plywood, Inc. v. Commissioner of Internal Revenue, 44 T.C. 305 (1965), requires that a Corporation possess the following characteristics:

- (1) Subordination of capital, with respect to control over the cooperative undertaking and to the ownership of the pecuniary benefits arising therefrom;
- (2) democratic control by the worker-Members themselves; and,
- (3) the vesting in and the allocation among the worker-Members of the fruits and increases arising from their cooperative endeavor (i.e., the excess of the operating

revenues over the costs incurred in generating those revenues), in proportion to the worker-Members' active participation in the cooperative endeavor.

The precise meaning of "operating on a cooperative basis" for tax purposes is based on the tax laws and regulations, as interpreted in court cases and administrative proceedings. We recommend that you consult with an attorney or an accountant familiar with cooperative taxation to assure that your Corporation is organized and operated in accordance with Subchapter T. [See Appendix 4 for further discussion of Subchapter T.]

Of course, the requirements of Subchapter T are not relevant if you choose to build a democratic cooperative structure within the corporate shell of an "S Corporation" (a business Corporation that elects Subchapter S of the Internal Revenue Code) or a "Limited Liability Company" (under newly enacted statutes in a majority of states). Both an S Corporation and a Limited Liability Company are taxed like partnerships, with no entity-level taxation, and all enterprise net income is taxed directly to the owners. [See Introduction and Appendix 10 for further discussion of S Corps and LLCs.]

Two key aspects of "operating on a cooperative basis" as required by Subchapter T are voting control by Members (see Article IV) and allocation of earning and losses on the basis of Patronage (see Article III). Article II cross-references these other parts of the Bylaws in Section 1, then focuses on defining Members, Membership Eligibility criteria, and Membership Shares in SECTION 2.

Membership Eligibility is outlined in SECTION 2.A. The first eligibility requirement is that a Member works in the company. In the language of cooperative law, this means the person will "patronage the Corporation through provision of his or her labor on a full-time or part-time basis." This provision is intentionally broad enough to allow policies that include independent contractors as Members, in addition to Members who are employees of the Corporation. Be sure to check with legal counsel regarding the corporate law and tax law implications of a worker cooperative with Members other than employees.

The second eligibility requirement for Members is procedural; i.e., that the Member must be approved by the Board of Directors or its designee. Once a person has worked in the cooperative for the requisite trial period, the Board or another body designated by the Board ordinarily will approve Membership based upon established eligibility criteria. Some cooperatives allow for workers to remain non-Member employees on a long-term basis, which requires attention to reducing tension or other problems that might arise when a cooperative includes a significant number of non-Member workers. Section 2 is sufficiently flexible to allow the Board to make exceptions to the eligibility criteria from time to time — e.g., to continue employing people who worked for the company prior to a cooperative conversion, but who do not want to join the new cooperative as Members.

The third eligibility criterion in SECTION 2.A is the payment of a Membership Fee. The payment of such a Fee by a prospective Member tends to reinforce his or her commitment to and understanding of the responsibility and risk of membership in a cooperative enterprise. The Membership Fee should be set high enough to meet certain capital needs of the Corporation and to demonstrate a serious commitment by the Member. It should be set low enough to be affordable, perhaps through direct payments or payroll deductions. The Board of Directors has responsibility for establishing the amount of the Membership Fee, and the terms for payment. The Fee could be a standard amount (periodically changed to account for inflation) or a percentage of starting salary, but should not be changed in an arbitrary or discriminatory manner.

Many states permit purchase of stock in installments, but generally stock Shares cannot be issued in exchange for a promise to pay. Nonetheless, a cooperative might want to extend membership rights while an employee is in the process of paying his or her Fee over a period of time, such as through payroll deductions. In that case, payment or consideration for the Membership Share might be set at a lesser amount than the full Membership Fee in order to allow for issuance of the share, with the Member making a further contribution to capital through payroll deductions or payments over time until reaching a certain level. Again, be sure to consult with local counsel, since the law and procedures vary from state to state.

SECTION 2.A(4) designates a trial period as the fourth eligibility criterion. This section defines a certain period of time that a person must work before becoming a Member. The Members have the discretionary authority to accept a person into membership at any time before the end of the trial period. The trial period gives the Members a chance to evaluate the prospective Member (and vice-versa) on such issues as job performance, compatibility, and commitment.

In determining membership, the permanent versus temporary distinction is more important than the full-time versus part-time distinction. A permanent part-time worker might be considered a part of the cooperative, whereas a full-time but temporary worker (e.g. a student with a summer job) might not. The definition of temporary could be any time shorter than the "trial period" (e.g., six months, or one year) specified in SECTION 2.A(4). Some cooperatives quantify the amount of work required during the trial period to meet this eligibility criterion. This can be accomplished by adding language such as the following to SECTION 2.A(4): "...and during the immediately preceding 3 months, have worked an average of at least 20 hours per week...."

SECTION 2.B defines the Membership Fee and limits ownership of Membership Shares to Members, each of whom may own only one Membership Share. SECTION 2.C. provides that, upon termination of employment, a Member's share is automatically redeemed by the Corporation in accordance with the terms in Article III. Temporary layoffs or absences are not events of termination under the Model Bylaws. The Board might establish standard policies as guidelines for these situations.

The provision for Class B Shares in SECTION 3 is more open-ended and less prescriptive than the SECTION 2 provisions for Membership Shares. The Bylaws state essentially that the Corporation may authorize Class B Shares, which would require a provision in the Articles of Incorporation, and gives the Board of Directors discretion to determine or negotiate the terms of Class B Shares.

Transfer of either class of Shares is severely restricted (SECTION 4), so that only the Members can hold Membership Shares and so that non-Member Shareholders, if any, can sell their Shares only back to the Corporation. Membership Shares may not be transferred during the course of Membership. When a Member's employment by the Corporation is terminated (SECTION 2.C), except in the case of temporary lay-offs, his or her share must be transferred back to the Corporation at a redemption formula determined according to the internal accounts as described in Article III. The Operating Rules or other policies should include a clear and equitable procedure for processing grievances and for avoiding unfair termination of membership.

Stock share transfer restrictions appear on the stock certificates (SECTION 5), which can be purchased at a legal stationery store. Following is sample language for the transfer restrictions appearing on the stock certificates for both classes of Shares:

"The holder of this share of stock may not sell, assign any interest in, or otherwise transfer this share except for a transfer to the Corporation."

Additionally, the following can supplement the transfer restrictions on membership certificates:

"Upon termination of his or her employment in the Corporation, the holder of this share must transfer the share back to the Corporation at redemption terms determined in accordance with the Bylaws."

The terms and valuation mechanism for redemption of Membership Shares and Class B Shares is determined with reference to the Internal Capital Account System, described in the next part of these annotations.

ARTICLE III: Internal Capital Account System

Article III is the heart of the capital structure created by the ICA Model Bylaws. It establishes the system of Internal Capital Accounts. These Accounts do not exist in a conventional Corporation where the Shares are themselves marketable pieces of property with a certain market value. Since the Membership Shares in a cooperative are not marketable, the Internal Capital Accounts provide a valuation mechanism that reflects the net worth of the Corporation and the allocation of net worth among the Members and Shareholders.

SECTION 1 establishes the Internal Capital Accounts as a system for valuation of corporate equity. It specifies that each Member has an Individual Capital Account, that there may be one or more Shareholder Accounts for an outside investor or investors, and that there is one Retained Earnings Account (sometimes called the "Collective Account") that reflects a portion of core equity not allocated to any individual Members. The Shareholder Accounts reflect the value of any outside investment in the Corporation as a portion of the equity of the cooperative. The sum of the Individual Capital Accounts, the Shareholder Accounts and the Retained Earnings Account equals the net worth (equity or net book value) of the cooperative. The net worth is the value of the assets on the accounting books after the value of the debts or liabilities have been subtracted away. This is illustrated in the following simplified cooperative balance sheet.

BALANCE SHEET

ASSETS	LIABILITIES
Cash Accounts Receivable Inventories Other Current Assets Plant and Equipment	Accounts Payable Wages Payable Current Notes Payable Other Current Liabilities Long Term Debt
	EQUITY (Internal Capital Accounts)
	Individual Capital Accounts. Shareholder Accounts Retained Earnings Account
TOTAL ASSETS	TOTAL LIABILITIES + EQUITY

For example, if a cooperative had assets totalling \$100,000 and debts totalling \$60,000, then the net worth would be the remaining \$40,000. Then there would be \$40,000 in the Internal Capital Accounts. That \$40,000 would reflect the history of allocations to each of the three types of Internal Capital Accounts. For example, the Individual Capital Account might have a total (credit) balance of \$25,000, the Shareholder Account might have a (credit) balance of \$5,000, and the Retained Earnings Account might have a (credit) balance of \$10,000, since $\$25,000 + \$5,000 + \$10,000 = \$40,000$.

It is a common source of confusion to envision "money in an Internal Account" in the same sense that there might be money in a safe. But a Member's Individual Capital Account

only records the amount of money that is ultimately to be paid back to the Member. That amount of money is not "sitting" in the Account. An amount of cash in a safe would be an asset account on the left-hand side of the balance sheet, whereas the Internal Capital Accounts are equity accounts on the right-hand side of the balance sheet. Thus a Member's Individual Capital Account represents his or her share of the Corporation's net worth — not a "pile of cash" set aside with the Member's name on it. [For more details on the Internal Capital Account system, see Appendix 8.]

SECTION 1.A explains the structure of a Member's Individual Capital Account. The Account could be divided into a short-term portion and a long term portion (even though, for the sake of simplicity, this long-term/short-term language was not used in the Bylaws). The short-term portion (or "rollover" portion) represents the amount (e.g. Written Notices of Allocation) the cooperative will attempt to pay out to the Member after a fixed time period whether or not the person is still working in the cooperative. The long-term portion of the Member's Account (e.g., Membership Fee) is not paid out until the Member terminates his or her Membership or retires, and then might be paid out over an extended period (e.g., five years).

The balance in a Member's Account increases as the Member pays in the Membership Fee, and as the cooperative retains part of the profits for the year and issues Patronage Dividends that are partly or entirely in the form of Written Notices of Allocation. This method of allocating profits to the Individual Capital Accounts, while retaining the cash to use for any corporate purpose prior to redemption, is a powerful self-financing tool. The Patronage Dividend is the Member's share of the income allocated in proportion to the Member's labor, since "Patronage" is defined as labor (measured by hours worked or wages paid) in a worker cooperative.

The balance in an Individual Account may decrease if the cooperative experiences a loss for the year or if a portion of the Account is paid out to the Member. An Individual Capital Account is different from a savings account in a bank. In particular, the money is at risk and cannot be withdrawn from an Internal Account upon demand by the account holder. The purpose is to use the money to help produce other goods and services, so the money is not available to be withdrawn or paid out at the option of individual Members. The payout conditions are discussed below in the context of Section 3.

SECTION 1.B provides the cooperative with the flexibility to authorize and issue capital stock as consideration for equity investment from non-Member investors. Many worker cooperatives have found it necessary to attract outside investors in order to finance corporate activities. These investors have at times required an equity position in the company in exchange for their investment. Any cooperative considering creating a non-Membership class of stock should consult with a local attorney regarding securities law compliance and state statutory limitations on the rights of holders of capital stock in a cooperative.

The federal Internal Revenue Code permits cooperatives with outstanding capital stock to deduct Patronage Dividends from taxable income, although with some limitations on the

economic and voting rights of capital stockholders. These limitations include a requirement that the voting rights of capital stockholders do not undermine Membership control in corporate decision-making. Dividend payments to capital stockholders also must be limited if the cooperative intends to claim deductions under Subchapter T. Consult with tax counsel regarding an appropriate cap on dividends payable on capital stock — a benchmark maximum of eight percent of the book value of the capital stock is common.

In order to protect Membership control over governance and to be consistent with the book value principle of the Internal Capital Account system, any capital stock should be non-transferable, except back to the cooperative. However, the Model Bylaws allow the cooperative the flexibility to define the terms of redemption as it deems appropriate, given its needs and the needs and expectations of any outside investors. The framework of multiple classes of stock and their relative terms is defined in the Articles of Incorporation, in any disclosure document offering Shares for sale, and in any agreement with the shareholder.

SECTION 1.C explains how additions and subtractions are made to the Retained Earnings Account. Each year a portion of the profits or losses is added to or subtracted from the Retained Earnings Account. This is a form of self-insurance. If the cooperative tried to put all its profits in the Individual Accounts or Shareholder Accounts, then given the uncertainties of business it would probably not be able to pay out these Accounts. By setting aside a portion of profits in the Retained Earnings Account, the cooperative is helping to insure that it meets the capital demands arising from business needs and will be able eventually to pay off the Individual Accounts. Allocations into the Retained Earnings Account, out of each year's earnings, are called "Unallocated Retained Earnings."

In establishing the Retained Earnings Account, the cooperative should set an overall dollar target for the Account. This target should be established to serve anticipated and specific business needs and may be adjusted from time to time. The dollar target and the reasons for its establishment should be recorded in detail in the corporate records, accompanied by any projections or other evidence justifying the Account allocation. This "target" approach and its documentation strengthens the cooperative's claim for eligibility under Subchapter T for deductibility of patronage dividends.

The Retained Earnings Account will be increased annually by any Unallocated Retained Earnings, calculated in accordance with SECTION 2.D (see below), and consistent with the overall target amount. The size of the Retained Earnings Account, and the amount of Unallocated Retained Earnings each year, can vary depending on the business needs and purposes the cooperative identifies. Gifts or grants to the cooperative might be allocated to the Retained Earnings Account, although such amounts are more likely to be invested in the enterprise in exchange for equity Shares and the value reflected in a Shareholder Account.

SECTION 2 explains the accounting treatment of the net income or profit at the end of each fiscal year. It also includes definitions of terms that are used primarily in this Article III.

An audit of a company's accounting books determines if the balance sheet and income statement have been prepared in accordance with the Generally Accepted Accounting Principles (GAAP). The profit or net income determined according to GAAP is called the "Accounting Net Income." The tax authorities will allow the use of some non-GAAP techniques. Hence there might be a tax-basis net income different from the accounting net income. Cooperatives usually base the Patronage Dividends and other Internal Capital Account calculations on the Accounting Net Income, even though the taxes might be based on a different tax-basis net income.

Having calculated its Accounting Net Income for the fiscal year, the cooperative must then identify that portion of the Accounting Net Income derived from business done with or for Members. This income is termed Patronage Income. For most worker cooperatives, Patronage Income is income resulting from the labor of the worker owners. According to federal tax law, deductible patronage dividends cannot exceed Patronage Income.

The cooperative must engage in a two step process to calculate Patronage Income. First, Ancillary Income must be subtracted from Accounting Net Income. Ancillary Income is income that results from transactions that do not actually facilitate the main activity of the cooperative and do not result from Member Patronage. Common examples of Ancillary Income include interest income on long-term investments, rental income (except where the rental directly relates to the main activity of the cooperative), and gain from the sale of capital assets.

Second, having subtracted Ancillary Income from Accounting Net Income, the cooperative multiplies this difference by the ratio of Member Patronage to the total Patronage of Members and non-Members combined. The resulting amount, the Patronage Income, represents the portion of corporate income resulting from the labor of the Members. In order to be deductible under Subchapter T of the Internal Revenue Code, Patronage Dividends must be paid solely from Patronage Income.

In the Model Bylaws, Patronage is based on hours worked. Alternatively, some cooperatives calculate patronage on the basis of income as stated on employees' W2 Forms issued annually for tax purposes. Either approach is valid under tax law. The approach in the Model Bylaws places all employees on the same footing, regardless of salary and wage differentials, while the W2-based alternative favors higher paid employees in the calculation of Patronage Dividends.

Once the cooperative has identified Patronage Income, it must determine what portion to allocate to Patronage Dividends. Before allocating Patronage Dividends, the cooperative must pay a pro rata share of dividends, if any, on capital stock from Patronage Income (see discussion of Section 2.C, below). In addition, the cooperative may elect to allocate a portion of Patronage Income to the Retained Earnings Account as Unallocated Retained Earnings. Cooperatives should employ one of the two methods described below (in the discussion of SECTION 2.D) in establishing and maintaining a Retained Earnings Account.

Any positive Patronage Income remaining after payment of Dividends on Capital Stock, if any, and after the allocation of any Unallocated Retained Earnings to the Retained Earnings Account, should be allocated to Members, on the basis of their relative Patronage, as Patronage Dividends. SECTION 2.B describes the process of allocating Patronage Dividends.

In a 1976 tax case, a federal District Court in Oregon allowed a worker cooperative to add weight to the number of hours worked by Members in the calculation of patronage income. The effect was to increase patronage and the base of patronage-sourced income available for deductible patronage dividends. Such weighting reflected the cooperative's assessment of the value added to the company by Members.

The court endorsed a formula that valued Member hours at one hundred and fifty percent of non-Member hours, provided the cooperative was able to demonstrate the value added by Members as contrasted with the value added by non-Members. Much of this proof centered around the responsibilities Members assumed for management (including sitting on the Board of Directors and staffing committees of the board). In addition, expert testimony was presented on the relative value of work performed by owners and non-owners.

Other worker cooperatives can advance similar arguments, provided that the Members play a significant role in the governance of the cooperative and that the cooperative can demonstrate the increased productivity of employee-owners as compared to non-owners. The primary effect of a weighted formula would be to increase the percentage of a cooperative's revenues eligible for distribution as deductible Patronage Dividends, resulting in a potential reduction of corporate taxes and of Unallocated Retained Earnings. That effect is demonstrated in the table below.

Accounting Net Income = \$200,000		
Total Hours Worked = 20,000		
Member Hours = 15,000		
	Non-weighted	Weighted @ 150%
Patronage ratio	$15000/20000 = 75\%$	$(15000+7500)/$ $(20000+7500) = 82\%$
Patronage income	\$150,000	\$164,000

[For the purposes of this table "Accounting net income" does not include any ancillary income not allocable to patronage income.]

SECTION 2.B(1) permits the payment of Patronage Dividends in cash, Qualified Written Notices of Allocation, or Non-Qualified Written Notices of Allocation, in such combinations as determined by the Board of Directors and/or the Membership. This section further requires delivery of the Written Notices and cash to the Member within eight and one-half months after the fiscal year ends (as required by Subchapter T of the Internal Revenue Code). Assuming that the cooperative wants to retain a portion of the Patronage Dividend, the principal choice is to issue Non-Qualified or Qualified Written Notices of Allocation for the retained Patronage Dividends as defined in Subchapter T. [See Appendix 4 for discussion of Subchapter T as applied to worker cooperatives.] Transactions concerning Patronage Dividends on income earned during a fiscal year must be completed during the "payment period," which is eight and one-half months following the end of the fiscal year.

Patronage Dividends that include "Qualified" Written Notices are deductible by the Corporation from its taxable income. However, such Patronage Dividends with Qualified Written Notices must be declared by the Member as taxable personal income for the year in which the Patronage Dividends were declared, i.e., the year after the fiscal year when the income was earned by the Corporation. The Corporation must, within the payment period, pay at least 20% of the Patronage Dividend (the amount of the Qualified Written Notice plus cash) in cash to the Member, presumably to enable the Member to pay the personal tax. If any Member's marginal tax rate on income from the cooperative is above 20%, then the cooperative should consider paying out more than 20% to that Member. The tax laws also require that the Members consent to include the face amount of any Qualified Written Notices plus the cash received in their reported taxable income. SECTION 2.B(3) of Article III gives a form of bylaw consent. A similar clause should be included in the Membership Agreement. [See sample Membership Agreement in Appendix 2.]

A "Non-Qualified" Written Notice is any Written Notice of Allocation of Patronage Dividends which fails to satisfy any one of the qualification conditions — ordinarily the 20% cash payment component. Thus, for example, a Written Notice of Allocation that comprises an entire Patronage Dividend to a Member would be Non-Qualified, since the Corporation would have failed to distribute at least 20% of the Patronage Dividend in cash. Non-Qualified Written

Notices require no personal tax payment by the recipient in the year of allocation, but also offer no current corporate deduction for the Patronage Dividends. Hence income allocated with Non-Qualified Written Notices is taxable "upfront" at the corporate level. In a later year, when such notices are paid out in cash to the Members, the Members pay personal tax and the cooperative deducts the amount of the cash payout.

If the marginal tax bracket for the cooperative is below 20%, then the cooperative would pay out less cash by using Non-Qualified Written Notices of Allocation. Cooperatives in a higher tax bracket might prefer to use the Qualified Written Notices of Allocation in addition to the Non-Qualified Notices.

Without express approval by the Board, Written Notices are non-transferable. SECTION 2.B (2) assures that the amounts of Written Notices are credited to the Individual Capital Accounts. The income retained by the cooperative, and externally evidenced by the Written Notices, can be used for any and all corporate purposes.

SECTION 2.B(4) requires that an accounting statement be issued to each Member after the year-end changes in his or her Individual Capital Account. If positive Patronage Dividends are declared, the Member will receive a Written Notice of Allocation. If old Written Notices are redeemed, the Members holding these Notices will receive the cash. The accounting statement should list these transactions, as well as any other changes in the Member's Account (e.g. current losses). [See Appendix 3]

As described in Subchapter T, a cooperative, as a Corporation operating on a cooperative basis, may deduct from taxable income: (a) any amounts paid during the payment period for the taxable year (eight and one-half months after the end of the fiscal year) as Patronage Dividends paid in cash, Qualified Written Notices of Allocation, or other property (except Non-Qualified Written Notices of Allocation); and (b) any amounts paid in redemption of Non-Qualified Written Notices of Allocation. Otherwise, the federal corporate income tax is computed as in a Corporation not operating on a cooperative basis.

Corporate taxes should be paid out of Non-Patronage and Ancillary Income. Any such income remaining after the payment of corporate taxes may be allocated as a pro rata share of dividends on capital stock, if any, and to the Retained Earnings Account as Unallocated Retained Earnings.

SECTION 2.C provides for the payment of dividends on capital stock. Such dividends should be limited — a benchmark maximum is eight percent of the book value of the capital stock, or less if the state cooperative statute under which the cooperative was incorporated mandates a more limited return on capital stock. (Check with tax counsel.) Those dividends should be drawn on a pro rata basis from Patronage Income and the sum of Non-Member Patronage Income and Ancillary Income, in proportion to the ratio of Member Patronage to Non-member Patronage, in accordance with the terms of the stock, the Articles of Organization, and any applicable state law.

SECTION 2.D describes the general principles a cooperative should apply in retaining Unallocated Earnings in the Retained Earnings Account. There are two methods cooperatives can use in calculating annual allocations to the Retained Earnings Account. The chosen method should be codified in the governing rules of the Corporation. Both methods require the Board of Directors and/or the Membership to set, from time to time, an overall, long-term dollar target amount for the Retained Earnings Account, with reference to necessary business purposes, as described above and in SECTION 1.C.

One method of calculating allocations to the Retained Earnings Account requires the Board and/or membership to engage in an annual assessment of the Corporation's capital requirements and its ability to meet those requirements with its current Retained Earnings Account balance. If the current level of Unallocated Retained Earnings appears inadequate to meet the identified or projected capital requirements, the Board and/or Membership should set aside a specific dollar amount to be allocated to the Retained Earnings Account. This amount should be drawn first from Non-Patronage and Ancillary Income, then from Patronage Income if necessary.

Another method of calculating annual Unallocated Retained Earnings involves the diversion of a fixed percentage of Patronage Income to the Retained Earnings Account. Each year, the cooperative should set aside the mandated percentage of Patronage Income, in addition to any Non-Patronage or Ancillary Income remaining after the payment of corporate taxes and any dividends on capital stock, in the Retained Earnings Account, until such time as the overall dollar target is reached. Notwithstanding the corporate policy establishing a fixed percentage of Patronage Income to be retained as Unallocated Earnings, that percentage can be increased (or decreased) based on unanticipated business needs, as they arise, at the discretion of the Board and/or the Membership.

The following chart summarizes the steps in determining the allocations of net income in a worker cooperative in accordance with Article III of the Model Bylaws.

A	Calculate Accounting Net Income.
B	Subtract Ancillary Net Income from Accounting Net Income.
C	Multiply the resulting difference by the ratio of Member Patronage to total Patronage, resulting in Patronage Income.
D	Subject to reductions in Step E & F, set aside as Unallocated Retained Earnings: <ol style="list-style-type: none"> (1) the sum of Ancillary Income and Non-member Patronage Income, and (2) that portion, if any, of Patronage Income required as additional reserves for business purposes, consistent with the established overall target.
E	Pay corporate tax on that portion of Accounting Net Income set aside as Unallocated Retained Earnings in Step D.
F	Pay dividends, if any, on capital stock from a combination of Ancillary income, Non-member Patronage Income, and Patronage Income. <div style="text-align: center; font-size: small;">[Such capital dividends are drawn on a pro rata basis from Patronage Income and the sum of Non-member Patronage Income and Ancillary Income, in proportion to the ratio of Member Patronage to Non-member Patronage.]</div>
G	Allocate to the Members as Patronage Dividends (in cash and/or written notices) that portion of the Patronage Income that remains after reduction in Steps D & F.
H	Allocate all remaining retained earnings to the Retained Earnings Account.

SECTION 2.E deals with the allocation of losses to the Internal Capital Accounts. This provision gives the Board of Directors the discretion to determine how losses are allocated among the Individual Capital Accounts, the Retained Earnings Account, and any Shareholder Accounts. Cooperatives differ in how they allocate losses. Most allocate losses first to the Retained Earnings Account, then to the Individual Capital Accounts. Different methods are employed in protecting some portion of the Individual Accounts, or in some cases in protecting Shareholder Accounts. One method is to allocate losses to Written Notices, then to Shareholder Accounts, and then only if necessary to the Membership Fee portion of the Individual Accounts. An alternative method provides that a Member's Patronage share of the losses is first subtracted from the long-term part of his or her Account (i.e., Membership Fee) and then, when that is exhausted, from the short-term part of the Account, consisting of Written Notices of Allocation. Within the short-term part of an Account, the losses should be applied first to the oldest Written Notices on a first-in-first-out (FIFO) basis.

By not subtracting losses from the previous positive Patronage Dividends until necessary, the cooperative reaps the maximal tax advantage from the Patronage Dividends. That is, if and when money is later paid out to Members, a maximum amount of it will be redemption of Non-Qualified or Qualified Patronage Dividends. If the original Patronage Dividends were Non-Qualified, the payout is deductible at the corporate level. On the other hand, if the terms of the outside investments require greater protection for that outside equity, it may be necessary for the cooperative to entirely deplete the Individual Capital Accounts before charging losses to capital stockholder equity. One of the purposes of the Membership Fee is to serve as a deposit, like a damage deposit made when one rents an apartment. It provides an initial positive balance in a new Member's Account, a balance from which losses can be subtracted. If the Membership Fee

"cushion" is eaten away by repeated losses, then the cooperative might consider the self-assessment of a second Membership Fee to replenish that buffer.

To the extent that losses are charged against Individual Capital Accounts, some cooperatives allocate such losses equally among all Member Accounts. Alternatively, some cooperatives allocate losses to Members in proportion to relative patronage. In the latter approach, negative patronage net income is treated just like a negative "Patronage Dividend." Each Member's share of the loss is subtracted from the balance in the Member's Account in proportion to their labor Patronage.

Some people question whether it is fair to allocate losses to the Members in proportion to Patronage (symmetrically with profits). Doesn't this penalize those who work the most (i.e., have the most labor Patronage)? Wouldn't it be more fair to divide losses equally between the Members? But an "equal" split of losses between Members might constitute very unequal treatment if the Members are working quite different amounts of time. When a cooperative is having losses, for instance, some of the Members might be suffering temporary lay-offs. The bulk of income paid out to Members as wages will go to those Members who are not laid off. Hence, in this case, the fair and equal treatment arguably is to allocate the most losses to those who worked the most hours and thus received the most wage income. It would seem unfair to allocate to the laid-off Members an "equal" share of the losses when they did not get an equal share of the income-producing work.

SECTION 3 deals with the capital paid into or paid out from the Internal Capital Accounts, i.e., basic contributions and distributions of corporate equity. There are two ways amounts are credited to a Member's Individual Capital Account: the Membership Fee and retained Patronage Dividends reflected in Written Notices of Allocation. The cooperative redeems the retained Patronage Dividends, with the timing of redemption determined by the Board of Directors or by the end of the redemption period as defined by each Written Notice of Allocation. Such redemption period ordinarily is either a fixed term or a period that ends upon Membership termination, corporate dissolution, or another specified event. The Membership Fee is in the long-term portion, which remains in the Account as a cushion against possible losses, until the Member terminates employment or retires. This remaining balance is paid out as the legal consideration for the returned Membership Share.

SECTION 3.A describes how the Patronage Dividends in the short-term part of a Member's Account are treated as a revolving or rollover fund. Each Member's portion of the retained Patronage Dividends is credited to the Member Account. The Written Notice of Allocation should specify its redemption period, if the cooperative chooses to set such a period. Some cooperatives elect not to establish a fixed redemption period, then redeem Written Notices annually when possible. Other cooperatives set redemption periods ranging from one to ten years in duration. Each cooperative should formulate its own redemption policy, based on its projected cash flow position and the expectations of its Members. The cooperative also retains the ability to further postpone cash payouts of Written Notices through the issuance of promissory notes at the time of redemption, if its cash position precludes redemption with cash.

The IRS has not established any specific guidelines regarding the timing of the redemption of Written Notices.

Any losses assigned to the short-term part of a Member's Account will subtract from those amounts due to be next paid out. To be finally redeemed or paid out in cash, each Member's Patronage Dividends for a given year must 'run the gauntlet' — must survive the designated period of exposure to possible losses. If the Patronage Dividends survive the gauntlet and if allowed by the cooperative's financial condition and agreements, then the Patronage Dividends are eventually paid out in cash. The cooperative should plan the level of wages to be paid out during the fiscal year so that, with no unpleasant surprises, the cooperative will be able to redeem the Written Notices. However, if unforeseen circumstances result in insufficient profits, then the redemptions may be postponed by the Board of Directors. Moreover, lenders may require restrictive covenants in the financing agreements of the cooperative. The following language is suggested as an addition to the Bylaws in the event a lender requests a subordination clause:

"Notwithstanding the terms and conditions of any and all written notices of allocation issued by the cooperative, if a subordination agreement executed by the Corporation or the Member to whom the notices of allocation were issued requires that the Corporation delay or withhold any payment with respect to a written notice of allocation, then such subordination agreement shall govern the timing of payment of such written notices of allocation."

SECTION 3.B describes the distribution triggered by a Member's termination or retirement from the cooperative. The Written Notices in the short-term part of the Member's Account may be scheduled, whether or not the Member is terminated, to be redeemed within a certain period of years. Termination brings no changes in the status of those Written Notices of Allocation. The terminating Member's Membership Share is automatically transferred back to the cooperative. The legal consideration for the returned Share is the long-term balance in the Member's Account which represents the surviving Membership Fee. That long-term balance is paid out to the departing Member in some combination of cash and subordinated notes as determined by the Board of Directors. If the long term balance in the Member's Account is zero or negative, the Membership Share is forfeited back to the Corporation for no legal consideration.

SECTION 3.C provides for the redemption of Class B Shares according to their terms, as defined in the Articles of Incorporation and any other relevant instruments. SECTION 3.D governs the treatment of the Retained Earnings Account if the cooperative is liquidated, dissolved, or sold. If a cooperative is liquidated or dissolved, there is unlikely to be much if anything left after normal debts and (if possible) the Individual Accounts are paid off. If the entire business is sold, the market value sale price may be substantially greater than the book value of the Corporation. This greater value will be reflected in a more valuable Retained Earnings Account.

Since all the past Members contributed to the Retained Earnings Account, it would be unfair for the current Members to try to "raid" and appropriate it. In the event of any positive residual assets, the Bylaws allow the cooperative, in effect, to reconstruct the Individual Capital Accounts as if there had been no Retained Earnings Account in the past. The result is an additional distribution of any residual amounts to all past and present Members in proportion to their patronage.

Some cooperatives have elected to limit dissolution distributions to those former Members who have worked for the cooperative at some point in the last ten years. These cooperatives have also issued Written Notices of Allocation with ten year redemption periods. By setting the outside limit for redemption and the horizon for dissolution distribution at ten years, these cooperatives reduce the costs of administration involved in maintaining current addresses for all past Members indefinitely. Members who have outstanding Written Notices are more likely than those who do not to make an effort to update their own addresses with the cooperative. To further ease the burden of locating past Members, the Bylaws contain a notice provision enabling the company to limit distributions to those former Members who respond to the notice.

ARTICLE IV: Shareholder Meetings

Most state Corporation laws require at least one annual meeting of Shareholders. In a worker cooperative, the Members hold the basic rights and responsibilities of common stockholders. In practice, Members of a worker cooperative are likely to play a more active role and have greater rights than Class B Shareholders. Article IV envisions Shareholder meetings that include both classes of Shareholders — Members and holders of Class B Shares, if any. In your cooperative, you might wish to adjust the role of Class B Shareholders with respect to Shareholder meetings, depending in part on the extent of Class B voting rights.

The Annual Meeting (SECTION 1) gives Members and Shareholders at least the minimum opportunity to elect a majority of the Board of Directors. In addition, the Annual Meeting provides an opportunity for review, discussion, and ratification of important corporate policies and plans.

Ordinarily, the Board and/or Officers determine the agenda for the Annual Meeting of Shareholders, but 10% of either the Members or the Class B Shareholders can ensure consideration of issues other than those presented by the Directors and Officers. The date and location of the Annual Meeting is fixed in the Bylaws to achieve regularity and to comply with state law. For the sake of flexibility, however, SECTION 1 permits a special meeting in place of the scheduled Annual Meeting.

In many cooperatives, especially smaller ones, meaningful Membership input requires more than just one meeting a year. Thus, SECTION 2 permits more frequent "regular" meetings, held at a regular time and place determined by the President or by the Members. In addition,

SECTION 3 permits special meetings to be called at any time and for any lawful purpose. Power to call such a meeting rests with the Board, the President, or 10% of either class of Shareholders. But, in the ordinary course of business, especially in large cooperatives, the elected Board can act on most corporate matters between occasional Shareholder meetings.

To enable a Shareholder to exercise his or her voting rights, he or she must receive a 10-day advance notice of the time, place, and purpose of Annual or Special Meetings (SECTION 4) unless state law requires earlier notice. (Be sure to check state law to determine the statutory notice requirement.) Such notice may be given in person at the workplace, and might, for instance, be included with distribution of paychecks. The Shareholders' ability to provide a written waiver of the notice requirement can simplify the process in cases where notice is impractical. Notice is not required for each Regular Meeting, provided that Shareholders are notified of the establishment of a regular time and place for such meetings. A majority of Members and a majority of Class B Shareholders must attend a Shareholders Meeting (SECTION 5) to achieve a quorum and take valid votes of Shareholders, although the Class B Shareholders can waive their attendance requirement for quorum purposes. Depending upon the rights of Class B Shareholders and their role in your cooperative, these quorum provisions and the necessity of attendance by Class B Shareholders can be adjusted.

The basic cooperative principle of one-member/one-vote appears in SECTION 6. This applies at least to the addition, election, or removal of Directors, as well as to other matters requiring Membership voting. State corporate laws often require Shareholder voting on major corporate changes such as merger, dissolution, sale of all or substantially all corporate assets, or amendment of the Articles of Incorporation. In addition, these Bylaws give Shareholders voting rights to amend the Bylaws and to adopt Operating Rules. Precise division of responsibility between the management, the Board, the Members and any non-Member Shareholders should be defined in Operating Rules and policy resolutions — consistent with the legal responsibilities of the Board under state law.

This section also envisions class voting on matters for which Class B Shareholders are entitled to vote. For such issues — as defined in the Articles, in the Bylaws, or by agreement — a majority of each class must vote for approval of any Shareholder action. This effectively grants each class of Shareholders a veto on these selected issues. Some cooperatives use this portion of the Bylaws to outline more specifically the governance rights of Members and Class B Shareholders, listing issues that require voting by each class of Shareholders.

Many Corporations permit proxy voting — i.e., delegation of an absent Shareholder's voting rights to another Shareholder present at a meeting. A proxy can be directed (specifying how to vote) or undirected (giving the proxy holder discretion in voting the proxy). SECTION 6 prohibits proxy voting, unless the Board adopts an explicit policy allowing proxy voting, in order to encourage active participation by the full Membership. For practical reasons, this section acknowledges the possibility of voting by proxy or absentee ballot, but only if the Board adopts specific rules and procedures authorizing proxies. You may choose to alter this provision further

to allow for proxy voting, or simply leave it to the Board's discretion as drafted in the Model Bylaws.

Ordinarily, a Shareholder Meeting with a quorum can take action on the basis of a majority vote of Members present or by a majority of Members and a majority of Class B Shares voting by class (SECTION 7). Exceptions might be prescribed in the Articles or the state Corporation law, e.g., requiring 2/3 vote for certain amendments of the Articles involving major Corporation changes. The Board designates which officer or other persons will preside at meetings of the Members. Finally, Shareholder action can be taken by unanimous written consent (SECTION 8), even without a meeting.

ARTICLE V: Board of Directors

Corporate law vests the Board of Directors with primary responsibility for managing the affairs of the Corporation. This usually involves selecting and monitoring management personnel. Many worker cooperatives, especially smaller ones, reserve certain policy decisions to the Members, through the Bylaws and Operating Rules. As a legal matter, however, major responsibility remains with the Board of Directors. Members usually exercise ultimate control through the power to elect and remove Directors. As a practical matter, the Board is the representative body that meets regularly to develop policy and oversee management.

Analogous to a parliamentary political system where the elected parliament selects the prime minister, the elected Board in a worker cooperative selects the President as the chief executive officer. Some cooperatives require Membership approval of the Board's selection of President, if permitted under state corporate law. SECTION 1 expressly authorizes the Board to authorize the issuance of stock — without such a provision (in some states), such a power would rest with the Shareholders. Check your local law.

Whatever division of responsibility you choose, the Board of Directors retains primary legal responsibility and in some cases even personal liability. For instance, Directors can be held personally liable for the Corporation's failure to pay federal tax. The "fiduciary duties" of directors — the duty of loyalty and duty of care — require them to act responsibly and honestly with persons outside and inside the Corporation, and forbids them from seeking personal gain at the expense of the Corporation.

The number of Directors (SECTION 2) is chosen initially by the incorporators (the Corporation organizers) and thereafter by the Shareholders. The number should be odd (to avoid tie votes), small enough to comprise a working group, and within the boundaries defined by state law. (For instance, Massachusetts requires a minimum of three directors in Corporations with three or more Shareholders.) SECTIONS 2 and 4 provide for staggered two-year terms for Directors, adding some continuity from year to year. You might choose a shorter or longer term in the Bylaws. A simpler alternative is to provide for one-year terms and annual election for all Directors.

Vacancies (SECTION 3) may be filled through voting by the Board or by those Shareholders entitled to vote. SECTION 4 ensures that a Director can resign before the end of the term or remain beyond the term until he or she is replaced. Thus, if an annual election is delayed, the Board will remain intact and operational. SECTION 2 permits non-Member Directors. This enables the cooperative to have outside expertise or a link with other institutions through the Board. Some cooperatives use this portion of the Bylaws to define a particular composition of the Board, e.g., designating a certain class and number of Directors elected by Members or establishing an ex officio seat on the Board for the President.

The Members' right to remove Directors (SECTION 5) is the analogue to their right to elect Directors. The right is unlimited, insofar as the Members can remove a Director for any reason at all, i.e., "without cause." The Board, on the other hand, can remove a Director only "for cause" — i.e., if the Director acted dishonestly, irresponsibly, or inconsistently with the best interest of the Corporation. Thus, without cause, the Board cannot undercut the Membership selection of Directors. A Director removed for cause has minimum due process rights — i.e., reasonable notice and an opportunity for a hearing. Directors elected by Class B Shareholders can be removed with or without cause by Class B Shareholders, and with cause by the Members or Directors.

The Board of Directors should meet regularly (SECTION 6) in order to be responsible in overseeing management, developing policy, and responding to problems. Monthly meetings are common for a "working board," although the opportunity for special meetings might decrease the need for such frequent regular meetings. Notice (SECTION 7) is essential, since Directors must pay close attention to their legal and operational responsibilities. A majority of Directors constitutes a quorum (SECTION 8), and a majority of Directors present ordinarily can take action (SECTION 9). Board power to take action by unanimous consent (SECTION 10), absent a meeting, is important for practical reasons; so is delegation of certain powers to Board committees (SECTION 11).

ARTICLE VI: Officers

SECTION 1 of Article VI, like many state laws, requires the Board to select a President, Treasurer, and Secretary or Clerk as Officers. The Board may create and fill other Officer positions at its discretion such as Chair of the Board, Vice President, Assistant Treasurer or Assistant Secretary. The choice of Officers is important since, in most cases, the Officers are responsible for managing the day-to-day business of the Corporation. They administer the policies developed by the Board and the Shareholders.

A Chairperson, as the presiding Officer of the Board, can be selected from among the Directors. The other officers need not be Directors (unless required by state law). One person can hold more than one office, which might prove practical in smaller operations; some state laws, however, restrict certain joint office-holders. The term of office of the Officers is

determined by the Board (SECTION 2). An Officer may resign in writing in accordance with this section.

The Board can remove any Officer for any reason, as long as the Officer is given notice and a chance for a hearing before the Board (SECTION 3.) The Board can choose persons to fill any vacant offices until their next annual election of Officers (SECTION 4.)

The President is the chief executive officer (SECTION 5) — presumably with the full-time role of managing the business of the Corporation. Although subject to Board supervision and removal, the President must be given adequate discretion for managing the day-to-day operation of the Corporation.

The President and the Treasurer have power to enter binding contracts on behalf of the Corporation (Article I, Section 3.) This power may be altered or limited by Board or Shareholder resolution, or by amending these Bylaws. Cautious business practice suggests that such power to enter contracts be limited to one or a few individuals. Beware, however, that state law often gives any Officer legal authority to enter contracts for the Corporation. A contract can be binding on the Corporation if the party with whom an Officer contracts believes the Officer has the necessary authority — i.e., if the Officer has apparent authority. And, the other party might be able to escape a contractual obligation if signed by a corporate Officer without actual authority. Thus, the Corporation should be clear and consistent about signing authority, and should always choose responsible Officers.

The Treasurer (SECTION 6) is responsible for the finances of the Corporation. This involves administration, custody, and record-keeping with respect to all financial concerns. Check-signing authority may be delegated, but the Treasurer and Board retain legal responsibility for money matters. As an additional protection, some Corporations require two Officers to co-sign checks over a certain amount. In performance of its supervisory role, and to protect the Corporation from any mishandling of funds by the Treasurer, the Board may require the Treasurer to give a bond for faithful performance of his or her duty. Bonding is usually arranged with an insurance company.

The Secretary (SECTION 7) is the primary record-keeper of the Corporation. Such records, at a minimum, should include: (1) a Shareholder list and stock transfer information; (2) minutes of all meetings of Members, Shareholders, and Directors; and (3) other corporate documents, such as Articles of Incorporation, Bylaws, contracts, and corporate filings. The Secretary may also serve as resident agent of the Corporation to be served with legal papers in the event of litigation. In some states, the term Clerk is used instead of Secretary.

ARTICLE VII: Indemnification

Indemnification (SECTION 1) is a protection that many Corporations provide for Directors and Officers. To indemnify a person means to secure against loss or damage, and to

compensate that person for such a loss. This provision gives individual Directors and Officers a guarantee that the Corporation will cover any expenses or losses incurred by virtue of their position as Directors or Officers. This right to indemnification applies only to the responsible execution of a Director's or Officer's duties. Thus, the Corporation need not compensate a person for damages resulting from actions that the person took (or failed to take) in bad faith and not in the best interest of the Corporation. The specific exceptions to indemnification, listed in this Article, defer to the law or to a court's decision for determining whether an exception applies.

Indemnification is an important provision in attracting people to serve as Directors or Officers. It can also be very costly to the Corporation if the indemnification rights are triggered. Therefore, a Corporation might obtain "Director and Officer Liability Insurance" to be authorized by SECTION 2, to cover indemnification costs.

ARTICLE VIII: Amendments

These Bylaws may be amended by a vote of a majority of each class of Shareholders (SECTION 1). Along with the power to elect or remove Directors, the power to amend the Bylaws can be among the most important Membership rights with which to control the Corporation. The extent of Class B rights to amend the Bylaws therefore should be considered with caution and might be limited in order to promote greater Member control.

For practical reasons, the Directors also have the power to amend the Bylaws (SECTION 2). This power, however, is carefully limited in order to retain ultimate control of Bylaw amendments in the Shareholders. Thus, SECTION 2 prohibits the Board from changing the procedure for amending the Bylaws or removing Directors, and from changing the terms of Membership eligibility. Moreover, any amendment by the Board can be amended subsequently by the Shareholders, who must receive timely notice of any amendment by the Directors.

ARTICLE IX: Operating Rules

This provision authorizes and suggests the adoption of Operating Rules, to provide a more detailed "governance system" within the framework of the Bylaws. Operating Rules can specify important day-to-day operating procedures and rights, including (but not limited to): personnel policies, grievance procedures, and decision-making mechanisms. For more guidance on developing a governance system that might be embodied in Operating Rules, see the ICA publication by Jan Saglio and Richard Hackman, "The Design of Governance Systems for Small Worker Cooperatives."

E. ICA MODEL BYLAWS: DRAFTING CHECKLIST

Following is a checklist to assist you in identifying some of the key decisions you will need to make when drafting Articles of Incorporation and Bylaws. The decisions prompted by this checklist should be made with the assistance of a local attorney familiar with your state's corporation laws. Note that this is not a comprehensive list of drafting decisions, but simply an outline of selected choices of importance.

1. DECISIONS FOR ARTICLES OF INCORPORATION

Article	Decision
I	The name of corporation.
II	The corporate purposes; these may be all purposes for which a corporation may be legally formed in that state, or it may be a more specific (and therefore limited) list of purposes. See the sample Articles (Appendix 1) for both types of provisions.
III	Authorized stock, one or more classes, and par value (if any).
IV	Relative rights of different classes of stock.
V	Transfer restrictions (if any).
VI	Other provisions (e.g. indemnification, contracts).
VII	Initial Directors.

2. DECISIONS FOR BYLAWS

Threshold question: Will the Cooperative issue a second class of stock to outside investors? If so, use the two-class model bylaws (Part C.1). If not, use the single class version (Part C.2). This checklist uses the terms Members and Shareholders interchangeably, except where the context indicates otherwise. Article numbers are for both one and two class model bylaws; where numbers are different, [brackets] indicate numbers for one class bylaws.

Article/ Section	Decision
I/1	Name of cooperative (see local statute regarding the use of the word "cooperative" in the name).

- I/2 End of fiscal year (often the calendar year).
- II/2.A(4) Eligibility criteria for membership (trial period, minimum number of hours, months worked).

- II/2.B(2) Determination of the Membership Fee by the Board. In states where stock cannot be sold in exchange for a promise, the Fee may need to be separated into a portion payable upon receipt of the Membership Fee (consideration for the share) and additional capital paid in over time.
- III/2.A(2) Patronage can be defined, as in the Bylaws, as hours worked during the year, or as W2 income (favoring higher paid employees).
- III/2.A(2) Member Patronage can be calculated by using a weighted ratio—for example Member Patronage could be multiplied by up to 150%, then divided by the sum of weighted Member Patronage and non-member patronage. These Bylaws do not use a weighted ratio; a cooperative should only do so in the belief that the relative value of Member work (running the cooperative and fulfilling other Member responsibilities) is greater than that of non-members. [See the Annotations, p. D-12.]
- III/2.C For cooperatives with two or more classes of stock, this section provides for the payment of dividends on those shares. The dividend rate should be below 8%, to comply with the tax law requirement that a cooperative not be a vehicle for investment profits by outsiders.
- III/2.D
[III/2.C] Calculation of Retained Earnings Account allocation: can be accomplished by (1) setting a fixed percentage in the Bylaws, and justifying that percentage by reference to business reasons each year, or (2) authorizing the Board to calculate a new percentage each year, again with reference to business reasons. [See the Annotations, pp. D-14 to D-16.]
- III/2.E
[III/2.D] Determination of policy for allocation of losses, and whether to include the details of that policy in the Bylaws. Some cooperatives employ a "Start-Up Losses Account," enabling them to amortize start-up losses over time by reducing the balance in that account before charging those losses to the other Internal Capital Accounts. Such an account would be a sub-account of the Retained Earnings Account. These Bylaws omit this account.
- III/3.A The Bylaws of some cooperatives establish a time period (often five or ten years) during which all Written Notices will be redeemed. These Bylaws leave the redemption schedule to the discretion of the Board.
- III/3.A Even if a redemption period is established, the Board should retain discretion not to redeem Written Notices when they might result in the insolvency of the Corporation. Some lenders require that the redemption of Written Notices be subordinated to the repayment of loans due those lenders. A subordination clause similar to the one appearing on p. D-18 of the Annotations can be inserted in this section of the Bylaws.
- III/3.D/
[III/3.C] Dissolution distributions by some cooperatives are limited to current Members, former Members who have worked for the cooperative in the five

or ten years preceding dissolution, and other classes of Shareholders, if any. Others limit distributions to current Members and any other classes of Shareholders.

- IV/1 In these Bylaws, the date for the annual meeting is designated as the first Friday of that month, although this provision can be drafted to schedule the annual meeting on any day of the week, at any point in the month.
- IV/1 This section further provides that business may be added to the agenda at the request of at least 10% of the Members (or if an additional class of stock is issued, by request of at least 10% of the holders in interest of that class of stock). A cooperative may wish to provide more or less discretion to Shareholders, based in part on any limitations imposed by state law.
- IV/3 This provision empowers the holders of 10% of any class of stock to call a special meeting, upon written application. Changes may also be made to this section, increasing or decreasing the ability of different classes of Shareholders to initiate meetings of the owners of the cooperative.
- IV/5 For cooperatives with two classes (or more) of stock, this section requires the presence of a majority of the holders of each class to constitute a quorum. For decisions not requiring the affirmative vote of non-member Shareholders, this provision enables those Shareholders to block action by the Members by denying a quorum. To limit the power of non-member Shareholders, a cooperative may provide that a quorum consists of a majority of the holders of those classes of stock entitled to vote on the matters presented at the meeting.
- IV/6 This section bars voting by proxy, except as authorized by explicit Board policy, on the theory that proxies strip decision-making of its deliberative aspect by enabling Shareholders to vote without participating in a meeting. If the operation of the cooperative requires the ability to make decisions without the presence of many Shareholders, proxies may be permitted by policies and procedures adopted by the Board or by amending this section. It also possible for the Bylaws to list at this point all the issues requiring Member voting.
- IV/7 For cooperatives with two or more classes of stock, a decision must be made whether to provide for class voting on all issues requiring a vote of all the Shareholders. The cooperative's ability to limit class voting is constrained by state law, which typically provides for a number of actions which require class voting.
- V/2 These Bylaws allow for outside directors. Some cooperatives may prefer to maintain complete Member (or shareholder) control of the Board. They can do so by altering this section.

- V/4 These Bylaws provide for staggered 2-year terms of office for Directors. That term can be shortened or lengthened with or without staggered terms of office, depending on the priorities of the cooperative.
- VIII/1 Amendments to these Bylaws can be made by the Shareholders only with an affirmative class vote of the holders of the majority of the shares of each class of stock. The cooperative may limit the ability of non-member Shareholders to vote on amendments, although those limitations are constrained by state law requiring class voting on certain amendments; the cooperative may also here limit the authority of the Board to amend the Bylaws.
- IX/1 A question to consider is whether the cooperative will have a separate set of operating rules or governance policies, and if so, which body (Board, Shareholders, or both) will be empowered to make changes to such rules or policies.

ICA MODEL BYLAWS FOR A WORKER COOPERATIVE

VERSION III (1995)

APPENDIX

1. Sample Articles of Incorporation
2. Sample Membership Agreement
3. Sample Written Notice of Application
4. Peter Pitegoff, "Taxation of Worker Cooperatives," Employee Ownership (1982)
5. Selected Tax Forms (Subchapter T)
6. David Ellerman & Peter Pitegoff, "The Democratic Corporation: The New Worker Cooperative Statute in Massachusetts," 11 NYU Review of Law & Social Change 441 (1982-1983)
7. David Ellerman, "The Mondragon Cooperative Movement," Harvard Business School Case Study (1982)
8. Richard Feldman, "An Illustrated Guide to the Internal Capital Account System for Worker-Owned Cooperatives: Concepts, Mechanics, Taxation," The ICA Group (1988)
9. Excerpt: "How the ESOP Really Works," The ESOP Association (1992)
10. R. Keatinge, "LLCs: Wave of the Future? — New Gang in Town," and J. Cunningham, "LLCs: Wave of the Future? — The Tax Angle," Business Law Today (Mar/Apr 1995)

APPENDIX 1

SAMPLE DOCUMENT:

Articles of Incorporation
for ABC, Inc.,
a worker cooperative

NOTE: The required form and content for Articles of Incorporation will vary, depending upon the state of incorporation and your choice of corporation statute under state law. This sample document can be adapted to your state law and requirements. We recommend that you **consult local legal counsel** when drafting and filing Articles of Incorporation.

**ARTICLES OF INCORPORATION
OF
ABC, Inc.**

**(Under Section [number] of the Business Corporation Law
[or other statutory title]
of the State of [name of state])**

The undersigned, natural persons over the age of eighteen years, and acting as the incorporators of the corporation herein being formed under the Business Corporation Law [or other appropriate statutory title] of the State of [name of state] hereby certify that: [alternatively, one incorporator]

ARTICLE I: NAME

The name of the corporation is ABC, Inc. (hereinafter the "Corporation").

ARTICLE II: PURPOSES

The Corporation is formed for the following purposes:

(a) To conduct any business or other activity which lawfully may be conducted by a corporation organized under the Business Corporation Law [or other appropriate statutory title] of the State of [name of state], whether or not related to those purposes described in the following paragraphs.

[Optional]:

(b) To conduct the business of [general description of business purposes], and to do all other things necessary, appropriate, or proper for the accomplishment or furtherance of or incidental to these purposes which lawfully may be done by a corporation organized under the Business Corporation Law [or other appropriate statutory title] of the State of [name of state].

[Optional]:

(c) To operate as a corporation controlled democratically by the members, as defined in the Bylaws of the Corporation;

[in a state with applicable worker cooperative statute, add the following]: ...and, to operate on a cooperative basis in accordance with [cite worker cooperative statute].

The foregoing enumeration of purposes shall not be deemed to limit or restrict in any manner the powers of the Corporation, and the enjoyment and exercise thereof, as conferred by the laws of the State of [name of state] upon corporations organized under the Business Corporation Law [and/or other appropriate statutory title, including worker cooperative statute if elected].

[Optional: list specific corporate **powers**, prompted by governing statute]

ARTICLE III: AUTHORIZED STOCK

The Corporation is hereby authorized to issue 1,000 [or other appropriate number] shares of Class A common stock at a par value of \$0.01 each and 1000 [or other appropriate number] shares of Class B preferred [or common] stock at a par value of \$0.01 each, as described herein. No share of any class shall entitle its holder to a preemptive right to acquire or subscribe to additional shares of any class of stock.

(a) **Class A Common Stock:** Shares of Class A common stock are designated as "Membership Shares," and holders of Class A common stock are designated as "Members." Members shall vote as a separate class and each Member is entitled to one (1) vote on any matter requiring voting by Members.

(b) **Class B Preferred Stock:** Holders of Class B preferred stock shall vote as a separate class on a one vote per share basis on any matter requiring voting by holders of Class B stock.

ARTICLE IV: RIGHTS OF STOCK CLASSES

[Define here the relative voting, dividend, redemption, and dissolution rights of Members and Class B shareholders, which must be tailored to the corporation's unique circumstances and needs. These terms should be consistent with the bylaws, any disclosure documents, and any investment contracts or shareholder agreements, and might cross-reference these documents. Particular care is advisable in light of corporate, tax, and securities law implications. **Consult with legal counsel in drafting these terms.**]

ARTICLE V: TRANSFER RESTRICTIONS

No share of any class or interest therein may be sold, assigned, or otherwise transferred, voluntarily or involuntarily, by operation of law or otherwise, except for a transfer to the Corporation. Shares of Class A common stock may be held only by natural persons eligible as Members in accordance with the bylaws of the Corporation, and no person may hold more than one (1) share of Class A common stock. Upon termination of his or her employment in the

Corporation, a shareholder must transfer his or her share back to the Corporation at redemption terms in accordance with the bylaws of the Corporation.

ARTICLE VI: OTHER LAWFUL PROVISIONS

(a) The corporation elects to be governed as a worker cooperative under [cite state worker cooperative statute]. [If no applicable statute exists, then eliminate this item (a).]

(b) The Board of Directors of the Corporation may make, amend, or repeal the bylaws of the Corporation, except as may be limited by law or the bylaws.

(c) The Corporation may be a partner in any business enterprise which the Corporation would have the power to conduct without a partner.

(d) The principal office address of the Corporation is:

[mailing address of Corporation, including county]

(e) The Secretary of State of the State of [name of state] is designated as the agent of the Corporation upon whom any process against the Corporation may be served. The post office address to which the Secretary of State shall mail a copy of any such process served upon him is the principal office address as listed herein.

[Alternatively, list the corporate secretary as "resident agent" for service of process at the principal office address.]

(f) No director or officer of the Corporation shall be personally liable to the Corporation or its shareholders for monetary damages for any action taken, except if such director or officer breached or failed to perform the duties of his or her office as provided by [cite state laws with respect to self-dealing, willful misconduct, or recklessness], is responsible pursuant to any criminal statute, or is liable for the Corporation's failure to pay taxes pursuant to federal, state, or local law.

(g) The Corporation shall indemnify, advance expenses to, and reimburse all persons whom it may indemnify, advance expenses to, and reimburse, to the extent provided in and pursuant to the bylaws of the Corporation.

(h) The Corporation shall have perpetual existence.

ARTICLE VII: DIRECTORS

The Board of Directors of the Corporation shall consist of the following persons until the first annual meeting of shareholders or until their successors are elected:

[List names and mailing addresses of the initial directors, where required by state law.]

IN WITNESS WHEREOF, the undersigned, in order to form a corporation under the Business Corporation Law [or other appropriate statutory title] of the State of [name of state], have executed these Articles of Incorporation on the _____ day of _____, 19__.

Incorporators:

[Notarization, if required]

APPENDIX 2

SAMPLE DOCUMENT:

Membership Application & Agreement
for ABC, Inc.,
a worker cooperative

NOTE: The offer and sale of membership shares requires careful attention to federal and state securities law and to other state laws regarding stock purchase agreements. We recommend that you **consult local legal counsel** in adapting this membership application and agreement to your needs.

MEMBERSHIP APPLICATION AND AGREEMENT

ABC, Inc.

Name of Applicant: _____

Address of Applicant: _____

Date of Application: _____

1. **Membership.** I hereby apply to be a Member of ABC, Inc. (hereinafter, the "Corporation"), a corporation incorporated and doing business under the laws of the State of _____ and operating on a cooperative basis.

2. **Articles & Bylaws.** I acknowledge receipt of a copy of the Articles of Incorporation (hereinafter the "Articles") and the bylaws (hereinafter the "Bylaws") of the Corporation. I agree to abide by the provisions of the Articles and Bylaws and hereby approve and ratify the Articles and Bylaws. Capitalized terms used in this agreement have the same meaning as in the Bylaws.

3. **Membership Share.** I agree to pay to the Corporation a Membership Fee of _____ dollars (\$_____) as consideration for receipt of a Membership Share, issued to me by the Corporation in accordance with the Articles and Bylaws. I understand that my Membership Share is not transferable, and I agree not to sell, assign any interest in, or otherwise transfer my Membership Share, except as provided herein.

4. **Membership Eligibility and Voting.** I agree to patronize the Corporation through provision of my labor and, during the period of my Membership, to satisfy the eligibility criteria for Members determined in accordance with the Articles and Bylaws. I understand that I will be entitled to one vote in any matter requiring voting by Members.

5. **Patronage Allocations.** I understand that the Corporation may allocate a portion of its annual net income or loss to the Members and that I will receive such allocations, if any, on the basis of patronage and at the discretion of the Board of Directors. In any proportions determined by the Board of Directors, such allocations may be in cash or in the form of Written Notices of Allocation credited to my Internal Capital Account and redeemed in cash at a future date.

6. Distributions & Losses. I understand that my Membership Fee and any Written Notices of Allocation are subject to loss and will be repaid to me only in such amounts, at such times, and in accordance with terms as determined by the Board of Directors pursuant to the Articles and Bylaws.

7. Termination. I agree that, upon the voluntary or involuntary termination of my employment and Membership in the Corporation, I will transfer my Membership Share back to the Corporation for the consideration, if any, determined in accordance with the Articles and Bylaws. I understand that allocations of annual net income and loss to the Members may increase or decrease the consideration that I will receive for my Membership Share upon termination. I understand that such consideration may be paid over a period of time determined by the Board of Directors in accordance with the Articles and Bylaws.

8. Taxation. I agree to include in my taxable income the stated dollar amount of any Qualified Written Notices of Allocation that I receive and to satisfy any federal and state income tax obligations imposed on those amounts under the tax laws.

9. Operating Rules. [Optional] I acknowledge receipt of the Operating Rules of the Corporation and agree to adhere to all policies contained therein.

10. Withdrawal. I understand that I may at any time withdraw my labor and terminate my Membership in the Corporation; provided, however, that I agree to be bound by any terms and conditions in the Articles, the Bylaws, the Operating Rules, or this agreement.

Accepted and agreed to:

(Signature of Applicant)

APPLICANT

DATE

The foregoing application and agreement is hereby accepted on behalf of ABC, Inc. by the undersigned duly authorized officer, subject to the terms and conditions hereof.

ABC, Inc.

BY: (Signature of President of Corporation)

Its President

DATE

APPENDIX 3

SAMPLE DOCUMENTS:

Written Notices of Allocation
for ABC, Inc.,
a worker cooperative

NOTE: The issuance of patronage dividends and written notices of allocation requires careful attention to federal and state tax law. We recommend that you **consult a lawyer or accountant** familiar with cooperative taxation when issuing patronage dividends. Note, also, that the first of the two following sample forms is a "qualified written notice of allocation," which requires that at least 20% of the total patronage dividend be paid in cash. The second is a "non-qualified written notice of allocation," which permits an allocation with no cash payment. See Appendix 4 for further explanation.

[INSERT SAMPLE DOCUMENT HERE: "Written Notice of Allocation"]

APPENDIX 4

ARTICLE:

Peter Pitegoff, "Taxation of Worker Cooperatives,"
Employee Ownership (1982)

TAXATION OF WORKER COOPERATIVES

By Peter Pitegoff

[reprinted from Employee Ownership,
Vol. II, No. 4, Dec. 1982, page 5]

A worker cooperative, like any business, faces a battery of federal and state taxes. Careful tax planning can minimize this burden, through special tax benefits for cooperatives as well as tax breaks available to any corporate enterprise. This article presents a brief introduction to the primary cooperative tax advantage: Subchapter T of the Federal Internal Revenue Code.

Ordinarily, corporate earnings are subject to double taxation. The corporation pays corporate income tax on its taxable income and individual shareholders pay personal income tax on their share of corporate earnings distributed as dividends. Subchapter T enables a cooperative to avoid this double taxation, by legally avoiding the corporate level tax.

Subchapter T works as follows. The worker cooperative deducts from corporate taxable income any earnings allocated to members on the basis of work performed (called "patronage," often measured by hours worked). These allocations or "patronage dividends" may be in the form of cash distributions. Alternatively, patronage dividends may be in the form of written obligations ("written notices of allocation") credited to members' individual capital accounts. Thus, Subchapter T can provide a dual benefit. The cooperative can avoid double taxation *and*, at the same time, retain and reinvest a portion of the earnings allocated to members. Such allocations, of course, would be in addition to ordinary cash wages.

There are two different ways to use Subchapter T, each with different cash-flow implications depending on the particular tax brackets of the cooperative and the members. Patronage dividends in the form of "qualified" written notices are currently deductible by the corporation. However, the member must pay personal tax currently on any allocations, and the corporation must pay at least 20% of the dividend in cash to the member immediately, presumably to enable the member to pay the personal tax. Alternatively, "non-qualified" written notices require no up-front personal tax payment, but also offer no current corporate deduction for the patronage dividend. In a later year, when the written notice is paid out in cash to the member, the member pays personal tax, and the cooperative deducts the amount of the cash pay-out. The choice between qualified and non-qualified written notices requires careful attention to Subchapter T provisions and to a cash-flow analysis.

The benefits of Subchapter T are available, in the words of the Tax Code, to "any corporation operating on a cooperative basis." Unfortunately, the IRS and the courts have produced no precise definition of "operating on a cooperative basis." Nonetheless, IRS rulings and court cases tend to cite certain criteria for use of Subchapter T. Two criteria appear to be most important: (1) a worker cooperative must allocate earnings on the basis of patronage, as opposed to relative capital investment; and (2) the cooperative must be democratically controlled by the members. Clearly some variation from these criteria will not necessarily preclude use of Subchapter T — courts have allowed non-cooperative elements within corporations using Subchapter T. But, the tax benefit becomes less certain as one strays away from patronage allocations and democratic structure. A note of caution: consult with your lawyer before relying on Subchapter T.

Two other important points are established by case law. First, Subchapter T is expressly available to worker cooperatives, although it originated as a tax break for agricultural cooperatives. Second, the particular state-level incorporation statute is not controlling for federal tax purposes. For instance, if an enterprise is incorporated as a business corporation but operates in substance on a cooperative basis, it can still qualify under Subchapter T.

The mechanics of using Subchapter T are simple. No prior election or approval is required. A corporation that is operating on a cooperative basis simply files the appropriate IRS forms (1099-PATR and 1096) when paying taxes.

The potential for creative tax planning by a worker cooperative extends far beyond Subchapter T. This article merely scratches the surface. For more information on cooperative taxation, consult with your lawyer or accountant, or contact the ICA Group. ■

APPENDIX 5

SELECTED TAX FORMS:

Under Subchapter T
of the federal Internal Revenue Code
(26 U.S.C. §§ 1381 et seq.)

NOTE: Tax planning and accounting under Subchapter T requires careful attention to federal and state tax law. We recommend that you **consult a lawyer or accountant** familiar with cooperative taxation. Note, also, that the following tax forms relate only to patronage dividends and not to the full array of reporting required by the Internal Revenue Service.

[INSERT SELECTED TAX FORMS HERE]

APPENDIX 6

ARTICLE:

David Ellerman & Peter Pitegoff,

"The Democratic Corporation:
The New Worker Cooperative Statute in Massachusetts,"

11 NYU Review of Law & Social Change 441
(1982-1983)

Reprinted with permission of the NYU Review of Law & Social Change.

[INSERT REPRINT HERE: Ellerman & Pitegoff, "The Democratic Corporation"]

APPENDIX 7

CASE STUDY:

David Ellerman,

"The Mondragon Cooperative Movement,"

Harvard Business School Case Study
(1982)

[INSERT REPRINT HERE: Ellerman, "The Mondragon Cooperative Movement"]

APPENDIX 8

ARTICLE:

Richard Feldman,

"An Illustrated Guide
to the Internal Capital Account System
for Worker-Owned Cooperatives:
Concepts, Mechanics, and Taxation,"

The ICA Group, Inc.
1988

NOTE: This guide to the internal capital account system is based upon the earlier Version II of the ICA Model Bylaws, and thus does not reflect the 1995 revisions in this Version III. Nonetheless, it remains quite useful and instructive with respect to the concepts and mechanics of internal capital accounts. Be sure to read it in conjunction with the annotations in this Version III and to note some inconsistency between the two.

APPENDIX 9

BOOKLET EXCERPT:

"How the ESOP Really Works,"
[Chapters 2 and 3]

The ESOP Association
(1992)

and

"Issue Brief #1"

The ESOP Association
(1994)

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[INSERT REPRINT HERE: Chapters 2 and 3 of "How the ESOP Really Works" and Issue Brief
#1
(1994)]

APPENDIX 10

ARTICLES:

Robert Keatinge,
"LLCs: Wave of the Future? — New Gang in Town,"

and

John Cunningham,
"LLCs: Wave of the Future? — The Tax Angle,"

Business Law Today
(Mar/Apr 1995)

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[INSERT REPRINT HERE: Keatinge & Cunningham articles on LLCs]