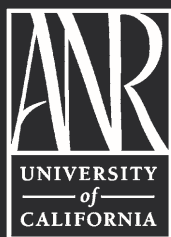


# Legal Sourcebook For California Cooperatives: *Start-up and Administration*

*A Legal Guide for Co-ops Incorporating and  
Operating under the  
California Consumer Cooperative Corporation Law*

**Third Edition**

**Van P. Baldwin**



**Center for Cooperatives**  
University of California, Davis

**University of California**  
Agriculture and Natural Resources  
Publication 3487

# A LEGAL SOURCEBOOK FOR CALIFORNIA COOPERATIVES: START-UP AND ADMINISTRATION

Van P. Baldwin

This Publication is Not Fully Updated for Subsequent Changes in the Law or Other Information Provided Herein.

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## Errata and Updates

(Posted January 2009)

It should be noted that the "model" articles of incorporation should be modified to delete the words "the Incorporators and" from the "witness" sentence. Also related to the model articles, the reference to "Director" beneath each "signature line" of both the "witness" & "declaration" sections should be replaced by the typed name of each initial Director. These article changes are based upon subsequent interactions with the Secretary of State's office.

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**RE Page 125:**(Posted December 4, 2006)

Related to the first sentence of Section 16.A., it should be noted that for tax years ending on or after December 31, 2006, all cooperatives subject to "Subchapter T" of the Internal Revenue Code (i.e, co-ops distributing patronage refunds) will file federal Form 1120-C as their annual tax return. Co-ops not distributing patronage refunds will continue to file federal Form 1120.

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**RE "Subsection "a" of section 10.01."**(Posted July 6, 2006)

There should be a "comma" between the words "redemption" & "transfer." in subsection "a" of section 10.01.

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**RE "ELECTRONIC COMMUNICATIONS"**(Posted May 9, 2005)

In the latter part of 2004, the California legislature enacted a number of provisions related to electronic communications within corporate settings. For example, meetings of a cooperative's members or Board of Directors may be held via video screen, and "notices" of meetings and "annual reports" could be sent by e-mail, assuming certain requirements are met.

Although the Sample Bylaws (and related "Legal Sources and Comments")in the Sourcebook do not reflect these new provisions, generally electronic communications would not have to be provided for in the bylaws(even though it would certainly be helpful, and perhaps less confusing, to have relevant bylaw provisions guiding co-op personnel). Approximately 11 sections of the Sample Bylaws could be expanded

to reflect the new electronic provisions. Generally, however, the Board of Directors may simply authorize the use of electronic communications. But, again, the Board needs to make sure that the various requirements for lawful electronic communications are followed.

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**Page 52:**(Posted January 11, 2005)

In the third line of Section 5.03(b) of the "Sample Bylaws," the word "or" should be replaced by "of."

**Page 110:**

Due to a recent change in the Internal Revenue Code, any distribution of dividends on capital no longer reduces the amount of surplus available for the distribution of patronage refunds, assuming that the cooperative's governing documents do not provide otherwise. This law change is effective for tax years beginning after October 22, 2004, and could result in significant tax savings for at least some co-ops. Cooperatives distributing patronage refunds should review all relevant documents (e.g., bylaws) to determine whether any amendments are needed.

**Page 129:**

The footnote ("10" re Chapter 12) related to the above change in the tax law should now read "Internal Revenue Code section 1388(a), as amended in 2004."

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## FOREWORD

About twenty years after the publication of the first *California Consumer Cooperative Incorporation Sourcebook*, the Center for Cooperatives at the University of California, Davis, provided funding for the original author to update and expand this edition of the *Sourcebook* for the second time. This edition takes into account subsequent changes in the law and the author's further experience in working with numerous consumer and worker co-ops.

This third edition also incorporates and updates the information found in a second publication, *A Legal Guide to Co-op Administration*, by the same author and first published about two years after the second edition of the *Sourcebook* appeared. Such information is designed to assist directors, officers, and other persons responsible for the ongoing administration of worker and consumer cooperatives in California.

By familiarizing yourself with the *Sourcebook's* summary and detailed table of contents, you should be able to locate information relevant to a particular area of concern.

Cooperatives are strongly advised not to rely solely on this *Sourcebook*. While organizations may refer to this *Sourcebook* as a reference document, many of the matters that are treated within it are complex and warrant additional assistance from professionals.

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## ABOUT THE AUTHOR

Van Baldwin has worked with cooperatives since 1975. He received his undergraduate degree in business administration from Baylor University, majoring in accounting. He attended the Graduate School of Business at the University of California, Berkeley, before obtaining his law degree at Hastings College of the Law (University of California).

Baldwin authored the precursors to this *Sourcebook*, the *Legal Guide to Co-op Administration*, and the first and second editions of the *Co-op Incorporation Sourcebook*.

Baldwin practices as a certified public accountant and attorney in Berkeley, California. His practice serves both individuals and organizations. The author is a member of the Business Law and Taxation sections of the State Bar of California, the California Society of Certified Public Accountants, and the National Society of Accountants for Cooperatives.

## ACKNOWLEDGMENTS

The author would like to thank Shermain Hardesty and Kim Coontz of the Center for Cooperatives at the University of California, Davis, for their helpful comments, criticisms, and suggestions during the production of this publication. Ms. Coontz's input was particularly helpful due to her extensive interaction with numerous types of cooperative organizations. The anonymous input of three reviewers, all attorneys, was also greatly appreciated; these reviews were required by the University of California's publications review process.

The author also wishes to thank Jonathan Barker of the Center for his word processing skills and Mary Rodgers for her editing assistance. Finally, the author expresses his gratitude to the many co-ops for which he has provided assistance over the years. The experience gained has been invaluable in hopefully making this a more useful publication for the co-op community.

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**Legal Sourcebook**  
**For California Cooperatives:**  
*Start-up and Administration*

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# INTRODUCTION

## A. IN GENERAL

The Consumer Cooperative Corporation Law (“co-op law”)<sup>1</sup> of California became effective as of January 1, 1984, and applies to all co-ops incorporating under it as well as (with certain limited exceptions) to those co-ops incorporated under the repealed pre-1984 law related to co-ops.<sup>2</sup> Generally, the “new” co-op law represents a synthesis of provisions from the former co-op statutes and the current Nonprofit Mutual Benefit Corporation Law, in addition to some completely new provisions. Co-op law is found in Sections 12200 through 12704 of the California Corporations Code.

A “consumer” cooperative is not the only type of co-op that may incorporate under co-op law. Workers, producers (individuals or businesses), and others may find co-op law quite suitable for their needs. Other types of entities already in existence may also become co-ops by following proper legal procedures. In general, current co-op law is seemingly flexible enough to accommodate numerous types of ventures seeking to mutually benefit their members. Still, many “cooperatively” run ventures may decide to conduct their activities in an entity that is *not* incorporated as a “cooperative.”

This *Sourcebook* is written primarily as a resource for groups considering forming a cooperative and for members and management of existing cooperatives. It is also intended to serve as a reference for attorneys working with cooperatives. Specifically, it is designed to help newly forming cooperative corporations effectively organize themselves, and it can assist existing co-ops in administering their ongoing affairs. To this end, this *Sourcebook* provides both background information and sample documents for the organization of a new co-op and also provides existing co-ops with useful information, particularly related to administrative matters. For example, the sample bylaws may be used by existing co-ops to help determine whether any of their current procedures, bylaw provisions, transactions, etc., may be at variance with co-op law, and they may also be used as a “guide” where no procedures, provisions, documents, etc., currently exist.

While co-ops incorporated prior to 1984 are not required to amend their articles of incorporation (“articles”) to take into account current co-op law,<sup>3</sup> those same co-ops may find at least some of their bylaw provisions now in conflict with co-op law. Where there is a conflict, co-op law generally supersedes the contrary bylaw provisions for acts, transactions, etc., occurring after 1983.<sup>4</sup>

Also, many co-ops have relatively brief bylaws that do not deal at all with certain corporate “housekeeping” matters (e.g., how to properly “notice” a meeting or retain unclaimed member equity interests). Such gaps in the bylaws may well lead to legally improper actions (or omissions) by a co-op.

Cooperatives incorporating under the California Consumer Cooperative Corporation Law are *not* formed under the “nonprofit” statutes of the California Corporations Code. Similarly, it is virtually impossible for co-ops incorporated under the co-op law to attain tax-exempt status, mainly due to the fact that co-ops are established to further the mutual benefit of their *members*, not the general public.

Finally, while co-op law is not a quickly changing area of law, it is subject to periodic legislative revisions. This is one of the major reasons why a co-op should always consult an attorney when legal issues arise, even if the issues are directly addressed in a publication such as this one.

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## 2 INTRODUCTION

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### B. COVERAGE OF DISCUSSION

The California Consumer Cooperative Corporation Law is relatively detailed concerning a co-op's legal administrative requirements and procedures, and thus gives a co-op comprehensive guidance on how to run its legal affairs. On the other hand, co-op law allows cooperatives some latitude in both structure and procedures. *The areas of discussion in this publication have been selected for their practical importance to both the setup and the ongoing administration of a co-op.*

Cooperatives are very similar to and very different from other forms of business. Five basic topics critical to the formation and administration of cooperatives are addressed in this manual: getting started; basic corporate documents; directors, officers, and members; financing issues; and reporting and filing matters.

Newly-forming groups face numerous legal issues in getting started. One of the most critical organizational issues that newly forming groups need to address is the choice of entity for doing business. Businesses created for the benefit of their members or owners by operating “at cost” can be organized as one of several types of entities: cooperative corporations, nonprofit “mutual benefit” corporations, nonprofit “public benefit” corporations, limited liability companies, general partnership, for-profit corporations, and unincorporated associations. These basic forms of business are described in chapter 1, and their advantages and disadvantages are reviewed briefly. The preoperational matters a cooperative faces before and after incorporation are discussed in chapter 2. Issues needing to be addressed during the first meeting of a cooperative's board of directors are outlined in chapter 3.

Numerous legal documents provide a foundation for the organization of a cooperative. Chapters 4 and 5 contain discussions of the core documents of a cooperative—the articles of incorporation and bylaws. Membership-related documents are covered in chapter 6.

Three key groups of individuals are involved in the formation and administration of a cooperative: the board, the corporate officers, and the members. Chapter 7 covers the process of electing board members and board operations and board ethics, while chapter 8 describes the critical roles of a cooperative's corporate officers. Numerous issues related to the membership's rights and responsibilities are reviewed in chapters 9 and 10, with chapter 10 dedicated solely to membership voting matters.

Cooperatives face unique financing issues. Sources of financial capital are discussed in chapter 11. The intricacies of distributions to members are reviewed in chapter 12. Consumer cooperatives are often faced with the challenges of unclaimed membership interests, an issue addressed in chapter 13.

The proper administration of a cooperative requires filing certain legal and financial reports. California's Consumer Cooperative Corporation Law provides fairly detailed rules regarding cooperatives' record keeping and the disclosure of these records; these rules are discussed in chapter 14. Chapter 15 is dedicated solely to filings required by the Secretary of State. Finally, income tax filing requirements are reviewed in chapter 16.

While other areas of discussion could have been included in this publication, they have been omitted due to their unusual and complex nature and because a co-op would have to seek very specific legal advice about them related to its particular situation. Areas of co-op law that have been purposely not included in the discussion include those related to a cooperative discontinuing business (e.g., provisions related to mergers, antitrust, dissolution, bankruptcy, and dispositions of substantially all of a co-op's assets); litigation and various court-related actions; indemnification of corporate agents; creditors' rights;

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various technical transition provisions (i.e., between the former and current co-op law); certain crimes and penalties; and miscellaneous provisions that would generally have little impact on the creation or ongoing administration of a co-op.

## C. SAMPLE DOCUMENTS, LEGAL SOURCES, AND COMMENTS

Various sample documents are included in this *Sourcebook*. The legal sources and comments associated with these documents are placed at the end of the appropriate chapters. Some of the comments include detailed explanations of complex issues.

The sample documents in this *Sourcebook* make the simplifying assumption that the new or existing co-op will have or has only one “class” of members and shares, that is, all members and shares have identical rights in and obligations to the co-op. The bylaws and disclosure document would need to be more complex to provide for additional classes, and most co-ops probably need only a single class of members and shares (if shares are desired). It should be noted that this *Sourcebook*'s sample articles of incorporation, bylaws, disclosure document, and minutes of the first meeting of the board of directors all specifically apply to organizations incorporating under the California Consumer Cooperative Corporation Law.

## D. CROSS-REFERENCES AND NOTES

Various cross-references to assist the reader will be found in this publication. Obviously, many more cross-references could have been made but they would have detracted from readability. Thus, some discretion has been used to cross-reference in only the more technical or confusing areas. If the reader finds any part of the discussion unclear, he or she may benefit by scanning the summary and the detailed table of contents to find another part of the *Sourcebook* that may shed light on the matter at hand.

Also, the text contains many numbered notes to further aid the reader. These notes refer to specific statutory sections of California law, the Internal Revenue Code, or administrative regulations, or provide some further explanation of the text. The notes can be found in the “Notes” section at the end of the book beginning on page 126.

## E. NEED FOR LEGAL COUNSEL

A cooperative should not conclude that this discussion generally precludes the co-op's need for the legal assistance of an attorney in administering its affairs. An attorney's assistance is often still needed, for at least the following reasons. First, co-op law can be technical and sometimes difficult to understand in certain areas, and some of its provisions may be open to varying interpretations.

Second, as previously noted, several important aspects of co-op law have been mostly omitted from this publication because they are relevant only in relatively unusual situations (e.g., mergers). An attorney would almost certainly be involved in unusual situations or transactions, in any event.

Third, very important areas of law outside co-op law affect co-ops. While two such areas of the law, securities regulation and taxation, are touched upon in this *Sourcebook*, a co-op generally should seek professional advice in these areas.

Finally, laws and regulations change. While co-op law is relatively stable, various provisions may be

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## 4 INTRODUCTION

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added, deleted, or amended. Also, other areas of law that affect co-ops (e.g., taxation) regularly change, and often in very significant ways.

## F. IMPORTANT DEFINITIONS

### 1. In General

Because certain important terms and concepts appear at more than one point in this publication, it seems appropriate to define them at the outset. Co-op law itself provides the following definitions. (Throughout this publication, “co-op law” refers the California Consumer Cooperative Corporation Law.)

### 2. Approval by or Approval of the Board

Throughout the discussion, “approval by (or approval of) the board” is mentioned. This means that the board of directors, or a board committee properly authorized to exercise board powers, has approved or ratified some act.<sup>5</sup> Board approval is generally by a majority vote unless the articles of incorporation or bylaws require a greater proportion.<sup>6</sup>

### 3. Approval by or Approval of the Members<sup>7</sup>

“Approval by (or approval of) the members” means approved or ratified by the affirmative votes (including by written ballot) of a majority of votes represented and voting at a duly held meeting or by written ballot. Of course, a quorum must be present or accounted for, and the number of affirmative votes must be at least a majority of the required quorum. The bylaws, or co-op law in certain situations, may provide for larger-than-majority approvals (e.g., two-thirds) of the votes, including those of any membership class, unit, or grouping of members.

In certain situations beyond the scope of this publication (e.g., in cases of dissolution), co-op law may require the affirmative vote of a majority of all of a cooperative’s members.

### 4. Central Organizations

A “central organization” is a cooperative whose membership is composed wholly or partly by other co-ops.<sup>8</sup> A central organization differs from a regular co-op mainly in that a central organization may provide for unequal voting powers and “cumulative” voting procedures for directors.<sup>9</sup> Under cumulative voting procedures, each member gets the number of votes equal to the number of directors to be elected at that election.

A central organization is prohibited, however, from using written ballots in director elections where cumulative voting is used.<sup>10</sup>

### 5. Mailing<sup>11</sup>

Unless a specific discussion in this publication indicates that co-op law specifies or permits otherwise, any reference to “mailing” means prepaid first-class mail.

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## **6. Notices: When Given<sup>12</sup>**

Any “notice” referred to in this discussion is given or sent, unless co-op law provides otherwise, when a written notice by mail is deposited in the mail, postage prepaid. Nonmailed written notices are given when they are delivered to someone for transmission or actually transmitted electronically to the person needing the notice. Oral notices may be given personally or by telephone or wireless to the person needing notice. Also, the notice may be given to someone at the office of the person needing notice if the person giving the notice has reason to believe it will be promptly communicated to the person for whom notice is required.

## **7. Notice in Regular Co-op Communications<sup>13</sup>**

“Written” notice includes any notice mailed or delivered to members as part of a newsletter, magazine, or other written communication regularly sent to members. Any written notice sent to members by one of these means must be sent by prepaid first- or second-class mail or delivered to the address appearing in the cooperative’s records.

Where multiple members live at the same address, according to the cooperative’s records, the regular communication containing a notice needs to be mailed or delivered to only one of the members at the address. To avoid any confusion, however, especially if members have moved, it may be best for a co-op to send or deliver notices to each member, regardless of his or her address.

## **8. Person**

Unless specifically provided otherwise in co-op law, a “person” includes any individual, association, company, corporation, estate, joint stock company, joint venture, partnership, limited liability company, government or political subdivision, or governmental agency.<sup>14</sup>

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