

BY-LAWS: Version A (Patronage Dividend Tax Break)

Article I Membership and Shares of Stock

1. Eligibility This business corporation [change "business corporation" to "cooperative corporation" if incorporated under coop statutes] shall function on a cooperative basis with the patrons all being employees of the company. The shareholders shall also be referred to as the members of the corporation. Stock may be held only by natural persons who (1) patronize the corporation through contributions of their labor on a full or part-time basis, (2) are residents of the State of _____ at the time of the issuance of the stock to them, and (3) have been approved by the Board of Directors or its designees. Within a trial period of _____ months, an employee must either be accepted into membership or terminated as an employee. Restrictions shall be placed on the ownership and transfer of the shares of stock so that the shares will function for all intents and purposes as membership certificates. Accordingly, one and only one share of common stock shall be held by each member, and that share shall be referred to as a membership share. The legal consideration paid to the corporation for a membership share shall be the share's par value, and that par value shall be referred to as the membership fee.

2. Transfer Restrictions During Membership No member may sell, assign any interest in, or otherwise transfer his or her membership share during the period of the person's ~~work and membership~~ in the corporation.

3. Share Transfers at Membership Termination Upon issuance of a new membership share, the new member shall sign a certificate stating that, upon the voluntary or involuntary termination of his or her work in the company, the membership share shall be deemed transferred back to the corporation at the time of the termination. The legal consideration for the share transfer shall be the lesser of the membership fee (par value) or the balance at the end of the fiscal year of the member's internal account, maintained pursuant to Article II of these By-laws. If the lesser of the two is negative, the share will be deemed transferred to the corporation for no consideration. The consideration shall be fully paid in cash or, at the election of the corporation, by means of the corporation's promissory note payable on such terms and at such interest rate as the Board of Directors shall determine, provided that the note be payable in full no later than one year after the end of the fiscal year.

4. Legend on Stock Certificates All certificates representing shares of stock of the corporation shall, in accordance with law, have a notation thereon referring to the foregoing provisions governing the transfer of shares.

5. Replacement of Membership Certificates In case of the loss, destruction, or mutilation of a membership certificate, a duplicate certificate may be issued in place thereof, upon such terms as the Board of Directors may prescribe.

Article II Distribution and Retention of Corporate Earnings

1. Patronage Dividends In accordance with the Internal Revenue Code of 1954 section 1381, this corporation, as a corporation operating on a cooperative basis and allocating amounts to patrons on the basis of the business done with or for such patrons, may (subject to conditions specified below) declare a patronage dividend to be distributed among the members in proportion to their earnings from the corporation for the fiscal year. Thus each member/patron shall receive a fraction of the patronage dividend whose numerator is his or her gross compensation from the corporation for his or her patronage during the fiscal year and whose denominator is the gross labor compensation of all members from the corporation for the fiscal year. Such a patronage distribution shall be paid partly in cash and partly in qualified written notices of allocation as defined in the Internal Revenue Code of 1954, section 1388 (c) (1). The aggregate of these qualified written notices of allocation shall be referred to as the Revolving Loan Fund, and the notices shall be referred to as revolving fund credits.

In accordance with the Internal Revenue Code of 1954, section 1382 (b) (1), the patronage dividends declared at the end of a fiscal year are deductible from the taxable income of the corporation for that fiscal year and must be included in the taxable personal income of the members. By becoming a stockholder in the corporation, each member shall be deemed to have consented to include in his or her taxable personal income any qualified written notice of allocation (within the meaning of section 1388 of the IRC as it may be hereafter amended) received at its stated dollar amount, in the manner provided by the section 1385 of the IRC as it may be hereafter amended, and to pay the tax thereon. A copy of this Article II and a statement of its significance shall be given to each prospective stockholder before he or she becomes a stockholder/member of the corporation.

2. Collective Reserve Fund The after-tax earnings shall be retained until a reserve, which shall be referred to as the Collective Reserve Fund, has been accumulated totaling at least the target level of _____ percent of the par value of the corporate stock outstanding. No patronage dividends may be declared for as long as the Collective Reserve Fund is below its target level. The capital of the Collective Reserve Fund is not attributed or imputed to the members as individuals. Any gifts or grants to the corporation shall be referred to as Endowment and listed as a source of equity capital on the balance sheet separate from the Collective Reserve Fund. If the corporate net income is negative, those operating losses shall be debited from the Collective Reserve Fund. If that should exhaust the Collective Reserve Fund, the remaining losses shall be debited from the internal accounts of the members in proportion to their earnings from the corporation during the fiscal year.

3. Internal Capital Accounts After the Collective Reserve Fund has reached its target level and patronage dividends have been declared, any remaining after-tax net income shall be retained and allocated to the members' internal capital accounts, unless the directors declare a cash distribution of part of those net earnings. Each member shall have an internal capital account in his or her name. After the membership fee is paid in cash or by payroll deductions, that fee plus any additional paid-in capital shall be the initial balance in the member's account. At the end of each fiscal year, the total amount to be distributed between the internal accounts shall be allocated in accordance with the following rule:

each member's account shall be credited with the fraction of the total amount whose numerator is his or her gross compensation from the corporation for his or her labor during the fiscal year and whose denominator is the gross labor compensation of all members from the corporation for the fiscal year. The internal capital accounts shall accrue interest at a rate not to exceed _____ percent, as determined by the Board of Directors. When a person terminates membership in the company and has transferred his or her membership share back to the corporation, then any positive balance, after subtraction of the membership fee, of the member's internal capital account as of the end of the fiscal year shall become a subordinate debt of the company to the individual. This promissory note shall be payable on such terms as the Directors shall determine, provided that the note shall be payable in full within five (5) years of the termination date.

4. Revolving Loan Fund The qualified written notices of allocation or revolving fund credits, whose aggregate is the Revolving Loan Fund, shall be subordinate to all other indebtedness of the corporation without regard to the time when any other indebtedness was contracted or the nature thereof. The revolving fund credits shall accrue interest at a rate not to exceed _____ as determined by the Directors. The funds retained in the company, when new revolving fund credits are issued, may be used for any corporate purpose which includes paying off the most senior of the old revolving fund credits. All revolving fund credits shall be paid off within five (5) years of their date of issuance unless the Directors rule that extraordinary circumstances require an exception in the form of an extension of the deadline.

[Articles III through VIII the same in versions A and B]

Article III The General Assembly of Members

1. Powers All powers of the corporation originate in the General Assembly of members of the corporation. The powers entrusted, by means of these by-laws, to the Directors, the President, and other officers are ultimately delegated from the members of the corporation. Accordingly, any specific decision of the Board of Directors or the President may be overturned or reversed at a meeting of the General Assembly by a vote of an absolute majority of all the members of the corporation.

2. Annual Meeting The annual meeting of the General Assembly of members (stockholders) shall be held on the _____ of the month of _____ in each year (or if that is a holiday, on the next full business day) at _____ o'clock in the _____ or at such other hour as shall have been fixed by the Board of Directors or by the President and stated in the notice of the meeting.

3. Special Meetings Special meetings of the members may be called by the Board, the President, or upon written application of ten (10) percent of the members. The notice for each special meeting shall state the date, hour, place, and the purposes of the meeting.

4. Notice of Meetings A written notice of each annual or special membership meeting stating the time, place, and purpose shall be given by the clerk or person calling the meeting, at least seven days before the meeting, to each member by leaving such notice with the member, at the member's residence or usual workplace, or by mailing it to the member's address as shown on the records of the corporation.

5. Quorum A majority of the members shall be required to constitute a quorum at any meeting of the General Assembly.

6. Voting and Proxies Each member is entitled to one and only one vote. A member may vote in person or by a written proxy, signed by the absent member, which shall specify the person entitled to vote for the absent member and the specific meeting at which the proxy may be used. Proxies shall be filed with the clerk of the meeting before being voted.

7. Action at a Meeting When a quorum is present at a meeting of the members, a majority of the members present or represented shall decide any matter to be voted upon by the members unless a larger vote is required by the Articles of Organization or these By-laws. Any election by members shall be determined by a plurality of the voted cast. A secret ballot is required if requested by any member present or represented at the meeting.

Article IV The Board of Directors

1. Powers The general powers to direct the business of the corporation are delegated to the Board of Directors from the General Membership of the corporation. These powers shall be exercised in accordance with the Articles of Organization, the By-laws, and the Operating Rules of the corporation.
2. Election and Size The exact number of directors shall be determined at the first meeting of the incorporators and thereafter at each annual meeting of the members (subject to change as provided in Section 4 of this Article IV). The incorporators shall elect the initial directors at their first meeting, and, thereafter, at each annual membership meeting. The vacancies created by the directors whose terms have expired shall be filled by the shareholders. As a director exercises power delegated from the members, a director need not be a member.
3. Vacancies Any vacancy in the Board of Directors, occurring between the annual General Assembly meetings, may be filled at a special meeting of the members or, in absence of member action, by the majority of the directors then in office.
4. Enlargement of the Board The number constituting the Board of Directors may be increased and one or more additional directors elected at the annual meeting or any special meeting of the members.
5. Tenure Each director's term of office shall be x years. The terms shall be staggered so that $1/x$ times 100% = percent of the directors are elected at each annual meeting. Any director may resign by delivering his or her written resignation to the corporation at its principal office or to the President, Clerk, or Treasurer.
6. Removal A director may at any time be removed from office (a) with or without cause by a vote of a majority of the total membership or (b) 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.
7. Meetings Regular meetings of the Board may be held without call or notice at such places and times as the Board may from time to time determine, provided that any director who is absent from such a decision shall be notified of the determination. Special meetings of the Board of Directors may be called by the President or three or more of the directors designating the time and place.
8. Notice of Special Meetings Notice of the time, place, and purpose of the special meeting shall be given to each director not less than twenty-four hours before the meeting.
9. Quorum At any meeting of the Board of Directors, a majority of the directors then in office shall constitute a quorum.
10. Action at a Meeting If a quorum is present, a majority of the directors present may take any action on behalf of the Board of Directors, unless a larger number is required by law, by the Articles of Organization, or by these By-laws.

Article V Officers

1. Enumeration The officers of the corporation shall consist of a President, a Treasurer, and Clerk, and any other officers as the Board of Directors may determine.

2. Election The President, Treasurer, and Clerk shall be elected annually by the Board of Directors at its first meeting following the annual membership meeting.

3. Qualification Each officer shall be a member and the Chairperson of the Board shall be a director. The President, if not elected to the Board, sits ex officio on the Board of Directors.

4. Tenure The term of office of the President, Treasurer, and Clerk shall be _____ year(s). The Chairperson of the Board shall be elected annually.

5. Removal The Board of Directors may remove any officers with or without cause provided that an officer may be removed for cause only after reasonable notice and opportunity to be heard by the Board of Directors.

6. Vacancies Any vacancy in office may be filled by the Board for the unexpired portion of the term.

7. Powers of the President and Chairperson of the Board The chairperson of the Board shall preside at all meetings of the Board (and of the members if the President is absent or declines to preside) and shall have such other duties and powers as determined from time to time by the Board. The President shall be the chief executive officer of the corporation, shall, subject to the direction of the Board, have general supervision and control of the business of the corporation, shall preside at all General Assembly meetings (and Board meetings if the Chairperson is absent or declines to preside) and shall have such other duties and powers as the Board shall from time to time determine.

8. Treasurer The Treasurer shall, subject to the direction of the Board, have general charge of the financial affairs of the corporation, shall cause to be kept accurate books of account of the affairs of the corporation, and shall have such other duties and powers as determined by the Board.

9. Clerk The Clerk shall keep a record of all membership meetings and Board meetings, and shall have such other duties and powers as determined by the Board. In the absence of the Clerk at a meeting, a temporary clerk shall be appointed by the person presiding.

Article VI Indemnification of Directors and Officers

The corporation shall indemnify each person now or hereafter elected or appointed a director or officer of the corporation (including each person who serves at its request as a director or officer of any other organization in which the corporation has any interest, as a stockholder, creditor, or otherwise) against all expense reasonably incurred or paid by him/her in connection with the defense or disposition of any actual or threatened claim, action, suit, or proceeding (civil, criminal, or other, including appeals) in which he/she may be involved as a party or otherwise by reason of his/her having served in any such capacity, or by reason of any action or omission or alleged action or omission (including those ante-dating the adoption of these By-laws) by him/her while serving in any such capacity; except for expense incurred or paid by him/her (i) with respect to any matter as to which he/she shall have been adjudicated in any proceeding not to have acted in the reasonable belief that his/her action was in the best interests of the corporation, or (ii) with respect to any matter as to which he/she shall agree or be ordered by any court of competent jurisdiction to make payment to the corporation, or (iii) which the corporation shall be prohibited by law or by order of any court of competent jurisdiction from indemnifying him/her. Such indemnification shall include payment by the corporation of expenses incurred in defending a civil or criminal action or proceeding in advance of the final disposition of such action or proceeding, upon receipt of an undertaking by the person indemnified to repay such payment if he/she shall be adjudicated to be not entitled to indemnification under these By-laws.

No matter disposed of by settlement, compromise, or the entry of a consent decree, nor a judgment of conviction or the entry of any plea in a criminal proceeding, shall of itself be deemed an adjudication of not having acted in the reasonable belief that the action taken or omitted was in the best interests of the corporation. The term "expense" shall include, without limitation, settlements, attorneys' fees, costs, judgments, fines, penalties, and other liabilities. The right of indemnification herein provided for shall be severable, shall be in addition to any other right which any such person may have or obtain, shall continue as to any such person who has ceased to be such director or officer and shall inure to the benefit of the heirs and personal representatives of any such person.

Article VII Amendments

The power to make, amend, or repeal these By-laws shall be in both the General Assembly and the Board of Directors. Such power may be exercised by a majority of the members present or represented at a General Assembly meeting, provided that the notice for such meeting indicated a change in the By-laws was to be considered. Such power may be exercised by vote of a majority of the directors in office, provided that:

- (a) The Board may not make, amend, or repeal any provision which by law, by the Articles of Organization, or by these By-laws requires an action by the membership;
- (b) The Board may not create, amend, or repeal any provision of these By-laws which alters the procedure for making, altering, and repealing the By-laws; and
- (c) Any new by-law or amendment or repeal of any provision made or adopted by the Board may be amended or repealed by the General Membership.

Article VIII Operating Rules

1. General A set of internal company statutes, which shall be called the Operating Rules and which are separate from these By-laws, may be established by the General Assembly of members or by the Board of Directors. The Operating Rules may be added to, amended, or repealed at any meeting of the General Assembly or the Board, which has a quorum, by a majority of the quorum. The Operating Rules shall be binding on all members and affairs of the corporation provided that the Rules do not conflict with the law, the Articles of Organization, or these By-laws.

Article I Membership and Shares of Stock

1. Eligibility The shareholders shall also be referred to as the members of the corporation. Stock may be held only by natural persons who (1) work in the company on a full or part-time basis, (2) are residents of the State of _____ at the time of the issuance of the stock to them, and (3) have been accepted as members by the Board of Directors or its designees. Within a trial period of _____ months, an employee must either be accepted into membership or terminated as an employee. Restrictions shall be placed on the ownership and transfer of the shares of stock so that the shares will function, for all intents and purposes, as membership certificates. Accordingly, one and only one share of common stock shall be held by each member, and that share shall be referred to as a membership share. The legal consideration paid to the corporation for a membership share shall be the share's par value, and that par value shall be referred to as the membership fee.

Article I, Sections 2 through 5 the same as in Version A.

Version B

Article II Distribution and Retention of Corporate Earnings

1. General At the end of each fiscal year, the Board of Directors may, subject to the conditions specified below, distribute a portion of the pre-tax net earnings as wage and salary bonuses to the members to be paid partly in cash and partly in the form of promissory notes. The aggregate of the corporate promissory notes issued as pay bonuses shall be referred to as the Revolving Loan Fund. The after-tax net earnings shall be retained until a reserve, which shall be referred to as the Collective Reserve Fund, has been accumulated totaling at least the target level of _____ percent of the par value of the corporate stock outstanding. No pay bonuses may be declared for as long as the Collective Reserve Fund is below its target level. All the remaining post-tax net earnings shall be retained and allocated to the members' internal capital accounts, unless the directors declare a cash distribution of part of the said net earnings.

2. Revolving Loan Fund As the pay bonuses are to be deducted from the taxable corporate income, the size shall be limited by the total amounts permitted by the Internal Revenue Service to be deducted as labor compensation. By becoming a stockholder and member of the corporation, each member shall be deemed to have consented to include in his or her taxable personal income the total pay bonus in the form of cash and promissory notes.

The revolving loan fund notes shall be subordinated to all other indebtedness of the corporation without regard to the time when any other indebtedness was contracted or the nature thereof. The revolving fund notes may accrue interest at a rate not to exceed _____ percent as determined by the Directors. The funds retained in the company, when new revolving fund notes are issued, may be used to pay off the most senior of the revolving fund notes or be used for any other corporate purposes. All revolving fund notes shall be paid off within five (5) years of their date of issuance unless the Directors rule that extraordinary circumstances require an exception in the form of an extension of the deadline.

3. Collective Reserve Fund The capital of the collective reserve fund is not attributed or imputed to the members as individuals. Any gifts or grants to the corporation shall be referred to as endowment and listed as a source of net worth on the balance sheet separate from the collective reserve fund. If the corporate net income is negative, those operating losses shall be debited from the collective reserve fund. If that should exhaust the collective reserve fund, the remaining losses shall be debited from the internal accounts of the members in proportion to their labor compensation during the fiscal year.

4. Internal Capital Accounts Each member shall have an internal capital account in his or her name. After the membership fee is paid in cash or by payroll deductions, that fee (plus any additional paid-in capital) shall be the initial balance credited to the member's account. At the end of each fiscal year, the total amount (positive or negative) to be distributed between the internal accounts shall be allocated in accordance with the

following rule: each member's account shall be credited with the fraction of the total amount whose numerator is the member's total labor compensation for the fiscal year and whose denominator is the total labor compensation of all the members for the fiscal year. The internal accounts shall accrue interest at a rate not to exceed _____ percent as determined by the Board of Directors. When a person terminates membership in the company and has transferred his or her membership share back to the corporation, then the balance of the member's internal capital account as of the end of the fiscal year shall become a subordinate debt of the company to the individual. This promissory note shall be payable on such terms as the Directors shall determine, provided that the note shall be payable in full within five years of the termination date.

Notes on the By-laws

The purpose of these By-laws is to internally restructure a company so that it will function as a genuine workers' cooperative. The outer legal shell can be that of a business corporation or that of a statutory cooperative. The two versions A and B correspond to two ways of avoiding the bulk of the corporate income tax. For more details on the tax breaks or on cooperative theory in general, see the paper 'What is a Workers' Cooperative?' available from the: Industrial Cooperative Assn., 2161 Massachusetts Ave., Cambridge, Ma. 02140.

At a number of points in the By-laws, specific numbers are required. In some cases, specific numbers have been provided and in other cases the space was left blank. Some suggestions about the blanks will be given below. In any case the specific numbers are only tentative suggestions. The final decisions, of course, rest with the coop members drafting their By-laws.

Some suggestions for the 'blanks':

Article I: The suggested trial period is around three months.

Article II: The suggested target level of the Collective Reserve Fund is 30% of the shares' par value, but also check local statutes on the matter. The suggested interest ceiling on the Revolving Loan Fund and the Internal Capital Accounts is in the range of 6-8%, but also check local statutes on the matter.

Article IV: The suggested term of office for directors is $x = 2$ or $x = 3$ years, since there might be too much loss of continuity with one year terms.

Article V: The suggested term for officers is 3 years, but it could be shorter.

DISCLAIMER: The Industrial Cooperative Association presents these By-laws (versions A and B) only as a suggested model. There is no guarantee, explicit or implied, by the ICA that the use of these By-laws will obtain from the IRS the sought after tax break. A local lawyer should always be consulted to help insure compliance with the relevant local, state, and federal laws.