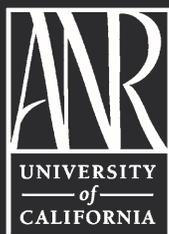


# Legal Sourcebook For California Cooperatives: *Start-up and Administration*

*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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# CONTENTS

Foreword .....	vi
About the Author .....	vii
Acknowledgments .....	vii
Introduction .....	1
A. In General.....	1
B. Coverage of Discussion .....	2
C. Sample Documents, Legal Sources, and Comments.....	3
D. Cross-References and Notes .....	3
E. Need for Legal Counsel .....	3
F. Important Definitions .....	4
Part I. Getting Started.....	7
Chapter 1. Choice of Entity for Doing Business .....	9
A. Introduction .....	9
B. Cooperative Corporations .....	10
C. Nonprofit “Mutual Benefit” Corporations.....	11
D. Nonprofit “Public Benefit” Corporations .....	12
E. Limited Liability Companies and General Partnerships .....	12
F. For-Profit Corporations .....	12
G. Unincorporated Associations .....	13
H. Summary and Conclusions.....	14
Chapter 2. Pre-operational Matters .....	15
A. Before Incorporation .....	15
B. After Incorporation .....	18
Chapter 3. First Meeting of the Board of Directors .....	19
A. In General.....	19
B. Sample Waiver of Notice of the First Meeting .....	20
C. Sample Minutes of the First Board Meeting .....	21
Part II. Basic Corporate Documents .....	27
Chapter 4. Articles of Incorporation .....	29
A. In General.....	29
B. Contents .....	29
C. Amendments .....	30
D. Sample Articles of Incorporation.....	34
E. Sample Cover Letter to the Secretary of State .....	36
F. Legal Sources and Comments to the Sample Articles.....	37
Chapter 5. Bylaws.....	39
A. In General.....	39
B. Contents .....	39
C. Bylaw Changes .....	40
D. Sample Bylaws .....	42
E. Legal Sources and Comments .....	61
Chapter 6. Member-Related Documents .....	72
A. Membership and Share Certificates .....	72

---

---

B. Sample Membership Disclosure Document .....	74
C. Legal Sources and Comments.....	76
Part III. Directors, Officers, and Members .....	77
Chapter 7. The Board of Directors .....	79
A. Directors Defined .....	79
B. Authority .....	79
C. Selection, Removal, and Resignation.....	79
D. Nomination and Election of Directors .....	81
E. Board Meetings.....	82
F. Board Action without a Meeting .....	83
G. Board Committees .....	83
H. Minutes and Resolutions .....	84
I. Directors' Standards of Conduct.....	84
J. Alternate Directors .....	86
Chapter 8. Corporate Officers.....	87
A. In General.....	87
B. President.....	87
C. Vice-President.....	88
D. Secretary .....	88
E. Chief Financial Officer .....	89
F. Loans to or Guarantees for Officers .....	89
G. Crimes and Penalties .....	89
Chapter 9. Members and Memberships: In General .....	90
A. Definitions .....	90
B. Eligibility .....	90
C. Voting Power and Proxies .....	90
D. Transfer of Memberships .....	91
E. Membership Classes .....	91
F. Cessations and Redemptions of Memberships .....	91
G. Valuation of Membership Interests.....	92
H. Dues, Assessments, and Fees.....	92
I. Identity Cards.....	93
J. Record Dates Other than for Notice and Voting.....	93
Chapter 10. Membership Meetings and Voting.....	94
A. Regular and Special Meetings.....	94
B. Notice of Meetings .....	94
C. Written Ballots Used at a Meeting .....	96
D. Written Ballots Used without a Meeting .....	96
E. Form of Written Ballot .....	97
F. Referendums.....	98
G. Quorum Requirements .....	98
H. Voting .....	98
I. Delegates .....	101
J. Voting by Units.....	101
K. Voting by Organizational Members .....	101
L. Certification of Minutes and Resolutions.....	101

---

---

M. “Good Faith” Protections .....	102
Part IV. Financing Issues .....	103
Chapter 11. Raising Capital: Memberships, Shares, and Loans .....	105
A. Memberships .....	105
B. Shares .....	105
C. Promissory Notes or Loans .....	106
D. Securities Regulation .....	106
E. Summary and Conclusions.....	108
Chapter 12. Distributions and Patronage Refunds.....	109
A. In General.....	109
B. Distributions.....	109
C. Patronage Refunds.....	109
Chapter 13. Unclaimed Membership Interests.....	112
A. Background.....	112
B. California’s Unclaimed Property Law .....	112
C. Minimizing or Avoiding the Law’s Impact.....	114
Part V. Reporting and Filing Matters .....	117
Chapter 14. Records, Reports, and Inspection Rights.....	119
A. In General.....	119
B. Required Records and Reports .....	119
C. Inspection Rights.....	121
D. Prohibited Uses of Membership List .....	122
E. Voting Report.....	122
Chapter 15. Filings with the Secretary of State .....	123
A. In General.....	123
B. Required Annual Statement and Designation of Corporate Agent...	123
Chapter 16. Income Tax-Related Filings.....	125
A. Income Tax Returns .....	125
B. Forms 1099 .....	125
Notes .....	126
Introduction.....	126
Chapter 1. Choice of Entity for Doing Business.....	126
Chapter 2. Preoperational Matters.....	126
Chapter 4. Articles of Incorporation .....	126
Chapter 5. Bylaws.....	127
Chapter 6. Member-Related Documents .....	127
Chapter 7. The Board of Directors.....	127
Chapter 8. Corporate Officers .....	127
Chapter 9. Members and Memberships: In General.....	128
Chapter 10. Membership Meetings and Voting .....	128
Chapter 11. Raising Capital: Memberships, Shares, and Loans .....	129
Chapter 12. Distributions and Patronage Refunds .....	129
Chapter 13. Unclaimed Membership Interests.....	129
Chapter 14. Records, Reports, and Inspection Rights .....	130
Chapter 15. Filings with the Secretary of State .....	130

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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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**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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# **Part I. GETTING STARTED**

Chapters 1 through 3

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# Chapter 1. CHOICE OF ENTITY FOR DOING BUSINESS

## A. INTRODUCTION

Forming an appropriate legal entity to carry out the anticipated activities is one of the most important steps in getting an organization “off the ground.” The choice of entity has both short-term and long-term implications. In the short term, the “mechanics” (including costs) of the formation are dictated by the type of entity to be formed; in the long run, the flexibility and success, or the lack thereof, of the organization will be impacted by the legal vehicle originally chosen.

For the discussion here, it is assumed that the main purpose of the proposed organization is to benefit its members or owners by providing an entity by which a common activity may be engaged in more or less “at cost” (e.g., through the payment of “patronage refunds”). Profits may also be retained to further the activities of the organization; “dividends” related to any capital contributions are limited (by co-op law) or may be prohibited by a co-op’s bylaws or articles.

It is important to note that Section 12311(b) of the California Corporations Code generally prohibits the use of the words “cooperative” and “co-op” in the name of an organization unless it is incorporated (1) as a “generic” co-op under the California Consumer Cooperative Corporation Law, (2) as an “agricultural” co-op, (3) as a “limited equity” or “stock” real estate-related co-op, or (4) as a credit union. Thus, many organizations that might think of themselves as operating on a “cooperative” basis almost certainly will not be able to use that term in their name unless legally incorporated as one of the foregoing types of co-ops.

California and federal securities laws and regulations impact all the possible entity choices discussed here. Although co-ops incorporated under the California Consumer Cooperative Corporation Law generally have a “special” exemption (up to \$300 in nondebt securities per member), securities issues are generally more related to the facts surrounding any particular offering. For smaller organizations, however, *California* securities regulations in particular have to be recognized and complied with. Other than some summary information provided elsewhere in this publication, securities issues are outside the scope of this discussion.

Federal and California income tax laws also impact the various entities in differing ways (e.g., tax return filings, tax burdens), some of which are outlined below and elsewhere in this publication. Because of the complexities involved, an organization should probably seek professional assistance related to tax matters.

Although the focus of this publication is on organizations (typically made up of consumers or workers) ultimately incorporating under the California Consumer Cooperative Corporation Law, the discussion below briefly outlines other “general purpose” choices for organizing entities created for the mutual benefit of their members or owners. “Special purpose” organizations (e.g., housing and agricultural co-ops, credit unions) are outside the scope of this publication. Also, “limited partnerships” are not discussed since they are mainly used as an investment vehicle. At the end of this chapter, there is a discussion of the entity choices typically made by groups in specific business sectors.

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Since this publication is probably most applicable to consumer and worker cooperatives, the advantages and disadvantages of incorporating under the California Consumer Cooperative Corporation Law will be discussed first. For the same reason, sample documents are provided only for organizations actually incorporating under the California Consumer Cooperative Corporation Law.

It should be noted that issues related to a *transformation* of an organization to another type of entity (e.g., a for-profit corporation changing to a cooperative corporation) are outside the scope of this publication. Professional advice should be sought for the specific situation involved.

## B. COOPERATIVE CORPORATIONS

“Cooperative” corporations are one of the many types of corporations that may be established in California. Although there are other cooperative laws (e.g., for housing and agricultural co-ops) in California, this publication is concerned only with the California Consumer Cooperative Corporation Law. In a sense, such law is a legal hybrid of partnership, for-profit corporation, and nonprofit corporation law.

Section 12201 of the Consumer Cooperative Corporation Law succinctly states that co-ops “are democratically controlled and are not organized to make a profit for themselves, as such, or for their members, as such, but primarily for their members as patrons.” This legal description identifies characteristics that distinguish cooperatives from other forms of business. Each member of a cooperative, no matter how many shares or memberships she or he has purchased, is generally entitled to only one vote. The primary objective of a cooperative is to provide benefits to its members, rather than a return on members’ capital investment. Unlike the similar nonprofit mutual benefit corporations, however, co-ops may distribute “surplus” to their members. Although consumer and worker cooperatives are rarely tax-exempt, surplus income may be distributed to members in such a way as to minimize corporate taxes.<sup>1</sup>

The California Consumer Cooperative Corporation Law is fairly flexible, partly because it is something of a legal hybrid. On the financial side, a co-op may distribute dividends on shares or memberships (unless the articles of incorporation or bylaws prohibit such dividends) and distribute patronage refunds to its members (based on their relative activity with the co-op).<sup>2</sup> Assuming that certain requirements of the Internal Revenue Code and related Treasury Regulations are met, patronage refunds are income tax-deductible to the co-op, thus often reducing the overall cost of doing business.

Another important advantage for cooperatives is that no “permit” is needed from the California Department of Corporations for the sale of memberships or shares up to \$300 per member (if certain legal requirements are met).<sup>3</sup> Unlike nonprofit “mutual benefit” corporations, co-ops may issue unlimited shares of stock (or memberships) to any single member to help generate capital.

Like other types of corporations, co-ops tend to be better organized than unincorporated associations since articles of incorporation have to be filed with the Secretary of State and co-op law is extensive and relatively well defined. Also, as in other corporate and LLC (limited liability company) settings, individual members are not generally personally liable for the debts of the co-op.<sup>4</sup>

Although partnerships and limited liability companies have greater tax flexibility in allocating tax-related items to various partners and members, cooperatives (like partnerships and LLCs) may achieve, as explained above, a relatively tax-free status at the entity level through the distribution of tax-deductible patronage refunds to members. Such refunds are taxable to the members if their activity with the co-op is business-related (e.g., employment); if the activity is for “personal” purposes (e.g., buying food for the members’ own consumption), the refunds are not taxable to the members.

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Relative to unincorporated associations and partnerships, the creation of a cooperative corporation is more involved (e.g., articles of incorporation with certain mandatory provisions must be filed with the Secretary of State.<sup>5</sup>) If “profits” are to be distributed to the members through “patronage refunds,” a co-op will have more complex accounting and tax problems than some other entities that may not (or do not) distribute such refunds. The distribution of tax-deductible patronage refunds can be particularly burdensome for smaller consumer co-ops with numerous members.

Because each member generally has only one vote in the affairs of a cooperative (no matter what her or his capital contribution may be), decision making in co-ops can be at times cumbersome, and the original “founders” may eventually lose “control” of the cooperative. In a related vein, the fact that voting power is not related to capital contributions (as in “regular” for-profit corporations), potential larger investors may be discouraged. Further, Section 12451 of the California Consumer Cooperative Corporation Law limits “distributions” to fifteen percent each year on capital contributions (including “membership fees”). Such distributions include dividends on shares or memberships (but not patronage refunds) as well as any amounts paid to members to repurchase capital contributions, to the extent such amounts exceed what the member has previously paid in and/or been allocated (i.e., through noncash patronage refunds or dividends).

### **C. NONPROFIT “MUTUAL BENEFIT” CORPORATIONS**

Nonprofit “mutual benefit” corporations may be established in California for any lawful purpose.<sup>6</sup> A nonprofit mutual benefit corporation is formed, like all other corporations, by filing articles of incorporation with the Secretary of State. A nonprofit mutual benefit corporation will not qualify for tax-exempt status since its primary goal is to provide direct benefits to individual members. It would also not qualify for favorable tax treatment as a cooperative (i.e., under Subchapter T of the Internal Revenue Code) since a nonprofit mutual benefit corporation is prohibited from making distributions to its members except to redeem memberships and upon dissolution.<sup>7</sup> An organization incorporated as a nonprofit mutual benefit corporation files corporate income tax returns like any regular for-profit corporation unless a specific tax-exempt purpose is established (e.g., a trade association or a power company, under Internal Revenue Code Section 501(c)(6) and (12)).

Unlike the situation of an unincorporated association or partnership, the members of a nonprofit mutual benefit corporation generally enjoy limited liability (assuming that corporate formalities are adhered to). Like other types of corporations and LLCs, “articles” are required to be filed with the Secretary of State to create the mutual benefit corporation. Because articles of incorporation must be filed with certain mandatory provisions<sup>8</sup> and because nonprofit corporation law is extensive and relatively well defined, the legal terrain is relatively cohesive and predictable.

Relative to cooperatives and profit-oriented entities, nonprofit mutual benefit corporations face certain obstacles in raising capital. For example, although mutual benefit corporations may levy dues and assessments on their members, members may generally acquire only a single membership in any “class” of memberships.<sup>9</sup> Secondly, any surplus assets (i.e., cash or property) may not be distributed to members except to redeem memberships or until the corporation is dissolved.<sup>10</sup> As a result, members receive no current income on their “investment.” Thus, growth is generally restrained, and, where it does occur, it’s often locked up in the corporation until dissolution. Also, unlike certain advantages the co-op option enjoys, the sale of memberships will more likely require a permit from the Department of Corporations, and the permit process may take several months and could be quite costly in legal and filing fees.<sup>11</sup>

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## D. NONPROFIT “PUBLIC BENEFIT” CORPORATIONS

Nonprofit “public benefit” corporations are another possible option for organizations operating in California. Such corporations, while usually tax-exempt, face a number of legal constraints (found in both California corporate and federal income tax laws) under which most business-oriented organizations would not want to operate. Capital generation is a particularly salient problem, especially since assets and profits (if any) may not be distributed to members. Still, organizations formed for certain purposes (e.g., educational) possibly meeting tax-exempt criteria may find this “public benefit” status appealing.

Because tax-exempt status is usually difficult for most “cooperatively”-run entities to achieve (since individual members instead of the public at large are the intended beneficiaries), nonprofit public benefit corporations are not emphasized in this publication.

## E. LIMITED LIABILITY COMPANIES AND GENERAL PARTNERSHIPS

“Limited liability companies” (LLCs) are membership organizations normally established to be taxed as if they *were* a partnership. Such tax status is considered an advantage because of the flexibility and single level (i.e., “pass-through”) of taxation it offers. Unlike a general partnership, where individual partners face unlimited *personal* liability for partnership activities, the LLC member’s liability is generally limited to his or her investment in the organization. The favored tax flexibility, however, can result in complex accounting and tax issues, especially where relatively large numbers of members or partners are routinely joining and leaving the organization. LLCs and partnerships are managed by the members and partners themselves or by chosen managers.

Currently, an LLC is annually subject to both an \$800 California “minimum” tax and a California “fee” on gross receipts in excess of \$250,000, assuming it is taxed as a partnership. In the alternative, an LLC may “elect” (under the “check-the-box” rules of the Internal Revenue Code) to be taxed as a “C” corporation for both federal and California purposes, but it would then be subject to “double taxation” (of both earnings of the corporation and of dividends to shareholders). Conceivably, an LLC could be taxed as a “cooperative” (i.e., subject to Subchapter T of the Internal Revenue Code), but the very reasons it chose *not* to be a co-op in the first place (e.g., to avoid “democratic” control) would probably preclude this treatment. Assuming that a “co-op”-type group wanted to be taxed as a partnership, an LLC would probably be best utilized by a relatively small and stable group.

Finally, unlike a general partnership that has to make no filings with the state of California upon its creation, an LLC has to file “articles of organization” with the Secretary of State. Analogous to corporate bylaws, a partnership or LLC needs to have an “agreement” among the partners or members; although not required, the agreement should be in writing.

## F. FOR-PROFIT CORPORATIONS

A “regular” for-profit corporation is generally established to make a profit for its shareholders based upon their relative shareholdings. In a for-profit corporation, shares of stock are issued in exchange for capital contributions, with voting power of individual shareholders related to the number of shares they own. Thus, unlike cooperatives, for-profit corporations are not concerned with “democratic” (i.e., one person, one vote) voting rights. Further, corporate stockholders are generally concerned with the

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dividends received on and the growth in value of their shares of stock, and these factors are less likely to concern co-op members (who are usually more interested in cost-saving transactions with their co-op).

“S” corporations are simply corporations that have “elected” under the Internal Revenue Code to be taxed similarly to partnerships (and most limited liability companies), that is, the entity itself is not subject to federal income taxes, only the owners are. Like any other corporation (and LLC), however, the shareholders generally have limited personal liability. Unlike LLCs and partnerships (both of which have tremendous flexibility in allocating income, deductions, and credits), “S” corporations must distribute “pass-through” items on the basis of relative shareholdings. Although “S” corporations in general have a less complex tax situation than LLCs or partnerships, they may face a somewhat more complicated and restrictive tax situation than cooperatives. For example, “S” corporations are limited to 75 shareholders and may not issue more than one class of stock.

## G. UNINCORPORATED ASSOCIATIONS

An unincorporated association is probably the simplest legal form that a “membership” organization might take. An unincorporated association consists of a group of persons who have joined together for some common purpose. In some ways, the association is like a corporation. For example, it may hold and transfer property and register names and insignias with the Secretary of State.<sup>12</sup> An unincorporated membership association (with two or more members) that did not attain tax-exempt status would be taxed as a partnership for federal and state purposes unless it elects to be taxed as a corporation.<sup>13</sup>

Unincorporated associations are relatively easy to form. No filings with the state of California are required upon formation, and no particular documents are required of the association itself. In relation to the corporate options discussed below, however, privacy and ease of the legal aspects of formation and dissolution are the main advantages to this form. It might best be used in a “tentative” situation (e.g., where it is unclear whether the unincorporated association is really economically viable) or where only a relatively few members are involved.

In relation to corporate options, the disadvantages of an unincorporated association are significant. Perhaps most importantly, except for specified types of debts, individual members may be held personally liable for all sorts of association liabilities.<sup>14</sup> Also, because there are no requirements of corporate-type documents analogous to articles of incorporation and bylaws, an unincorporated association can be chaotic and disorganized, hindering its ability to function as a viable entity. To minimize this latter problem, “articles of association” and bylaws are often used. Adoption by an unincorporated association of these documents would probably do little or nothing to solve the potential liability problems for individual members, however. Further, in contrast to certain advantages enjoyed by the cooperative option, it is probably more likely that an unincorporated association would have to “qualify” the sale of any “memberships” with the California Department of Corporations. Qualification can be a costly and time-consuming process for an organization of any type or size.

Finally, in a more general sense, California statutory law related to unincorporated associations is limited to a few provisions, making the legal environment relatively undefined in relation to other options.<sup>15</sup> While some may consider this an advantage, such a vacuum in the law can create a host of problems for the organization and its members.

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## H. SUMMARY AND CONCLUSIONS

Obviously, the ultimate choice of legal form will depend on the facts and circumstances of the particular organization. For a very small organization with no long-term goals, an unincorporated association may be the best choice, at least at its outset. The nonprofit “mutual benefit” corporation could be effectively used where raising capital may never be particularly important, or when tax-exempt status is desired and possible to attain. “Public benefit” corporations would seem to have relatively narrow uses, due to the various restrictions and limitations placed on them by both tax and corporate legal structures.

When “democratic” control is important (or profit *less* important), the cooperative corporation option provides a relatively flexible financing vehicle and also offers certain favorable “securities” (particularly for smaller co-ops) and tax advantages (especially for larger co-ops). Where flexibility, profits, and capital are particularly important, partnerships, LLCs, and for-profit corporations may offer the more favorable vehicles to the owners. For example, control of a for-profit corporation is generally determined by the number of voting shares each shareholder owns, and nonvoting investors are often present.

In any event, a group forming an organization should consult competent counsel to assist it in making an effective choice of entity and to ensure that the proper documents are generated and appropriate filings are made with governmental agencies.

Finally, because this publication is specifically oriented toward organizations that actually incorporate under the California Consumer Cooperative Corporation Law, sample documents are provided only for organizations incorporated under this law.

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## Chapter 2. PRE-OPERATIONAL MATTERS

While the following outline does not necessarily list all the items that need to be considered when forming a cooperative, it does list major items confronting any new co-op before it begins operations.

### A. BEFORE INCORPORATION

#### 1. General Orientation

This discussion assumes that it has been decided to incorporate a co-op under the California Consumer Cooperative Corporation Law, that is, that a co-op corporation is the legal entity most appropriate to conduct the business of the members. As discussed above, professional advice should be sought in selecting the most appropriate entity to conduct the proposed activities. If a cooperative corporation is the entity chosen, the incorporators should review the sample minutes of the first meeting of the board of directors to orient themselves to many of the initial steps that will need to be addressed. To legally form a cooperative, California Corporations Code Section 12300 requires that one or more persons, known as the “incorporators,” sign and file with the Secretary of State “articles of incorporation.”

#### 2. Corporate Name

The incorporators should decide on a name of the co-op, which must include the word “cooperative” *and* some word or abbreviation that will indicate that the co-op is a corporation (e.g., Inc., Incorporated, etc.).<sup>1</sup>

When a name is decided upon, its availability for use should be checked with the California Secretary of State. A name-check may be done by telephone or online; if the name is available, it may be reserved with the Secretary of State for a 60-day period for a small fee.<sup>2</sup>

#### 3. Initial Board Members and Officers

The incorporators should next decide who will comprise the initial board of directors. The initial directors, who may also be the incorporators, will serve until directors are elected by the members at the first annual meeting (or by written ballot). Either the articles of incorporation or the bylaws must set the number of directors, or a minimum (not less than three) and maximum number of directors, with the exact number to be fixed by the board or members in a manner provided in the bylaws.<sup>3</sup> Generally, a cooperative should provide for an odd number of directors to help minimize the possibility of tie votes. The bylaws (or articles of incorporation) may set out the eligibility requirements for directors,<sup>4</sup> and most cooperatives would probably want to require directors to be members of the co-op.

The incorporators should also consider who should be selected as the first officers of the co-op, since officers should be designated at the first meeting of the board of directors. The designation of the first corporate secretary is particularly important, since that officer is responsible for maintaining various corporate documents, records, minutes of corporate meetings, etc.

#### 4. Bylaws

The incorporators should agree on the contents of the cooperative’s initial bylaws so operations can

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begin as soon as possible after incorporation. The bylaws are perhaps the most important corporate document, and this publication's sample bylaws and related discussions should be carefully reviewed. Many of the issues facing a newly forming co-op (e.g., membership qualifications, distributions, etc.) will be resolved in the bylaws. In reviewing bylaw issues, some groups decide that they do not want to operate in a co-op format, or in a corporate format. Thus, bylaws should be agreed upon *before* incorporation, wherever possible, to help ensure that a cooperative legal structure is consistent with the goals of the incorporators and that the co-op does not soon have to be “transformed” into another type of organization.

### **5. Shareholder Disclosure Document and Receipt**

The membership “disclosure document” is based mainly upon the articles of incorporation and the bylaws. This document needs to be prepared at the outset since it is required (by law) to be given to people before they are accepted as members,<sup>5</sup> including those accepted at the first meeting of the board of directors. Also, some form of “receipt” needs to be created, since a receipt must be given to anyone purchasing his or her first membership or share.<sup>6</sup>

### **6. Incorporation Fees**

Next, the incorporating group should decide on how to pay the various incorporation fees. A small filing fee is required in order to file the articles of incorporation with the Secretary of State. Some attorney's fees are also likely to be incurred. The amount of the attorney's fees will depend on the degree of the cooperative's structural complexity, particularly the membership and share structures. Whoever advances such fees on behalf of the co-op will probably expect to be reimbursed by the new cooperative shortly after incorporation.

### **7. Shares**

The incorporators should also decide how and for how much the initial shares or memberships will be sold. The group should attempt to structure the cooperative's share transactions so that the co-op will not need to apply for a permit to issue its initial shares.<sup>7</sup> (This is discussed in more detail in chapter 11 of this publication, and an attorney should be consulted before any shares are issued.) A membership or share issuance price should also be decided upon. The price will often be inversely related to the number of equity units a member may initially be required to purchase (i.e., the higher the price, the fewer the number of units). Particularly where members may own more than one unit, the price per unit may be set at a specific amount (to avoid confusion or complex valuation issues).

The share price may be set in the bylaws, or the bylaws may allow the board to set (and change) the price. The incorporators should consider setting a “permanent” price in the bylaws (to avoid any later confusion over price), and the bylaws may allow the board to vary the number of shares required to be initially purchased. It should be noted that co-op law does *not* require shares to be issued. Because capital is of crucial importance to most co-ops and shares are fairly simple to understand, however, this *Sourcebook* assumes throughout that shares, in fact, will be issued.

A cooperative is not required to issue any shares, or it may issue more than a single class of shares. When more than a single class of memberships or shares is issued, the complexity of either or both of the articles and bylaws, as well as the disclosure document, is increased. Some co-ops may want

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or need to issue one or more additional share classes to attract more investment in the organization. Shares may not be lawfully issued until after the co-op is incorporated.

It should be noted that other “units” of equity ownership could be utilized instead of “share” ownership. Shares are assumed throughout this *Sourcebook*, however, since shares provide the most common description of equity ownership. On the other hand, some (particularly smaller) cooperatives may decide that *no* ownership units of any kind are needed or desired (i.e., all equity in the co-op would be owned “in common”).

## **8. Loans**

Loans to a cooperative are *not* exempted from the “permit” process with the California Department of Corporations by the special co-op “equity” exemption. Although another exemption (or exemptions) may be available, an attorney should be consulted before any loans are taken. (This is discussed in more detail in chapter 11 of this *Sourcebook*.)

## **9. Federal Securities Regulation**

The above discussions of shares and loans pertain to California law only. An attorney should be consulted regarding the applicability of federal securities regulation, particularly the antifraud provisions (and possibly the laws of other states). In most situations involving small cooperatives doing business only in California, however, shares or loans will probably not need to be federally registered (or subject to the laws of other states), particularly if only California residents are allowed to become and remain members.

## **10. Bank Accounts**

The incorporators should investigate which bank or banks will be used by the cooperative for checking and savings accounts, since one or more accounts will almost certainly have to be opened shortly after incorporation and before operations begin. An employer identification number will need to be obtained from the Internal Revenue Service before a bank account can be opened.

## **11. Licenses and Permits**

The incorporators should make at least a preliminary determination of what licenses and permits the cooperative will need to acquire either before or shortly after beginning operations. For example, a business license will almost certainly be required, and sales tax and health permits may be needed; a consumer food co-op may also need a license to sell alcoholic beverages.

## **12. Articles of Incorporation**

The articles of incorporation should be prepared and filed with the Office of the Secretary of State in Sacramento. The articles must be signed by one or more persons acting as the incorporators. A small fee must accompany the original and two copies of the articles. If the initial directors are named in the articles (which is recommended wherever possible), the directors must sign and acknowledge the articles.<sup>8</sup> Generally, the articles are “filed” as of the date they are received by the Secretary of State.<sup>9</sup> A co-op’s existence begins when the articles are filed with the Secretary of State.<sup>10</sup>

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## B. AFTER INCORPORATION

### 1. The First Board Meeting

Sample minutes of the first meeting of the initial directors are provided in this *Sourcebook*. While other items may be added to the agenda of this meeting, items included in the sample minutes should be acted upon before actual operations begin.

### 2. Accounting Records

A competent accountant or bookkeeper should be retained to set up the cooperative's "general ledger" and all "journals" necessary to support the ledger. Many co-ops make the mistake of postponing this action until well after operations have begun, and it is often a costly mistake: many business failures are due to inadequate management information and financial records. Adequate accounting records are also necessary to generate the financial reports a co-op is required by law to prepare (see chapter 14).<sup>11</sup>

### 3. Membership Records

Cooperatives are required to maintain accurate membership records, including the names and addresses of all members and how much capital each member has invested.<sup>12</sup> The co-op's secretary should see that such records are immediately established and accurately maintained. Because many co-ops have relatively large numbers of members (especially consumer co-ops), membership records may soon be a major problem for a new co-op unless adequate procedures are established before operations begin. As a practical matter, computer data processing of membership records is virtually mandatory for any new co-op with a potentially large membership.

### 4. Employer Requirements

A cooperative should file Form SS-4 with the Internal Revenue Service to obtain an employer identification number. This number is needed before any employees are compensated by the co-op. Co-op personnel should also contact the Internal Revenue Service and California's Employment Development Department for information and forms to properly report compensation and pay payroll-related taxes, and unemployment and disability insurance. Proper reporting and payment of payroll-related taxes is very important, since co-op personnel may be held personally liable for such taxes.

Cooperatives (as well as all other businesses) are required to file annual Forms 1099-MISC for any *nonemployee* business service provider who is *not* incorporated (and to any attorney, whether or not incorporated), if her or his compensation from the co-op exceeds \$600.00 in a given calendar year. In addition, California has separate reporting requirements related to such nonemployee service provider; the Employment Development Department should be contacted for further details.

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## Chapter 3. FIRST MEETING OF THE BOARD OF DIRECTORS

### A. IN GENERAL

As soon as practical after incorporation, the initial directors should meet to perform certain acts to help get operations of the new cooperative started. Two of the most important acts are adoption of the bylaws and the appointment of officers. The board of directors generally should adopt the initial bylaws on its own initiative, since there are no members or related voting procedures prior to the adoption of the bylaws.

Although additional items may be added to the agenda of the board's first meeting, it is important that the initial directors of a co-op act upon the agenda items presented in the "sample" minutes presented below. The items presented in the minutes here are either self-explanatory or are discussed in chapter 2 of this *Sourcebook*.

All of the initial directors should sign a "Waiver of Notice and Consent to Holding of the First Meeting of the Board of Directors" (see the sample waiver in this publication) to avoid any problems concerning the adequacy of "notice" of the meeting.

Even before the initial board meeting, the incorporators would be well advised to consult an attorney regarding at least the share issuance item of the minutes, due to the complexities of securities regulation. In order for the cooperative's equity exemption from qualification to apply at the outset, none of the initial members may receive shares in excess of \$300.00. (For any number of reasons, the co-op may not need this exemption, or another exemption might be used.) The named members will be the first members of the co-op, assuming that they comply with the membership requirements as set forth in the bylaws. Since the sample bylaws require directors to be members, the directors should pay for and be issued shares at this first meeting, after adopting forms for a membership application, a disclosure document, and a "receipt" for a share purchase.

Although a corporate "seal" (item "12" of the sample minutes) is of little or no legal importance today, many banks still require it when a corporation opens a bank account. The adoption of a seal is thus provided for in the minutes. For the seal to be adopted at the initial board meeting, it must be obtained prior to the meeting but after the incorporation filing, since the seal will include the date of the incorporation as well as the corporate name. A seal can be obtained at many office supply stores.

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## B. SAMPLE WAIVER OF NOTICE OF THE FIRST MEETING

NOTE: It is especially important that this waiver be signed by all of the initial directors prior to the initial board meeting since proper “call” and “notice” procedures are not yet in effect.

### WAIVER OF NOTICE AND CONSENT TO HOLDING OF THE FIRST MEETING OF THE BOARD OF DIRECTORS OF [NAME OF COOPERATIVE]

We, the undersigned, \_\_\_\_\_, \_\_\_\_\_, \_\_\_\_\_, \_\_\_\_\_, and \_\_\_\_\_, being all of the initial Directors of [name of co-op], a California Cooperative Corporation, waive notice of the first meeting of the Board of Directors of the cooperative, and consent to the holding of a special meeting of the Board at \_\_\_\_\_, California, on the \_\_\_\_ day of \_\_\_\_\_ 20\_\_ , at \_\_\_\_ [A.M./P.M.], for the purpose of transacting any and all business, including the election of officers, adoption of Bylaws, adoption of a corporate seal, issuance of shares, adoption of the forms of the membership disclosure statement and receipt, and any other action that may be required or appropriate to complete the organization of the Corporation.

We, the undersigned, request that this waiver and consent be filed with the corporate records or be made a part of the minutes of the meeting for the purpose of showing that the business transacted at the meeting is valid and of the same source and effect as if the meeting were held after regular call and notice.

Dated: \_\_\_\_\_, 20\_\_

\_\_\_\_\_  
Director

\_\_\_\_\_  
Director

\_\_\_\_\_  
Director

\_\_\_\_\_  
Director

\_\_\_\_\_  
Director

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## C. SAMPLE MINUTES OF THE FIRST BOARD MEETING

### MINUTES OF THE FIRST MEETING OF THE BOARD OF DIRECTORS OF [NAME OF COOPERATIVE]

#### 1. Identification of Meeting Directors Present and Action Taken

The Board of Directors of the cooperative met for the first time on \_\_\_\_\_, 20\_\_.  
The following named Directors were present, and are all the persons named as Directors in  
the cooperative's Articles of Incorporation filed in the Office of the California Secretary of  
State: \_\_\_\_\_.

\_\_\_\_\_ was chosen to act as temporary President, and \_\_\_\_\_  
\_\_\_\_\_ was chosen to act as temporary Secretary.

A signed waiver of notice and consent to hold this first meeting of Directors was presented  
and ordered filed with the minutes of this meeting.

On motions made and seconded, the following resolutions were unanimously adopted or  
adopted by a majority of the Directors:

#### 2. Minutes and Books

RESOLVED, that the Secretary of the cooperative shall record, or cause to be recorded, all  
proceedings of the Board of Directors, Board Committees, and members in a book to be kept  
for that purpose at the principal executive office of the cooperative;

RESOLVED, FURTHER, that the minutes of all meetings of the Board of Directors, Board  
Committees, and members shall include the following information in addition to a record  
of the proceedings: the time and place of the meeting; whether it is regular or special and,  
if special, how it was authorized; what notice of the meeting was given; the names of those  
present and absent from Board and Board Committee meetings; and the number of members  
present at meetings of members; and

RESOLVED, FURTHER, that the Secretary of the cooperative is directed to procure a minute  
book and any other books and records that may be required by the cooperative.

#### 3. Articles of Incorporation

RESOLVED, that a copy of the Articles of Incorporation of the cooperative bearing the file  
stamp and certification of the California Secretary of State shall be inserted in the minute  
book of the cooperative.

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#### 4. Bylaws

RESOLVED, that the Bylaws presented to and considered at this meeting are hereby approved and adopted as the Bylaws of the cooperative: and that the Secretary of the cooperative is directed to certify one copy of the Bylaws and keep that copy at the cooperative's principal executive office where it shall be open to inspection by the members at all reasonable times during office hours, and to certify another copy of the Bylaws and insert that copy in the minute book of the cooperative.

#### 5. Officers

RESOLVED, that the following named persons are hereby elected to the offices of the cooperative as set forth below:

Name	Office
_____	President
_____	Vice-President
_____	Secretary
_____	Chief Financial Officer

The above officers shall serve at the pleasure of the Board.

#### 6. Membership Disclosure Document and Records; Conditions of Membership

RESOLVED, that the cooperative hereby adopts the membership application, membership disclosure document, and "receipt" presented to this meeting as the forms that will be used by the cooperative, and that the Secretary is directed to attach a copy of such forms to the minutes of this meeting:

RESOLVED FURTHER, that the cooperative hereby adopts the following uniform conditions of membership, pursuant to Section 1.02 of the Bylaws: \_\_\_\_\_

RESOLVED, FURTHER, that a record of all memberships and shares issued or canceled shall be kept by the Secretary in a separate corporate book to be known as the "Record of Members and Shares of the Cooperative," and the Secretary is instructed to procure such a book.

#### 7. Attorney and Incorporation Costs

RESOLVED, the sum of \$\_\_\_\_\_ was advanced for attorney's fees and other costs in forming the cooperative, and that the cooperative received the benefit of the services and expenditures thereof; and

RESOLVED, FURTHER, that \_\_\_\_\_ be reimbursed for such advancements by the

cooperative in the amount of \$\_\_\_\_\_, and that any further amounts due on account of attorney's fees or other costs connected with the formation of the cooperative, the issuance of memberships and shares by the cooperative, or its qualification to transact business, shall be a liability of the cooperative whether or not the services were performed before or after the date of this meeting.

**8. Issuance of Memberships and Shares Without Permit**

RESOLVED, that until the Board of Directors sets another amount, as provided in Section 3.01 of the Bylaws, all shares will be issued for \$\_\_\_\_\_ each. Fractional shares may be issued to members only in relation to transactions other than their minimum share purchase to qualify for membership.

RESOLVED FURTHER, that inasmuch as the cooperative is authorized by its Bylaws to issue only one class of shares, this cooperative, acting pursuant to Subdivision (r) of Section 25100 of the California Corporations Code, hereby issues \_\_\_\_\_ of its shares in exchange for cash at a price of \$\_\_.00 per share to the following named persons in the number of shares set forth opposite their respective names:

Name of Member	Number of Shares
_____	_____
_____	_____
_____	_____

RESOLVED, FURTHER, that on \_\_\_\_\_, 20\_\_, upon receipt by the cooperative of the consideration to be paid for its shares, the officers of the cooperative are directed to issue to each of the persons named in these minutes the number of shares set forth opposite their respective names above, related to each person's respective membership in the cooperative; and

RESOLVED, FURTHER, that until the Board of Directors sets another amount, as provided in Section 2.01 of the Bylaws, all shares will be issued for \$\_\_\_\_\_ each. Fractional shares may be issued to Members only in relation to transactions other than their minimum share purchase to qualify for Membership.

**9. Licenses and Permits**

RESOLVED, that the officers of the cooperative are directed to procure in the name of the cooperative such licenses and permits as may be required to conduct the business of the cooperative by any federal, state, county, or municipal governmental ordinance, regulation, or law, and to do all things necessary or convenient to qualify the cooperative to transact its business in compliance with the laws and regulations of any appropriate federal, state, county, or municipal governmental authority.

### **10. Corporate Data Statement**

RESOLVED, that the appropriate officers of this cooperative shall, within 90 days after the date that the Articles of Incorporation of the cooperative were filed with the California Secretary of State, to wit within 90 days after \_\_\_\_\_, 20\_\_, and annually thereafter during the applicable filing period as that term is defined in Section 12570(c) of the California Corporations Code, on a form prescribed by the Secretary of State, file with the Secretary of State the statement containing the information required by Section 12570 of the California Corporations Code; and

REVOLVED, FURTHER, that the Secretary of the cooperative is directed to procure without delay from the California Secretary of State copies of the form prescribed by that office for the filing of the statement required by Section 12570 of the California Corporations Code.

### **11. Deposit Accounts**

RESOLVED, that \_\_\_\_\_, a deposit institution, is hereby selected and designated as a depository of funds of this cooperative, and that a checking account be established and maintained by and in the name of this cooperative at the office of this institution, on and subject to such terms and conditions as the President and Secretary of the cooperative and the institution may agree; and

RESOLVED, FURTHER, that all checks, drafts, and other instruments for the payment of money earned or accepted by this cooperative for payment from such account or at such office of the institution be signed on behalf of this cooperative by \_\_\_\_\_, one of the officers of the cooperative, or any person or persons so authorized by the Directors of the cooperative; and

RESOLVED, FURTHER, that any checks, drafts, or other instruments for the payment of money, endorsed on behalf of this cooperative for deposit with or collection by said deposit institution, may be so endorsed in the name of the cooperative by written or stamped endorsement and without designation of the signature of the person making such endorsement; and

RESOLVED, FURTHER, that the Secretary of the cooperative is hereby authorized and directed to certify to the deposit institution that these resolutions have been duly adopted, and are in conformity with the Articles of Incorporation and the Bylaws of the cooperative, and to further certify to the institution the names and specimen signatures of the present officer(s) or other person(s) of the cooperative authorized to sign on such account, and if and when any change is made in the identity or authority of such officers or other person(s), the fact of such change and the name and specimen signature of each new officer(s) or other person(s); and

RESOLVED, FURTHER, that the deposit institution is required and authorized to honor, receive, certify, or pay any instrument signed or endorsed in accordance with these resolutions

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and the certification provided for by these resolutions then in effect, including any such instrument drawn or endorsed to the personal order of, or presented for negotiation, deposit, or payment by, any officer signing or endorsing the same; and

RESOLVED, FURTHER, that these regulations and each certification herein provided for shall remain in full force and effect, and the deposit institution is authorized and requested to rely and act thereon until it shall receive, at its office to which the certified copy of these resolutions is delivered, either a certified copy of a further resolution of the Board of Directors amending or rescinding these resolutions, or a further certification of the names and signatures of the officer or other person(s) authorized to sign on such account.

**12. Corporate Seal**

RESOLVED, that the corporate seal presented at this meeting is adopted as the corporate seal of the cooperative, and that the Secretary is instructed to impress such seal on the minutes of this meeting opposite the place where this resolution appears.

**13. Principal Executive Office**

RESOLVED, that the principal executive office of this cooperative shall be established and maintained at \_\_\_\_\_, California.

**14. Adjournment**

The president asked whether there was any further business to come before the Directors at this meeting, and there being no response, the meeting was adjourned at \_\_\_\_\_.

Dated: \_\_\_\_\_, 20\_\_.

\_\_\_\_\_  
Secretary

**APPROVAL OF MINUTES**

The foregoing minutes are approved as the acts of the Directors of the cooperative:

Dated: \_\_\_\_\_

Dated: \_\_\_\_\_

Dated: \_\_\_\_\_

Dated: \_\_\_\_\_

Dated: \_\_\_\_\_

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

## **Part II. BASIC CORPORATE DOCUMENTS**

Chapters 4 through 6

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

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## Chapter 4. ARTICLES OF INCORPORATION

### A. IN GENERAL

A corporation's articles of incorporation are analogous to a "constitution": they comprise the basic document that gives the cooperative its legal existence. The articles are filed with the California Secretary of State. Generally, the articles should be as simple and short as possible to minimize the need for any amendments, since amendments must generally be approved by both the board of directors and the members and must be filed with the Secretary of State. Too often, provisions are found in articles that could have been established in the bylaws, instead, where amendments are generally easier to effect (and no filings with the Secretary of State are required).

### B. CONTENTS

#### 1. Required Provisions<sup>1</sup>

The California Consumer Cooperative Corporation Law requires certain information in the articles of incorporation. First, the articles must state the name of the co-op, and the name must include the word "cooperative" and some word or abbreviation indicating that the co-op is a corporation. Second, the following statements must appear: "This corporation is a cooperative corporation organized under the California Consumer Cooperative Corporation Law. The purpose of this Corporation is to engage in any lawful act or activity for which a corporation may be organized under such law." Third, the articles must state the co-op's initial agent for service of process (assuming a co-op just forming). Fourth, the articles must state whether the members' voting power and ownership interests are equal or unequal. Equal voting power and ownership interests mean one vote per member and one ownership unit per member, respectively. If the voting power or ownership interests are unequal, the articles must state the rules by which the voting power and ownership interests are determined or, instead, that the rules are described in the bylaws.

If a co-op is a "central organization" (i.e., a cooperative made up of co-op members), it may allow for voting power based on patronage or the number of members in its member co-ops, but only if its articles specifically provide for unequal voting. In no event, however, may a member of a central organization have less than one vote.

#### 2. Provisions Needed to be Expressed<sup>2</sup>

Two types of provisions need to be stated in the articles of incorporation for the provisions to be effective. First, any limitation on the duration of the cooperative's existence must be stated. Second, if the co-op wishes to distribute its assets upon dissolution to a charitable trust, that also must be stated.

#### 3. Optional Provisions

California Consumer Cooperative Corporation Law allows six other types of provisions in the articles<sup>3</sup>:

- (1) a further description of the co-op's purposes or a further statement limiting the purposes or powers of the co-op;

- (2) the names and addresses of persons appointed as initial directors;
- (3) provisions related to the transfer of memberships or shares;
- (4) provisions related to membership and share classes, and if more than one, a description of the rights, privileges, preferences, restrictions, and conditions attached to each class;
- (5) a provision giving the members the right to determine the consideration for which memberships or shares must be issued; and
- (6) any other lawful provision for the management of the activities of the co-op, including any provision which is required or permitted to be stated in the bylaws.

As a practical matter, a co-op is usually well advised not to include any unnecessary optional provisions in its articles since any article amendments needed later are generally more difficult to effect than bylaw amendments.

#### **4. Effect of Current Co-op Law on Pre-existing Co-ops<sup>4</sup>**

California Consumer Cooperative Corporation Law, which became effective January 1, 1984, generally applies to all California co-ops that were subject to the former “general purpose” co-op law, no matter when they were incorporated. The articles of incorporation of a co-op incorporated before 1984 do *not*, however, have to reflect the contents described above unless the co-op files an article amendment stating that it elects that its articles be in conformity with current law. Any amendment, however, may not state the co-op’s initial agent for service of process if the required statement to the Secretary of State has been filed. (See chapter 15, “Filings with the Secretary of State.”) Co-op law should be further consulted for the method of adoption of conformity-type amendments.

### **C. AMENDMENTS**

#### **1. Authorized and Prohibited Amendments**

A cooperative may amend its articles of incorporation in any way so long as the articles, as amended, contain only those provisions that would be lawful as of the time the provisions are filed with the California Secretary of State.<sup>5</sup> Although co-op law mandates certain provisions in a co-op’s articles, these provisions do not have to be adopted by a co-op that was incorporated before current co-op law went into effect (i.e., January 1, 1984).<sup>6</sup>

A cooperative may not, however, amend its articles to change any statement appearing in the original articles giving the names and addresses of the first directors or the initial agent for service, except to correct an error or to delete the information after the co-op has filed an annual statement with the Secretary of State.<sup>7</sup>

#### **2. Adoption of Amended Articles**

##### **a. By Incorporators**

Any amendment of the articles may be adopted in a written document signed by at least a majority of the incorporators, but *only* if the co-op has no members *and* no directors are named in the original articles or have been elected.<sup>8</sup>

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**b. By the Board and Members**

Except where a class of membership or shares is affected, amendments to the articles of incorporation may generally be adopted if approved by the board of directors and the members, and it makes no difference which group approves first.<sup>9</sup> The board by itself may approve certain article amendments, however, including an amendment deleting the names and addresses of the initial directors and agent for service, or any amendment when the cooperative has no members.<sup>10</sup>

Whenever the articles require the majority approval of a particular class of members or shares, or of a larger proportion of the votes of any class, or of a larger proportion (than a majority) of directors than is otherwise required by the California Consumer Cooperative Corporation Law, the article provision requiring the greater than majority vote may not be amended or repealed except by the particular class or the greater than majority vote, unless the articles themselves provide otherwise.<sup>11</sup>

**c. Approval by a Membership Class<sup>12</sup>**

In addition to the above-required approvals, an amendment must also be approved by the members or shareholders of a particular class, whether or not the class is entitled by the articles of incorporation to vote on the matter, if the amendment would:

- (1) materially and adversely affect the rights, privileges, preferences, restrictions, or conditions of that class as to voting, dissolution, transfer, or the obligations of that class in relation to other classes;
- (2) materially and adversely affect that class as to voting, dissolution, redemption, or transfer by changing the rights, privileges, preferences, restrictions, or conditions of another class;
- (3) increase the number of memberships or shares authorized for any class;
- (4) cause an exchange, reclassification, or cancellation of all or a portion of the memberships or shares of that class; or
- (5) authorize a new class of memberships or shares.

**3. Change of Corporate Status**

A cooperative may amend its articles to change its status to that of a nonprofit public benefit or mutual benefit corporation, religious corporation, or for-profit business corporation, provided the co-op complies with all applicable provisions of the California Consumer Cooperative Corporation Law.<sup>13</sup>

**4. Certificate of Amendment**

**a. Signed by Officer**

When an amendment to the articles of incorporation is adopted, the cooperative must file with the California Secretary of State a “certificate of amendment,” which is an officer’s certificate stating: (1) the wording of the amendment or amended articles is in accordance with the California Consumer Cooperative Corporation Law (see below); (2) the amendment has been approved by the board of directors; (3) the amendment was approved by at least a quorum of the members or by all the members, as required; and (4) the facts entitling the board alone to approve the amendment.<sup>14</sup>

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**b. Signed by Incorporators**

Where amendments to the articles of incorporation are adopted by the *incorporators*, the cooperative must file a certificate with the California Secretary of State signed and verified by a majority of the incorporators.<sup>15</sup> (“Verified” means that the statements contained in the certificate are declared to be true by the incorporators executing the certificate in either (1) an “affidavit” signed by them under oath before a notary public or (2) a “declaration” in writing executed by them under penalty of perjury and stating the date and place of execution.<sup>16</sup>) The certificate must state that its signers constitute at least a majority of the incorporators, directors were not named in the original articles and have not yet been elected, the co-op has no members, and the incorporators adopted the amendments.<sup>17</sup>

**c. Wording<sup>18</sup>**

The “certificate of amendment” must establish the wording of the amendment or amended articles of incorporation by one or more of the following methods: by stating that (1) the articles are amended to read as stated in full in the certificate, (2) any provision in the articles, clearly identified, is eliminated or amended to read as stated in the certificate, and (3) the stated provisions in the certificate are added to the articles.

If the purpose of the article amendment is to reclassify, cancel, exchange, or otherwise change outstanding memberships or shares, the amended articles must state the effect on all outstanding memberships or shares.

**d. Effect of Filing<sup>19</sup>**

When the “certificate of amendment” is filed with the Secretary of State, the articles of incorporation are then amended in accordance with the certificate; any change, reclassification, or cancellation of memberships or shares caused by the amendment is then effective. A copy of the certificate certified by the Secretary of State is evidence of the performance of the conditions necessary to adopt the amendment.

**5. Co-ops Formed for a Limited Period<sup>20</sup>**

A cooperative formed for a limited period of time may extend the term of its existence by amending its articles of incorporation to remove any provision limiting its existence. Special rules beyond the scope of this discussion are provided for this type of action.

**6. Restated Articles of Incorporation<sup>21</sup>**

A cooperative may restate in a single certificate its entire articles of incorporation as amended by filing with the Secretary of State an officer’s certificate entitled “Restated Articles of Incorporation of \_\_\_\_\_.” The certificate must state the articles, as amended, up to the date of filing, except that the following *must* be omitted: (1) the signatures and any acknowledgments of the incorporators; (2) any statements about the effect of prior amendments upon memberships; (3) any provisions of merger agreements (other than article amendments of the surviving corporation); (4) the names, addresses, signatures, and acknowledgments of the initial directors and agents for service of process. (The foregoing omissions are not themselves considered alterations or amendments of the articles.) If the officer’s certificate itself alters or amends the articles, the certificate must comply with the signature and wording requirements above.

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If the certificate does not itself alter or amend the articles, it must be approved by the board and is subject to the rules concerning article amendments *not* requiring approval of the members. On the other hand, if the certificate itself *does* alter or amend the articles, it is subject to all the rules related to article amendments.

Restated articles properly filed with the Secretary of State supersede for all purposes the original articles and all previous amendments.

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## D. SAMPLE ARTICLES OF INCORPORATION

### ARTICLES OF INCORPORATION OF [NAME OF COOPERATIVE]

**Article 1.** The name of this Corporation is \_\_\_\_\_.

**Article 2.** This Corporation is a cooperative corporation organized under the California Consumer Cooperative Corporation Law. The purpose of this Corporation is to engage in any lawful act or activity for which a corporation may be organized under such law.

**Article 3.** The name and address in the state of California of this Corporation's initial agent for service of process is \_\_\_\_\_, \_\_\_\_\_.

**Article 4.** The voting rights of each member of the Corporation are equal, and each member is entitled to one vote. The proprietary interests of each member of the Corporation are unequal, and the rules by which the proprietary interests are determined shall be prescribed in the Bylaws of the Corporation.

**Article 5.** The names and post office addresses of Directors who shall serve until the first annual meeting are:

Name	Address
------	---------

IN WITNESS WHEREOF, the undersigned, being the Incorporators and the initial Directors of this Corporation, have executed these Articles of Incorporation on \_\_\_\_\_, 20\_\_.

\_\_\_\_\_  
Director

\_\_\_\_\_  
Director

\_\_\_\_\_  
Director

\_\_\_\_\_  
Director

\_\_\_\_\_  
Director

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### DECLARATION

We are the persons whose names are subscribed below. We collectively are all of the Incorporators of this Corporation and all of the initial Directors named in the Articles of Incorporation, and we have executed these Articles of Incorporation. The foregoing Articles of Incorporation are our act and deed, jointly and severally.

Executed \_\_\_\_\_, 20\_\_, at \_\_\_\_\_, California. We, and each of us, declare that the foregoing is true and correct.

\_\_\_\_\_  
Director

\_\_\_\_\_  
Director

\_\_\_\_\_  
Director

\_\_\_\_\_  
Director

\_\_\_\_\_  
Director

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## E. SAMPLE COVER LETTER TO THE SECRETARY OF STATE

Secretary of State

1230 J Street

Sacramento, CA 95814

Re: Request to File Articles of Incorporation

I am enclosing the original and two copies of the Articles of Incorporation which are hereby submitted for filing. Please certify the two copies and return them to me in the enclosed self-addressed envelope

I am also enclosing a check for \$\_\_.00, payable to the Secretary of State, to cover your filing fee of \$\_\_.00.

Sincerely,

Enclosures

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## F. LEGAL SOURCES AND COMMENTS TO THE SAMPLE ARTICLES

With the exception of naming the initial directors, the sample articles of incorporation provided in this publication are possibly the simplest possible (under the California Consumer Cooperative Corporation Law) for a cooperative having unequal ownership interests among its members.

The articles of incorporation should be filed with the Secretary of State with the proper fee amount and a cover letter similar to the sample provided. Unless the articles are rejected for some reason, they are usually considered “filed” on the day they are received by the Office of the Secretary of State.

The following paragraphs include cross-references to the sample articles. Also provided are citations to the applicable sections of the California Consumer Cooperative Corporation Law and, where appropriate, discussions of common issues that incorporators should consider.

### *Article 1.*

The name of a co-op must include the word “cooperative” and some word or abbreviation indicating that it is a corporation (e.g., “Inc.” or “Incorporated”).<sup>22</sup>

### *Article 2.*

Both sentences in this article are required by co-op law<sup>23</sup>, and the exact wording used here must be used in the articles to be filed. A further description of a co-op’s purposes may be included, and the corporate purposes may be limited.<sup>24</sup>

### *Article 3.*

An agent for service of process is someone who is designated by the corporation to receive service of legal summons, court complaints, and other legal documents for the corporation. An agent for service of process with an address in California must be identified in the articles.<sup>25</sup> The agent can be either a natural person or another corporation.<sup>26</sup> The initial agent for service of process is often one of the original directors.

### *Article 4.*

California Corporations Code Section 12310(d) requires the articles to state whether the voting power or proprietary interests of the members are equal or unequal. If unequal, the articles must state either the general rule or rules by which the voting power and proprietary interests of the members are determined or it must state that such rule or rules are described in the corporation’s bylaws. Equal voting power means one vote for each member. Equal proprietary rights means property rights apportioned on the basis of one proprietary unit per member.<sup>27</sup>

Except for cooperatives comprised of other co-ops, each member is entitled to only one vote on any matter submitted to a vote of the members.<sup>28</sup>

### *Article 5.*

The names and addresses of the initial directors are not required to be stated in the articles. To avoid any later confusion regarding the identity of the initial directors (e.g., for the first meeting of the board of directors), it is recommended by the author that they be named in the articles wherever possible, in order for the board to hold its first meeting as soon as possible after it receives notification that the articles have been “filed.”<sup>29</sup>

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The number of directors may bear a relation to the likely number of members: a cooperative with potentially a large number of members may desire more directors than a co-op with only a few members. Also, an odd number of directors should be used wherever possible to lessen the possibility of “tie” votes.

*Execution and Declaration*

If the initial directors are named in the articles, the articles must be both signed and acknowledged by the directors.<sup>30</sup>

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# Chapter 5. BYLAWS

## A. IN GENERAL

While the articles of incorporation usually state only certain fundamental items related to a cooperative's existence, bylaws provide more detailed rules by which the co-op governs itself. While many of these rules could be put into the articles,<sup>1</sup> a co-op is usually best advised to put them in the bylaws, instead. This is particularly true since the bylaws are almost always easier to amend than the articles.

## B. CONTENTS

### 1. Required<sup>2</sup>

Unless the number of directors is stated in the articles of incorporation, the bylaws must set the number or state a minimum and maximum number of directors, with the exact number to be established by board or member approval in a manner determined by the bylaws. A co-op must have at least three directors, however. Any "alternate" directors and the method and time of their selection must be specified in the bylaws, along with provisions stating the conditions of their service in place of directors.

### 2. Optional Provisions<sup>3</sup>

Bylaws may contain any provision not in conflict with any law or the articles of incorporation to manage and conduct the affairs of a cooperative. The bylaws may include, but are not limited to, the following provisions:

- (1) any of the last five listed optional provisions for articles (see chapter 4 of this publication);
  - (2) the time, place, and manner of calling, conducting, and giving notice of member, board of directors, and board committee meetings, and of conducting mail ballots;
  - (3) the qualifications, duties, and compensation of directors, the time of their election, and the quorum and frequency requirements for board and board committee meetings;
  - (4) the appointment of committees, comprised of directors or nondirectors, or both, by the board or any officer, and the authority of any committee;
  - (5) the appointment, duties, compensation, and tenure of officers;
  - (6) the way in which members "of record" are determined;
  - (7) the making of reports and financial statements to members;
  - (8) establishing, imposing, and collecting dues, assessments, memberships and shares, and membership or share transfer fees;
  - (9) determination of patronage versus nonpatronage income;
  - (10) the time and manner of patronage refunds;
  - (11) eligibility requirements, admission procedures, and procedures related to the admission, withdrawal, suspension, and expulsion of members (consistent with the discussion in chapter 9 of this publication);
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- (12) the establishment of a delegate system (see chapter 10 of this publication);
- (13) voting by organizational units (see chapter 10 of this publication);
- (14) limiting the number of members, in total or by class, of the co-op;
- (15) establishing an educational program related to the principles and techniques of cooperation;
- (16) indemnification; and
- (17) dissolution.

Finally, the bylaws may require, for any and all corporate actions, the vote of a larger proportion of the members or the members of any class, unit, or grouping or the vote of a larger proportion of the directors than is otherwise required by co-op law. Any bylaw provision requiring a greater proportion may not be altered, amended, or repealed except by that larger proportion, unless the bylaws themselves provide otherwise.

## C. BYLAW CHANGES

### 1. Adoption, Amendment, and Repeal by the Board

Except for certain changes which must be approved by the members (see below) and unless the bylaws or articles of incorporation restrict or eliminate the power of the board of directors to adopt, amend, or repeal the bylaws, the board may adopt, amend, or repeal bylaw provisions unless the action would (1) materially and adversely affect the rights or obligations of members as to voting, dissolution, redemption, transfer, distributions (e.g., dividends), patronage refunds, patronage, property rights, or rights to repayment of contributed capital; (2) change the total number of members or shares authorized for any class; (3) effect an exchange, reclassification, or cancellation of memberships or shares; or (4) authorize a new class of membership or shares.<sup>4</sup> (Related to the last two items of the foregoing list, the author presumes that *share* changes would be included, although the law is unclear.)

### 2. Adoption, Amendment, and Repeal by the Members

#### a. In General

In addition to the bylaw changes that must be approved by the members (below), co-op law provides that bylaws may generally be adopted, amended, or repealed by the approval of the members.<sup>5</sup> Any adoption, amendment, or repeal, however, also requires the approval of the members (and presumably “shares”) of a class if the action would:

- (1) materially and adversely affect the rights or obligations of that class as to voting, dissolution, redemption, transfer, distributions, patronage distributions, patronage, property rights, or rights to repayment of contributed capital, in a way different than the action affects another class;
  - (2) materially or adversely affect the same items as in (1) above of that class by changing the rights, privileges, preferences, restrictions, or conditions of another class;
  - (3) change the number of memberships (or shares) authorized for that class;
-

- (4) increase the number of memberships (or shares) authorized for another class;
- (5) effect an exchange, reclassification, or cancellation of memberships (or shares) of that class;  
or
- (6) authorize a new class of memberships (or shares).<sup>6</sup>

**b. Required Member Approval**

There are certain situations where co-op law prohibits bylaw amendments by the board of directors, requiring member action instead.<sup>7</sup> The members must approve the following bylaw changes:

- (1) after members have been admitted, a bylaw specifying or changing in any way the number of directors;<sup>8</sup>
- (2) any extension of the term of a director or any provision related to the designation or selection of directors other than by election by the members;<sup>9</sup>
- (3) a Bylaw provision allowing the board of directors to fill vacancies in the board caused by *removal* of directors;<sup>10</sup>
- (4) to increase the quorum requirements for a membership meeting;<sup>11</sup> or
- (5) the repeal or amendment of a bylaw provision authorizing cumulative voting in a central organization.<sup>12</sup>

**3. Larger than Majority Approvals**

Generally, only a simple majority of a quorum of the board of directors, members, or members of any class (if necessary) needs to approve any adoption, amendment, or repeal of the bylaws.<sup>13</sup> The bylaws, may require, however, that the vote of a larger proportion, or all, of the members (or members of any class, unit, or grouping) or the directors is required to approve the adoption, amendment, or repeal of any or all bylaw provisions.<sup>14</sup>

**4. Amendment and Repeal by Others**

California Corporations Code Section 12330(d) provides (as of 1996) that a cooperative's bylaws may allow that the repeal or amendment of the bylaws (or any specified parts of the bylaws) "occur only with the approval in writing of a *specified* person or persons other than the Board of Directors or members."

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## D. SAMPLE BYLAWS

The bylaws give legal guidance to the co-op on a routine basis. While the California Consumer Cooperative Corporation Law does not require any specific bylaw provisions, the sample bylaws presented below address the more common issues that confront co-op personnel, including directors and officers, and members. Although many of the sample provisions may be modified to fit a particular co-op's needs and desires, an attorney should be consulted to review proposed bylaws prior to adoption.

These sample bylaws provide for a single class of members and shares. Shares in these bylaws may be used for direct investment by members and to distribute any noncash portions of patronage refunds and dividends. Please note that most of the sample bylaw provisions are discussed in the section immediately following the sample bylaws.

### SUMMARIZED TABLE OF CONTENTS: BYLAWS OF \_\_\_\_\_ COOPERATIVE, INC.

- Article I. Membership
- Article II. Shares
- Article III. Termination of Membership
- Article IV. Membership Meetings and Members
- Article V. Directors
- Article VI. Officers
- Article VII. Corporate Records and Reports
- Article VIII. Inspection Rights
- Article IX. Surplus Allocations and Distributions
- Article X. Bylaw Changes

### DETAILED TABLE OF CONTENTS: BYLAWS OF \_\_\_\_\_ COOPERATIVE, INC.

#### **ARTICLE I. MEMBERSHIP**

- 1.01. Classification of Members
  - 1.02. Membership Qualifications
  - 1.03. Membership Application
  - 1.04. Acceptance of Members
  - 1.05. Transfers Prohibited
  - 1.06. Membership Fee
  - 1.07. Bylaws and Articles to Prospective Members
  - 1.08. Shareholders and Members
-

## **ARTICLE II. SHARES**

- 2.01. Share Issuance
- 2.02. Share Ownership
- 2.03. Share Receipt and Disclosure Document
- 2.04. Prohibition on Transfer of Shares
- 2.05. Partial Withdrawal
- 2.06. Insolvency Delay
- 2.07. Unclaimed Equity Interests

## **ARTICLE III. TERMINATION OF MEMBERSHIP**

- 3.01. Voluntary Withdrawal
- 3.02. Death or Dissolution
- 3.03. Expulsion
- 3.04. Settlement of Share Interest

## **ARTICLE IV. MEMBERSHIP MEETINGS AND MEMBERS**

- 4.01. Location
  - 4.02. Regular Annual Meetings
  - 4.03. Special Meetings
  - 4.04. Time for Notice of Meetings
  - 4.05. Method of Giving Notice
  - 4.06. Record Date for Notice
  - 4.07. Contents of Notice
  - 4.08. Waivers, Consents, and Approvals
  - 4.09. Quorum at Meeting
  - 4.10. Loss of Quorum at Meeting
  - 4.11. Adjournment for Lack of Quorum
  - 4.12. Adjourned Meetings
  - 4.13. Voting of Memberships
  - 4.14. Use of Written Ballots at Meetings
  - 4.15. Contents of Written Ballot Used at Meetings
  - 4.16. Action by Ballot without Meeting
  - 4.17. Written Ballot Used without Meeting
  - 4.18. Solicitation of Written Ballots
  - 4.19. Withholding Vote
  - 4.20. Appointment of Inspectors of Election
  - 4.21. Duties of Inspectors of Election
-

**ARTICLE V. DIRECTORS**

- 5.01. Number
- 5.02. Qualifications
- 5.03. Nomination
- 5.04. Election
- 5.05. Terms of Office
- 5.06. Compensation
- 5.07. Call of Meetings
- 5.08. Place of Meetings
- 5.09. Presence at Meetings
- 5.10. Regular Meetings
- 5.11. Special Meetings and Notice
- 5.12. Quorum at Meetings
- 5.13. Acts of Board at Meetings
- 5.14. Adjournment of Meetings
- 5.15. Action without Meeting
- 5.16. Executive Committees
- 5.17. Resignation of Directors
- 5.18. Removal of Directors
- 5.19. Cause of Vacancies on Board
- 5.20. Declaration of Vacancies
- 5.21. Filling Vacancies on Board

**ARTICLE VI. OFFICERS**

- 6.01. Titles
- 6.02. Appointment and Resignation

**ARTICLE VII. CORPORATE RECORDS AND REPORTS**

- 7.01. Required Records
- 7.02. Annual Report
- 7.03. Annual Statement of Transactions and Indemnifications

**ARTICLE VIII. INSPECTION RIGHTS**

- 8.01. Articles and Bylaws
- 8.02. Books and Records
- 8.03. Inspection of Membership List

**ARTICLE IX. SURPLUS ALLOCATIONS AND DISTRIBUTIONS**

- 9.01. Fiscal Year
- 9.02. Surplus and Patronage Defined
- 9.03. Annual Allocations and Distributions of Surplus

**ARTICLE X. BYLAW CHANGES**

- 10.01. Bylaw Changes by the Board
  - 10.02. Bylaw Changes by the Members
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## **ARTICLE I. MEMBERSHIP**

### **Section 1.01. Classification of Members.**

The Corporation shall have one (1) class of members.

### **Section 1.02. Membership Qualifications.**

Any person, including any organizations (except a subsidiary of the Corporation) may become and remain a member of this Corporation by:

- (a) Complying with such uniform conditions as may be prescribed by the Board of Directors;
- (b) Making full payment of any nonrefundable membership fee as set forth in Section 1.06 of these Bylaws;
- (c) Making full payment for \_\_\_\_\_ share(s); and
- (d) If a natural person, being a resident of California.

### **Section 1.03. Membership Application.**

An applicant eligible for and desiring admission to membership in the Corporation shall file a written application for admission in whatever form and containing whatever information the Board of Directors shall prescribe.

### **Section 1.04. Acceptance of Members.**

Applications for membership shall be reviewed by the Board of Directors or by a Membership Committee duly authorized by resolution to admit members. The application shall be accepted unless rejected in writing within thirty (30) days for reasons satisfactory to the Board. If accepted, the applicant shall be admitted to membership and shall be allowed to vote and hold office. If rejected, the applicant shall be entitled to a refund of any amounts paid for membership fees and shares.

### **Section 1.05. Transfers Prohibited.**

No member may transfer his or her membership or any right arising therefrom.

### **Section 1.06. Membership Fee.**

A one-time nonrefundable membership fee, in an amount set from time to time by the Board of Directors, may be charged to and collected from each member upon joining the Corporation.

### **Section 1.07. Bylaws and Articles to Prospective Members.**

Each prospective member, upon application for membership, shall receive a copy of the Articles of Incorporation, Bylaws, and disclosure document of the Corporation.

### **Section 1.08. Shareholders and Members.**

“Shareholder” and “member” and their plurals shall be synonymous terms throughout these Bylaws.

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## **ARTICLE II. SHARES**

### **Section 2.01. Share Issuance.**

Shares may be issued for money paid in an amount as is determined from time to time by the Board of Directors and as share dividends, patronage refunds, or other changes affecting outstanding shares.

### **Section 2.02. Share Ownership.**

Share ownership entitles a member to only one (1) vote in the affairs of the Corporation, irrespective of the total number of shares a member owns, and to all the rights of membership as described by statute, the Articles of Incorporation, and these Bylaws. Pursuant to Subsection (b) of Section 9.03 of these Bylaws, the Directors may declare noncumulative dividends on shares not to exceed any maximum rate established by statute.

### **Section 2.03. Share Receipt and Disclosure Document.**

- (a) Nothing in this section shall restrict the Corporation from issuing identity cards or similar devices to members which serve to identify members qualifying to use facilities or services of the Corporation.
- (b) Except as provided in Subsection (c) of this Bylaw section, prior to issuing a share, the Corporation shall provide the purchaser of a share with a “disclosure document.” The disclosure document may be a prospectus, offering, circular, brochure, or similar document, a specimen copy of the share certificate, or a receipt that the Corporation proposes to issue. The disclosure document shall contain the information required by Section 12401 of the California Corporations Code.
- (c) The Corporation shall issue a receipt or written advice of purchase to anyone purchasing a share upon the member’s first purchase of a share. No disclosure document need be provided to an existing member prior to the purchase of additional shares if that member has previously been provided with a disclosure document which is accurate and correct as of the date of the purchase of additional shares.

### **Section 2.04. Prohibition on Transfer of Shares.**

No shares of this Corporation may be assigned or transferred. Any attempted assignment or transfer shall be wholly void and shall confer no rights on the intended assignee or transferee.

### **Section 2.05. Partial Withdrawal.**

A member having a monetary amount in his or her share account in excess of a monetary amount to be determined from time to time by the Board of Directors may cause the Corporation to purchase his or her excess share amount upon written request to the Board. Subject to Section 2.06 of these Bylaws, the Board must, within one (1) year of such request, pay the amount the member requests in cash or other property or both. The exact form of payment is within the discretion of the Board.

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**Section 2.06. Insolvency Delay.**

The Corporation shall delay the purchase of shares as described in Sections 2.05 and 3.04 of these Bylaws if the Corporation, in making such purchase is, or as a result thereof would be, likely to be unable to meet its liabilities (except those whose payment is otherwise adequately provided for) as they mature.

**Section 2.07. Unclaimed Equity Interests.**

Any share of a member, together with any accrued and unpaid dividends and patronage distributions related to that member, that would otherwise escheat to the State of California as unclaimed personal property shall instead become the property of the Corporation if the Corporation gives at least sixty (60) days' prior notice of the proposed transfer to the affected member by (1) first-class or second-class mail to the last address of the member shown on the Corporation's records, and (2) by publication in a newspaper of general circulation in the county in which the Corporation has its principal office. No shares or amounts shall become the property of the Corporation under this section of the Bylaws if written notice objecting to the transfer is received by the Corporation from the affected member prior to the date of the proposed transfer.

**ARTICLE III. TERMINATION OF MEMBERSHIP**

**Section 3.01. Voluntary Withdrawal.**

A member shall have the right to resign from the Corporation and terminate his or her membership by filing with the Secretary of the Corporation a written notice of resignation. The resignation shall become effective immediately without any action on the part of the Corporation.

**Section 3.02. Death or Dissolution.**

A membership shall immediately terminate upon the death of a member or the dissolution of a member that is an organization.

**Section 3.03. Expulsion.**

- (a) A member may for failure to comply with these Bylaws, rules, or regulations of the Corporation, for failure to patronize the Corporation during the immediately preceding fiscal year of the Corporation in the amount of at least \_\_\_\_\_ dollars (\$\_\_\_\_.00), or for any other justifiable reason, be expelled from the Corporation by resolution adopted by a two-thirds (2/3) vote of all members of the Board of Directors. Expulsion shall become effective immediately unless the Board shall, in the resolution, fix another time. On expulsion, the name of the member expelled shall be stricken from the membership register and all of his or her rights shall cease except as provided in Section 3.04 of these Bylaws.

- (b) Prior to expulsion of a member, the Board of Directors shall give such member at least fifteen (15) days notice prior thereto and the reasons thereof. Such member shall have the opportunity to be heard, orally or in writing, not less than five (5) days before the effective date of expulsion by the Board.
- (c) The notice required pursuant to Subsection (b) of this section of these Bylaws may be given by any method reasonably calculated to provide actual notice. Any notice given by mail must be given by first-class or registered mail sent to the last known address of the member shown on the Corporation's records.

**Section 3.04. Settlement of Share Interest.**

If a membership is terminated for any reason set forth in this Article of the Bylaws, the share interest held by the member shall be purchased by the Corporation, subject to Section 2.06 of these Bylaws, within one (1) year of the date of termination to the extent of the paid-up value of the member's shares on such date. The Board of Directors, in so settling the member's share interest, shall have the right to set off any and all indebtedness of the member to the Corporation. The paid-up value of the member's share interest is the monetary amount of such interest (including fractional shares) that the member has been issued in accordance with Section 2.01 of these Bylaws.

**ARTICLE IV. MEMBERSHIP MEETINGS AND MEMBERS**

**Section 4.01. Location.**

Meetings of members shall be held at the principal office of the Corporation.

**Section 4.02. Regular Annual Meetings.**

A regular meeting of members shall be held annually on the first \_\_\_\_\_ in \_\_\_\_\_ at \_\_\_\_:00 p.m. for the purpose of transacting any proper business, including the election of Directors, that may come before the meeting. If the day fixed for the regular meeting falls on a legal holiday, the meeting shall be held at the same time and place on the next day.

**Section 4.03. Special Meetings.**

Special meetings of members for any lawful purpose may be called by the Board of Directors, the President, or by five percent (5%) or more of the members.

**Section 4.04. Time for Notice of Meetings.**

Whenever members are required or permitted to take action at a meeting, a written notice of the meeting shall be given not less than ten (10) nor more than ninety (90) days before the date of the meeting to each member who is entitled to vote on the record date for notice of the meeting. In the case of a specially called meeting of members, within twenty (20) days after receipt of a written request, the Secretary shall cause notice to be given to the members entitled to vote that a meeting will be held at a time fixed by the Board of Directors not less than thirty-five (35) nor more than ninety (90) days after receipt of the request.

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**Section 4.05. Method of Giving Notice.**

Notice shall be given either personally or by mail or other written communication to the address of a member appearing on the books of the Corporation or provided by the member. If no address appears or is given, notice shall be given at the principal office of the Corporation.

**Section 4.06. Record Date for Notice.**

The record date for determining the members entitled to notice of any meeting of members is thirty (30) days before the date of the meeting.

**Section 4.07. Contents of Notice.**

The notice shall state the place, date, and time of the meeting. The notice of a regular meeting shall state any matters that the Board of Directors, at the time of giving notice, intends to present for action by the members. The notice of a special meeting shall state the general nature of the business to be transacted. The notice of any meeting at which Directors are to be elected shall include the names of all nominees at the time of giving notice.

**Section 4.08. Waivers, Consents, and Approvals.**

The transactions of a meeting, whether or not validly called and noticed, are valid if a quorum is present and each of the absent members who is entitled to vote, either before or after the meeting, signs a written waiver of notice, a consent to the holding of the meeting, or an approval of the minutes of the meeting. All waivers, consents, and approvals shall be filed with the corporate records or made a part of the minutes of the meeting.

A member's attendance at a meeting shall constitute a waiver of notice of and presence at the meeting, unless the member objects at the beginning of the meeting. However, attendance at a meeting is not a waiver of any right to object to the consideration of matters required to be included in the notice but not included, if an objection is made at the meeting.

**Section 4.09. Quorum at Meeting.**

The lesser of two hundred fifty (250) members or members representing five percent (5%) of the voting power shall constitute a quorum at a meeting of members. Any Bylaw amendment to increase the quorum may be adopted only by approval of the members. When a quorum is present, the affirmative vote of the majority of the voting power represented at the meeting and entitled to vote shall be the act of the members, unless provided otherwise by these Bylaws or the law. The only matters that may be voted upon at any regular meeting actually attended by less than one-third (1/3) of the voting power are matters notice of the general nature of which was given pursuant to the first sentence of Section 4.04 of these Bylaws.

**Section 4.10. Loss of Quorum at Meeting.**

The members present at a duly called or held meeting at which a quorum is present may continue to transact business until adjournment, notwithstanding the withdrawal of enough members to leave less than a quorum, if the action taken, other than adjournment, is approved by at least a majority of the members required to constitute a quorum.

**Section 4.11. Adjournment for Lack of Quorum.**

In the absence of a quorum, any meeting of members may be adjourned by the vote of a majority of the votes represented in person, but no other business may be transacted except as provided in Section 4.10 of these Bylaws.

**Section 4.12. Adjourned Meetings.**

The corporation may transact any business at an adjourned meeting that could have been transacted at the original meeting. When a meeting is adjourned to another time or place, no notice is required if the time and place are announced at the original meeting. If the adjournment is for more than forty-five (45) days or if a new record date is fixed, a notice of the adjourned meeting shall be given to each member of record entitled to vote at the meeting.

**Section 4.13. Voting of Memberships.**

- (a) Each member of the Corporation is entitled to one (1) vote on each matter submitted to a vote of the members.
- (b) If a membership stands of record in the names of two (2) or more persons whether fiduciaries, members of a partnership, joint tenants, tenants in common, husband and wife as community property, tenants by the entirety, persons entitled to vote under an agreement, or otherwise, or if two (2) or more persons have the same fiduciary relationship respecting the same membership, unless the Secretary is given written notice to the contrary and furnished with a copy of the instrument or order appointing them or creating the relationship, the vote of one (1) joint holder will bind all, when only one (1) votes, and the vote of the majority will bind all, when more than one (1) joint holder votes.
- (c) The record date for determining the members entitled to vote at a meeting or cast written ballots is twenty (20) days before the date of the meeting or the day on which the first ballot is mailed or solicited.
- (d) Cumulative voting shall not be permitted for any purpose.
- (e) Voting by proxy shall not be permitted for any purpose.

**Section 4.14. Use of Written Ballots at Meetings.**

A combination of written ballot and personal voting may be used at any regular or special meeting of members, and may be used for the election of Directors. Prior to the meeting, the Board of Directors may authorize distribution of a written ballot to every member entitled to vote. The ballots shall be distributed in a manner consistent with the provisions of Sections 4.05, 4.17(b), and 4.19 of these Bylaws. When ballots are distributed, the number of members voting at the meeting by written ballot shall be deemed present at the meeting for purposes of determining a quorum but only with respect to the proposed actions referred to in the ballots.

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**Section 4.15. Contents of Written Ballot Used at Meetings.**

Any written ballot used at a meeting shall set forth the proposed action to be taken, provide an opportunity to specify approval or disapproval of the proposed action, and state that unless revoked by the member voting in person, the ballot will be counted if received by the Corporation on or before the time of the meeting.

**Section 4.16. Action by Ballot without Meeting.**

Any action that may be taken at any regular or special meeting, including election of Directors, may be taken without a meeting through distribution of a written ballot to every member entitled to vote on the matter. The Secretary shall cause a vote to be taken by written ballot on any action or recommendation proposed in writing by at least twenty percent (20%) of the members.

**Section 4.17. Written Ballot Used without Meeting.**

- (a) Any ballot used without a meeting shall set forth the proposed action, provide an opportunity to specify approval or disapproval of any proposal, and provide a reasonable time within which to return the ballot to the Corporation.
- (b) The form of written ballot distributed to ten (10) or more members shall afford an opportunity to specify a choice between approval and disapproval of each matter or group of related matters intended, at the time of distribution, to be acted on by the ballot. The form must also provide that whenever the person solicited specifies a choice with respect to any matter, the vote will be cast in accordance with that choice.
- (c) A written ballot cannot be revoked. Approval by written ballot shall be valid only when the number of votes cast by ballot within the time period specified equals or exceeds the quorum required to be present at a meeting authorizing the action, and the number of approvals equals or exceeds the number of votes that would be required to approve at a meeting at which the total number of votes cast was the same as the number of votes cast by ballot.

**Section 4.18. Solicitation of Written Ballots.**

Ballots shall be solicited in a manner consistent with Sections 4.05, 4.17(b), and 4.19 of these Bylaws. The solicitations shall indicate the number of responses needed to meet the quorum requirement and specify the time by which the ballot must be received to be counted. Ballots other than for the election of Directors shall state the percentage of approvals necessary to pass the measure.

**Section 4.19. Withholding Vote.**

In an election of Directors, any form of written ballot, which names the candidates for Director and which the member has marked "withhold" (or otherwise indicated that the authority to vote in the election of Directors is withheld) shall not be used for voting in that election.

**Section 4.20. Appointment of Inspectors of Election.**

In advance of any meeting of members, the Board of Directors may appoint inspectors of election to act at the meeting and any adjournment. If inspectors are not appointed or if any appointed persons fail to appear or refuse to act, the chairperson of the meeting may and, on the request of any member, shall, appoint inspectors at the meeting.

**Section 4.21. Duties of Inspectors of Election.**

The inspectors shall determine the number of memberships outstanding and the voting power of each, the number represented at the meeting, and the existence of a quorum. They shall receive votes, ballots, and consents, hear and determine all challenges and questions regarding the right to vote, count and tabulate all votes and consents, determine when the polls will close, and determine the result. They may do those acts which are proper to conduct the election or vote with fairness to all members. The inspectors shall perform these duties impartially, in good faith, to the best of their ability, and as expeditiously as is practical.

**ARTICLE V. DIRECTORS**

**Section 5.01. Number.**

The corporation shall have \_\_\_\_\_ ( ) Directors, collectively known as the Board of Directors.

**Section 5.02. Qualifications.**

The Directors of the Corporation shall be members of the Corporation and residents of California.

**Section 5.03. Nomination.**

- (a) The Board of Directors shall prescribe reasonable nomination and election procedures for the election of Directors given the nature, size, and operations of the Corporation. The procedures shall include: (1) a reasonable means of nominating persons for election as Directors, (2) a reasonable opportunity for a nominee to communicate the nominee's qualifications and the reasons for the nominee's candidacy to the members, (3) a reasonable opportunity for all nominees to solicit votes, (4) a reasonable opportunity for all the members to choose among the nominees.
  - (b) When the Corporation distributes any material soliciting a vote for any nominee for Director in any publication owned or controlled by the Corporation, it shall make available to each other nominee, in the same material, an equal amount or space with equal prominence to be used by the nominee for a purpose reasonably related to the election. The Corporation shall mail within ten (10) business days to all members any material related to the election which a nominee for Director has furnished, upon written request and payment of mailing costs by the nominee, or allow the nominee to obtain the names, addresses, and voting rights of members within five (5) business days after the request.
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**Section 5.04. Election.**

The Directors shall be elected at the annual meetings or by written ballot in accordance with Sections 4.16–4.19 of these Bylaws. The candidates receiving the highest number of votes up to the number of Directors to be elected shall be elected.

**Section 5.05. Terms of Office.**

The terms of office for Directors shall be \_\_\_( ) years. Each Director shall hold office until the expiration of the term for which elected and until the election and qualification of a successor.

**Section 5.06. Compensation.**

The Directors shall serve without compensation except that they shall be paid in advance or reimbursed by the Corporation for their actual and reasonable expenses incurred in the performance of their duties as Directors of the Corporation. Officers of the Corporation may also be paid in advance or reimbursed for such expenses.

**Section 5.07. Call of Meetings.**

Meetings of the Board of Directors may be called by the President, any Vice-President, the Secretary, or any two Directors.

**Section 5.08. Place of Meetings.**

Meetings of the Board of Directors may be held at any place designated in the notice of the meeting, or, if not stated in a notice, by resolution of the Board.

**Section 5.09. Presence at Meetings.**

Directors may participate at meetings of the Board through the use of conference telephone or other communications equipment, as long as all participating Directors can hear one another. Participation by communications equipment constitutes presence at the meeting.

**Section 5.10. Regular Meetings.**

Regular meetings of the Board of Directors shall be held, without call or notice, at the principal office of the Corporation immediately following the annual meeting of members, as set forth in Section 4.02 of these Bylaws.

**Section 5.11. Special Meetings and Notice.**

Special meetings shall be held on four (4) days' notice by first-class mail or forty-eight (48) hours notice delivered personally or by telephone or telegraph. Notice of regular or special meetings need not be given to any Director who signs a waiver of notice, a written consent to holding the meeting, or an approval of the minutes (either before or after the meeting), or who attends the meeting without protesting prior thereto or at its commencement, the lack of notice to that Director. All waivers, consents, and approvals shall be filed with the corporate records or made a part of the minutes of the meetings.

**Section 5.12. Quorum at Meetings.**

A majority of the authorized number of Directors constitutes a quorum for the transaction of business.

**Section 5.13. Acts of Board at Meetings.**

Unless provided otherwise in the Articles of Incorporation, these Bylaws, or by law, every act or decision done or made by a majority of the Directors present at a duly held meeting at which a quorum is present is the act of the Board. A meeting at which a quorum is initially present may continue to transact business notwithstanding the withdrawal of Directors, if any action taken is approved by at least a majority of the required quorum for the meeting or a greater number required by the Articles, these Bylaws, or by law.

**Section 5.14. Adjournment of Meetings.**

A majority of the Directors present, whether or not a quorum is present, may adjourn to another time and place. If the meeting is adjourned for more than twenty-four (24) hours, notice of the adjournment shall be given prior to the time of the adjourned meeting to the Directors who were not present at the time of adjournment.

**Section 5.15. Action without Meeting.**

Any action required or permitted to be taken by the Board of Directors may be taken without a meeting, if all Directors individually or collectively consent in writing to the action. The consents shall be filed with the minutes of the proceedings of the Board. Action by written consent has the same force and effect as a unanimous vote of the Directors.

**Section 5.16. Executive Committees.**

- (a) The Board of Directors may create one or more committees to serve at its pleasure by resolution adopted by a majority of the number of Directors then in office when a quorum is present. Each committee shall consist of two (2) or more Directors appointed by a majority vote of the Directors then in office.
  - (b) Any executive committee, to the extent provided in the resolution of the Board, shall have all the authority of the Board, except with respect to the following actions:
    - (1) The approval of any action for which the approval of the members or a majority of all members is required by law;
    - (2) The filling of vacancies on the Board or in any committee that has the authority of the Board;
    - (3) The fixing of compensation of the Directors for serving on the Board or on any committee;
    - (4) The amendment or repeal of Bylaws or the adoption of new Bylaws;
    - (5) The amendment or repeal of any resolution of the Board which by its express terms are not amendable or repealable;
    - (6) The appointment of committees of the Board or the members of such committees:
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- (7) The expenditure of corporate funds to support a nominee for Director after there are more people nominated for Director than can be elected.

**Section 5.17. Resignation of Directors.**

Any Director may resign effective upon written notice to the President, the Secretary, or the Board of Directors, unless the notice specifies a later time for the effectiveness of the resignation. If a resignation is effective at a future time, a successor may be elected to take office when the resignation becomes effective.

**Section 5.18. Removal of Directors.**

Any or all Directors may be removed without cause by the members. If the Corporation has fewer than fifty (50) members, the removal shall be approved by an affirmative vote or written ballot of a majority of all the votes entitled to be cast. If the Corporation has fifty (50) or more members, the removal shall be approved or ratified by the affirmative vote of a majority of all the votes represented and voting at a duly held meeting at which a quorum is present, or by written ballot, or by the affirmative vote or written ballot of any greater proportion of the votes as required in these Bylaws or by law.

**Section 5.19. Cause of Vacancies on Board.**

Vacancies on the Board of Directors shall exist on the death, resignation, termination of membership, or removal of a Director; whenever the authorized number of Directors is increased; whenever the Board declares an office vacant pursuant to Section 5.20 of these Bylaws; and on the failure of the members to elect the full number of Directors authorized.

**Section 5.20. Declaration of Vacancies.**

The Board of Directors may declare vacant the office of any Director whose eligibility for election has ceased, who has been declared of unsound mind by a final order of court, who is convicted of a felony, or who has not attended \_\_\_\_\_ ( ) or more consecutive regular or special meetings of the Board.

**Section 5.21. Filling Vacancies on Board.**

Except for vacancies created by removal of a Director pursuant to Section 5.18 of these Bylaws, vacancies may be filled by a majority of the Directors then in office, whether or not less than a quorum, or by a sole remaining Director. Vacancies created by the removal of a Director may be filled only by approval (as defined by Section 12224 of the California Corporations Code) of the members. The members may elect a Director at any time to fill any vacancy not filled by the Directors.

## **ARTICLE VI. OFFICERS**

### **Section 6.01. Titles.**

The officers of the Corporation shall be a President, Secretary, Chief Financial Officer, and any other officers with such titles and duties as determined by the Board of Directors and as may be necessary to enable it to sign instruments. The President is the Chief Executive Officer of the Corporation. The same person may hold any number of offices. The President shall be chosen from among the Directors elected by the membership of the Corporation.

### **Section 6.02. Appointment and Resignation.**

The officers shall be chosen by the Board of Directors and serve at the pleasure of the Board, subject to the rights, if any, of an officer under any contract of employment. Any officer may resign at any time on written notice to the Corporation without prejudice to the rights, if any, of the Corporation under any contract to which the officer is a party.

## **ARTICLE VII. CORPORATE RECORDS AND REPORTS**

### **Section 7.01. Required Records.**

The Corporation shall keep adequate and correct books and records of account and minutes of the proceedings of its members, Board of Directors, and committees of the Board. It shall also keep a record of the members, including the names, addresses, and number of shares held by each. The minutes shall be kept in written form. Other books and records shall be kept either in written form or in any other form capable of being converted into written form.

### **Section 7.02. Annual Report.**

- (a) For fiscal years in which the Corporation has, at any time, more than twenty-five (25) members, the Corporation shall notify each member yearly of the member's right to receive an annual financial report. The Board of Directors shall promptly cause the most recent annual report to be sent to a member on written request. The annual report shall be prepared no later than one hundred twenty (120) days after the close of the Corporation's fiscal year.
  - (b) The annual report shall contain in appropriate detail all of the following: (1) a balance sheet as of the end of the fiscal year, an income statement, and a statement of changes in financial position for the fiscal year; (2) a statement of the place where the names and addresses of the current members are located; and (3) the statement required by Section 7.03 of these Bylaws.
  - (c) The annual report shall be accompanied by any pertinent report by independent accountants, or, if there is no such report, by the certificate of an authorized officer of the Corporation that the statements were prepared without audit from the books and records of the Corporation.
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**Section 7.03. Annual Statement of Transactions and Indemnifications.**

In addition to the annual report described in Section 7.02 of these Bylaws, the Corporation shall furnish annually (pursuant to Section 12592 of the California Corporations Code) to its members and Directors a statement of the transactions and indemnifications to interested persons. If the Corporation does not issue an annual report pursuant to Section 7.02 of these Bylaws, such statement shall be mailed or delivered to members within one hundred twenty (120) days after the close of the fiscal year.

**ARTICLE VIII. INSPECTION RIGHTS**

**Section 8.01. Articles and Bylaws.**

The corporation shall keep at its principal office in California the original or a copy of its Articles of Incorporation and Bylaws as amended to date, which shall be open to inspection by the members at all reasonable times during office hours. If the Corporation has no office in California, it shall furnish on the written request of any member a copy of the Articles or Bylaws as amended to date.

**Section 8.02. Books and Records.**

The accounting books and records and minutes of proceedings of the members, the Board of Directors, and committees of the Board shall be open to inspection on the written demand of any member at any reasonable time, for a purpose reasonably related to that person's interests as a member.

Every Director has the absolute right at any reasonable time to inspect and copy all books, records, and documents of every kind, and to inspect the physical properties of the Corporation.

**Section 8.03. Inspection of Membership List.**

(a) Subject to the Corporation's right to set aside a member's demand for inspection pursuant to Section 12601 of the California Corporations Code and the power of the court to limit inspection rights pursuant to Section 12602 of the California Corporations Code, and unless the Corporation provides a reasonable alternative pursuant to Section 8.03(c) of these Bylaws, a member may do either or both of the following:

- (1) Inspect and copy the record of all the members' names, addresses, and voting rights, at reasonable times, on making a written demand five (5) business days in advance which states the purpose for which the inspection rights are requested;
- (2) Obtain from the Secretary, upon written demand and tender of a reasonable charge, a list of names, addresses, and voting rights of those members entitled to vote for the election of Directors, as of the most recent record date for which it has been compiled, or as of a date specified by the member subsequent to the date of demand. The demand shall state the purpose for which the list is requested. The membership list shall be made available on or before the later of ten (10) business

days after the demand is received or after the date specified as the date as of which the list is to be compiled.

- (b) The rights set forth in Subsection (a) of this Bylaw section may be exercised by any member or members possessing five percent (5%) or more of the voting power for a purpose reasonably related to the members' interest as members. The Corporation may deny access to the membership list where it reasonably believes that the information therein will be used for another purpose or where the Corporation provides a reasonable alternative pursuant to Section 8.03(c) of these Bylaws.
- (c) The Corporation may within ten (10) days after receiving a demand, deliver a written offer of an alternative method of achieving the purpose identified in the demand without providing access to or a copy of the membership list. An alternative method that reasonably and in a timely manner accomplishes the proper purpose set forth in a demand made pursuant to Section 8.03(a) of these Bylaws shall be a reasonable alternative, unless the Corporation fails to do the things that it offered to do within a reasonable time after acceptance of the offer. Any rejection of the offer shall be in writing and indicate the reasons the proposed alternative does not meet the proper purpose of the demand.

## **ARTICLE IX. SURPLUS ALLOCATIONS AND DISTRIBUTIONS**

### **Section 9.01. Fiscal Year.**

The fiscal year of the Corporation shall end at the close of the business day on the last day of the month of \_\_\_\_\_ of each year.

### **Section 9.02. Surplus and Patronage Defined.**

- (a) "Surplus" shall be defined as the excess of revenues and gains over expenses and losses for a fiscal year. Such surplus shall be determined in accordance with generally accepted accounting principles and shall be computed without regard to any patronage refunds, capital allocations, dividends, or income taxes.
- (b) "Patronage" shall be defined as \_\_\_\_\_.

### **Section 9.03. Annual Allocations and Distributions of Surplus.**

- (a) Before any dividends or patronage refunds are distributed for each fiscal year, any surplus should first be allocated to any deficit in the accounting of "retained earnings" of the Corporation.
  - (b) After any deficit in retained earnings has been eliminated, the Board of Directors may declare a dividend upon shares at a rate not to exceed any maximum rate established by Section 12451 of the California Corporations Code (taking into account any other "distributions" as defined by Section 12235 of the California Corporations Code). No such dividends shall be cumulative.
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- (c) The Directors may [or “shall”: see “Legal Sources and Comments” at the end of these Sample Bylaws] then uniformly distribute all the remaining surplus attributed to patronage of the members of the Corporation to such members as described in the following paragraphs of this subsection of these Bylaws. For the purposes of this subsection of the Bylaws, the remaining patronage surplus shall be computed consistent with Subchapter T of the Internal Revenue Code, related Treasury Regulations, and related court and other relevant interpretations.
    - (1) Any remaining patronage surplus attributed to the members and to be distributed to them shall be the total remaining patronage surplus attributed to both member and nonmember business (not reduced by dividends on shares but reduced by allocations to eliminate a deficit in retained earnings) multiplied by the ratio of member patronage to total patronage.
    - (2) A member is entitled to a patronage refund, if such is distributed, in the amount of the remaining patronage surplus, as determined by Paragraph (1) of this subsection of these Bylaws, multiplied by the ratio of such member’s patronage with the Corporation to the patronage of all members with the Corporation.
  - (d) Any dividends declared or patronage refunds paid or allocated pursuant to this section of the Bylaws may be in the form of shares, in whole or in part, subject to Subsections (e) and (f) of this section of these Bylaws.
  - (e) If a member owns three hundred dollars (\$300.00) or more in shares as of the end of the fiscal year for which dividends are declared or patronage refunds are to be paid or allocated, such member shall receive all of her or his dividends and patronage refunds in cash. The three hundred dollar (\$300.00) amount shall be known as a member’s “Fair Share.”
  - (f) If the cash payment to a member for such member’s dividends and patronage refunds together would total less than one dollar (\$1.00), the Board of Directors shall distribute such dividends and patronage refunds to the member wholly in shares.
  - (g) Each person who becomes a member of this Corporation consents to include in his or her gross income for federal income tax purposes the amount of any patronage refund paid to him or her by this Corporation in money or by written notice of allocation (as defined in the Internal Revenue Code), except to the extent that such a patronage refund is not income to the member because (i) it is attributable to the purchase of personal, living, or family items, or (ii) it should properly be treated as an adjustment to the tax basis of property previously purchased. The term “patronage refund,” as used herein, shall have the same meaning as the term “patronage dividend,” as used in the Internal Revenue Code.
  - (h) For the purpose of allocating and distributing any annual surplus, the entire operations of the Corporation shall be considered as a unit; provided that by resolution of the Board of Directors, the Corporation may distribute patronage refunds on the basis of the business transacted by each of the departments or divisions into which the operations of the Corporation shall be divided by the Board for the purpose of such allocation.
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**ARTICLE X. BYLAW CHANGES**

**Section 10.01 Bylaw Changes by the Board.**

The Bylaws shall be adopted, amended, or repealed by the Board of Directors unless the action would:

- (a) materially and adversely affect the rights or obligations of members as to voting, dissolution, redemption transfer, distributions, patronage distributions, patronage, property rights, or rights to repayment of contributed capital;
- (b) increase or decrease the number of members or shares authorized in total or for any class;
- (c) effect an exchange, reclassification, or cancellation of all or part of the memberships or shares;
- (d) authorize a new class of memberships or shares;
- (c) change the number of Directors or establish a variable number of Directors;
- (f) extend the term of a Director beyond that for which the Director was elected or increase the terms of the Directors;
- (g) allow all or any portion of the Directors to hold office by virtue of designation or selection rather than by election by the members: and
- (h) allow the Board to fill vacancies occurring in the Board by reason of the removal of Directors.

**Section 10.02. Bylaw Changes by the Members.**

Where the Board of Directors is denied the right to adopt, amend, or repeal these Bylaws pursuant to Section 10.01 of these Bylaws, these Bylaws shall be adopted, amended, or repealed by approval of the members.

CERTIFICATE OF SECRETARY OF [NAME OF CORPORATION]

I hereby certify that I am the duly elected and acting Secretary of this Corporation and that the foregoing Bylaws constitute the Bylaws of this Corporation, as duly adopted by the Board of Directors on \_\_\_\_\_, 20\_\_.

Dated: \_\_\_\_\_, 20\_\_.

[signature]

\_\_\_\_\_  
[typed name], Secretary

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## E. LEGAL SOURCES AND COMMENTS

Information related to most sections of the sample bylaws is provided here. All “Code Section” references are to the California Corporations Code, which includes the California Consumer Cooperative Corporation Law (sometimes referred to below as “co-op law”).

### *Section 1.01. Classification of Members*

Either the bylaws (preferably) or the articles of incorporation would need to be more complex in order to provide for multiple classes of members or shares. Most smaller cooperatives probably have no real need for more than one class of members or shares. Unless one or more different classes are established and described in the articles or bylaws, it is assumed that all members and shares have the same rights and obligations as all the other members and shares. Legal counsel should be sought before multiple classes are established.

### *Section 1.02. Membership Qualifications*

Code Section 12403 allows a co-op to admit any “person” (i.e., a natural person or an organization) to membership, except that a “subsidiary” corporation of the co-op may not be a member. A co-op may limit those who may become members through membership qualification provisions. To help a co-op avoid the applicability of federal security registration, members should be limited to California residents wherever possible.

### *Section 1.05. Transfers Prohibited*

Unless the articles of incorporation or bylaws provide otherwise, transfers of memberships and shares are prohibited by co-op law. As a practical matter, for a co-op issuing shares, such transfers should be prohibited. (See the discussion of sample bylaw Section 3.04 below and Code Section 12410(a)(1).)

### *Section 1.06. Membership Fee*

One-time nonrefundable membership fees are sometimes useful in covering expenses related to the administrative processing of new members. A cooperative also might consider charging annual dues to help defray recurring membership costs (e.g., newsletters). Code Section 12441 allows the imposition of such fees and dues; to be effective, such dues and fees should be provided for in the bylaws.

### *Section 1.07. Bylaws and Articles to Prospective Members*

This section not only recognizes that members should be given copies of a cooperative’s basic corporate documents, but that it is generally *required* to do so if the co-op is to distribute tax-deductible patronage refunds. (See Internal Revenue Code Section 1388 (c)(2)(B) and Treasury Regulations Section 1.1388-1(c)(3)(ii).)

### *Section 2.01. Share Issuance*

By changing the wording, a cooperative also could issue shares for other types of consideration (e.g., services, property, etc.), as allowed by Code Section 12400. To avoid “valuation” problems, however, a co-op may want to limit consideration to money paid.

### *Section 2.02. Share Ownership*

Unless a cooperative is a “central organization” (e.g., having two or more co-ops in its membership), co-op law mandates that each member is entitled to only one vote in the affairs of the co-op. (See Code Sections 12256, 12314, and 12480.)

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### *Section 2.03. Share Certificates and Disclosure Document*

Because cooperatives are *not* required to issue share or membership certificates, these sample bylaws assume such certificates will not be issued. It is important to note that, while certificates are not required to be issued, co-op law *does* require that a “disclosure document” be given to each applicant for membership. (The sample disclosure document of this publication is correlated to the sample articles of incorporation and bylaws.) The required contents of the document are listed in this bylaw section. Also, in accordance with co-op law, Subsection (c) of this bylaw section requires that, since share or membership certificates are not to be issued, a member be given some form of receipt or other written document for his or her initial share purchase. If membership or share certificates are to be issued, co-op law requires certain information on the certificates. (See Code Section 12401.)

### *Section 2.04. Prohibition on Transfer of Shares*

To minimize potential complex securities regulation and internal administrative problems, membership and share transfers should be prohibited, even between members.

### *Section 2.05. Partial Withdrawal*

If investment in a cooperative is to be encouraged, a member should be allowed to withdraw at least part of her or his share investment without having to terminate membership. Termination of membership would usually mean that the co-op would then have to refund *all* of the member’s share account. (See sample bylaws Section 3.04.) For convenience, the “amount to be determined from time to time by the board” should be set at the same amount as the “fair share” of sample bylaws Section 9.03(e).

### *Section 2.06. Insolvency Delay*

If share redemptions are to be allowed, this section reflects the restraints imposed by Code Section 12453.

### *Section 2.07. Unclaimed Equity Interests*

With this bylaw provision, a cooperative may retain any unclaimed equity interests of a member after three years of no contact with such member. Otherwise, the equity amounts would be reported to and paid over to the State of California. Code Section 12446 *mandates* the procedures provided by this bylaw section.

### *Section 3.01. Voluntary Withdrawal*

Code Section 12430 provides that a member has the right to “resign from membership at any time, although the articles of incorporation or bylaws may require reasonable notice before the resignation is effective.”

### *Section 3.02. Death and Dissolution*

This bylaw provision reflects the language of Code Section 12410(a)(2).

### *Section 3.03. Expulsion*

Fair and reasonable expulsion procedures are required by statute, and this bylaw section follows specific procedures described in Code Section 12431 as being reasonable. Most expulsions in cooperative settings are likely to be due to the “inactivity” standard of this bylaw section. A minimum patronage requirement allows a co-op to terminate memberships of those persons who are not at least minimally participating in the co-op. Because consumer co-ops in particular sometimes have problems meeting quorum requirements, terminating relatively inactive members can be an important issue.

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***Section 3.04. Settlement of Share Interest***

To avoid the potentially awkward situation where a former member (due to termination) would perhaps indefinitely hold shares in the cooperative because of the transfer prohibition, this bylaw section provides that the share interest must be redeemed upon termination of membership. Also, the co-op is allowed to deduct from the interest of the former member any amounts he or she may owe the co-op. The substance of this bylaw section is required by Code Sections 12430(b) and 12445.

***Section 4.01. Location***

Code Section 12460(a) provides that membership meetings may be held anywhere that is stated in or fixed by the bylaws; if no such place is fixed or stated, the meetings must be held at the principal office of the co-op.

***Section 4.02. Regular Annual Meetings***

Although membership meetings may be held more often, an *annual* meeting is required by Code Section 12460(b). Also, although the annual meeting may be held at any time, an appropriate time for the meeting might be at about the same time that the required annual report must be made available to members, i.e., within one hundred twenty days of the end of the cooperative's "accounting" year. (See sample bylaws Section 7.02.)

***Section 4.03. Special Meetings***

Code Section 12460(e) allows the bylaws to specify any other persons who may call a special meeting of the members, besides the ones mentioned in this sample bylaw provision.

***Section 4.04. Time for Notice of Meetings***

It is important that "notice" of a meeting be properly given so that later procedural challenges of the results of any voting may be avoided. This section follows the language of Code Section 12461(a),(c).

***Section 4.05. Method of Giving Notice***

This bylaw section tracks the requirements of Code Section 12461(b) related to proper notice.

***Section 4.06. Record Date for Notice***

This bylaw section determines which members are entitled to notice of a membership meeting. In the alternative, Code Section 12481(a) allows the board of directors to set each particular record date.

***Section 4.07. Contents of Notice***

Code Section 12461(a) requires that the notice to members contain the items of information described in this bylaw section.

***Section 4.08. Waivers, Consents, and Approvals***

This section follows the language and requirements of Code Section 12461(e).

***Section 4.09. Quorum at Meeting***

Code Section 12462(a) provides these quorum requirements unless the bylaws provide otherwise. These sample bylaws provide that membership approval on any vote is by simple majority. While the bylaws or articles of incorporation may require approval by more than a majority of the members, a cooperative with a relatively large number of members would probably be well advised not to require approvals by more than a majority. See also Code Sections 12224 and 12331 related to majority and super-majority approvals. Code Section 12462(b) requires the "less than one-third" rule of this sample bylaws section.

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***Section 4.10. Loss of Quorum at Meeting***

Code Section 12462(c) provides that a meeting may continue under the conditions stated in this sample bylaws section.

***Section 4.11. Adjournment for Lack of Quorum***

Code Section 12462(d) provides conditions for adjournment as provided in this bylaw section.

***Section 4.12. Adjourned Meetings***

Code Section 12461(d) provides the minimum rules as described in this bylaw section, but also allows the bylaws to set more stringent notice requirements, if desired.

***Section 4.13. Voting of Memberships***

Except in the case of cooperatives that are “central organizations” as defined in Code Section 12256 (i.e., those whose membership includes other co-ops organized under co-op law), each member of a co-op is entitled to only one vote in the corporate affairs. Although a co-op may want to limit each membership to one person, Subsection (b) of this sample bylaws section provides a voting procedure where a single membership is made up of more than one person or organization. The record date for determining which members are entitled to vote cannot be more than sixty days before the meeting or before written ballots are mailed or solicited. See Code Sections 12480–12484 for more details related to voting.

***Section 4.14. Use of Written Ballots at Meetings***

Although a cooperative generally does not have to provide for written ballots, such ballots *must* be used for “referendums.” (See sample bylaws Section 4.16.) In any event, if a relatively large number of members were involved, most co-ops would probably find written ballots the more convenient voting procedure. See Code Section 12463 for more details regarding the use of written ballots.

***Section 4.15. Contents of Written Ballot Used at Meeting***

Code Section 12461(h) is the basis of this sample bylaws provision.

***Section 4.16. Action by Ballot without Meeting***

Although the articles of incorporation or bylaws may prohibit voting outside of meetings, except where at least twenty percent of the members force a vote (Code Section 12463(a) and (f)), cooperatives with relatively large numbers of members may want to conduct votes only by mail since quorums may be difficult to achieve otherwise.

***Section 4.17. Written Ballot Used without Meetings***

Code Section 12464(a) provides procedures for voting by written ballots. This sample bylaws section describes the California Consumer Cooperative Corporation Law’s prescribed form of a written ballot, where the ballot is to be distributed to ten or more members of a cooperative having at least one hundred members. Failure to comply with Subsections (a) and (b) of this sample bylaws provision will not invalidate a corporate action but may be a basis for challenging the vote. Code Section 12463(d) provides that a written ballot cannot be revoked unless the articles of incorporation or bylaws provide otherwise.

***Section 4.18. Solicitation of Written Ballots***

Code Section 12463(c) states the solicitation requirements for written ballots, and this sample bylaws section closely follows the statutory language.

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***Section 4.19. Withholding Vote***

Code Section 12464(b) provides the statutory basis for this bylaw provision. Failure to comply will not necessarily invalidate an election but may open it to challenge.

***Section 4.20. Appointment of Inspectors of Election***

Code Section 12483(a) provides for the appointment of “election inspectors.” Although the board of directors may always provide for election inspectors, such inspectors are *not* required to be appointed unless a member so requests. It is wise for a cooperative to appoint inspectors for any election.

***Section 4.21. Duties of Inspectors of Election***

Subsections (b) and (c) of Code Section 12483 describe the required duties of election inspectors. This sample bylaws provision tracks the statutory language almost verbatim.

***Section 5.01. Number***

Unless provided for in the articles of incorporation, the bylaws must state the exact number of directors or set a minimum and maximum number of directors, the exact number of which may be established by the board or the members. To avoid confusion, a fixed number of directors is usually preferable. In any event, a cooperative must have at least three directors. Code Section 12331(a) provides these rules.

***Section 5.02. Qualifications***

While most cooperatives probably require that directors also be members of the co-op, California’s Consumer Cooperative Corporation Law does not require such membership. Also, although not provided for in these sample bylaws for simplicity’s sake, “alternate” directors are permitted by Code Section 12331(a), and Code Section 12360(d) permits all or some of the directors to hold office other than by election by the members. (Code Section 12360(c) states that the bylaws or articles of incorporation may set qualifications.) California residency is required in this sample bylaws provision (since these sample bylaws require all directors to be members and, thus, to be California residents) to minimize potential securities regulation problems.

***Section 5.03. Nomination***

These procedures are required by Code Sections 12470, 12473, and 12474 to help ensure fair and open elections. Although the specific procedures of Subsection (a) of this bylaw section are no longer required by the California Consumer Cooperative Corporation Law, they have been retained for the purposes of these sample bylaws.

***Section 5.04. Election***

Code Section 12460(b) requires that in any year that directors are to be elected, the election must be held at the regular annual meeting of members (unless the directors are chosen in some other manner). Except in the case of those cooperatives that are “central organizations” as defined in Code Section 12256 (those whose membership includes other co-ops organized under co-op law), “cumulative” voting procedures are not permitted (Code Section 12484).

***Section 5.05. Terms of Office***

Code Section 12360(a) requires that the terms of elected directors be fixed (not to exceed four years) in the articles of incorporation or the bylaws; these sample bylaws provide for two-year terms. To simplify the sample bylaws, no “staggering” of terms is provided. The initial directors serve only until the first annual membership meeting, as provided in the sample articles of incorporation and Code Section 12360(b).

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**Section 5.06. Compensation**

Although cooperative directors are generally not paid for their services as directors, they are often reimbursed for certain “out-of-pocket” expenses they incur in their role as directors. Code Section 12375(b) requires that co-ops be *allowed* to reimburse reasonable and necessary expenses if they so desire.

**Section 5.07. Call of Meetings**

Code Section 12351(a)(1) allows a cooperative to expand or contract the identified people who may call a meeting of the board of directors.

**Section 5.08. Place of Meetings**

Code Section 12351 allows cooperatives much flexibility regarding “regular” and “special” meetings of the board of directors, although Subsection (a)(2) states that the articles of incorporation or bylaws may not dispense with notice of special meetings.

**Section 5.09. Presence at Meetings**

Code Section 12351(a)(6) provides for the types of participation described in this bylaw section, but Subsection (a) itself allows cooperatives to vary or even prohibit these types of electronic meetings.

**Section 5.10. Regular Meetings**

Code Section 12351(a)(2) allows “regular” meetings (without notice) to be fixed in the bylaws. Such a meeting should be held at the time of the annual membership meeting.

**Section 5.11. Special Meetings and Notice**

The statutory language of Code Section 12351(a)(2) does not include “fax” transmissions. The articles of incorporation and bylaws may not dispense with the notice requirements of “special” meetings of the board of directors.

**Section 5.12. Quorum at Meetings**

Code Section 12351(a)(7) provides that a majority of the board of directors constitutes a quorum, unless the articles of incorporation or bylaws provide otherwise. A quorum of less than twenty percent of the directors, or less than two directors, whichever is larger, is prohibited.

**Section 5.13. Acts of Board at Meetings**

Code Section 12351(a)(8) requires that at least a majority of directors is required to approve an act of the board. Many cooperatives would probably not want supermajority approvals required by the articles of incorporation or bylaws. Code Section 12350 states that the management of a co-op is ultimately the responsibility of the board of directors. Although the board may delegate the management of the co-op, the board still retains ultimate responsibility.

**Section 5.14. Adjournment of Meetings**

Code Section 12351(a)(4) permits adjournment of a meeting of the board of directors to another time and place, unless the articles of incorporation or bylaws provide otherwise.

**Section 5.15. Action without Meeting**

Code Section 12351(b) permits board of directors’ actions without a meeting.

**Section 5.16. Executive Committees**

Code Section 12352 provides for the establishment of committees with the authority of the board of

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directors, with the exceptions as listed. Such committees may be established in the bylaws or by board resolution. The bylaws, however, may restrict the use of such committees (under Subsection (c) of Code Section 12352). See also Code Section 12331(c)(4) related to committee makeup and authority.

***Section 5.17. Resignation of Directors***

Code Section 12364(c) provides the right of resignation to all directors in language very similar to this provision of the sample bylaws.

***Section 5.18. Removal of Directors***

Where a cooperative has fewer than fifty members, Code Section 12362(a)(1) requires that the majority of all members (not just the majority of a quorum) must approve removal.

***Section 5.19. Cause of Vacancies on Board***

Code Section 12363 also provides that directors and members can sue in court to remove directors for fraudulent or dishonest acts or for gross abuse of authority or discretion.

***Section 5.20. Declaration of Vacancies***

Code Section 12361 allows the board of directors to declare vacancies for the reasons stated in this sample bylaws provision. Any specified number of missed meetings should probably take into account how often the board of a particular cooperative will meet.

***Section 5.21. Filling Vacancies on Board***

Code Section 12364(a) allows the articles of incorporation or bylaws to vary this provision, although members may elect a director for any vacancy not filled by the directors.

***Section 6.01. Titles***

Code Section 12353(a) requires that a cooperative have officers, including a chairman of the board and/or a president, a secretary, and a chief financial officer, and that the titles and duties of the officers must be stated in the bylaws or determined by the board of directors. “Chief financial officer” is now generally used throughout the entire California Corporations Code in place of the term “treasurer.”

Unless the articles of incorporation or bylaws provide otherwise, any number of offices may be held by the same person, although the chairman of the board *or* the president must be directors elected by the members.

***Section 6.02. Appointment and Resignation***

Code Section 12353(b) provides that the manner in which officers are chosen and their terms may be specified in the articles of incorporation or the bylaws (preferably the latter). Typically, officers are appointed by the board of directors. Officers are often more likely to be employees of a cooperative rather than directors. Officers’ duties tend to be more “operational” than the more policy-oriented nature of board actions.

***Section 7.01. Required Records***

Code Section 12590 requires that membership records (including names, addresses, and each member’s class and number of membership units) as well as adequate and accurate accounting records be maintained (either in writing or some other format that is capable of being converted to written form). It also requires written “minutes” of all member, board, and board committee meetings.

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### *Section 7.02. Annual Report*

Code Section 12591 provides that the “annual report” is not required for a cooperative having fewer than twenty-six members at all times during the fiscal year covered by the report. This sample bylaws provision is included to alert co-ops of the requirements of co-op law. Please note that the “statement of changes in financial position” is now a “statement of cash flows”; the statutory language has not yet been amended to conform to changes in accounting principles.

An income statement shows the income and expenses for whatever period (e.g., a twelve-month period) is being reported upon, while the related balance sheet shows the assets, liabilities, and members’ equity as of the end of the last day of the period covered by the income statement. The statement of cash flows, the other required financial statement, shows how cash was generated and used in the operating, financial, and investing activities of the co-op.

### *Section 7.03. Annual Statement of Transactions and Indemnifications*

Code Section 12592 provides that the “annual report” must include information regarding transactions with, and indemnification of, “interested persons” (e.g., directors and officers).

### *Section 8.01. Articles and Bylaws*

Code Section 12340 requires the availability of the articles of incorporation and bylaws, as described in this sample bylaws provision.

### *Section 8.02. Books and Records*

This sample bylaws provision is taken almost verbatim from Code Section 12603.

### *Section 8.03. Inspection of Membership List*

Code Section 12600 delineates the rights of a member regarding the membership list of a cooperative, and this sample bylaws provision incorporates its mandates.

### *Section 9.01. Fiscal Year*

Although any fiscal year not exceeding twelve months (except in the case of the 52/53-week option) may be adopted by a cooperative, certain factors should be taken into consideration in choosing the fiscal year. First, if a 52/53-week fiscal year is to be adopted, the co-op should consult a tax accountant or attorney regarding the tax rules surrounding such an alternative. Second, the fiscal year preferably should end on (or, in the case of a 52/53-week year, about) the last day of some calendar quarter (i.e., March 31, June 30, September 30, or December 31). Such a date should be (1) the one in which any “inventory” to be counted will be at a relatively low point or (2) the *last* of the four dates that fall within twelve months of the date of incorporation, or (3) the end of the calendar year. Tax rules require that any inventories (for resale) be physically counted at reasonable intervals. Although a retail or wholesale co-op would probably want to count inventory more often, the inventory should be counted on or very near the last day of the fiscal year (for both accounting and tax reasons).

### *Section 9.02. Surplus and Patronage Defined*

“Surplus” is defined in order to determine what amount is available for any dividends and patronage refunds at the end of the fiscal year. The surplus is generally determined in accordance with “generally accepted accounting principles,” which imply the “accrual” (rather than the “cash”) basis of accounting. Code Section 12591(a) at least implies that accrual basis statements are required, because of both the titles and types of financial statements required in the “annual report.”

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“Patronage” should be defined as whatever activity the members are engaged in with their cooperative (e.g., workers as employees, consumers as purchasers). Tax-deductible patronage refunds (distributed from the surplus) are based on the relative patronage of each member to all members of the cooperative.

**Section 9.03. Allocations and Distributions of Surplus**

Please note that the following “subsections” correlate to the subsections of this sample bylaws provision.

- (a) To help restore working capital following “loss” years, a cooperative should retain any current surplus needed to eliminate any “deficit” (i.e., the accumulated total net losses and distributions of dividends and patronage refunds) in “retained earnings” (i.e., assets less liabilities and contributed capital).
- (b) Unless a cooperative prohibits the distribution of dividends or shares, the board of directors may declare a dividend of up to fifteen percent of the value of the co-op’s shares (Code Section 12451), assuming a surplus is available after the elimination of any deficit and that share redemptions are based upon original amounts paid or allocated. If a co-op wishes to encourage members to invest in the co-op, dividends should be an option. Even if a surplus is available and dividends are not prohibited, the board must still determine the amount, if any, of dividends to be paid.
- (c) Code Section 12201 provides for the distribution of patronage refunds. *The third word of the sample bylaws Subsection (c), is all-important* (see p. 59). For patronage refunds to be tax-deductible, tax law requires that the bylaws, articles of incorporation, or some other document *mandate* in advance that the cooperative distribute patronage refunds. (See Internal Revenue Code Section 1388(a)(2) and Treasury Regulations Section 1.1388-1(a)(1).) A smaller consumer co-op, for example, probably will not want to be initially obligated to pay patronage refunds because the related administrative costs could very well be much greater than any tax savings generated by mandatory refunds.

The Internal Revenue Code becomes all-important in structuring a cooperative’s patronage refunds. Only “patronage-sourced” income may be distributed as tax-deductible patronage refunds, as such income is defined in Section 1388(a)(3) of the Internal Revenue Code, Treasury Regulations Section 1.1388-1(a), and various interpretations by the Internal Revenue Service and the courts. Also, the “ordinary income” portion of the gain from the disposition of a co-op’s equipment must generally be distributed in accordance with the patronage of those persons who were members during the year when depreciation deductions were taken by the co-op. (See IRS Revenue Ruling 74-84.) Because such a distribution would be very burdensome for a co-op with a relatively large number of members, however, this sample bylaws subsection excludes such a distribution. (See Treasury Regulations Section 1.1382-3(c)(3).)

Tax-deductible patronage refunds must also be paid to members on the basis of the volume of business done with each member (Internal Revenue Code Section 1388(a)(1), (3); Treasury Regulations Section 1.1388-1(a)(i),(ii)) and determined by reference to the patronage-based “net earnings” of the cooperative (Internal Revenue Code Section 1388(a)(3); Treasury Regulations Section 1.1388-1(a)(1)(iii)).

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This subsection of the sample bylaws does not obligate a cooperative to distribute patronage refunds, and the co-op may wish to delete this subsection and Subsections (g) and (h), and revise Subsections (d) through (f) to delete references to refunds if the co-op does not want to obligate itself to distribute refunds. If tax-deductible refunds are desired, however, the word “may” *must* be changed to “shall,” and professional assistance should be retained to ensure that all other requirements are met to ensure the tax-deductibility of the refunds. (See Internal Revenue Code Sections 1381–1388 and the related Treasury Regulations.)

*For tax years beginning after October 22, 2004, a co-op is no longer required to reduce the amount available for tax-deductible patronage refunds by the amount of dividends on shares, assuming that the bylaws or articles of incorporation do not provide otherwise.*

- (d) Additional shares or debt may be issued to members for the purpose of distributing dividends and refunds. Shares should be used, however, for the cooperative to be able to later take advantage of the co-op exemption related to unclaimed member *equity* interests. (See chapter 13 of this publication.) At least twenty percent of any refunds must be distributed in *cash* within eight and one-half months following the close of the fiscal year, however, in order for the entire refund amount (i.e., the noncash and cash portion) to be tax-deductible (Internal Revenue Code Sections 1382(d) and 1388(c)(1)). Please note that the option of distributing “nonqualified” refunds is outside the scope of this discussion; such refunds are deductible only as cash is actually distributed.
- (e) By paying *all* dividends and refunds in cash to members already owning at least three hundred dollars in shares, this bylaw subsection provides an incentive for members to invest in the cooperative. If the co-op wishes to take advantage of California’s co-op equity exemption from securities “qualification” (Code Section 25100(r)), this bylaw subsection helps ensure that no member owns more than three hundred dollars in shares after any given distribution. Normally, the amount set here would be the same amount as set by the board of directors pursuant to Section 2.05 of these sample bylaws.
- (f) This bylaw subsection allows a cooperative to avoid costs associated with writing checks for amounts of less than one dollar. Although a larger amount might be chosen, professional advice should be sought to ensure that any larger amount would not jeopardize the tax-deductibility of any patronage refunds (since at least twenty percent of tax-deductible refunds need to be distributed in cash).
- (g) For any cooperative distributing tax-deductible patronage refunds, this subsection is necessary (Internal Revenue Code Section 1385(b)). All or some members of some co-ops will have to pay income taxes on the refunds, while few if any members would be taxed in others. On the other hand, any and all *dividends* on capital contributions (e.g., shares) are taxable. The nature of the particular co-op will generally determine whether members will be taxed or not (i.e., whether “patronage” is of a business *or* of a personal nature).
- (h) This provision serves notice that the cooperative may determine, allocate, and distribute its surplus on an organization-wide basis unless the board of directors resolves otherwise. Using an organization-wide basis usually simplifies the accounting, allocation, and distribution procedures related to any surplus.

#### ***Section 10.01. Bylaw Changes by the Board***

A cooperative may place more restrictions on, or even eliminate, the power of the board of directors to make bylaw changes. See Code Sections 12330, 12331(b), 12360(a)(d), and 12364(a) for more

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detailed and specific information regarding bylaw changes and restrictions upon the board related to such changes.

*Section 10.02. Bylaw Changes by the Members*

Where the board of directors is denied the right to adopt, amend, or repeal the bylaws pursuant to Subsections (a) through (h) of Section 10.01 of these sample bylaws, the bylaws are to be adopted, amended, or repealed *only* by approval of the members. Please note that Sections 10.01 and 10.02 of these sample bylaws do *not* provide for changes by “others” other than the board or members. (See Section C(4) of this chapter for more information.)

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## Chapter 6. MEMBER-RELATED DOCUMENTS

### A. MEMBERSHIP AND SHARE CERTIFICATES

#### 1. In General

Under the California Consumer Cooperative Corporation Law, a cooperative may, but is not required to, issue membership or share “certificates.”<sup>1</sup> A membership or share certificate is a document describing an ownership interest in the co-op.<sup>2</sup> If certificates are issued, they must provide the same information required in the “disclosure document” described below.<sup>3</sup> Of course, it is probably to the co-op’s advantage to *not* issue a membership or share certificate each time it issues one or more shares to a member; the co-op may simply issue a single disclosure document instead (in addition to the required “receipt”; see below).

#### 2. Effect of Bylaw and Article Amendments<sup>4</sup>

If the bylaws or articles of incorporation are amended so that any information required on the membership or share certificate is no longer accurate, the board of directors may cancel the outstanding certificates and substitute new certificates in conformity with the amended articles or bylaws.

When new certificates are issued due to article or bylaw changes, the board of directors may order current certificate holders to surrender or exchange the old certificates for the new ones within some reasonable time period fixed by the board. The board may also mandate that a holder of the old certificate will not be entitled to exercise any membership rights until the certificate is surrendered. The suspension of rights, however, may occur only after notice of the surrender order is given to the holder.

If a cooperative does not issue new certificates as described above and if a member who has been transferred a membership (or share) certificate by another member was not provided with a disclosure document that was accurate as of the date of transfer, the co-op must provide a disclosure document to the member to whom the certificate was transferred. (The disclosure document is discussed in more detail later in this chapter; a sample document is also provided.)

#### 3. Required Certificate, Receipt, or Written Advice

The cooperative must issue a membership or share certificate, receipt, or written advice of purchase to anyone purchasing his or her first membership or share of any class.<sup>5</sup> This requirement implies that a member may purchase more than one membership of any one class and, thus, strongly implies that “memberships” are equated with “shares” under co-op law.

#### 4. Replacement Certificates<sup>6</sup>

A cooperative may issue a new membership or share certificate to replace one that has been lost, stolen, or destroyed. The co-op may require the member whose certificate is missing to give the co-op a bond (or other sufficient security) to reimburse the co-op for the costs of any problems related to missing or replacement certificates.

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## 5. Disclosure Document

### a. Required Contents

Whether or not a cooperative issues membership or share certificates, it must provide each new member with a “disclosure document” before membership becomes effective.<sup>7</sup> The disclosure document may be in the form of a prospectus, offering, circular, brochure, specimen copy of membership certificate, or receipt.<sup>8</sup> In any format, however, the document *must* contain the following information:<sup>9</sup>

- (1) a statement that the organization is a cooperative corporation;
- (2) a statement that a copy of the articles of incorporation and bylaws must be furnished to each member or potential member upon written request; the co-op’s office address, and the address where the request should be directed;
- (3) any restrictions imposed upon the transfer of memberships (or, implicitly, shares);
- (4) any dues, assessments, membership fees, or transfer fees and the conditions under which they may be imposed;
- (5) the amount and nature of any required contributions of services to the co-op;
- (6) whether and under what circumstances a membership (or share) is redeemable at the option of the member or the co-op; and
- (7) the rules by which the voting power and proprietary rights are determined if the voting power or proprietary rights of members are unequal.

Instead of detailing items (3) through (7) above, the disclosure document may state that the information will be provided free to a member or potential member upon her or his written request.<sup>10</sup> The disclosure document must then also provide the cooperative’s office address and the address to which the request must be sent.<sup>11</sup>

### b. Subsequent Membership Purchases

A disclosure document is not required to be provided to an existing member prior to the purchase of *additional* memberships (or shares) if the member has previously been provided with a disclosure document that is accurate as of the date that the additional memberships (or shares) are purchased.<sup>12</sup>

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## B. SAMPLE MEMBERSHIP DISCLOSURE DOCUMENT

Legal sources and comment related to this sample form are found at the end of this chapter. NOTE: The following sample conforms to the sample articles of incorporation and sample bylaws of this *Sourcebook*.

### MEMBERSHIP DISCLOSURE DOCUMENT FOR [NAME OF COOPERATIVE]

#### 1. Cooperative Status

\_\_\_\_\_ is a cooperative corporation organized under the Consumer Cooperative Corporation Law of California.

#### 2. Copy of Articles and Bylaws

A copy of the Corporation's Articles of Incorporation and its Bylaws will be furnished without charge to each member upon written request. Requests should be sent to [address], the Corporation's office address.

#### 3. Assignment or Transfer

No share or membership of this Corporation may be assigned or transferred. Any attempted assignment or transfer shall be wholly void and shall confer no rights on the intended assignee or transferee. (See Bylaw Sections 1.05 and 2.04.)

#### 4. Membership Fee

A one-time nonrefundable membership fee, in an amount set from time to time by the Board of Directors, may be charged to and collected from each member upon joining the Corporation. (See Bylaw Section 1.06.)

#### 5. Partial Withdrawal of Shares

A member having a monetary amount in his or her share account in excess of a monetary amount to be determined from time to time by the Board of Directors may cause the Corporation to purchase his or her excess share amount upon written request to the Board. Subject to Section 2.06 of these Bylaws, the Board must, within one (1) year of such request, pay the amount the member requests in cash or other property or both. The exact form of payment is within the discretion of the Board (Bylaw Section 2.05).

#### 6. Termination of Membership

Sections 3.01 through 3.04 of the Bylaws of the Corporation provide as follows:

*Section 3.01. Voluntary Withdrawal*

A member shall have the right to resign from the Corporation and terminate his or her membership by filing with the Secretary of the Corporation a written notice of resignation.

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The resignation shall become effective immediately without any action on the part of the Corporation.

*Section 3.02. Death or Dissolution*

A membership shall immediately terminate upon the death of a member or the dissolution of a member that is an organization.

*Section 3.03. Expulsion*

- (a) A member may, for failure to comply with the Bylaws, rules, or regulations of the Corporation, for failure to patronize the Corporation during the immediately preceding fiscal year of the Corporation in the amount of at least \_\_\_\_ dollars (\$\_\_\_\_.\_\_), or for any other justifiable reason, be expelled from the Corporation by resolution adopted by a two-thirds (2/3) vote of all the members of the Board of Directors. Expulsion shall become effective immediately unless the Board shall, in the resolution, fix another time. On expulsion, the name of the member expelled shall be stricken from the membership register and all of his or her rights shall cease except as provided in Section 3.04 of these Bylaws.
- (b) Prior to expulsion of a member, the Board of Directors shall give such member at least fifteen (15) days' notice prior thereto and the reasons therefor. Such member shall have the opportunity to be heard, orally or in writing, not less than five (5) days before the effective date of expulsion by the Board.
- (c) The notice required pursuant to Subsection (h) of this section of these Bylaws may be given by any method reasonably calculated to provide actual notice. Any notice given by mail must be given by first-class or registered mail sent to the last known address of the member shown on the Corporation's records.

*Section 3.04. Settlement of Share Interest*

If a membership is terminated for any reason set forth in this Article of the Bylaws, the share interest held by the member shall be purchased by the Corporation, subject to Section 2.06 of these Bylaws within one (1) year of the date of termination to the extent of the paid-up value of the member's shares on such date. The Board of Directors, in so settling the member's share interest, shall have the right to set off any and all indebtedness of the member to the Corporation. The paid-up value of the member's share interest is the monetary amount of such interest (including fractional shares) that the member has been issued in accordance with Section 2.01 of these Bylaws.

**7. Member's Proprietary Interest**

A member's proprietary interest in the Corporation is equal to the unredeemed (1) total of money received by the Corporation in exchange for all shares purchased by such member, and (2) the monetary amount of any shares allocated to a member by the Corporation. (See Article 4 of the Articles of Incorporation and Bylaw Sections 2.01, 2.02, 2.05, 3.04, and 9.03.) A member or former member's proprietary interest does not include amounts transferred to the Corporation pursuant to Section 2.07 of the Bylaws (related to "unclaimed" equity interests).

## C. LEGAL SOURCES AND COMMENTS

A cooperative must give each prospective member a copy of a “disclosure document” whether or not it issues share or membership “certificates” (California Corporations Code Section 12401(a),(b)). A receipt, certificate, or written advice or purchase must also be given to a member upon his or her first purchase of a membership of any “class.” (California Corporations Code Section 12401(e).)

If the articles of incorporation or bylaws are amended in any way that affects the accuracy of the information in the disclosure document, both existing and prospective members must be given an updated document. (Code Section 12401(e).)

The sample Membership Disclosure Document contains the information required by law for a cooperative using the sample articles of incorporation and sample bylaws provided in this *Sourcebook*. Variations from the sample articles or bylaws may require changes in the sample membership disclosure document. Legal sources for the specific provisions of the sample membership disclosure document are as follows (“Code Section” refers to the California Corporations Code):

1. *Cooperative Status*

Code Section 12401(b)(1).

2. *Copy of Articles and Bylaws*

The address of both the co-op’s office and the place where a request for a copy of the articles of incorporation and bylaws should be sent (if different) should be inserted. (Code Section 12401(b)(2)).

3. *Assignment or Transfer*

Code Section 12401(b)(3).

4. *Membership Fee*

Code Section 12401(b)(4).

5. *Partial Withdrawal of Shares*

Code Section 12401(b)(6).

6. *Termination of Membership*

Code Section 12401(b)(6).

7. *Member’s Proprietary Interest*

Code Section 12401(b)(7).

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## **Part III. DIRECTORS, OFFICERS, and MEMBERS**

Chapters 7 through 10

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

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# Chapter 7. THE BOARD OF DIRECTORS

## A. DIRECTORS DEFINED<sup>1</sup>

“Directors” are individuals who are elected, designated, or appointed to act as members of the governing body (“Board of Directors”) of a cooperative. The term “directors” also includes any “alternate” directors (see the last section of this chapter). Although the members of the governing body are usually called directors, some other designated term may lawfully be used.

## B. AUTHORITY

Subject to the California Consumer Cooperative Corporation Law and any limitations in the articles of incorporation or bylaws relating to actions requiring membership approvals, the activities and affairs of a co-op are conducted and all corporate powers are exercised by and under the board of directors.<sup>2</sup> The directors, however, may delegate management of the co-op’s activities to any person or persons, management company, or committee (however composed), provided that the board retains ultimate control of the co-op’s affairs, activities, and corporate powers.<sup>3</sup>

## C. SELECTION, REMOVAL, AND RESIGNATION

### 1. Term of Office

Unless a cooperative’s articles of incorporation or bylaws provide otherwise, the directors’ terms are for one year.<sup>4</sup> The articles or bylaws, however, may not specify terms in excess of *four* years for elected directors.<sup>5</sup> (Various provisions related to nonelected directors will also be referred to below.) The articles or bylaws may not be amended to extend the terms of a director or increase the number of directors without approval of the members.<sup>6</sup> (Although a co-op must have at least three directors, there is no limit to the number of directors a co-op may have.<sup>7</sup>) Also, unless the articles or bylaws provide otherwise, a director remains in office until his or her term expires and a successor has been elected.<sup>8</sup> Except for vacancies and removals (see below), a director may not be terminated before the end of her or his term.<sup>9</sup>

If the bylaws or articles provide for the selection of some or all of the cooperative’s directors other than by membership election, these directors remain in the office for the term indicated in the bylaws or articles.<sup>10</sup> If no term is prescribed, they serve until the bylaw or article provision is amended or repealed by the approval of the members, the seats are declared vacant, or such directors are removed.<sup>11</sup>

### 2. Resignations<sup>12</sup>

Any director may resign upon giving written notice to the chairperson of the board, the president or secretary of the cooperative, or the board of directors as a whole; the resignation is effective immediately unless it specifies some future time. When the resignation is effective at a future time, a successor may be elected to take office when the resignation is effective.

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### 3. Vacancies

The board of directors may declare vacant the office of a director whose eligibility for election as a director (as may be described in the articles of incorporation or bylaws) has ended, who has failed to attend a specified number of meetings as prescribed by the bylaws, or who has been found by a court to be of unsound mind or guilty of a felony.<sup>13</sup>

### 4. Removal from Office

#### a. In General

Any and all directors may be removed without cause.<sup>14</sup> If the cooperative has at least fifty members, removal must be approved by a majority of the members voting. If the co-op has less than fifty members, however, a majority of all the members must approve the removal.<sup>15</sup> Any reduction in the number of directors authorized by the articles of incorporation or bylaws does not remove a director before her or his term has ended.<sup>16</sup>

#### b. Central Organizations

Where a cooperative's bylaws or articles of incorporation allow members to "cumulate" (defined later in this chapter) their votes for directors (i.e., in a "central organization" only), special rules apply.<sup>17</sup> Unless the entire board of directors is removed, no director may be removed when the votes cast against removal (or not consenting to removal) would be enough to elect the director if voted cumulatively at an election where the same total number of votes were cast and all the directors authorized at the time of the directors' most recent election were being elected.<sup>18</sup>

#### c. Class Voting

Where the articles of incorporation or bylaws provide that the members of any membership (or share) class, voting as a class, are to elect one or more directors, these directors may be removed only by the vote of that class.<sup>19</sup>

#### d. Designated Directors

Where the articles of incorporation or bylaws provide that one or more persons may *designate* directors, the designated directors may be removed only in accordance with the related article or bylaw removal provision.<sup>20</sup> Where the bylaws or articles of incorporation have no provision for the designation of a *replacement* person, however, Section 12362(f)(2) of the California Corporations Code repeals the designation provisions.

### 5. Filling of Vacancies

#### a. In General

A "vacant" board seat means any authorized seat that is not currently filled, whether due to death, resignation, removal, a change in the number of seats authorized by the articles of incorporation or bylaws, or otherwise.<sup>21</sup> Unless otherwise provided in the articles or bylaws, vacancies on the board of directors created for reasons other than removal may be filled by the majority of the remaining directors.<sup>22</sup> Also, unless the articles or a bylaw approved by the members allow the board to fill the vacancy caused by the removal of a director, vacancies due to removal must be approved by the members.<sup>23</sup> In any event, the members may elect a director to fill any vacancy not filled by the board.<sup>24</sup>

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**b. Nonelected Directors**

Where a vacancy exists in a seat held by a nonelected director (i.e., where some or all of the directors are designated or selected in accordance with the bylaws or articles of incorporation and not elected by the members), the designation or selection of a new director must be made in accordance with the procedure stated in the articles or bylaws.<sup>25</sup> If no provision for replacement is made in the articles or bylaws, the articles or bylaws providing for the nonelective designation or selection are deemed to be repealed by co-op law<sup>26</sup> (i.e., the directors *must* be elected by the members).

## **D. NOMINATION AND ELECTION OF DIRECTORS**

### **1. Reasonable Procedures**

A cooperative must provide its members with “reasonable” nomination and election procedures for directors.<sup>27</sup> The reasonableness of the procedures is determined by the nature, size, and operations of the co-op.<sup>28</sup> Of course, a candidate for director must meet any eligibility requirements stated in the articles or bylaws.<sup>29</sup>

### **2. Solicitation of Votes**

Where a cooperative distributes any material soliciting a vote for any nominee in any publication owned or controlled by the co-op (e.g., its newsletter), the co-op must make the same material and equal amount of space with equal prominence available to all other nominees.<sup>30</sup>

Within ten business days of the written request of any nominee and her or his payment of mailing costs, the cooperative must mail to all members (or a portion of, if the nominee requests) any material furnished by the nominee which is reasonably related to the election.<sup>31</sup> Instead, and within five business days of the nominee’s request, the co-op may (1) allow the nominee to inspect and copy the records of all members’ names, addresses, and voting rights *or* (2) direct the secretary to give the nominee (at a reasonable cost) the same information.<sup>32</sup>

In general, a cooperative must publish and mail materials on behalf of nominees, regardless of the content of the material.<sup>33</sup> Also, without board authorization, no co-op funds may be spent to support a nominee after there are more people nominated than can be elected.<sup>34</sup>

### **3. Ballots<sup>35</sup>**

Election of directors at a meeting does not have to be by written ballot unless the bylaws require the use of ballots. If a member demands the use of ballots at a meeting before the voting begins, however, ballots must be used.

### **4. Determination of Winning Candidates**

Subject to any provisions related to voting by membership (or share) classes, candidates receiving the highest number of votes are elected.<sup>36</sup> For example, if three seats are up for election, the three highest vote-getters are elected.

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### 5. Central Organizations and Cumulative Voting<sup>37</sup>

Cumulative voting for directors is permitted only in “central organizations” (defined in the Introduction of this publication), and then only if the articles of incorporation or bylaws authorize it. Cumulative voting allows each member of a central organization entitled to vote in an election for directors to have a total number of votes equal to the total number of directors being elected multiplied by the number of votes the member otherwise has. The member may then distribute his or her votes among the candidates in any fashion, including “cumulating” them for one or more candidates. An article or bylaw provision authorizing cumulative voting may be repealed or amended only by approval of the members, although the article or bylaw provision may require something greater than a majority of the members or a class of members for its repeal.

A member of a central organization may not, however, cumulate votes for a candidate unless that candidate’s name has been placed in nomination before the vote *and* the member has given notice at the meeting before the vote that she or he intends to cumulate votes. Once any member does give notice that he or she will cumulate votes, then all members may do the same for that particular election. The candidates receiving the largest numbers of votes are elected (subject to allowable provisions concerning election by different classes of members).

## E. BOARD MEETINGS

### 1. In General<sup>38</sup>

All rules below related to meetings of the board of directors apply to any cooperative and to its incorporators or board committees unless the co-op’s articles of incorporation or bylaws provide otherwise.

### 2. Who May Call<sup>39</sup>

Board meetings may be called by the chairperson of the board, president, vice-president, secretary, or any two directors.

### 3. Place<sup>40</sup>

A board of directors meeting may be held anywhere so long as the place has been designated in the notice, the bylaws, or by board resolution. The directors may also participate in a meeting by way of a conference call or similar setup if all the directors can hear each other.

### 4. Notice<sup>41</sup>

“Regular” meetings of the board may be held without notice if the time and place of the meetings are fixed in the bylaws. Four days’ notice by first-class mail or forty-eight hours’ notice delivered personally (or by telephone or telegraph) is required for “special” board meetings; the articles of incorporation or bylaws may *not* eliminate this notice requirement for special meetings. A “notice” (or “waiver of notice”) does not have to specify the purposes of any board meeting. (Notice by mail is considered given when it is deposited in the mail.<sup>42</sup>)

Notice of a meeting does not have to be given to any director who (1) signs a waiver of notice, a written consent to holding the meeting, or an approval of the minutes, or (2) attends the meeting

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and does not protest the lack of notice. Any director not receiving proper notice may sign the waiver, written consent, or approval of minutes before or after the meeting; any waivers, consents, or approvals must be filed with the corporate records or made part of the meeting's minutes.

**5. Quorum<sup>43</sup>**

Although a majority of the number of directors authorized in the articles of incorporation or bylaws represents the quorum needed to transact business, the bylaws or articles may not allow for a quorum representing less than one-fifth of the number of directors, or two, whichever is larger.

**6. Continued Meetings<sup>44</sup>**

A majority of the directors present, whether or not a quorum is attained, may adjourn any board meeting to another time and place. If the meeting is adjourned for more than twenty-four hours, however, notice of the follow-up meeting must be given to all directors not present when the first meeting was adjourned.

**7. Approval Requirement<sup>45</sup>**

Generally, when something must be “approved” by the board of directors, it must be approved or ratified by the vote of the board or a committee authorized to exercise board powers, except those powers reserved to the board alone (see Section G(2) of this chapter).

Subject to special situations involving board committees, conflicts of interest, or indemnification of corporate agents, all acts or decisions made by a majority of the directors at a duly held board meeting at which a quorum is present are acts of the board. The articles of incorporation or bylaws may not provide for less than a majority approval but may provide for approval of more than a majority. Where a quorum is initially present at a board meeting, the directors may continue to transact business even if one or more directors leave, provided that any action taken is approved by at least a majority (or a greater proportion, if otherwise required) of the necessary quorum.

**F. BOARD ACTION WITHOUT A MEETING**

Any board of directors' action may be taken without a meeting if all the directors consent in writing and the consent is filed with the minutes of the board.<sup>46</sup>

**G. BOARD COMMITTEES**

**1. In General<sup>47</sup>**

The board of directors may resolve, by at least a majority of directors where a quorum is present, to create one or more committees to serve at the pleasure of the board. Appointments to any committee must be by a majority of the directors then in office, unless the articles of incorporation or bylaws require the approval of a majority of directors authorized by the articles or bylaws. Any committee must be made up of at least two directors.

The bylaws may authorize one or more committees, each having two or more directors, and also provide that specified officers who are also directors must be members of any committee. In addition,

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the board may appoint directors as alternate members of any committee to replace any directors absent from committee meetings. Unless the bylaws provide otherwise, the board may delegate to any committee all of its powers, with the exception of the seven actions listed below

## **2. Authority<sup>48</sup>**

Any board committee has all the authority of the board of directors, to the extent provided in board resolutions or the bylaws, except for:

- (1) actions requiring the members' approval;
- (2) filling vacancies on the board and committees;
- (3) setting of compensation for directors;
- (4) making any changes in the bylaws;
- (5) amending or repealing any board resolution which expressly denies the right of any committee to do so;
- (6) appointing of board committees or their members; and
- (7) spending the cooperative's funds to support a nominee for director after there are more people nominated than can be elected.

## **H. MINUTES AND RESOLUTIONS<sup>49</sup>**

The original or a copy of the minutes or resolutions of any board of directors or board committee meeting may be certified by the secretary or any assistant secretary of the cooperative. In any legal disputes, the certified document would provide supporting evidence of the meeting or resolutions.

## **I. DIRECTORS' STANDARDS OF CONDUCT**

### **1. Standards of Performance<sup>50</sup>**

A director must perform the duties of a director (including any duties as a board committee member) in good faith, in a manner that the director believes to be in the best interests of his or her cooperative, and with sufficient care (including reasonable inquiry) as an ordinary person in a similar position would use in similar circumstances.

In the performance of her or his duties, a director may rely on information, opinions, reports, or statements (including financial) prepared or presented by:

- (1) officers or employees of the cooperative whom the director thinks are reliable and competent related to the matters presented;
  - (2) attorneys, accountants, etc., as to items that the director believes to be within the person's professional or expert competence; or
  - (3) a board committee upon which the director does not serve, as to matters within that committee's designated authority and where the director has confidence in the committee.
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A person who performs the duties of a director in accordance with the foregoing will have no liability based on a failure to discharge his or her obligations as a director. Further, the foregoing performance standards also apply to directors' duties regarding any acts or omissions in connection with the election, selection, and nomination of directors.

## 2. Conflicts of Interest<sup>51</sup>

### a. Defined

A contract or other transaction between a cooperative and one or more of its directors or between a co-op and another organization in which a co-op director has a *material financial interest* is not void or voidable simply because the director or the other organization is a party to the transaction or because the director is present at the board or committee meeting which adopts the transaction. This is true, however, only if:

- (1) the material facts related to the transaction and the director's interest are fully disclosed or known to the co-op's members, the transaction is approved by the members in good faith, and the "interested" director does not vote on the transaction; or
- (2) the material facts of the transaction and the director's interest are fully disclosed or known to the board or board committee, and the board or board committee authorizes, approves, or ratifies the transaction in good faith without counting the vote of the interested director, and the transaction is fair to the co-op at the time it is adopted; or
- (3) the person who claims the validity of the transaction proves the transaction was fair and reasonable at the time of its adoption.

Just because a cooperative director is also a director of another corporation or because a co-op director is also a member-patron of the co-op on the same basis as all other members does not mean that a material financial interest exists. Also, just because a director is receiving compensation from the co-op does not mean that she or he may not be involved in fixing the compensation of another director in that director's capacity as a director, officer, or employee of the co-op.

Further, a mere "common" directorship does not make a transaction void or voidable just because the director is present at the board of directors or board committee meeting which adopts the transaction, if:

- (1) the material facts of the transaction and the common directorship are known to the board of directors or board committee and the transaction is adopted in good faith without counting the vote of the director, or the transaction is approved by the members in good faith; or
- (2) the transaction is fair and reasonable to the cooperative at the time of its adoption.

### b. Quorum

"Interested" directors may be counted in determining whether a quorum is present at a meeting of the board or a board committee that adopts a transaction in which a director is interested.<sup>52</sup>

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### 3. Loans to or Guarantees of Directors and Officers<sup>53</sup>

Unless prohibited by the bylaws or articles of incorporation, a cooperative may loan money or property to, or guarantee an obligation of, any director or officer of the co-op, if:

- (1) the board believes the loan or guaranty may reasonably benefit the co-op; and
- (2) prior to adopting all or part of the transaction, the loan or guaranty is either approved by the members (not counting the vote of the director or officer if he or she is also a member) or approved by the majority of all directors then in office (not counting the vote of the benefited director).

The above conditions do not apply, however, to situations where the cooperative is merely advancing money to a director or officer for any expenses reasonably anticipated to be incurred in the performance of the director's or officer's duty and where the director or officer would be entitled to reimbursement in any case.

The above conditions also do not apply to the payment of any life insurance premiums on the life of a director or officer if repayment to the cooperative is secured by the proceeds of the policy and the cash surrender value.

### 4. Director Liability for Certain Acts<sup>54</sup>

#### a. Civil Liabilities

Except for situations where a director reasonably relied on information, etc., provided by others (see "Standards of Conduct" above), cooperative directors who approve any of the following actions are liable individually and collectively to the co-op or its creditors:

- (1) the payment of any "distribution" (see chapter 12 of this publication) or the purchase or redemption of memberships or shares where the distribution, purchase, or redemption would violate any restriction in the bylaws or articles of incorporation, or the law, or would likely cause the co-op to be unable to meet its liabilities as they became due;
- (2) the making of any loan or guarantee contrary to the conditions stated in the above discussion; and
- (3) the distribution of assets after the dissolution of the co-op has begun without paying or adequately providing for all known liabilities of the co-op (excluding any claims timely filed with the proper court).

A director who is present at a board of directors or board committee meeting where an action described above is approved is liable whether he or she votes to approve the action or abstains from voting.

#### b. Criminal Acts and Penalties

In addition to liability for the acts listed above, directors, as well as others (e.g., officers) may be subject to criminal penalties under the California Consumer Cooperative Corporation Law for acts such as the fraudulent issuance of memberships, distributions, or reports.<sup>55</sup> While a detailed listing of these crimes is outside the scope of this discussion, directors should be aware of their existence.

## J. ALTERNATE DIRECTORS

The California Consumer Cooperative Corporation Law allows "alternate" directors, but *only* if the bylaws specify the manner and time of their election and the conditions of their service in place of regular directors.<sup>56</sup>

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## Chapter 8. CORPORATE OFFICERS

### A. IN GENERAL

#### 1. Required and Other Officers

A cooperative must have a chairperson (of the board) or a president, or both, a secretary, and a chief financial officer. It may also have any other officers (e.g., a vice-president) whose titles and duties are stated in the bylaws or determined by the board of directors and as may be needed to sign various documents (e.g., banking agreements).<sup>1</sup> Officers, unless otherwise provided in the articles of incorporation or bylaws, are chosen by and serve at the pleasure of the board, and are subject to any employment contract rights.<sup>2</sup> Also, officers may or may not be employees of the co-op. The president (or the chairperson if there is no president) is the “chief executive officer” of the co-op, and any number of offices may be held by the same person unless the bylaws or articles provide otherwise.<sup>3</sup> Either the president or the chairperson must be chosen from those directors elected by the members.<sup>4</sup> Finally, any officer may resign at any time by giving the co-op a written notice of resignation.<sup>5</sup>

#### 2. Duties and Responsibilities

Cooperatives vary widely in the duties and responsibilities they assign to officers. In some cases, the officers are named merely to take care of necessary formalities such as signing various documents on behalf of the co-op. In other cases, the officers take an active role in the activities of the co-op and may even be full-time employees. In any event, all documents or agreements between the co-op and any other person or organization that are signed by an officer of the co-op will probably bind the co-op even if the officer was not authorized to sign them, unless the person or organization actually knew the officer had no such authority.<sup>6</sup> The following lists of traditional duties and responsibilities assume that the president, vice-president, secretary, and chief financial officer are full-fledged participants in the affairs of the co-op.<sup>7</sup>

### B. PRESIDENT

The president is the chief executive officer of a cooperative and has (1) general supervision, direction, and control over the business and officers of the co-op, (2) general powers and duties of management usually vested in the office of the president of a corporation, and (3) other powers and duties prescribed by the board of directors or the bylaws. Within the authority and in the course of his or her duties, he or she generally:

- (1) presides at all meetings of the members and the board, and is a member of all board committees;
  - (2) signs, with the secretary or the treasurer, any membership or share certificates of the co-op;
  - (3) signs corporate instruments on behalf of the co-op;
  - (4) is subject to direction from the board, appoints and removes, employs, and discharges, and prescribes the duties and fixes the compensation of all agents and employees of the co-op other than the officers (although these functions may be delegated by the president or the board to specified persons in the various levels of management); and
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- (5) unless otherwise directed by the board and subject to its control, acts and votes, on behalf of the co-op, at all meetings of the shareholders of any corporation in which the co-op holds shares.

### **C. VICE-PRESIDENT**

In the absence or disability of the president, the vice-president performs all the duties of the president and has all the powers of, and is subject to all the restrictions on, the president. The vice-president has other powers and performs other duties as may be prescribed by the board of directors in the bylaws.

### **D. SECRETARY**

The secretary generally has the following duties and responsibilities:

- (1) retains custody of the corporate seal and affixes it in appropriate cases to all corporate documents;
  - (2) retains custody of the records of the co-op and sees to it that the books, reports, statements, certificates, and all other documents and records required by law are properly kept and filed;
  - (3) ensures that all notices are given in accordance with the provisions of the bylaws or as required by the California Consumer Cooperative Corporation Law (in the secretary's absence, disability, or neglect or refusal to act, notice may be given and served or caused to be served by the president, the vice-president, or the board);
  - (4) acts as secretary at all membership and board meetings and records, or causes to be recorded, all actions taken at the meetings in the minute book (in case of the secretary's absence, disability, or neglect or refusal to act, this duty may be performed by any other person as may be appointed by the person presiding at the meeting);
  - (5) keeps written minutes of the proceedings of the members, board, and board committees in a book to be kept for that purpose at the principal executive office of the co-op;
  - (6) retains the original or a copy of the articles of incorporation, certified by the Secretary of State, with all amendments to date in the minute book;
  - (7) keeps at the co-op's principal executive office the original or a copy of the bylaws as amended to date, which must be open to inspection by the members at all reasonable times during office hours;
  - (8) retains at the co-op's principal executive office a record of the co-op's members showing the names and addresses of all members and the number of shares (or other equity credits) held by each;
  - (9) certifies as a true copy a copy of the bylaws of the co-op, or of the minutes of any meeting of the incorporators, members, directors, board committee, or other body, or of any resolution adopted by the board, board committee, or the members when requested to do so by the board, any director individually, board committee, the president, or other officer of the co-op (or when so required by law);
  - (10) signs, with the president or vice-president, any membership or share certificates of the co-op, unless co-signed by the chief financial officer;
  - (11) facilitates inspection rights; and
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- (12) performs any and all other functions and duties that may be specified in the bylaws and, in general, performs all the duties incident to the office of secretary and other duties as may be assigned by the board.

## **E. CHIEF FINANCIAL OFFICER**

The chief financial officer generally has the following duties and responsibilities:

- (1) oversees all funds and securities of the cooperative, and deposits funds in the name of the co-op;
- (2) receives and gives receipts for monies due and payable to the co-op;
- (3) disburses or causes to be disbursed the co-op's funds as directed by the board, taking proper vouchers for all disbursements;
- (4) keeps and maintains adequate and accurate books and records of account either in written form or in any other form capable of being converted into written form;
- (5) renders to the president and directors, upon request, an account of all transactions and the financial condition of the co-op;
- (6) prepares or causes to be prepared the annual financial report (see chapter 14 of this publication);
- (7) provides the inspection rights of members and directors related to accounting and financial records;
- (8) signs, with the president or vice-president, any membership or share certificates of the co-op (unless the certificates are signed by the secretary of the co-op);
- (9) gives to the co-op, if required by the board or the president, a bond in a sum satisfactory to the board, for the faithful performance of the duties as chief financial officer and for the restoration to the co-op (in the event of the chief financial officer's death, resignation, retirement, or removal from office) of all books, papers, vouchers, money, and other property of whatever kind in her or his possession or under her or his control belonging to the co-op; and
- (10) performs any and all other functions and duties required of the chief financial officer as may be specified in the bylaws and, in general, performs all the duties related to the office of chief financial officer and any other duties assigned by the board.

## **F. LOANS TO OR GUARANTEES FOR OFFICERS**

See the discussion in chapter 7, which applies to *both* directors and officers in an identical manner.

## **G. CRIMES AND PENALTIES**

While outside the scope of this discussion, a cooperative's officers may be subject to criminal penalties similar to those for fraudulent actions by directors.<sup>8</sup> (See the discussion in chapter 7 of this publication.)

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## Chapter 9. MEMBERS AND MEMBERSHIPS: IN GENERAL

### A. DEFINITIONS

#### 1. Members<sup>1</sup>

A cooperative “member” is any person who, according to the articles of incorporation or bylaws, has the right to vote for directors or possesses an ownership interest in the co-op. A “person” may be a natural person or an entity (i.e., a corporation, partnership, or some other type of organization), although many co-ops are made up of either individuals only or organizations only.

The articles of incorporation or bylaws may confer all or some rights of a member upon any persons who are not allowed to vote for directors. Also, just because a person is a “delegate” (see chapter 7 of this publication), has selection or designation rights concerning directors (see chapter 7), or is a director, does not necessarily indicate that he or she is also a member.

#### 2. Membership

“Membership” refers to the rights conferred upon a cooperative member by the California Consumer Cooperative Corporation Law and the co-op’s articles of incorporation and bylaws,<sup>2</sup> including share ownership.

### B. ELIGIBILITY

Subject to any eligibility requirements or exclusions provided for in its articles of incorporation or bylaws, a cooperative may admit any person (including an organization) to membership, *except* its own subsidiary corporation.<sup>3</sup> Unless the bylaws or articles provide otherwise, memberships may be issued for no or any “consideration” (e.g., a specific amount of money to buy a share) the board establishes.<sup>4</sup>

### C. VOTING POWER AND PROXIES

Except in “central organizations” (defined in the Introduction of this publication), the voting power of those members having voting rights must be equal.<sup>5</sup> Generally, this means that each cooperative member will have one vote in the affairs of the co-op. Of course, the co-op could provide for one or more additional membership classes with no voting power. In certain unusual situations, however, even nonvoting members have the right to vote.<sup>6</sup> As to any members who are not generally permitted voting power in the co-op, the issuance of memberships or any shares to those members would not be eligible for the co-op exemption from California securities qualification.<sup>7</sup> (See chapter 11 of this publication.) Also, voting by proxy is prohibited under the California Consumer Cooperative Corporation Law.<sup>8</sup>

A “central organization” cooperative may have unequal voting procedures based on the number of its members’ members, patronage of its members, or both.<sup>9</sup>

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## D. TRANSFER OF MEMBERSHIPS<sup>10</sup>

Unless the articles of incorporation or bylaws provide otherwise, no member may transfer his or her membership or any right she or he has as a result of the membership. This prohibition also presumably applies to any shares held by the member. Where transfer rights within a membership class have been provided, however, no restrictions on them are binding for those memberships issued before the restrictions were adopted unless the persons holding those memberships voted in favor of the restriction.

## E. MEMBERSHIP CLASSES<sup>11</sup>

A “class” of membership refers to those members that (1) are identified in the articles of incorporation or bylaws as being a different type of membership or (2) have the same rights (within the class) related to voting, dissolution, redemption, distributions, and transfer. All memberships in a cooperative must have identical rights, privileges, preferences, restrictions, and conditions *unless* the articles or bylaws provide otherwise. A uniform formula determining certain rights within a class (e.g., as to dividends) does not, however, imply differing rights. These rules would also seem to apply to classes of shares in a co-op, especially since “shareholders” and “members” are synonymous terms in co-op law.

## F. CESSATIONS AND REDEMPTIONS OF MEMBERSHIPS

### 1. Resignation from a Failure to Renew Membership<sup>12</sup>

A cooperative member may resign from membership at any time, although the articles of incorporation or bylaws may require reasonable notice before the resignation is effective. A resigning member, however, is not relieved from any amounts he or she owes to the co-op for services, fees, contractual obligations, etc. Also, any membership issued for a period of time (e.g., a year) expires at the end of the period unless the membership is renewed.

### 2. Expulsion, Termination, or Suspension<sup>13</sup>

A member of a cooperative may not be expelled, suspended, or terminated except according to the requirements below; any attempt to do so will be void if such requirements are not met. First, any expulsion, suspension, or termination must be done in good faith and in a fair and reasonable manner. The three criteria below, if met, will legally ensure that a fair and reasonable manner is used:

- (1) the procedures have been described in the articles of incorporation or bylaws or in materials required by the articles or bylaws to be sent annually to all members;
- (2) the procedures include fifteen days’ prior notice to the member and the reasons for the expulsion, suspension, or termination; and
- (3) the procedures provide an opportunity for the member to be heard orally or in writing at least five days before the effective date by the person or group who may set aside the expulsion, termination, or suspension.

Second, certain notice requirements must be met. While notice to the member may be given by any reasonable method to provide actual notice, any notice by mail must be sent by first-class or registered mail to the last address of the member shown in the cooperative’s records.

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Of course, a termination, expulsion, or suspension of a member for *improper* reasons is not made valid simply because the cooperative complies with the above procedures. (A person may challenge her or his expulsion, termination, or suspension through legal proceedings begun within one year of the co-op's action.)

### 3. Redemption

#### a. In General

Unless the cooperative's articles of incorporation or bylaws provide otherwise, memberships (or shares) are *not* redeemable.<sup>14</sup> This means that the co-op may not give back to the member any amount he or she paid for the membership or any share, even if the member is resigning or is being terminated, suspended, or expelled.<sup>15</sup> Co-ops issuing shares will probably want the articles or bylaws to provide for redemption rights, however, particularly if share transfer is severely restricted or prohibited *and* the co-op wants to encourage member investment. Obviously, members are likely to be discouraged from investing in shares if they are both nontransferable and nonredeemable. Co-ops issuing shares may also wish to provide that members may redeem *some* of their shares without terminating membership.

#### b. Restrictions on Redemption

Neither a cooperative nor its subsidiary corporation may purchase or redeem memberships, if, as a result, the co-op would likely be unable to meet its liabilities as they became due.<sup>16</sup> Further, a co-op's articles of incorporation, bylaws, or other agreements may place additional restrictions on the purchase or redemption of memberships.<sup>17</sup> Presumably, these rules apply to shares or other capital credits held by members.

#### c. Wrongful Redemptions

Any members who have their memberships redeemed under improper circumstances, and where those members know the redemptions are improper, are liable to the cooperative for any amounts received, plus interest.<sup>18</sup>

## G. VALUATION OF MEMBERSHIP INTERESTS

The articles of incorporation or bylaws must state the way in which each member's capital contribution to the cooperative is determined *and* the time and manner of any repayment if the articles or bylaws allow repayment.<sup>19</sup> This is often done in the bylaws by stating a specific price for each share or membership or allowing the board of directors to set share or membership prices. Further, if a member is entitled to any monetary interest in the co-op's capital apart from any capital he or she has contributed, the articles or bylaws must state the way in which a member's interest in the noncontributed capital is valued and the time and manner of the co-op's purchase of that interest, if required.<sup>20</sup> An example of a member's noncontributed capital interest would be his or her claim on the accumulated nonallocated profits (i.e., "retained earnings") of the co-op.

## H. DUES, ASSESSMENTS, AND FEES

If a cooperative's articles of incorporation or bylaws so allow, co-op members may be charged dues, fees, or assessments.<sup>21</sup> Generally, a member may avoid paying any of them if he or she promptly resigns from membership upon learning of them.<sup>22</sup> Further, unless the dues, fees, or assessments are called to

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the attention of the member and agreed to in writing by the member, the article or bylaw provisions by themselves do not create a liability for the member.<sup>23</sup>

Cooperatives often charge members some type of fee to join or annual dues. Fees are often used to cover administrative processing of new memberships, and dues are sometimes used to help cover ongoing administrative costs in maintaining membership records. Again, however, dues or fees may *not* be charged unless the articles of incorporation or bylaws specifically provide for them (including allowing the board of directors to establish such charges).

## **I. IDENTITY CARDS**

A cooperative may issue identity cards or similar items to help identify members who are eligible to use the co-op's facilities or services.<sup>24</sup>

## **J. RECORD DATES OTHER THAN FOR NOTICE AND VOTING**

There may be times when a “record date” related to members' rights *other than* notice and voting is needed. As with the other record dates (see chapter 10 of this *Sourcebook*), unless the bylaws provide otherwise, the board may set in advance a record date for determining which members are entitled to exercise any rights related to some other lawful action.<sup>25</sup> The record date for this purpose must be no more than sixty days prior to the action.<sup>26</sup> If no record date is fixed by the bylaws or the board, members as of the close of the business day on the day the board adopts the resolution related to the action or the sixtieth day prior to the date of the action, whichever is later, are entitled to exercise their rights.<sup>27</sup>

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# Chapter 10. MEMBERSHIP MEETINGS AND VOTING

## A. REGULAR AND SPECIAL MEETINGS<sup>1</sup>

Unless the bylaws designate or provide a means to select a meeting place, meetings of the members must be held at a cooperative's principal office. A "regular" meeting must be held annually. The election of any directors needed to be elected must be held at the annual meeting (unless a written ballot is to be used), and any other proper business may be transacted at the annual meeting.

"Special" meetings of the members may be called only by the board or the president (or the chairperson), unless the bylaws specify that certain additional persons may call a special meeting.

## B. NOTICE OF MEETINGS

### 1. When Notice Is Given

Whenever members are required or permitted to take any action at a meeting, a written notice of the meeting must be given to each member who, on the "record date" (see below) for notice for the meeting, is entitled to vote at that meeting.<sup>2</sup> Further, the notice must be given at least ten days but not more than ninety days before the date of the meeting.<sup>3</sup> If the notice is given by mail but not by first-class, registered, or certified mail, the notice must be placed in the mail at least twenty days before the meeting (e.g., in the case of the "bulk" mailing of a newsletter).<sup>4</sup>

### 2. Record Date for Notice<sup>5</sup>

Unless the bylaws provide otherwise, the board may fix, in advance, a "record" date to determine which members are entitled to notice of any meeting. The record date must be no more than sixty and no less than ten days before the date of the meeting. If no record date is fixed, members as of the close of business on the day preceding the day on which notice is given (or if notice is waived, at the close of business on the day preceding the day of the meeting) are entitled to notice. The same record date will apply to any continuation of an adjourned meeting unless the board fixes a new record date.

### 3. Contents

The notice must state the place, date, and time of the meeting.<sup>6</sup> In the case of a "special" meeting, the notice must also describe the general nature of the business to be transacted; for a "regular" meeting, the notice must specify the matters that the board of directors, at the time the notice is given, intends to present at the meeting to the members for action.<sup>7</sup> Any approval by the members at a regular meeting, however, concerning removal of directors, the filling of vacant board seats, director conflicts of interest, amendments to the articles of incorporation, or a plan of distribution upon dissolution, except where unanimous approval is required, is valid only if the general nature of the proposal was stated in the notice (or in any written waiver of notice).<sup>8</sup>

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Further, where a cooperative may conduct member meetings with a quorum of less than one-third of the voting power, the only matters that may be voted on at a regular meeting where less than one-third of the voting power is in attendance are those whose general nature was described in the notice.<sup>9</sup> The notice of any meeting at which directors will be elected must also include the names of all nominees as of the time that notice is given to the members.<sup>10</sup>

#### **4. How Notice Is Given<sup>11</sup>**

Notice must be given to members either personally, by mail, or by other means of *written* communication. Any written notice must be sent to the member's address that appears in the cooperative's records or has been given by the member to the co-op for notice purposes. If no address is available for a member, the co-op has two options: the notice may be posted at the co-op's principal office *or* it may be published at least once in a newspaper of general circulation in the county of the principal office.

#### **5. Evidence of Notice**

To provide evidence that notice was properly given, the secretary may sign an affidavit to that effect.<sup>12</sup>

#### **6. Future Notices When Returned<sup>13</sup>**

When any notice sent to a member at the address appearing in the cooperative's records is returned and marked by the post office that it was unable to deliver the notice to the member at that address, a special rule applies to any future notice. The notice will be considered given without being mailed if it is available to a member upon written demand at the principal office of the co-op for a one-year period from the date it is given.

#### **7. Special Meetings**

When a "special" meeting is properly requested (see sample bylaw Section 4.03 regarding how this is done), the meeting must be held at a time fixed by the board of directors at least thirty-five days but not more than ninety days after receipt of the request.<sup>14</sup> Proper notice, of course, must be given to all members entitled to vote at the meeting.

#### **8. Continued Meetings<sup>15</sup>**

Generally, notice does not have to be given for a meeting adjourned to another place or time if the place and time are announced at the original meeting. The cooperative may transact any business at the continued meeting that it could have transacted at the original meeting. Notice of the continued meeting does have to be given if (1) the bylaws require notice for a continued meeting, (2) the adjournment is for more than forty-five days, or (3) a new record date is set for the continued meeting.

#### **9. Validity Where Notice Is Not Proper**

Sometimes a cooperative will find that it must call a member meeting on such short notice that proper notice is impossible or the notice that was given was in some way faulty. California Consumer Cooperative Corporation Law provides methods of dealing with these problems.<sup>16</sup> The transactions of any meeting, no matter how it is called and noticed and no matter where it is held, are valid if

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(1) a quorum is present, and (2) either before or after the meeting, each member entitled to vote but not present at the meeting signs a written waiver of notice, a consent to the holding of the meeting, or an approval of the minutes.<sup>17</sup> All waivers, consents, and approvals must be filed with the co-op's corporate records or made part of the meeting's minutes.<sup>18</sup> Of course, these procedures may be practical only for co-ops with relatively small numbers of members; larger co-ops should be especially careful that notice is properly given.

The attendance of a person at a meeting is in itself presence and a waiver of notice, except when the person objects at the beginning of the meeting to the transaction of any business because of improper notice or the unlawful calling of the meeting.<sup>19</sup> Also, attendance is not a waiver of any right to expressly object at the meeting to the consideration of matters that should have been included in any notice (see above).<sup>20</sup>

Except where unanimous approval of all members entitled to vote is obtained, the written waiver of notice must include the general nature of any proposal related to removal of directors, filling vacant board seats, director conflicts of interest, amendments to the articles of incorporation, or a plan of distribution upon dissolution.<sup>21</sup> Also, except for the items listed in the preceding sentence or unless the bylaws or articles provide otherwise, neither the business to be transacted nor the purpose of any regular or special meeting needs to be specified in any written waiver of notice, consent to holding the meeting, or approval of the minutes.<sup>22</sup>

### C. WRITTEN BALLOTS USED AT A MEETING

To facilitate voting at a meeting of the members, a cooperative may wish to use written ballots. Written ballots at a meeting are particularly useful where relatively large numbers of members are present (e.g., making hand-counts or voice-votes difficult). Unless prohibited by the articles of incorporation or bylaws, before any regular or special meeting, the board of directors may authorize the distribution of written ballots to all members entitled to vote at the meeting.<sup>23</sup> The ballots must (1) describe the action proposed to be taken, (2) allow a member to indicate approval or disapproval, and (3) state that unless a member revokes the ballot by voting in person at the meeting, the written vote will be counted if it is received by the co-op at or before the time of the meeting.<sup>24</sup> Any members voting at the meeting through unrevoked written ballots are considered present at the meeting for quorum purposes (see below in this chapter), but only with respect to the proposed action referred to in the ballots.<sup>25</sup>

Written ballots that are to be used at a meeting must be distributed in a manner identical to a notice (see the discussion earlier in this chapter) and in the form of written ballots used in place of a meeting<sup>26</sup> (see below in this chapter). Also, except in the case of a "central organization" using cumulative voting procedures, written ballots used at a meeting may be used for the election of directors, unless prohibited by the articles of incorporation or bylaws.<sup>27</sup> ("Central organizations" using cumulative voting procedures may not distribute written ballots for the election of directors.<sup>28</sup>)

### D. WRITTEN BALLOTS USED WITHOUT A MEETING

#### 1. In General

Cooperatives sometimes experience difficulties in achieving quorums at membership meetings. The reasons for this vary: the physical dispersion of members, relatively large numbers of members,

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member apathy, etc. Also, membership meetings can be relatively expensive to undertake (e.g., publicity, location rental, travel expenses, child care, etc.). Thus, while a co-op must hold at least a regular *annual* meeting, the co-op may find it advantageous to use written ballots unrelated to any particular meeting to help ensure that enough people vote (to attain a quorum) and possibly to reduce administrative costs.

## 2. Requirements<sup>29</sup>

Except in the case of the election of directors by a “central organization” using cumulative voting procedures or unless prohibited by the articles of incorporation or bylaws, any action which may be taken at a regular or special meeting of the members may be taken without a meeting *if* the cooperative distributes a written ballot to every member entitled to vote on the matter. The ballots must state the proposed action, allow the member to indicate approval or disapproval of the proposal, and indicate a reasonable time within which the ballot must be returned to the cooperative.

Approval of the action is achieved only when (1) the number of votes cast by ballot within the specified time period at least equals the quorum required to be present at a meeting and (2) the number of affirmative votes at least equals the number needed to approve the action.

Written ballots must be solicited consistent with the requirements stated in this chapter. All solicitations must indicate the number of responses needed to meet quorum requirements, and all ballots not related to the election of directors must state the required approval percentage. Also, the solicitations must specify the time by which the ballot must be received to be counted.

## 3. Generally Irrevocable<sup>30</sup>

A written ballot used in place of a meeting may not be revoked, unless otherwise provided in the articles of incorporation or bylaws.

## 4. Election of Directors<sup>31</sup>

Directors may be elected by a written ballot in place of a meeting, but *only* if election by ballot is specifically allowed by the articles of incorporation or bylaws. (Again, a central organization using cumulative voting procedures may not use a written ballot to elect directors.) When directors are to be elected by a written ballot and the articles or bylaws describe a nomination procedure, that procedure may provide for a date for closing nominations before the printing and distribution of the written ballots.

## E. FORM OF WRITTEN BALLOT

Whether used at a membership meeting or *instead* of a meeting, the form of the written ballot is the same.<sup>32</sup> Any ballot distributed to at least ten members of a cooperative having at least one hundred members must provide (1) the member the opportunity to specify on the ballot itself her or his choice between approval and disapproval of each matter or group of related matters and (2) subject to reasonable specified conditions, that the vote or votes will be cast in accordance with the member’s choice.<sup>33</sup>

In any election of directors, a member may indicate on the ballot that he or she chooses not to vote.<sup>34</sup>

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## F. REFERENDUMS

If at least twenty percent of a cooperative's members propose in writing some action or recommendation, the Secretary must provide for a vote by written ballot (in accordance with the rules for a written ballot) in place of a meeting.<sup>35</sup>

## G. QUORUM REQUIREMENTS<sup>36</sup>

### 1. In General

Unless a quorum is at least initially present at a membership meeting, a valid vote may *not* be taken. Thus, cooperatives must be careful to ensure that, for any vote, a quorum is present. Unless the bylaws set a different number, a quorum is attained if the *lesser* of at least two hundred fifty members or members representing at least five percent of the voting power are at the meeting either in person or by written ballot (see the discussion earlier in this chapter). If a quorum is present, the affirmative vote of a majority of the voting power represented at the meeting, entitled to vote and voting, is the act of the members unless the vote of a greater number or voting by classes is required by California Consumer Cooperative Corporation Law, the articles of incorporation, or bylaws.

### 2. Special Rule for Small Quorums

If the cooperative may conduct a meeting with a quorum of less than one-third of the voting power, the only matters that may be voted on at any regular meeting actually attended by less than one-third are those matters which have been generally described in the notice of the meeting.

### 3. Loss of a Quorum

Once a duly held and called meeting has begun with a quorum present, the members may transact business until adjournment, even if a quorum is lost when some members leave the meeting. Any action taken (other than adjournment), however, must be approved by at least a majority of the number of members making up a quorum. In the absence of a quorum, any meeting may be adjourned by a vote of the majority of the votes represented in person.

### 4. Effect of Disqualified Voters

Whenever a member is disqualified from voting on any matter, she or he may not be counted in determining whether a quorum exists or whether there are enough affirmative votes to approve the action being voted upon.

## H. VOTING

### 1. General Rule of One Vote Per Membership

Except in the case of a "central organization" cooperative, each membership (even if composed of more than one person) entitled to vote has one vote on any matter presented to it for a vote.<sup>37</sup> Unless otherwise provided in the articles of incorporation or bylaws, where two or more persons have an indivisible interest in a single membership (e.g., a married couple), the following rules apply unless the secretary is given written notice and legal evidence of a different arrangement: if only one

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person votes, that vote binds all; if more than one votes, the vote of the majority binds all.<sup>38</sup> *For ease of administration wherever possible, both worker and consumer co-ops should consider allowing each membership to consist of only one person.*

## **2. Central Organizations<sup>39</sup>**

Cooperatives that are “central organizations” are allowed to have unequal voting powers among members, but only if the articles of incorporation establish voting power based on the number of members in each member co-op, the patronage of each member co-op with the central organization, or both. Each member co-op must have at least one vote, however. As noted earlier in this *Sourcebook*, a central organization is a co-op having at least one member incorporated under the California Consumer Cooperative Corporation Law.

## **3. Voting by Proxy Prohibited<sup>40</sup>**

Cooperatives are prohibited from using proxy voting techniques (i.e., where a member may assign his or her voting rights to some other person).

## **4. Election Inspectors**

### **a. Appointment**

Prior to any meeting of the members, the board of directors may appoint one or three election inspectors to act at the meeting and any continuation of that meeting at some other time or place.<sup>41</sup> If the board does not appoint election inspectors or if the inspectors fail to appear or refuse to act at the meeting, the chairperson of the meeting may, or must on at least one member’s request, appoint the one or three inspectors.<sup>42</sup> If appointed on the request of a member, the majority of the members present in person at the meeting must determine whether there will be one or three inspectors.<sup>43</sup>

Inspectors do not have to be appointed unless a member so requests. To avoid any confusion caused by inspectors not being appointed until the meeting is already under way, the board should probably always appoint inspectors well before any meeting. Advance appointment will almost certainly help inspectors better perform their required tasks.

### **b. Duties**

The inspectors must (1) determine the number of memberships outstanding and the voting power of each (e.g., one vote in non-central organizations), (2) determine the number of memberships represented at the meeting, (3) determine whether a quorum exists, (4) receive votes, ballots, or consents, (5) hear and determine all challenges and questions arising in relation to voting rights, (6) count and tabulate all votes or consents, (7) determine when voting closes, (8) determine the results, and (9) perform all acts otherwise necessary to conduct the election or vote fairly.<sup>44</sup>

Inspectors must perform their duties impartially, in good faith, to the best of their abilities, and as expeditiously as practical.<sup>45</sup> If there are three inspectors instead of one, the decisions, acts, or certificates of a majority control, and any report or certificate of the inspectors is supporting evidence as to their decisions or acts.<sup>46</sup>

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## 5. Approvals by or of the Members

Any reference to “approval of” or “approval by” the members means approved by or ratified by (1) the affirmative vote of a majority of the votes represented and voting at a duly held meeting at which a quorum is present (with the affirmative votes also being a majority of the required quorum), (2) a written ballot as described earlier in this chapter, or (3) the affirmative vote or written ballot of a greater proportion of the votes of any class of membership, unit, or grouping of members as may be provided in the bylaws or by the California Consumer Cooperative Corporation Law for any member action.<sup>47</sup> (Section 12216 of the California Corporations Code provides that in “central organizations” that allow members to cast more than one vote, the majority or supermajority approval required is based upon the total number of votes entitled to be cast.)

In general, a cooperative is probably wise to make member action as easy as possible. This can be accomplished by avoiding or minimizing supermajority approvals and by any requirement that at least a majority of *all* members affirm an act or decision (see below).

## 6. Approvals by or of All the Members

Sometimes California Consumer Cooperative Corporation Law or a cooperative’s bylaws or articles of incorporation may require approval by *all* members, not just the approval of a quorum of the members. This means that approval must be obtained from a majority of all members entitled to vote at either a meeting or by written ballot.<sup>48</sup>

Approval by or of all members includes the affirmative vote of a majority of the outstanding memberships of each class, unit, and grouping of members (on the subject matter being voted on) and also includes the affirmative vote of any greater proportion of any of the foregoing if the greater proportion is required by the bylaws or co-op law.<sup>49</sup> (See California Corporations Code Section 12216 concerning disqualified voters and “approvals” in certain central organizations.)

Again, to avoid potentially disruptive situations, a cooperative should probably avoid requiring the approval of all members (especially where supermajority approvals are required) unless it is required (as in certain situations) to do so by co-op law.

## 7. Record Dates for Voting

### a. In General

“Record dates” are important because they provide a cutoff point related to certain rights of members. This is especially important for cooperatives with relatively large numbers of members since it would otherwise be very difficult to determine who would be eligible to vote immediately before a meeting or an election. A record date provides the secretary, election inspectors, and others some “breathing room” in this respect. For example, the bylaws or the board of directors may provide that to vote at a meeting or by written ballot, a member would have had to be a member for at least ten days before the vote. This would allow time for the administrative processing of a new member. In this example, a member joining the co-op five days before an election would have no voting rights in that election. A record date set before an election also indirectly serves the purpose of denying voting rights to those new members who might not yet be informed about the issues related to the election.

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**b. Voting at a Meeting**

Unless the bylaws provide for a record date for determining which members may vote at a meeting, the board of directors may fix the date in advance.<sup>50</sup> The bylaw or board record date must be no more than sixty days before the meeting, and the record date will also apply to any continuation of an adjourned meeting unless the board of directors fixes a new record date.<sup>51</sup> If neither the bylaws nor the board fixes a record date, members on the day of the meeting (or the continued meeting) who are otherwise eligible to vote may vote.<sup>52</sup> Obviously, if no record date at least a few days before the meeting is fixed in the bylaws or by the board, the secretary and any election inspectors may encounter problems in sorting out voting rights, especially in cooperatives with relatively large numbers of members.

**c. Voting by Written Ballot**

For voting by written ballot (instead of having a meeting), unless the bylaws provide for a record date, the board of directors may determine the date.<sup>53</sup> The record date provided by the board or the bylaws must be no more than sixty days prior to when the first ballot is mailed or solicited.<sup>54</sup> If no record date is fixed, those members as of the day the first ballot is mailed or solicited and who are otherwise eligible to vote may vote.<sup>55</sup> Again, the cooperative would be well advised to set a record date before the day ballots are mailed or solicited, and that date would need to be determined by the bylaws or the board.

## **I. DELEGATES**

A cooperative's bylaws may provide for "delegates" having some or all the authority of members.<sup>56</sup> Where delegates are provided for, the bylaws must state the terms of office, any reasonable method for selection and removal, and any reasonable methods for the calling, noticing, and holding of delegate meetings.<sup>57</sup> Unless they are elected directly by the membership, delegates must be elected by a body or bodies directly elected by the membership.<sup>58</sup> Delegates may act at a meeting in person or by written ballot, but not by proxy.<sup>59</sup> Also, delegates maybe called some other name (e.g., "representatives").<sup>60</sup>

Cooperatives whose memberships are relatively large in number or highly dispersed, or both, may find delegate representation more feasible than the direct involvement of members.

## **J. VOTING BY UNITS**

A cooperative's bylaws may provide for voting by its members or delegates on the basis of "chapters" or other organizational units, or by region or some other geographical grouping.<sup>61</sup>

## **K. VOTING BY ORGANIZATIONAL MEMBERS**

Where a cooperative member is *not* an individual, the member may authorize in writing at least one individual to vote in its behalf on matters regarding a membership vote.<sup>62</sup>

## **L. CERTIFICATION OF MINUTES AND RESOLUTIONS**

An original or copy of the minutes of any meeting or resolutions adopted by the members and certified by the secretary to be true is supporting evidence of a meeting duly held, the adoption of any resolutions, and any matters stated in the minutes or resolutions.<sup>63</sup>

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## **M. "GOOD FAITH" PROTECTIONS**

Co-op law has specific provisions (as of 1996) for dealing with situations related to acceptances and rejections of members' ballots, consents, and waivers. Such provisions protect the corporation where it acts in "good faith" with respect to its members. While outside the scope of discussion in this publication, more information is provided in Section 12466 of the California Corporations Code.

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# **Part IV. FINANCING ISSUES**

Chapters 11 through 13

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

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# Chapter 11. RAISING CAPITAL: MEMBERSHIPS, SHARES, AND LOANS

## A. MEMBERSHIPS

A “membership” refers to the rights of a member as defined in a cooperative’s articles of incorporation and bylaws and under the California Consumer Cooperative Corporation Law.<sup>1</sup> If a co-op wants to provide for more than one class (e.g., voting and nonvoting) of memberships (or shares, see below), each class of members (or shares) should be described (i.e., the rights, privileges, preferences, restrictions, and conditions attaching to each class) in the articles or bylaws.<sup>2</sup>

Because membership confers voting rights and cooperative members are limited to one vote (except in “central organizations”), the use of “memberships” to raise capital will perhaps prove confusing or awkward (unless one or more *nonvoting* classes of memberships are created).<sup>3</sup> This is especially true where a membership is issued for some relatively small amount (ten dollars). (Subject to the articles of incorporation or bylaws, memberships may be issued for no consideration or for any consideration determined by the board of directors.<sup>4</sup>) To avoid other potential state and federal securities regulation problems, memberships should probably be made nontransferable. Many co-ops will find they probably need to issue shares of stock to raise equity (i.e., ownership) capital effectively.

## B. SHARES

Although the sale of shares (or their equivalent) does not have to be provided for in the articles of incorporation directly, if the ownership interests of the members may be unequal, which will usually be the case if shares are issued, the general rules by which the ownership interest of each member is determined must be stated in the articles, *or* the articles must state that the rules are described in the bylaws.<sup>5</sup> Thus, unless the articles provide for a statement related to unequal ownership interests, a co-op will not be able to legally issue shares (at least where members may have differing share interests).

For shares to be more attractive as an investment, a cooperative’s articles of incorporation or bylaws should not prohibit the payment of dividends.<sup>6</sup> Also, different classes of shares might be used to attract different types of member-investors. If different classes of shares *are* to be used, however, an attorney should be consulted to assist in the creation of the various classes and the related necessary article and bylaw amendments. It should be noted, however, that a single class of shares may be used in a number of ways, for example, for direct investments and to allocate noncash portions of any dividends on previously issued shares or patronage refunds.

As with memberships, shares should probably be made nontransferable to minimize potential securities regulation problems. If shares are not transferable, the members should probably have redemption rights; otherwise, members may be unduly discouraged from investing in shares, especially in larger amounts. An attorney should be consulted concerning any rights or restrictions related to share transfers or redemptions.

Finally, it should be noted that a “shareholder” has the same meaning as a “member” under the California Consumer Cooperative Corporation Law.<sup>7</sup>

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## C. PROMISSORY NOTES OR LOANS

Besides issuing shares or other forms of ownership interests, a cooperative may raise capital by taking loans from members or others.<sup>8</sup> A loan will usually be in the form of a promissory note that describes the terms of the loan (the amount, time period, and interest rate). The loan may be payable on demand, in installments over a period of time, or at the end of some period of time. Also, the loan may or may not be secured by property of the co-op.

Unlike shares and memberships, loans do not represent ownership interests in a cooperative; instead, loans represent *debts* of the co-op. Further, the “interest” a co-op pays on loans is tax-deductible to the co-op, while any “dividends” on *ownership* interests (e.g., shares) are not deductible.

Because equity interests in a cooperative would normally be reserved for members only, a co-op would probably be wise to minimize loans taken from members if relatively large amounts of “outside” debt (e.g., loans from banks) were needed; outside lenders generally like to see a strong equity position contributed by the owners of a business (indicating confidence in the organization by its owners).

## D. SECURITIES REGULATION

### 1. In General

For purposes of the discussion here, “securities” are defined as a cooperative’s memberships, shares of stock (or other units), and loans (usually in the form of promissory notes), whether or not they are represented by a written document.<sup>9</sup> While a thorough discussion of securities regulations is outside the scope of this *Sourcebook*, some of the more important regulatory aspects of the California regulations will be highlighted below. (While only California regulation is mentioned here, the laws and regulations of other states may also be relevant to some co-ops.)

There are numerous civil and criminal sanctions at both the California and federal levels designed to protect the public from misleading, fraudulent, or otherwise unfair offerings of securities, and significant problems in the securities area can often be inadvertent. A cooperative’s officers, directors, management personnel, and any employees involved with securities transactions may be liable if securities are offered or issued in violation of California or federal regulation, and the penalties can be quite high.

It should be emphasized that although throughout this *Sourcebook* references are made to “memberships” and “shares,” other descriptive terms may be used for the ownership “units” of a cooperative.

### 2. California Regulation and Co-op Securities

#### a. Qualification of Securities by Permit

Unless some exemption applies, a cooperative usually must get a permit from the Department of Corporations (the “Department”) before offering or issuing memberships, shares, or promissory notes<sup>10</sup> to other than certain types of investors (e.g., banks and other financial institutions). An annual application process is involved,<sup>11</sup> and it usually takes at least several weeks (and sometimes longer) before a permit is received after the application is filed. Depending on the amount of securities to be sold, the filing fee will vary from two hundred dollars up to twenty-five hundred

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dollars.<sup>12</sup> In addition, the cooperative will also undoubtedly incur attorney's fees. The Department may impose conditions on any permit issued that, in some cases, may be quite burdensome (e.g., requiring a deposit or "prospectus").<sup>13</sup>

Further, the cooperative must file semiannual reports to the Department after the permit has been granted,<sup>14</sup> its financial statements may have to undergo costly audits,<sup>15</sup> and complete records of the securities' sales (and of the proceeds) must be maintained.<sup>16</sup>

## b. Exemptions from Qualification

### (1) In General

If a cooperative desires to avoid the sometimes time-consuming and costly permit process, it must try to lawfully structure its securities transactions within some available California "exemption." The four exemptions discussed below are the ones most likely to apply to a co-op attempting to offer and issue memberships, shares, or promissory notes (i.e., loans) to individuals. *It should be emphasized that California and federal anti-fraud provisions apply to securities transactions even if one of the exemptions discussed below allows a co-op to escape the need for a California permit.*

### (2) Co-op Equity Exemption

A cooperative does not have to get a permit to issue shares or memberships to any person having no more than three hundred dollars invested in shares or memberships.<sup>17</sup> Two requirements must be met, however, if the permit process is to be avoided: (1) no promoter of the shares or memberships of the co-op can expect to make a profit directly or indirectly from the co-op other than a reasonable salary, and (2) any member acquiring the shares or memberships must have voting rights in the co-op.<sup>18</sup>

The requirements of this exemption are usually relatively easy to meet, and the exemption is obviously a big help to smaller "start-up" cooperatives. Problems could arise, however, related to the prohibition against "promoters," especially since some co-ops requiring large amounts of capital may have to initially sell shares or memberships to a large number of people. It should be emphasized that this cooperative-specific exemption does not apply to promissory notes or any other form of debt.

### (3) Nonpublic Debt Exemption

A cooperative may raise capital by issuing promissory notes to or otherwise taking loans from members or others. Unless an exemption is structured, however, a permit from the Department of Corporations will be required. The nonpublic debt exemption provides that a permit will not be needed if the note or loan does not involve a "public" offering.<sup>19</sup> The main issue is whether the specific offer and sale of the securities (i.e., loans, notes, etc.) is "public," and the Department has issued various guidelines in this area. Obviously, this exemption is more complex than the co-op equity exemption, and a co-op should not attempt to use this debt exemption without consulting an attorney.

### (4) Limited Offering Exemption

Another exemption available to cooperatives is the "limited offering" exemption that applies to both debt *and* equity securities.<sup>20</sup> As this exemption is broader than the debt exemption in a

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number of ways, it is also even more complex. In addition, a “notice” of use of the exemption must be filed with the Department of Corporations if any securities are actually sold under this exemption.<sup>21</sup> Again, an attorney should be consulted before a co-op attempts to make use of this exemption.

(5) “Qualified Purchaser” Limited Public Offering Exemption<sup>22</sup>

An additional exemption applies to all business entities subject to California law. It covers the offer and sale of both debt and equity securities, and a permit from the Department is generally *not* needed if the investors are “insiders,” financially sophisticated or relatively wealthy, institutional, etc. Certain disclosure and notice requirements must be met, however. Because the necessary disclosure may have to meet the requirements of regulations under the federal securities laws as well as other technical mandates, an attorney should be consulted before a co-op attempts to make use of this exemption.

## E. SUMMARY AND CONCLUSIONS

The offer and issuance of securities, including memberships, shares, loans, etc., may provide the cooperative with its most complex legal issues. A co-op’s directors, officers, and employees, as well as the co-op itself, can easily find themselves inadvertently exposed to civil and criminal penalties under both state and federal regulation. A co-op would be well advised not to attempt any transaction in the securities area without the assistance of an attorney.

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## Chapter 12. DISTRIBUTIONS AND PATRONAGE REFUNDS

### A. IN GENERAL

Unless a cooperative's bylaws or articles of incorporation (or California Consumer Cooperative Corporation Law in the case of possible insolvency) provide otherwise, the co-op's surplus (i.e., the excess of its revenues over expenses) can be applied in one or more of three ways: retained as "working capital" for the co-op as a whole; distributed on the basis of members' capital contributions to the co-op; or distributed as patronage refunds to individual members.<sup>23</sup>

The second application above will generally take the form of "dividends" on shares (although in some cases a cooperative may want to pay out "appreciation" when it repurchases shares from members). Most co-ops will probably not want to be constantly revaluing shares as members come and go; thus, bylaws often provide that any share repurchases will be in the exact monetary amount currently in the member's share account (from actual contributions and any allocations of patronage refunds or dividends).

A cooperative should seek professional advice before attempting to make any kind of distribution or to pay patronage refunds.

### B. DISTRIBUTIONS

Under California co-op law, a "distribution" is the payment or allocation of gains, profits, or dividends to any member as a member, but the term does *not* include a payment or allocation based on "patronage."<sup>1</sup> As a practical matter, a distribution will probably most often be in the form of a dividend on shares.

Distributions, if paid, are limited to 15 percent of contributed capital in each fiscal year.<sup>2</sup> In any given cooperative, contributed capital may be called memberships, shares, or some other name.<sup>3</sup> ("Shares" are probably the most familiar type of capital "unit.")

Unless the bylaws, articles of incorporation, or co-op law (in the event of insolvency) limit or prohibit distributions, any distribution is made at the discretion of the board.<sup>4</sup> If a cooperative seeks to attract substantial capital from its members, its articles or bylaws should probably not prohibit distributions; indeed, its articles or bylaws should probably provide for "shares," including redemption rights<sup>5</sup> (particularly where transferability is severely restricted or prohibited).

Unlike patronage refunds and interest on promissory notes and other debt, dividends are never tax-deductible to a nonagricultural cooperative. Also, dividends (as well as interest) from a co-op are *always* taxable to the members receiving them.

### C. PATRONAGE REFUNDS

#### 1. In General

The bylaws may provide for the time and manner of making any patronage refunds.<sup>6</sup> (As a practical matter, due to complexities surrounding them, any patronage refunds usually will be paid or

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allocated only once a year.) “Patronage” is measured by the volume or value, or both, of (1) a patron’s purchases of products or services marketed by the cooperative or (2) products or services provided to the co-op by the patron.<sup>7</sup> Any patronage refunds must be proportionately and equitably distributed to the co-op’s members or other patrons, based on their patronage of the co-op.<sup>8</sup> Patronage refunds must be distributed in the form of cash, property, debt, capital credits (e.g., shares), memberships, or services.<sup>9</sup>

Patronage refunds obviously represent a different type of payment or allocation than dividends, since the latter are based on a member’s capital contributions (e.g., shares). Again, patronage refunds are based on the business transacted between the patron and the cooperative. Although patronage refunds may theoretically be paid to *nonmember* patrons, most co-ops would probably have difficulty keeping track of the whereabouts of nonmembers; thus, as a practical matter, refunds are generally only paid or allocated to members.

To determine the amount of a cooperative’s “surplus” available for the payment of patronage refunds for any given fiscal year, any dividends distributed (or accrued) during the year would have to be first subtracted.<sup>10</sup> Also, any restoration by the cooperative of impaired capital (i.e., a deficit in “unappropriated,” or unallocated, retained earnings) may also reduce the amount of surplus available for patronage refunds.<sup>11</sup>

## 2. Tax Considerations

Patronage refunds, unlike dividends, are potentially tax-deductible to a cooperative. For refunds to be fully tax-deductible each year (not just the cash portion), certain requirements of the Internal Revenue Code must be met. (It should be noted that the Internal Revenue Code refers to patronage refunds as “patronage dividends.”) Without going into too much detail here,<sup>12</sup> five of the more important requirements are as follows:<sup>13</sup>

- (1) the co-op must have a pre-existing obligation to pay the refunds;<sup>14</sup>
- (2) the total refund must be based on the co-op’s current surplus;<sup>15</sup>
- (3) the amount paid to each member must be based on his or her patronage;<sup>16</sup>
- (4) at least twenty percent of the refunds must be distributed in cash or by check within eight and one-half months of the end of the co-op’s fiscal year;<sup>17</sup> and
- (5) each member of the co-op must receive a “qualified” written notice of allocation of any noncash portion of a refund.<sup>18</sup>

Because of administrative costs, a cooperative will probably not want to distribute patronage refunds unless the refunds are, in fact, tax-deductible to the co-op. An attorney should be consulted prior to the distribution of any refunds to help ensure their deductibility.

While tax-deductible patronage refunds could theoretically be distributed to nonmembers (based on their relative patronage), such payments and allocations are usually impractical due to administrative considerations (e.g., locating such patrons). To the extent, however, that patronage-related “net income” is not paid or allocated as patronage refunds (e.g., to nonmembers, for “reserve” creations), the cooperative will pay taxes on such income. The resulting “retained earnings” would

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accrue to the co-op as a whole and would not be identified with, or distributed to, specific members (except perhaps upon dissolution of the co-op).

As to the tax situation of members receiving patronage refunds, such refunds will generally be fully income taxable to the members except where the refunds are related to “personal” rather than “business” transactions between the co-op and the members. Whether patronage distributions may also be subject to “self-employment” taxes (e.g., in the case of worker cooperatives) is unclear, but the issue should be considered where relevant; a discussion of this issue is outside the scope of this publication.

### **3. Administrative Considerations**

The distribution of patronage refunds is a relatively costly undertaking for many cooperatives, especially if the refunds are to be fully tax-deductible. A co-op will have to keep track of its “patronage” transactions with each member and write checks to each member for the cash portion of the refund. In addition, the co-op may incur additional outside legal and accounting costs in relation to refund distributions.

Obviously, a cooperative should carefully weigh the costs of a refund system compared to the potential increased member participation and tax savings that patronage refunds may generate for the co-op.

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# Chapter 13. UNCLAIMED MEMBERSHIP INTERESTS

## A. BACKGROUND

Corporations often find themselves unable to locate their shareholders or other persons to whom they owe money (e.g., promissory notes, accrued interest, dividends, etc.). This is particularly true of cooperatives in which many members own relatively small amounts in shares, other membership interests, or accrued dividends and patronage refunds. Co-op members are often relatively transient (especially, for example, in student communities); co-op memberships and shares often have severe transfer restrictions; members' equity interests sometimes increase by "indirect" transactions (e.g., patronage refunds); and equity interests of individual members are often quite small. Because of these factors and others, co-op members often ignore or forget share or other interests held in their name by the co-op when they cease doing business with the co-op. A similar situation often results when a member dies. In these contexts, a co-op must determine what to do with a member's equity (e.g., share) or debt-related interests in the co-op.

The following discussion is not intended as a comprehensive explanation of the California Unclaimed Property Law. Instead, the discussion has a more narrow focus related to how this law most directly impacts co-ops. An attorney should be consulted for specific issues related to a co-op since (1) there could be subsequent changes in the Unclaimed Property Law, (2) a particular problem facing the co-op might not be fully explained by this discussion, and (3) an *exemption* from the Unclaimed Property Law is available to co-ops incorporated under the California Consumer Cooperative Corporation Law (provided certain requirements are met).

## B. CALIFORNIA'S UNCLAIMED PROPERTY LAW

### 1. In General

Under the California Unclaimed Property Law, any unclaimed equity or debt interests in a cooperative "escheats" to the state of California after three years<sup>1</sup> if the apparent owner's last known address is located in California.<sup>2</sup> "Escheat" means that the ownership of the affected property passes to California until the proper owner claims it.<sup>3</sup> In a co-op context, property that may escheat to California includes equity interests (i.e., ownership interests such as shares), promissory notes or other debts, and accrued interest, patronage refunds, or dividends.<sup>4</sup> Unclaimed distributions from a co-op employee benefit plan also escheat after three years unless the plan contains explicit forfeiture provisions.<sup>5</sup>

As to specific dividend, patronage refund, interest, or other amounts owed to a member or other person, if the person has not claimed the sum within three years after the payment or accrual date, or at least corresponded with the cooperative about it within the three-year period, the sum escheats to the state.<sup>6</sup>

An *equity* (e.g., share) interest in a cooperative also escheats to California if (1) the person has not claimed or communicated with the co-op about dividends or patronage refunds related to his or her

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equity interests for more than three years, and (2) the co-op does not know the whereabouts of the owner at the end of the three-year period.<sup>7</sup>

Further, any dividends or other distributions (e.g., patronage refunds) owed to the “missing” owner escheats to the state at the same time as the underlying equity interest.<sup>8</sup>

## 2. Reporting Requirements

Property escheats to California regardless of whether or not it is reported to the state controller. The Unclaimed Property Law requires certain reporting procedures,<sup>9</sup> and the controller provides various forms.<sup>10</sup> The cooperative is required to submit certain information on the forms, including the following:

- (1) the name and last known address, if any, of each person owning at least fifty dollars in escheated property;<sup>11</sup>
- (2) the nature and identifying number, if any, or description of the property and the amount due, except that items of less than fifty dollars may be reported in total (instead of individually);<sup>12</sup> and
- (3) except for items reported in the aggregate (above), the date when each amount became payable (or demandable or returnable) and the date of the last contact with the owner (related to the amount).<sup>13</sup> The controller may also require other information.<sup>14</sup>

Unless an extension is granted by the controller upon written request by the cooperative, the forms must be filed before the first day of November for property escheated on the preceding June 30 or the co-op’s fiscal year-end closest but prior to November 1.<sup>15</sup> Unless written consent is given by the controller for earlier destruction, the co-op must retain all records of the reported property for another three years.<sup>16</sup> An officer of the co-op must sign the forms.<sup>17</sup>

## 3. Payment and Delivery

As to shares or other equity interests still held in a cooperative by persons who cannot be located, the co-op must deliver a duplicate certificate of the equity interests to the state controller at the time of filing.<sup>18</sup> Presumably, since co-ops need not issue share or membership certificates, a receipt or other “written advice of purchaser” would also suffice.<sup>19</sup> (Share or membership certificates may be required for shares and membership issued prior to January 1, 1984, the date the California Consumer Cooperative Corporation Law became effective.)

Related to share or other equity interests, the cooperative must give notice to the owners by mail at least six to twelve months before the interests would become reportable to the controller.<sup>20</sup> The notice must state when the interest will escheat and provide a form (provided by the controller) by which an owner may confirm his or her current address.<sup>21</sup>

A cooperative that pays or delivers escheated property to the controller cannot be held liable for any further claim on the property to the extent of its value.<sup>22</sup> Further, if the co-op does pay a claim on the property after paying or delivering the property to the controller, the co-op may obtain reimbursement from the state.<sup>23</sup> (Reimbursement can also be obtained if the property is paid or delivered to the controller in error.<sup>24</sup>)

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#### **4. Enforcement**

The controller's office may, upon reasonable notice and at reasonable times, examine the records of a cooperative if it is believed that the co-op has failed to report unclaimed property.<sup>25</sup> In addition, the controller may go to court to (1) force a co-op to permit an examination, (2) identify property subject to escheat, and (3) force delivery of escheated property to the state controller.<sup>26</sup>

A cooperative or its key personnel (e.g., officers and directors) willfully failing to make a report or performing any other duties (e.g., allowing inspection of its records) under the Unclaimed Property Law is fined one hundred dollars per day that the report is late or a duty is not performed, up to a maximum of ten thousand dollars.<sup>27</sup> A co-op or its personnel willfully refusing to pay or deliver escheated property to the controller may face fines of five thousand to fifty thousand dollars.<sup>28</sup> Finally, in addition to any damages, penalties, or fines for which a co-op or its personnel may be liable under the Unclaimed Property Law, a co-op or its personnel failing to report, pay, or deliver unclaimed property within the proper time periods are liable to the controller for twelve percent annual interest on the property or its value from the date it should have been paid or delivered.<sup>29</sup>

### **C. MINIMIZING OR AVOIDING THE LAW'S IMPACT**

#### **1. Member Communications and Education**

One way for a cooperative to minimize the effect of the Unclaimed Property Law is to maximize communications with its members. A co-op should keep its membership list as current as possible and identify members for possible termination as soon as it appears they are no longer transacting business with the co-op. For example, some co-ops have bylaws providing that unless a member does a certain minimum annual amount of business with the co-op, the board of directors may terminate his or her membership, with the member's shares being repurchased by the co-op. Obviously, the longer a co-op waits to repurchase an "inactive" member's shares, the less likely it is to locate the member.

Another preventative step to minimize the impact of the Unclaimed Property Law is for a cooperative to educate its members about escheat provisions and the need for them to promptly notify the co-op when they are no longer using the co-op or when their addresses change.

#### **2. Attempted Agreements**

In terms of avoiding the Unclaimed Property Law altogether, at least prior to 1987, there was some speculation that a cooperative might "contract" with its members that any unclaimed property would automatically be forfeited to the co-op before escheating to the state of California. In theory, such a contract might be placed in the co-op's articles of incorporation, bylaws, or some other document. While there apparently has been no court decision directly related to such an attempt by a co-op, various court decisions in somewhat similar situations have emphasized the strong "public policy" against contractual agreements to avoid escheat.<sup>30</sup> The California Supreme Court has on occasion struck down bylaws at variance with "public policy."<sup>31</sup> Generally, the public policy of the Unclaimed Property Law is to protect property owners by locating them and returning their property. Such policy also gives the state, rather than the organization, the benefit of the property (since experience shows that most apparently abandoned property will never be claimed).<sup>32</sup>

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### 3. The Co-op Exemption

Because the strong public policy upholding escheat provisions may seem severe in certain situations, one court decision included a suggestion that a legislative exemption be sought if the relationship between the property holder and the property owner was somewhat “special.”<sup>33</sup> (That case dealt with a union and its members.) Such an exemption for cooperatives incorporated under the California Consumer Cooperative Corporation Law was, in fact, sought and enacted.<sup>34</sup> The exemption became effective as of January 1, 1987, and exempts co-op *equity*-related interests (i.e., co-op shares, memberships, and accrued dividends and patronage refunds) from the Unclaimed Property Law. For a co-op’s apparently abandoned equity-related interests to avoid being escheated to California, however, the three following requirements *must* be met.<sup>35</sup>

- (1) The cooperative’s articles of incorporation or bylaws must specifically allow for the transfer of equity-related interests from the “missing” member or shareholder to the co-op.
- (2) At least sixty days’ prior notice of the proposed transfer must be given to the affected member or shareholder, both by first- or second-class mail to the last address shown in the cooperative’s records *and* by publication in a general circulation newspaper in the county where the co-op has its principal office.
- (3) No written notice from the affected member or shareholder objecting to the proposed transfer is received by the cooperative prior to the transfer.

Under this cooperative exemption, the unclaimed equity-related interests must remain outstanding for three years. To minimize quorum and other types of administrative problems (e.g., mailings), however, the co-op may wish to terminate earlier the underlying “membership” (e.g., for lack of patronage). This will result in co-ops having nonmember equity or liability interests appear on their balance sheets and other corporate records. To ensure that the escheat exemption is not lost, however, some co-ops should seek legal advice before converting any unclaimed membership or share interests to *debt*-type instruments, since such converted interests may *not* be exempt from the Unclaimed Property Law.

It is obviously important that a cooperative take advantage of this special equity exemption by properly amending, if needed, its bylaws or articles of incorporation as soon as possible to provide for the transfer of otherwise escheated equity-related interests to the co-op. A bylaw amendment is preferable since bylaws are usually easier to amend than the articles. Any delays in amending either bylaws or articles will likely mean that additional property will escheat to the state. Care, of course, should be taken to ensure that the bylaws or articles are amended in accordance with any existing bylaw and article provisions concerning amendments, as well as applicable provisions of the California Consumer Cooperative Corporation Law.

Finally, it should be stressed again that this cooperative-related exemption does *not* cover debt instruments, and a co-op is required to comply with the Unclaimed Property Law concerning such instruments.

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

# **Part V. REPORTING AND FILING MATTERS**

Chapters 14 through 16

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

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# Chapter 14. RECORDS, REPORTS, AND INSPECTION RIGHTS

## A. IN GENERAL

The California Consumer Cooperative Corporation Law provides fairly detailed rules about the types of records a co-op must maintain and under what conditions they may be inspected. There are five general rules that should be stated initially, however.

- (1) If any document subject to inspection is not maintained in written form, upon a request for inspection, the cooperative must at its own expense provide the requested information in written form.<sup>1</sup>
- (2) Any proper inspection of information may be made by the person requesting the information or by her or his representative.<sup>2</sup>
- (3) Inspection rights include the right to make copies or extracts.<sup>3</sup>
- (4) All inspection rights extend to any subsidiary corporation of the cooperative.<sup>4</sup>
- (5) The members' inspection rights may not be limited by contract, the articles of incorporation, or the bylaws.<sup>5</sup>

## B. REQUIRED RECORDS AND REPORTS

### 1. Accounting Records, Minutes, and Membership Records

A cooperative must maintain (1) adequate and accurate accounting records, (2) minutes of board of directors, board committee, and member meetings, and (3) membership records containing each member's name, address, membership class, and the number of membership units (e.g., shares) held by each member.<sup>6</sup>

Minutes of all of a cooperative's meetings must be kept in written form.<sup>7</sup> Other records and books must be kept in written form or in some form capable of being converted to written form.<sup>8</sup>

### 2. Annual Report

#### a. Requirements

The following four rules apply only to cooperatives having more than twenty-five members at any time during the fiscal year.<sup>9</sup> First, the co-op must annually notify each member of her or his right to receive a financial report.<sup>10</sup> Second, upon the written request of a member, the board of directors must provide the member with a copy of the most recent annual report.<sup>11</sup> Third, the report must be prepared no later than one hundred twenty days after the end of the co-op's fiscal year.<sup>12</sup> Fourth, the annual report must contain the following information in appropriate detail:<sup>13</sup>

- (1) a balance sheet as of the end of the fiscal year and statements of income (or loss) and changes in financial position ("cash flows") for the entire fiscal year;
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- (2) where the names and addresses of all current members are located and any required information about “interested” or indemnification transactions (see chapter 7 of this *Sourcebook*); and
- (3) an independent accountant’s “report” (e.g., a compilation, review, or audit by a CPA) on the annual report *or* the certificate of an authorized co-op officer that the financial statements were prepared without audit from the co-op’s accounting records.

For more information about financial statements, please see Section 7.02 of the sample bylaws.

**b. Financial Statements and Accountants Defined**

For purposes of the California Consumer Cooperative Corporation Law, “financial statements” are statements prepared in conformity with generally accepted accounting principles or some other basis of accounting which reasonably states the assets, liabilities, income, and expenses of the co-op and discloses the accounting basis of the statements.<sup>14</sup> An “independent accountant” means a “certified public accountant” (CPA) or “public accountant” (a status which is being phased out) who is independent of the co-op in accordance with generally accepted auditing standards and who is engaged to audit the co-op’s financial statements or perform other accounting services.<sup>15</sup>

**c. Need for Current Financial Information**

While an annual report will be required for many cooperatives, almost all co-ops will also probably want to generate financial statements more often, e.g., quarterly or monthly. It is obviously much easier for the board of directors, members, and management personnel to assess the performance and financial position of the co-op if frequent and timely statements are generated.

**3. Annual Statement of Certain Covered Transactions and Indemnification**

All cooperatives, even those not required to issue an annual report (i.e. those with fewer than twenty-six members throughout the accounting year), must annually furnish to their members and directors a statement of any transactions or indemnifications as described below.<sup>16</sup> Like the annual report, this information must be mailed or delivered to all members within 120 days of the end of each fiscal year.<sup>17</sup>

Except for those transactions approved by the members (see chapter 10 of this *Sourcebook*), transactions which must be reported (i.e., “covered transactions”) are those where the cooperative or its subsidiary was a party *and* a director or officer of the co-op (or its subsidiary), or any holder of more than ten percent of the co-op’s (or subsidiary’s) voting power had a direct or indirect significant financial interest.<sup>18</sup> (A more-than-ten-percent holder is referred to below as an “interested person.”<sup>19</sup>) Neither a common directorship nor a regular member-patron relationship constitutes a material financial interest by itself, however.<sup>20</sup>

Any required annual statement must briefly describe or state:<sup>21</sup>

- (1) any “covered transaction” (not including compensation of officers and directors) during the previous fiscal year involving more than one thousand dollars or which was one of several covered transactions totaling more than one thousand dollars in which the same interested person had a direct or indirect material financial interest; and
  - (2) the names of any interested persons involved in covered transactions, the person’s relationship to the cooperative, the nature of the person’s interest in the transaction, and the amount of the interest (assuming that it may be reasonably determined).
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Finally, the required annual statement must also briefly describe the amount and circumstances of any loans, guarantees, indemnifications, or advances totaling more than one thousand dollars paid or made during the fiscal year to any officer or director.<sup>22</sup> A description is not necessary, however, for any loan, guaranty, or indemnification approved by the members or for a loan or guaranty not requiring any approval of the board of directors or members.<sup>23</sup> (See chapter 7 of this publication.)

Regarding this required annual statement, an attorney should almost certainly be consulted, since the law's provisions are quite technical and open to a certain amount of interpretation (e.g., the threshold amount for a "material" financial interest).

## C. INSPECTION RIGHTS

### 1. Membership List

Except where a court steps in or unless the cooperative provides a reasonable alternative (see below), a co-op member may do either or both of the following concerning inspection of the membership list.<sup>24</sup> First, he or she may inspect and copy the record of all members' names, addresses, and voting rights at any reasonable time after giving five business days' written demand, with the demand stating the purpose of the inspection.

Second, the member may obtain from the cooperative's secretary upon written demand and payment of a reasonable charge, a list of the names, addresses, and voting rights of all members entitled to vote for directors as of the most recent record date or as of a date specified by the member after the date of the demand. The demand must state the purpose of the request, and the list must be made available to the member by the tenth business day after the demand is received or by the tenth business day after the date specified in the demand.

The inspection of the membership list may only be exercised by a member or members having at least five percent of the voting power and then only for a purpose reasonably related to their interest as members.<sup>25</sup> If the cooperative reasonably believes that the information will be used for another purpose or if it provides a reasonable alternative (below), it may deny the member or members access to the list.<sup>26</sup>

As an alternative to providing access to the list, the cooperative may, within ten business days after receiving the demand, deliver to the member or members making the demand a written offer of a reasonable alternative method for achieving the purposes of the demand.<sup>27</sup> Any rejection of the offer must be in writing and state the reasons the co-op's alternative does not meet the members' proper purpose of the demand.<sup>28</sup>

Both the cooperative and its members have legal remedies to deny or restrict the inspection rights provided above if it is believed that the demand is for improper purposes.<sup>29</sup>

### 2. Availability of Records to Members

A cooperative's accounting records and minutes of board of directors, board committees, and membership meetings must be open to inspection upon the written demand of the co-op by any member.<sup>30</sup> Although the inspection may be made at any reasonable time, it must be for a purpose reasonably related to the person's interests as a member.<sup>31</sup>

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### **3. Availability of Records to Directors**

Each director has the *absolute* right at any reasonable time to inspect and copy any book, record, or document of any kind and to inspect the physical properties of the cooperative.<sup>32</sup>

### **4. Availability of Articles and Bylaws to Members<sup>33</sup>**

A cooperative must keep at its principal California office a copy of its articles of incorporation and bylaws as currently amended, and these documents must be open to inspection by members at all reasonable times during office hours. If the co-op does not maintain an office in California, it must, upon the written request of a member, provide her or him with a copy of the current articles or bylaws.

## **D. PROHIBITED USES OF MEMBERSHIP LIST<sup>34</sup>**

Without the consent of the board of directors, a member may not use a cooperative's membership list (i.e., the names and addresses of all the co-op's members) for any purpose not reasonably related to the member's interest as a member. Although there may be others, the following four purposes are definitely *not* reasonably related to a member's interest: (1) to solicit money or property unless it will be used to solicit members' votes in a co-op election; (2) for a purpose the user does not reasonably and in good faith believe will benefit the co-op; (3) for any commercial purpose or purpose in competition with the co-op; or (4) to sell the list. A co-op may seek damages as well as injunctive relief related to any unauthorized use of the membership list.

## **E. VOTING REPORT**

Up to sixty days after an annual, regular, or special meeting of the members, a cooperative must provide, upon the written request of any member, the results of any particular vote taken at the meeting (including the number of votes in favor, against, or abstaining). (See Section 12594 of the California Corporations Code, enacted in 1999, for more details related to the information required to be provided, including information related to the election of directors.)

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# Chapter 15. FILINGS WITH THE SECRETARY OF STATE

## A. IN GENERAL

### 1. Date of Filing<sup>1</sup>

Generally, whenever a cooperative sends a document that conforms to all legal requirements to the Secretary of State, it is “filed” when endorsed by the Secretary of State. Except for documents related to the annual statements or updated annual statements (see below), the filing date is the same date the document is received by the Secretary of State, unless the co-op requests a later filing date, or unless the Secretary of State believes the filing is intended to be coordinated with the filing of some other document which for some reason cannot be filed. If the co-op requests a future date for filing, that date may not be more than ninety days after nor less than one business day before the receipt of the document by the Secretary of State. Even if an incorrect filing fee is sent with the document, it will be filed if any unpaid amount does not exceed a limit established by policy of the Secretary of State.

### 2. Rejection and Resubmission<sup>2</sup>

If the Secretary of State finds that the document submitted for filing does not conform to applicable laws and returns it to the cooperative, the document may be resubmitted along with a written opinion of a California attorney stating that the specific provision objected to by the Secretary of State *does* conform to applicable laws. The opinion must also state appropriate legal authority. The Secretary of State must then rely upon the written opinion concerning a disputed point of law in determining whether the document conforms to law. Assuming the document is then filed, the filing date is the day the resubmitted document is received.

### 3. Delayed Effectiveness of Filing<sup>3</sup>

A cooperative document sent to the Secretary of State may provide that it not be effective for up to ninety days after its filing date. Where a delayed effective date is specified, the co-op may revoke the document before it becomes effective if it sends a certificate to the Secretary of State stating that the co-op (by appropriate action) has revoked the document, making it null and void. The certificate must be executed in the same way as the original document and filed before the stated effective date. If no revocation certificate is filed, the document original becomes effective on the stated date.

## B. REQUIRED ANNUAL STATEMENT AND DESIGNATION OF CORPORATE AGENT

### 1. In General<sup>4</sup>

A cooperative must, within ninety days after filing its original articles of incorporation and annually thereafter, file on a prescribed form with the Secretary of State a statement containing: (1) the names and business or residential addresses of its “chief executive officer” (i.e., chairperson of the board or president) or general manager, secretary, and chief financial officer; (2) the street address of its principal California office; and (3) the individual or corporation designated as the co-op’s agent

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for service of process. If a natural person is designated as agent, that person must be a resident of California and the annual statement must provide his or her business or residential address. If a corporate agent is named, no address need be provided.

## **2. Corporate Agent for Process**

Special rules beyond the scope of this discussion apply to the qualifications of a *corporation* to serve as an agent for process. California Consumer Cooperative Corporation Law should be consulted.<sup>5</sup> To avoid these rules related to a corporate agent, a co-op may use an individual as agent.

## **3. Annual Filing Period<sup>6</sup>**

Except for its first filing of the annual statement, a cooperative must file the statement each year during the six-month period ending with the last day of the same calendar month in which the original articles of incorporation were filed. The Secretary of State is supposed to mail the proper form to the co-op about halfway through its filing period. The co-op is obliged to file the form on time, even if the form is not sent by the Secretary of State's office. Thus, the co-op may have to request the form in order to file on time.

## **4. Changes in Required Information<sup>7</sup>**

For any changes in the required information other than the agent for process, the cooperative may (but is not required to) file an updated statement. To change its agent for process, however, the co-op *must* file an updated statement containing all required information.

## **5. Effect of the Most Recent Statement<sup>8</sup>**

Whenever any statement is filed (even if it is only to update a previously filed annual statement), the most recent statement supersedes any previous filings and the provision in the articles of incorporation stating the name and address of the agent for process.

## **6. Resignation of Agent<sup>9</sup>**

An agent for process designated by a cooperative may file a signed and acknowledged written statement of resignation with the Secretary of State. The authority of the agent to act in that capacity then ceases, and the Secretary of State must give written notice of the resignation to the co-op.

## **7. Designation of New Agent**

If an agent for process who is a natural person resigns, dies, or no longer lives in California, or if a corporate agent resigns, dissolves, leaves or forfeits its rights to do business in California, has its rights, powers, and privileges suspended, or ceases to exist, the cooperative must file a statement designating a new agent.<sup>10</sup>

## **8. Penalty for Failure to File**

A cooperative may be subject to a penalty by the California Franchise Tax Board if its required filing to the Secretary of State is not made within sixty days of any delinquency notice.<sup>11</sup>

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## Chapter 16. INCOME TAX–RELATED FILINGS

### A. INCOME TAX RETURNS

Unless a cooperative attains tax-exempt status, and assuming that it is incorporated under the California Consumer Cooperative Corporation Law, a co-op will file annual income tax returns just like other corporations (i.e., federal Form 1120 and California Form 100). Also, like other California corporations, a taxable co-op must annually pay California the greater of eight hundred dollars (the “minimum franchise tax”) or the amount based upon the current tax rate applied to the “taxable income” of the co-op. While the Internal Revenue Code imposes no minimum tax similar to California’s, the federal tax rates are higher.

While a comprehensive look at the taxation of cooperatives is outside the scope of this publication, co-ops that distribute patronage refunds (called “patronage dividends” in the Internal Revenue Code) may deduct such refunds from their income, provided certain requirements are met (see chapter 12 of this *Sourcebook*). “Special-purpose” co-ops, as well as other types of legal entities (e.g., limited liability companies) should seek professional advice to ensure that appropriate income tax returns are filed properly and in a timely manner.

### B. FORMS 1099

Cooperatives, like other taxpayers, must annually (based on the “calendar” year) file federal Forms 1099-DIV, 1099-INT, and 1099-PATR related to the payment or allocation of dividends, interest, and patronage refunds, respectively. Such forms are not required to be issued to recipients for amounts less than ten dollars, however. In addition, Form-MISC is required to be filed for other types of payments to generally noncorporate recipients (including service providers) of income from a co-op. Forms 1099 are required to be filed with the Internal Revenue Service by the end of February for the immediately prior calendar year, along with “transmittal” Form 1096. The income recipients are required to be sent their copy of Form 1099 by the end of January following the year of payment or allocation.

California has separate and different filing requirements related to noncorporate persons providing services to a cooperative; filings must be made with the Employment Development Department within twenty days of a co-op entering into a contract with or actually paying to a provider for services of at least six hundred dollars in a calendar year.

Related to patronage refunds, *consumer* cooperatives should seek an exemption (under Internal Revenue Code Section 6044(c)) from filing Forms 1099-PATR if at least eighty-five percent of its gross receipts are from retail sales of goods or services for personal, living, or family use. (To the extent that refunds are related to personal, living, or family use, refunds are not taxable to the recipient.) Federal Form 3491 is used to apply for such exemption.

Worker and other nonconsumer cooperatives issuing patronage refunds to their members should seek professional advice related to the reporting of such refunds on members’ personal income tax returns. While patronage refunds distributed to employee-members *are* subject to income taxes, a question exists as to whether the refunds are subject to “self-employment” taxes (i.e., Social Security and Medicare).

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# NOTES

## INTRODUCTION

1. Cal. Corp. Code §§ 12200–12704.
2. Id. §§ 12202, 12690–12704.
3. Id. § 12692(a).
4. Id. § 12691(c).
5. Id. § 12222.
6. Id. § 12351(a)(8).
7. Id. § 12224. In certain situations beyond the scope of this discussion (e.g., in cases of dissolution), co-op law may require the affirmative vote of a majority of all members for approval. Id. §§ 12223, 12630.
8. Id. § 12256.
9. Id. § 12314, 12484.
10. Id. § 12461(i), 12463(e).
11. Id. § 12215.
12. Id. § 12219.
13. Id. § 12220.
14. Id. § 12245.

## Chapter 1. CHOICE OF ENTITY FOR DOING BUSINESS

1. See chapter 12 of this publication.
2. Cal. Corp. Code §§ 12201, 12451.
3. Id. § 25100(r).
4. Id. § 12440.
5. Id. § 12310.
6. Id. § 7111.
7. Id. § 7411.
8. Id. § 7130.
9. Id. §§ 7140(g), 7312.
10. Id. § 7411.
11. The permit process is described in slightly more detail in chapter 9 of this publication.
12. Cal. Corp. Code §§ 20001, 21301.
13. See the “check-the-box” Treasury Regulation § 301.7701-3.
14. Cal. Corp. Code § 21100.
15. Such law is codified in §§ 20000–24007 of the California Corporations Code.

## Chapter 2. PRE-OPERATIONAL MATTERS

1. Cal. Corp. Code § 12311(a).
2. Id. § 12302(d).
3. Id. § 12331(a).
4. Id. § 12360(c).
5. Id. § 12401(b).

6. Id. § 12401(e).
7. Id. § 25100(r).
8. Id. § 12300(b).
9. Id. § 12214(a).
10. Id. § 12300(c).
11. Id. § 12591.
12. Id. § 12590(a)(3).

## CHAPTER 4. ARTICLES OF INCORPORATION

1. Cal. Corp. Code §§ 12310, 12314.
  2. Id. § 12313(a).
  3. Id. §§ 12312–12313.
  4. Id. § 12691–12692.
  5. Id. § 12500(a).
  6. Id. § 12692(a).
  7. Id. § 12500(b).
  8. Id. § 12501.
  9. Id. § 12502(a).
  10. Id. § 12502(b). In addition, if the co-op was organized before August 14, 1929, the board alone may vote to extend the co-op’s existence or make it perpetual.
  11. Id. § 12502(c).
  12. Id. § 12503.
  13. Id. § 12504.
  14. Id. § 12505(a). In the event of an amendment related to a merger, § 12535 of the California Corporations Code applies instead. Id. § 12505(b).
  15. Id. § 12506.
  16. Id. § 12251.
  17. Id. § 12506.
  18. Id. § 12507.
  19. Id. § 12508.
  20. Id. § 12509.
  21. Id. § 12510.
  22. Id. § 12311(a).
  23. Id. § 12310(b).
  24. Id. § 12312.
  25. Id. § 12310(c).
  26. Id. § 12570(b).
  27. Id. § 12214(a).
  28. Id. §§ 12256, 12480.
  29. Id. § 12313(c)(1).
  30. Id. §§ 12221(b), 12300(b), 12313(c)(1).
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## Chapter 5. BYLAWS

1. E.g., Cal. Corp. Code § 12313(c)(4).
2. Cal. Corp. Code § 12331(a).
3. Id. §§ 12331(c)–(g), 12332–12333.
4. Id. § 12330(a),(c).
5. Id. § 12330(b).
6. The article or bylaw provision authorizing cumulative voting may require the vote of a super-majority vote of the members (or of the members of any class) for its repeal. Id. § 12484(a).
7. Id. § 12330(a).
8. Id. § 12331(b).
9. Id. § 12360(a),(d).
10. Id. § 12364(a).
11. Id. § 12462(a).
12. Id. § 12484(a).
13. Id. § 12330(a),(b).
14. Id. § 12331(e).

## Chapter 6. MEMBER-RELATED DOCUMENTS

1. Id. § 12401(a).
2. Id. §§ 12240, 12248.
3. Id. § 12401(a).
4. Id. § 12401(c),(d),(f).
5. Id. § 12401(e).
6. Id. § 12402.
7. Id. § 12401(b).
8. Id.
9. Id. § 12401(b)(1)–(7).
10. Id. § 12401(b)(8).
11. Id.
12. Id. § 12401(e).

## Chapter 7. THE BOARD OF DIRECTORS

1. Id. § 12233.
2. Id. § 12350.
3. Id.
4. Id. § 12360(a).
5. Id.
6. Id. §§ 12331(b), 12360(a).
7. Id. § 12331(a).
8. Id. § 12360(b).
9. Id. § 12362(e).
10. Id. § 12360(d).
11. Id. §§ 12360(d), 12361, 12362(f).
12. Id. § 12364(c).
13. Id. § 12361.
14. Id. § 12362(a).
15. Id.

16. Id. § 12362(d).
17. Id. § 12362(b).
18. Id.
19. Id. § 12362(c).
20. Id. § 12362(g).
21. Id. § 12250.
22. Id. § 12364(a).
23. Id.
24. Id. § 12364(b).
25. Id. § 12362(f)(1).
26. Id. § 12362(f)(2).
27. Id. § 12470.
28. Id.
29. Id. § 12360(c).
30. Id. § 12473.
31. Id. § 12474.
32. Id.
33. Id. § 12475.
34. Id. § 12476.
35. Id. § 12484(d).
36. Id. § 12484(c).
37. Id. § 12484(a),(b),(c).
38. Id. § 12351(a).
39. Id. § 12351(a)(1).
40. Id. § 12351(a)(2),(6).
41. Id. § 12351(a)(2),(3).
42. Id. § 12219.
43. Id. § 12351(a)(7).
44. Id. § 12351(a)(4).
45. Id. §§ 12222, 12351(a)(8).
46. Id. § 12351(b).
47. Id. §§ 12352(a),(c), 12331(c)(4).
48. Id. § 12352(a).
49. Id. § 12355.
50. Id. §§ 12371–12372.
51. Id. § 12373.
52. Id. § 12374.
53. Id. § 12375.
54. Id. §§ 12450, 12452–12453, 12371, 12376(a),(b).
55. Id. §§ 12671–12676.
56. Id. § 12331(a).

## Chapter 8. CORPORATE OFFICERS

1. Id. § 12353(a).
2. Id. § 12353(b).
3. Id. § 12353(a).
4. Id.
5. Id. § 12353(b).

128 NOTES

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6. Id. § 12354.
7. The duties and responsibilities listed are generally taken from 1 Cal. Legal Forms: Transaction Guide 4.
8. Cal. Corp Code §§ 12671, 12673–12676.

**Chapter 9. MEMBERS AND MEMBERSHIPS: IN GENERAL**

1. Id. §§ 12245, 12238(a),(b),(d).
2. Id. § 12239.
3. Id. § 12403.
4. Id. § 12400.
5. Id. § 12404.
6. For example, even members of a nonvoting membership class must be allowed to vote for an amendment to the articles of incorporation establishing a new membership class. Cal. Corp. Code § 12503(f).
7. Id. § 25100(r).
8. Id. § 12405.
9. Id. § 12314.
10. Id. § 12410.
11. Id. §§ 12230, 12247, 12420–12421.
12. Id. § 12430.
13. Id. § 12431.
14. Id. § 12422.
15. Id.
16. Id. § 12453.
17. Id. § 12454.
18. Id. § 12455.
19. Id. § 12445(a).
20. Id. § 12445(b).
21. Id. § 12441.
22. Id.
23. Id.
24. Id. §§ 12320(f), 12401(a).
25. Id. § 12481(d).
26. Id.
27. Id.
9. Id. § 12462(b).
10. Id. § 12461(a).
11. Id. § 12461(b).
12. Id.
13. Id.
14. Id. § 12461(c).
15. Id. § 12461(d).
16. Id. § 12461(e).
17. Id.
18. Id.
19. Id.
20. Id.
21. Id. § 12461(f).
22. Id. § 12461(e).
23. Id. § 12461(h).
24. Id.
25. Id.
26. Id.
27. Id. § 12461(i).
28. Id.
29. Id. § 12463 (a)–(c).
30. Id. § 12463(d).
31. Id. § 12463(e).
32. Id. §§ 12461(h), 12463(c). The use of electronic balloting (e.g., by e-mail) is not provided for in co-op law, at least at the time this publication was in production (2004).
33. Id. § 12464(a).
34. Id. § 12464(b).
35. Id. § 12463(f).
36. Id. §§ 12216, 12462.
37. Id. § 12480.
38. Id. § 12482.
39. Id. §§ 12256, 12314.
40. Id. § 12405.
41. Id. § 12483(a).
42. Id.
43. Id.
44. Id. § 12483(b).
45. Id. § 12483(c).
46. Id.
47. Id. § 12224.
48. Id. § 12223.
49. Id.
50. Id. § 12481(b).
51. Id.
52. Id.
53. Id. § 12481(c).
54. Id.
55. Id.

**Chapter 10. MEMBERSHIP MEETINGS AND VOTING**

1. Id. § 12460(a),(b),(e).
  2. Id. § 12461(a).
  3. Id.
  4. Id.
  5. Id. § 12481(1).
  6. Id. § 12461(a).
  7. Id.
  8. Id. § 12461(f).
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56. Id. § 12332.
57. Id.
58. Id.
59. Id.
60. Id.
61. Id. § 12333.
62. Id. § 12238(c).
63. Id. § 12355.

### Chapter 11. RAISING CAPITAL: MEMBERSHIPS, SHARES, AND LOANS

1. Id. § 12239.
2. Id. §§ 12313(c)(3), 12331(c)(1). Co-op law requires that any differences in the voting power or proprietary interests be described in the articles or bylaws (Id. § 12310(d)).
3. Because generally only one vote is allowed per member, it may be assumed that a member would own only one membership of a class having voting rights.
4. Cal Corp. Code § 12400.
5. Id. § 12310(d).
6. Dividends may be prohibited by the articles or bylaws. Id. § 12454.
7. Id. § 12247.
8. Id. § 12320(d).
9. Id. § 25019. In California, “securities” are broadly defined.
10. Cal Corp. Code §§ 25110, 25113(a),(b).
11. Id. § 25132.
12. Id. § 25608(e).
13. Id. §§ 25141, 25148.
14. Id. § 25146.
15. 10 Cal. Admin. Code § 260.613(c).
16. Cal Corp. Code § 25145.
17. Id. § 25100(r).
18. Id.
19. Id. § 25102(e).
20. Id. § 25102(f).
21. 10 Cal. Admin. Code § 260.102.14(a), pursuant to Cal. Corp. Code § 25102(f)(4).
22. Cal. Corp. Code § 25102(n).
23. Id. §§ 12201, 12235, 12451, 12453–12454.

### Chapter 12. DISTRIBUTIONS AND PATRONAGE REFUNDS

1. Id. § 12235.
2. Id. § 12454.
3. Id.
4. Id. §§ 12376, 12453–12454.

5. Id. § 12445.
6. Id. § 12331(c)(9).
7. Id. § 12243.
8. Id. § 12201.
9. Id.
10. Treas. Reg. § 1.1388-1(a)(1).
11. Such allocation would most likely be upheld where mandated by a bylaw provision, especially since California law prohibits refunds in situations where a co-op is potentially insolvent (Cal. Corp. Code § 12453).
12. The Internal Revenue Code, Treasury Regulations, Revenue Rulings, and various legal interpretations and decisions must be reviewed for a comprehensive understanding of tax-deductible patronage refunds.
13. The procedures listed assume that the cooperative will distribute “qualified” tax-deductible refunds. Other options are available, however, and the Internal Revenue Code should be consulted.
14. I.R.C. § 1388(a)(2).
15. Id.
16. Id.
17. Id. §§ 1382(d); Treas. Reg. § 1.1388-1(c)(1)(ii).
18. I.R.C. § 1382(b)(1).

### Chapter 13. UNCLAIMED MEMBERSHIP INTERESTS

1. Cal. Code of Civil Proc. §§ 1510, 1516, 1520.
2. Id. § 1510(a).
3. Id. § 1300(c).
4. Id. §§ 1516, 1520.
5. Id. § 1521.
6. Id. § 1520(a).
7. Id. § 1516(b).
8. Id. § 1516(c).
9. Id. § 1530(a).
10. Id. § 1530(b).
11. Id. § 1530(b)(1). The “threshold” amount is amended from time to time by the state legislature.
12. Id. § 1530(b)(4). The “threshold” amount is amended from time to time by the state legislature.
13. Id. § 1530(b)(5).
14. Id. § 1530(b)(6).
15. Id. § 1530(d).
16. 2 Cal. Admin. Code § 1175.
17. Cal. Code of Civ. Proc. § 1530(e).

## 130 INTRODUCTION

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18. Id. §§ 1516(b), 1532(a),(b).
19. Cal. Corp. Code § 12401(e).
20. Cal. Code of Civ. Proc. § 1516(d).
21. Id.
22. Id. § 1560(a).
23. Id. § 1560(b),(c).
24. Id. § 1560(d).
25. Id. § 1571(a).
26. Id. § 1572(a).
27. Id. § 1576(a). These amounts are changed from time to time by legislative amendments.
28. Id. § 1576(b). These amounts are changed from time to time by legislative amendments.
29. Id. § 1577.
30. E.g., *Screen Actors Guild, Inc. v. Cory*, 91 Cal. App. 3d 111, 154 Cal. Rptr. 77 (1979); *Blue Cross of Northern California v. Cory*, 120 Cal. App. 3d 723, 174 Cal. Rptr. 901 (1981).
31. *Westlake Community Hospital v. Superior Court*, 17 Cal.3d 465, 131 Cal. Rptr. 90 (1976). See also Cal. Civ. Code § 1668.
32. *State v. Pacific Far East Line, Inc.*, 261 Cal. App. 2d 609, 68 Cal. Rptr. 67 (1968).
33. *Screen Actors*, *supra*, at 116, 154 Cal. Rptr. At 80.
34. Cal. Corp. Code § 12446.
35. Id. § 12446(b).

### Chapter 14. RECORDS, REPORTS, AND INSPECTION RIGHTS

1. Cal. Corp. Code § 12580.
2. Id. § 12581.
3. Id.
4. Id. § 12582.
5. Id. § 12583.
6. Id. § 12590(a).
7. Id. § 12590(b).
8. Id.
9. Id. § 12591(c).
10. Id. § 12591(a).
11. Id.
12. Id.

13. Id. §§12218, 12591(a),(b).
14. Id. § 12217.
15. Id. § 12218.
16. Id. § 12592(a).
17. Id.
18. Id. § 12592(b).
19. Id.
20. Id. § 12592(c).
21. Id. § 12592(d). As to the second requirement, if a partnership is involved in the transaction, only the interest of the partnership needs to be stated.
22. Id. § 12592(e).
23. Id.
24. Id. § 12600(a).
25. Id. § 12600(b).
26. Id.
27. Id. § 12600(c).
28. Id.
29. See id. §§ 12601–12602.
30. Cal. Corp. Code § 12603.
31. Id.
32. Id. § 12604.
33. Id. § 12340.
34. Id. § 12608.

### Chapter 15. FILINGS WITH THE SECRETARY OF STATE

1. Cal. Corp. Code § 12214(a).
  2. Id. § 12214(b).
  3. Id. § 12214(c).
  4. Id. § 12570(a),(b).
  5. Id. §§ 12505, 12570(b).
  6. Id. § 12570(c).
  7. Id. § 12570(d).
  8. Id.
  9. Id. § 12571. (Id. § 12221 defines an acknowledgment.)
  10. Id § 12572.
  11. Id. § 12670(a),(b).
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