COOPERATIVES IN WISCONSIN

Wisconsin has two cooperative statutes which can be found at Chapter 185 and Chapter 193 of the Wisconsin Code.

Chapter 185 defines Wisconsin's cooperative corporation and codifies traditional cooperative principles. It subordinates the authority of capital investors to that of patrons by limiting dividends and voting rights conferred to preferred shareholders (both directly and indirectly through constraints on board representation). The expectation is that cooperatives formed under Chapter 185 are largely capitalized by members and operate at or near the financial break-even point. Investment maximization is not a priority.

The model outlined in Chapter 185, while loyal to cooperative principles, poses challenges with regards to equity formation for startup ventures and expanding enterprises. The constraints it imposes on raising capital ultimately led to Wisconsin's adoption of the "unincorporated cooperative" in 2006.

Unincorporated cooperatives, defined in Chapter 193 of the Wisconsin Code, have increased flexibility with regards to governance, taxation, and capitalization. The law is designed to entice investment in cooperatives. It deviates from Chapter 185 in that it allows non-patron members to participate in governance of the cooperative and permits them receipt of profits in proportion to their investment without a ceiling.

This more flexible framework opens the door to a cooperative organization adopting a profit incentive. In addition to operating for the benefit of its members, the organization may adopt practical tools for pursuing the secondary purpose of earning a return on member investment. Additionally, because Chapter 193 borrows many features from limited liability company laws, cooperatives formed under this statute have default pass-through taxation status.

Despite deviating from tradition, Chapter 193 does not wholly abandon cooperative principles. The law incorporates protection for patron-member interests by setting minimums for patronage-based earnings distributions, and by making special provisions for patron-member voting and patron majority representation on the board of directors. This ensures that patron

members maintain voting control over passive investors, thereby preserving the tenant of democratic member control.

PRACTICAL APPLICATIONS OF CHAPTER 185 AND 193

Most cooperatives elect to organize in Wisconsin under Chapter 185. This is true whether the organization is an agricultural, worker, housing, or consumer cooperative. The general preference for Chapter 185 arises from a variety of factors, including but not limited to: philosophy, risk tolerance, and capital sensitivity.

With regards to philosophy, many in the Wisconsin cooperative ecosystem view Chapter 193 with skepticism. The statute deviates from traditional cooperative principles, and in so doing, creates tension between serving patron-member interests and maximizing investment for outside capital contributors. The traditional cooperative tenet of subordination of capital is placed in a more precarious position in Chapter 193 entities as compared to Chapter 185 entities.

In terms of risk tolerance, some cooperatives prefer to organize under Chapter 185 because it is an older and therefore more familiar statute. Chapter 193 is relatively new law. Comparatively speaking, Chapter 193 has been subject to less litigation, and by extension, less judicial scrutiny. The practical effect of this is that we draw from a smaller body of law in understanding and applying Chapter 193. Cooperative organizations with a lower risk tolerance may prefer to organize under Chapter 185 simply because we have a richer understanding of the various applications of the law.

Finally, capital sensitivity may be a determinative factor in deciding which law best suits a cooperative organization. If a cooperative needs to raise significant operational capital upfront, it may be inclined to organize under Chapter 193. Chapter 193 provides greater flexibility in terms of designing incentives to attract outside capital contributors. In spite of this, the present trend among cooperatives in Wisconsin greatly favors organization under Chapter 185, no matter the type of membership.

EMPLOYMENT LAW CONSIDERATIONS

Employees Versus Independent Contractors

Before discussing the employment implications under Chapter 185 and Chapter 193, it is necessary to define the difference between an employee and an independent contractor.

An independent contractor is a worker who contracts to provide limited-scope services in exchange for compensation. An independent contractor does not work regularly for the contracting organization. Under federal law, the contracting organization has no obligation to provide benefits to the independent contractor or withhold or pay employment taxes on the contractor's behalf. Organizations that engage independent contractors issue them Form 1099-NEC (before tax year 2020, Form 1099-MISC) for income-reporting purposes if they satisfy an annual payment threshold.

An employee, by comparison, is subject to significant oversight by a company. Additionally, an employee:

- Is paid wages and is eligible for company-sponsored benefits.
- Pays the full amount of their income taxes and a portion of their social security and Medicare taxes, generally through the amounts their employer is obligated to withhold from their wages.
- Is protected by applicable federal, state, and local employment laws.

It is common for early-stage organizations to rely heavily on independent contractors, but this is not always appropriate. Just because someone signs an independent contractor agreement and receives Form 1099-MISC doesn’t necessarily mean that person is an independent contractor. The question turns on the reality of the arrangement, as demonstrated by the permanency of the relationship as well as the degree of behavioral and financial control that the organization exerts over the independent contractor.

It is not permissible to misclassify an employee as an independent contractor, *even if the employee agrees to it*. And misclassifying employees as independent contractors may lead to

significant penalties. Thus, it is vital for emerging cooperatives to properly recruit, categorize, and compensate their staff.

Employment in the Context of Chapters 185 and 193

For the most part, labor issues are treated the same under Chapter 185 and Chapter 193. A cooperative organized under either statute may build its staff using employees or independent contractors, as long as the organization complies with the principles articulated above.

There is one special situation, though, that may arise under Chapter 185. In a worker cooperative organized under Chapter 185, worker-owners will likely have to be treated as employees. This means that worker-owners must be compensated in accordance with minimum wage requirements (presently $7.25 in Wisconsin), and the cooperative must comply with any additional rules derived from federal, state, and local employment laws.

This can be a significant challenge, particularly in the earliest, cash-sensitive stages of building the worker cooperative. There are some exemptions to this rule. If you are navigating the employment implications of organizing a worker cooperative under Chapter 185, you would be well served to contact the University of Wisconsin Center for Cooperatives (UWCC) for support.

STATUTES

Chapter 185

The Cooperative Corporation At-A-Glance

- **Scope**: Cooperative may be formed for any lawful purpose except banking, insurance, and railroads.
- **Name**:
  - Name must differ from the names of other entities incorporated, registered, or doing business in Wisconsin.
  - Name is not considered distinguishable if the only difference involves the abbreviation of a business entity designation.
  - Cooperative shall use "cooperative" (or an abbreviation) in its corporate name.
  - Use of "cooperative" in an organization's name is impermissible except by cooperatives and credit unions. A cooperative has standing to obtain injunction against an entity misrepresenting itself as a cooperative. Violators may be fined $100 for each day of misrepresentation.
- **Number Required to Organize**: Five incorporators, one of whom must be a resident of Wisconsin.
- **Bylaws**: Adopted and amended by members, unless members adopt a bylaw to permit the board to make and amend specified bylaws.
- **Members:**
  - Members/voting shareholders (who earn patronage in proportion to their use) and preferred shareholders (who earn capped distributions in proportion to their investment)
  - Both persons and business organizations may be members in accordance with the cooperative's bylaws.
- **Board of Directors**:
  - A cooperative with 50 or more members must have at least five directors; a cooperative with less than 50 members must have at least three directors.

- Generally, directors are cooperative members or representatives of member organizations.
- Non-member “outside” directors may be elected to the board and have the same voting rights as member directors, but cannot be more than 20% of the board or number more than two.
- Bylaws may prescribe other qualifications.

- **Capital Stock**:
  - Generally, cooperative may be organized with or without stock. If cooperative is organized with stock, the articles of incorporation must state the number and par value of shares of each authorized class of stock. If more than one class is authorized, the designation, preferences, limitations, and relative rights of each class shall also be set forth. Cooperative may offer “non-membership” (investor) stock, but such stock pays a limited dividend of 8% annually and confers limited voting rights.
  - Cooperative may be organized without capital stock to primarily establish nonprofit plans for health care in the state.
  - Health benefit purchasing cooperatives shall be organized on a membership basis with no capital stock.
- **Member Voting:** One member one vote, but:
  - If members include organizations, the articles may permit voting rights based on organization’s size or patronage.
  - A cooperative holding company and its subsidiaries may base member voting rights on member patronage, equity, or a combination of both.
- **Non-Member Voting**:
  - A holder of “non-member” (investor) stock is entitled to one vote on amendments to articles of incorporation that affect stock, or in cases of mergers, consolidations, or divisions.
  - Articles of incorporation may allow “non-member” (investor) stockholder voting on dissolution.
- **Apportionment of Net Proceeds**:
  - Payment to patrons in accordance with the ratio that their patronage bears to total patronage.
  - Reasonable reserves for necessary purposes.

- 5% or less may be set aside as an educational fund to be used in teaching or promoting cooperative organization or principles.
- A share of the net proceeds may be set aside for or paid to officers or employees, or both.
- Dividends may be paid as is authorized by the articles of incorporation. No dividend may be paid if the capital is impaired or if payment of such dividend would result in an impairment of capital.

- **Merger and Consolidation**: A two-thirds majority vote of members present, and a two-thirds vote of all "non-members" (investors) who meet statute-specified voting criteria, are required to approve a board-prepared merger plan.
- **Voluntary Dissolution**: Net proceeds of liquidation distributed to all persons entitled by the law, the articles, and the bylaws. Unclaimed assets shall be distributed to one or more organizations that are either:
  - Cooperatives with articles containing limitations on distribution of assets equivalent to limitations in the articles of the liquidating cooperative, or
  - 501(c)(3) organizations
- **Tax Treatment**:
  - Except for patronage payments, organization is a corporation for tax purposes.
  - Section 521 tax exemption is available for certain agricultural cooperatives.
- **Conversion of a Corporation:** A corporation may convert itself into a cooperative by adopting an amendment to its articles by which it elects to become subject to Chapter 185, together with corresponding changes in its articles or incorporation.
- **Cooperatives Defined in the Statute**
  - § 185.043(2): A cooperative operating as a small winery cooperative wholesaler under § 125.545 may be formed by owners of small wineries certified by the department of revenue under § 125.545(6)(a). Membership in a cooperative formed under this subsection is limited to small wineries certified by the department of revenue under § 125.545 (6)(a).
  - § 185.981(2): Cooperative associations organized under this section shall operate only on a cooperative nonprofit basis to provide voluntary health care plans or care to members and subscribers.
  - § 185.981(5): Cooperative associations organized under this section are charitable and benevolent corporations.

- § 185.99(2)(c)1-5: Health benefit purchasing cooperatives shall be designed to better inform members about health care trends and costs; all members receive benefits under a single group health care policy or plan; members actively engaged in designing plan options that meet member needs; health insurance risk of all members is pooled; members actively participate in health improvement decisions for their community.

- **Additional Resources**:
  - Statute
  - Detailed Summary of Chapter 185 (includes citations)

Chapter 193

The Limited Cooperative Association At-A-Glance

- **Scope**: Cooperative may be formed for any lawful purpose except utilities.
- **Name**:
  - Cooperative may use the term “cooperative” in its name.
  - The name must be distinguishable from the name of all business entities authorized to do business in the state.
- **Number Required to Organize**: One organizer is required.
- **Bylaws**:
  - Adopted and amended by members or board, except as specified in articles or bylaws.
  - Bylaw changes regarding member allocations require patron member approval.
- **Members:**
  - Patron members (who earn patronage in proportion to their use) and non-patron members (who earn unlimited distributions in proportion to their investment)
  - Bylaws define classes of membership interests, rights, and requirements.
  - At least 5 individual patrons or one organizational patron must be a member.
  - Non-patron members permitted with majority vote by patron members.
- **Board of Directors**:
  - A majority of the directors must be members, and must be elected exclusively by patron members, unless otherwise provided in the articles or bylaws.
  - The directors elected by the patron members must have at least 51% of the voting power on “general” matters of the cooperative. Further, the directors elected by the patron members must also vote as a bloc, as determined by a majority vote of the patron member directors. This ensures that patron membership controls routine issues facing the cooperative. It also provides “non-patron” (investor) members a mechanism for vetoing non-general or specific

matters pertaining to the cooperative. (Note that the bylaws of such a cooperative may specify certain matters that will require the consent of “non-patron” interests.)

- All directors must, at least annually, attend a course given by a “recognized provider of cooperative director education” on at least two out of eleven topics mandated in Chapter 193. As with the establishment of an audit committee (see below), this requirement is an added expense a startup cooperative must consider.

- **Financial Director and Audit Committee**
  - The patron members may also elect an outside director who is an expert in financial matters but does not possess a financial interest in the cooperative. Such a director may not vote unless the articles or bylaws authorize voting rights for the outside director.
  - Cooperative shall establish an audit committee to ensure an independent review of the cooperative’s finances is conducted. The board of directors must ensure audited financial statements (or unaudited, if authorized by the articles or bylaws) are given to the members.
- **Capital Stock**:
  - Cooperative may be organized with multiple classes of member interests, with rights, preferences, and restrictions for each.
  - Cooperative may offer “non-patron” (investor) membership interests that may have voting rights if authorized in the articles or bylaws.
  - Unless the cooperative’s articles or bylaws otherwise provide, a “non-patron” (investor) member may force the cooperative to buy the non-patron member’s interest if the articles or bylaws are amended in a way that materially and adversely affects the non-patron member’s rights and preferences.
  - No limit on investor returns.
- **Member Voting:**
  - Patron members have one vote, but bylaws may authorize additional votes in specific circumstances.
  - “Non-patron” (investor) members may have voting rights if authorized by patron members.

- The collective patron member vote may not be reduced to less than 51% of the total member vote.

- **Non-Member Voting**:
  - Articles or bylaws may authorize a “non-member” (investor) class to vote at a members’ meeting.
- **Apportionment of Net Proceeds**:
  - Profits and loss allocation to patron and “non-patron” (investor) members based on collective values of contributions, unless specified otherwise in bylaws or articles.
  - Patron members must receive a minimum of 51% of both profit allocations and distributions, unless patron members, by majority vote, authorize lower percent, but not less than 30%.
  - Profits allocated to patron members in excess of equity dividends and capital reserve additions must be distributed to patron members on patronage basis.
- **Merger and Consolidation**: A majority of a quorum of voting members must approve a board-prepared merger plan. Articles or bylaws may specify other voting requirements.
- **Voluntary Dissolution**: Remaining property after discharge of debts, obligations, and liabilities are distributed to members and former members as provided in the bylaws. Unclaimed assets can be forfeited to the cooperative for distribution, or are paid to the state treasury.
- **Tax Treatment**: A cooperative formed under Chapter 193 is an unincorporated association, and similar to a limited liability company, may elect to be taxed as a partnership under Subchapter K of the Internal Revenue Code, or as a cooperative under Subchapter T.
- **Conversion of a Corporation:** An existing businesses may convert into a Chapter 193 cooperative. However, a Wisconsin cooperative formed under Chapter 185 may not convert into a Chapter 193 cooperative.
- **Specific Cooperative Organizations Mentioned in Statute**:
  - § 193.201(1): Cooperative purpose may be to market, process, or otherwise change the form or marketability of products, including crops, livestock, and other agricultural products; to manufacture products; to accomplish other purposes that are necessary or convenient to facilitate the production or marketing of products

by patron members and others; and to accomplish other purposes that are related to the business of the cooperative.
    - § 193.201(2): Cooperative purpose may be to provide products, supplies, and services to its members.
- **Additional Resources**:
    - Statute
    - Comparison of Chapter 193 to similar statutes in other states

SAMPLE BYLAWS AND ADDITIONAL RESOURCES

- Bylaws of Willy Street Co-op (formed under Chapter 185)
- Bylaws of Basic Cooperative (formed under Chapter 185)
- Articles and Bylaws of Viroqua Food C-op (formed under Chapter 185)
- Bylaws of Legacy Solar Co-op (formed under Chapter 185)
- Bylaws of Ridge Side Cooperative (formed under Chapter 185)
- Bylaws of Basics Cooperative (formed under Chapter 185)
- Bylaws of Fifth Season Cooperative (formed under Chapter 185)

STATE-SPECIFIC SECONDARY SOURCES

- Legal Manual for Small Rural Homes Cooperatives
- Guideline for Cooperative Bylaws
- Cooperative Business Planning
- The Power of Cooperative Action

COOPERATIVE SUPPORT ORGANIZATIONS

The University of Wisconsin Center for Cooperatives (UWCC) fosters understanding about cooperatives through research, education and outreach programs, and provides general technical assistance to groups interested in cooperative start-ups. Their website is an extensive resource for information, contacts, publications, and articles related to co-ops.

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