

# THE DEMOCRATIC CORPORATION: THE NEW WORKER COOPERATIVE STATUTE IN MASSACHUSETTS

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## I

### INTRODUCTION

The worker cooperative corporation law recently enacted<sup>1</sup> in Massachusetts presents a democratic corporate form new to American law. On a practical level, the law adopts the legal structure of the successful industrial cooperatives of Mondragon, Spain and adapts it to the American context.<sup>2</sup> On a theoretical level, the law brings into the workplace two related normative principles which are absent in the conventional corporate form: the democratic principle of self-government and the principle of basing property acquisition on the fruits of one's labor.

In the short run, the law facilitates the emerging worker ownership movement in the United States. Worker ownership has emerged as a stopgap job preservation tactic in potential plant closings and as a structural form of local ownership which can play a strategic role in the reindustrialization of America.<sup>3</sup> Given the destructive effects of the hypermobility of capital in today's economy, worker ownership is a much needed alternative form of organization.

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1. The Employee Cooperative Corporations Act, MASS. GEN. LAWS ANN. ch. 157A (West 1982) [hereinafter cited as MGL ch. 157A]; see *infra* Appendix for complete text of the Act; a complete legislative history appears in INDUSTRIAL COOPERATIVE ASSOCIATION, THE NEW MASSACHUSETTS LAW FOR WORKER COOPERATIVES: MGL CHAPTER 157A (1982) (available from ICA, 249 Elm Street, Somerville, MA 02144 as are all other ICA publications cited *infra*; on April 11, 1983, the State of Maine enacted a statute almost identical to MGL ch. 157A, see *infra* note 93.)

2. See *infra* Part II.B.1. See generally D. ELLERMAN, THE SOCIALIZATION OF ENTREPRENEURSHIP (1982); H. THOMAS & C. LOGAN, MONDRAGON: AN ECONOMIC ANALYSIS (1982).

3. See *infra* Part II.B.3. See also B. BLUESTONE & B. HARRISON, THE DEINDUSTRIALIZATION OF AMERICA 231-64 (1982); Pitegoff, *Worker Ownership: Is It a Strategy for Labor?*, LABOR UPDATE, July-August 1982 at 9ff.

From a broader perspective, the new law illustrates one possibility for restructuring the modern business corporation. Rare are the times in human history when the major institutional form in a society has been bereft of conventional legitimation. With the separation of ownership and control in large corporations, corporate management largely governs its dominion without even the traditional basis of property ownership.<sup>4</sup> With the rapid growth of the modern corporate conglomerate, there is a widening gap between the exercise of corporate power and conventional institutional legitimation, as owners become ever more removed from management. Even where ownership and control are united in the modern corporation, its authoritarian structure lacks legitimation by the democratic ideals of self-government. In contrast, these ideals serve to give the worker-owned cooperative or self-managed firm its inherent legitimacy as a social organization.

This Article addresses these problems—the absence of legitimacy and democracy—by demonstrating how the concept of democracy can be applied directly to the corporation.<sup>5</sup> The Article proceeds upon the assumption that the democratic structure is an inherently legitimate ideal. The new law and the theory behind it demonstrate one way of reconstituting a corporation as a democratic social institution—wherein people receive the fruits of their labor and retain democratic control over their worklives.

In order to set this out most clearly, the Article begins with a description of the mechanics of the recently enacted Massachusetts law and the Mondragon model upon which it is based. After explaining the industrial cooperative model, the Article then articulates the theoretical justifications underlying the industrial democracy model of corporate organization as a viable and inherently legitimate alternative to the prevailing corporate form.

## II

### THE WORKER COOPERATIVE STATUTE

#### *A. Enactment of M.G.L. Chapter 157A*

In August 1982, Massachusetts enacted the nation's first corporate governance statute designed exclusively for worker cooperatives.<sup>6</sup> Chapter

4. The locus classicus is A. BERLE & G. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932). For a sample of the modern literature, see *THE CORPORATION IN MODERN SOCIETY* (E. Mason ed. 1959); R. DAHL, *AFTER THE REVOLUTION?* (1970); *CORPORATE POWER IN AMERICA* (R. Nader & M. Green 1973); C. STONE, *WHERE THE LAW ENDS* (1975); R. NADER, M. GREEN, & J. SELIGMAN, *TAMING THE GIANT CORPORATION* (1976); C. LINDBLOM, *POLITICS AND MARKETS* (1977); *Symposium on Corporate Governance*, 8 *HOFSTRA LAW REVIEW* 1 (1979).

5. See generally R. DAHL, *supra* note 4; C. LINDBLOM, *supra* note 4; Ellerman, *The Employment Relation, Property Rights, and Organizational Democracy*, 1 *INTERNATIONAL YEARBOOK OF ORGANIZATIONAL DEMOCRACY* (forthcoming).

6. MGL ch. 157A. Although many states have cooperative corporation statutes, most such laws are geared to agricultural cooperatives and only to a lesser extent to other types of cooperatives. The handful of corporation laws that expressly recognize worker cooperatives

157A of the Massachusetts General Laws creates statutory authority for a democratic corporate form, derived in part from the successful cooperatives in Mondragon, Spain.<sup>7</sup>

The new law has four primary attributes. First, it expressly converts the business corporation into a membership organization democratically controlled by the workforce.<sup>8</sup> Secondly, it permits equitable allocation of earnings and losses to members in accordance with their relative contribution of labor rather than their relative capital investment.<sup>9</sup> Third, it authorizes a unique capital structure and internal accounting system designed to encourage long-term survival of democratic cooperative control.<sup>10</sup> And fourth, it spells out a capital allocation system consistent with requirements for "co-operative" tax advantages under subchapter T of the federal Internal Revenue Code.<sup>11</sup> Before discussing the mechanics of the new law, we will discuss its origin in Mondragon and the context of worker ownership in the United States today.

## B. Origin and Context

### 1. The Mondragon Model

The most successful network of worker cooperatives in the world today exists in the Basque region of northern Spain. Centered in the town of Mondragon, this democratic labor-based economy boasts over eighty-five successful industrial cooperatives including the largest producers of consumer durables (stoves, refrigerators, washing machines, and dishwashers) in Spain. Started from a single firm in 1956, the Mondragon group now includes not only over eighty-five industrial cooperatives with around eighteen thousand worker-members, but also six agricultural cooperatives, two services cooperatives, forty-three cooperative schools, fourteen housing cooperatives, and one consumer-worker cooperative with over forty stores. The cooperative group also has a central cooperative bank, the Caja Laboral Popular, a polytechnical university, a technological research institute, and its own social security system—all run as cooperatives.

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do so in the context of a broader statute. They not only lack the precision of a chapter exclusively designed for worker cooperatives, they also fail to implement the successful Mondragon model. For further discussion of the range of co-op laws, *see infra* notes 28 & 29, and accompanying text.

7. *See supra* note 2.

8. MGL ch. 157A, §§ 6, 7, and 10.

9. MGL ch. 157A, §§ 8, 9, and 10.

10. *Id.*

11. I.R.C. §§ 1381-1388 (1976) (subchapter T). MGL ch. 157A § 10 defines an "internal capital account cooperative" in such a way that it is likely to qualify for the subchapter T advantage. For further discussion of subchapter T, *see infra* Part II.C.3 and notes 69-71.

The lessons of Mondragon are numerous. For example, the Caja Laboral Popular has an entrepreneurial department which has so successfully institutionalized and socialized the entrepreneurial function that there have been no failures in the over eighty industrial cooperatives it has helped launch (although there have been one or two failures in the agricultural sector).<sup>12</sup> We focus here, however, on only one specific lesson of Mondragon—an appropriate legal structure for a democratic worker cooperative.

The Mondragon model redresses some structural weaknesses found in more conventional worker ownership structures. To understand these structures, we shall briefly consider here how various worker ownership arrangements restructure the traditional bundle of corporate ownership rights, preliminary to the more detailed analysis in Part III. In a conventional stock corporation, the bundle of ownership rights can be reduced down to the following three essential rights:<sup>13</sup>

- the right to vote (voting rights),
- the right to the net income, and
- the right to the equity or the net worth of the corporation.

We define the first two rights, the voting and net income rights, as *membership rights* and the remaining rights to net worth as *capital rights*.

A worker cooperative can be defined theoretically as a firm where the membership rights are *personal rights* attached to the functional role of working in the firm. The worker cooperative is thus an industrial democracy, analogous to a political democracy, where the voting and other citizenship rights are personal rights attached to the functional role of residing in the community. In a worker cooperative, labor (inclusive of all who work in the firm) hires capital. Workers are the members of the firm, not just the employees of the firm, and the net return, after a payment for the other factors, is a return to labor.

It is the treatment of the capital rights which has typically caused structural problems in traditional worker-owned firms. Two diametrically opposed treatments, both flawed, are common: either the firm is organized using a *nonprofit* treatment where workers are forced to forfeit any recoupable claim on the retained income, i.e., to forfeit the capital rights; or the firm is organized using a *capitalist* treatment where the capital rights are combined with the membership rights. Traditional worker cooperatives or self-managed firms generally make either the first mistake or the second.

Many worker co-ops or self-managed firms, such as the common ownership firms in England<sup>14</sup> and the self-managed enterprises in Yugoslavia,<sup>15</sup>

12. See D. ELLERMAN, *supra* note 2.

13. See D. ELLERMAN, *THEORY OF LEGAL STRUCTURE: WORKER COOPERATIVES* (1982); D. ELLERMAN, *ECONOMICS, ACCOUNTING, AND PROPERTY THEORY* (1982).

14. See R. OAKESHOTT, *THE CASE FOR WORKERS' CO-OPS* (1978).

15. See J. DIRLAM & J. PLUMMER, *AN INTRODUCTION TO THE YUGOSLAV ECONOMY* (1973); *SELF-GOVERNING SOCIALISM* (B. Horvat, M. Markovic & R. Supek eds. 1975).

are structured like an American nonprofit corporation in the sense that the worker has no recoupable claim on the net worth of the firm.<sup>16</sup> This "common ownership" or "social property" treatment of net worth eliminates any incentive to finance capital investment by retained earnings rather than borrowing, and creates many other hindrances to efficient economic operation.<sup>17</sup> Moreover, it denies exiting workers such value of the fruits of their labor as is reinvested in the firm.

Most American employee-owned firms are organized with a capitalist structure. Capital rights are attached to the membership rights, so that in order for an entering worker to qualify for the membership rights, the worker must additionally purchase the capital rights due a retiring member. This has an inherent tendency toward increasing concentration of capital ownership. Some of these corporations are employee-owned directly, with a conventional ownership structure in which a majority of the owners happen to be employees.<sup>18</sup> Others are employee-owned indirectly, as in Employee Stock Ownership Plans (ESOPs) where stock is held in trust with the employees as beneficiaries.<sup>19</sup>

A third form is that found in traditional U.S. worker cooperatives, such as the plywood cooperatives in Oregon and Washington, which use a hybrid co-op-capitalist structure.<sup>20</sup> In such co-ops, while voting rights are allocated equally among members, capital rights are still attached to the stock shares. The more successful plywood co-ops illustrate one problem of attaching capital rights to employee stock ownership. To become a co-op member, a worker has to buy a share (or a standard block of shares) where the value of the share represents the capital value accumulated by a retiring member. In the financially successful plywood co-ops, a share can be priced in the \$60,000 to \$80,000 range. In theory, this structure violates the cooperative principle that a worker is supposed to qualify for membership on the

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16. The notion of no recoupable claim on the net worth of a nonprofit corporation is codified in American law at both the federal and state level. *See, e.g.*, 26 U.S.C. § 501(c)(3) ("no part of the earnings of which inures to the benefit of any private shareholder or individual . . ."); *see also* MGL ch. 180 § 11A (requiring continued use of corporate funds for public charitable purposes after voluntary dissolution of a charitable nonprofit corporation).

17. For discussion of these drawbacks, *see* SELF-MANAGEMENT (J. Vanek ed. 1975); THE ECONOMICS OF PROPERTY RIGHTS (E. Furubotn & S. Pejovich eds. 1974); THE LABOR-MANAGED ECONOMY (J. Vanek ed. 1977).

18. The Vermont Asbestos Group or VAG was a prominent example of an employee-owned corporation with direct employee-ownership of the shares. Within a few years, a businessman obtained majority control and took over the company. *See* D. ZWERDLING, DEMOCRACY AT WORK (1978).

19. The South Bend Lathe Company is a well-known example of a 100% employee-owned company where the ownership is indirect through a ESOP. *See* D. ZWERDLING, *supra* note 18. *See infra* note 42 & 43, and accompanying text, for description of the ESOP form.

20. *See* K. BERMAN, WORKER-OWNED PLYWOOD COMPANIES (1967); Bellas, *Industrial Democracy Through Worker Ownership: An American Experience* in THE LABOR-MANAGED ECONOMY, *supra* note 17.

basis of his or her work and should not have to "buy" the membership rights. In practice, many workers cannot afford to purchase the shares and thus are hired as non-member workers. Over a period of time, these firms become increasingly conventional with fewer and fewer owners and more and more hired workers. Eventually the remaining owners may be forced to sell the whole company to conventional investors in order to recoup their accumulated capital.<sup>21</sup>

The Mondragon cooperatives solved this problem by detaching membership rights from capital rights. The membership rights are attached to the act of working while capital rights are attached to a new institutional structure, an internal capital account for each member. To understand their solution, imagine first that all net earnings were distributed to the members, deposited in a savings bank, and then loaned back to the cooperative. Then, move the savings account into the cooperative. The members can recoup their claim on that capital value through their savings accounts, yet the cooperative can self-finance its own capital investment rather than indirectly through an external savings bank. This is the solution worked out by the Mondragon cooperatives.

In the Mondragon model, each member's internal capital account represents the capital value which is due back to the member after a fixed rollover period or after retirement.<sup>22</sup> The account is quite separate from the membership rights. Workers, depending on their seniority and pay-rate, might have quite differing amounts in their accounts and yet they retain the same membership rights, e.g., equal voting rights. An entering worker need not individually finance the payout to a retiring worker; the cooperative pays off the accounts. A cooperative could, hypothetically, pay off workers with interest-bearing perpetual bonds which could be capitalized on external markets for such debt instruments. However, in the absence of such external markets, the cooperative firm must "provide the market" by eventually paying off the accounts of the members.<sup>23</sup>

In addition to the individual capital accounts of the members, there is an unindividuated collective account. Each year, the retained income is split between the individual capital accounts and the collective account (on, say, a fifty-fifty or seventy-thirty percent basis). The individual portion is allocated amongst the individual accounts according to each member's labor (defined according to the hours worked or rate of pay). The sum of balances in the individual accounts and the collective account is the net book value or net worth of the cooperative.

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21. *Id.*

22. *Cf.* MGL ch. 157A §§ 8, 9, and 10; *see infra* Part II.C.4 for further discussion of internal accounts.

23. The cash-flow burden of paying off members' internal accounts can be eased by careful financial planning, including effective use of the collective account as a self-insurance mechanism. *See infra* Part III.F. for fuller explanation.

The collective account can be understood on the basis of uncertainty. In an uncertain world, a cooperative could not always pay back one hundred percent of the retained earnings to the members. The collective account allocation can be seen as a form of self-insurance, a cost incurred to ultimately reduce the uncertainty of the payback. By promising to only pay back fifty percent or seventy percent of the retained earnings rather than one hundred percent, the cooperative can substantially increase the likelihood of keeping its promise and retain necessary flexibility.

Conventional corporations and traditional worker cooperatives such as the northwest plywood co-ops have each member's capital rights carried by external financial instruments (for example, ordinary shares or co-op capital shares) which are valued through market exchanges. The valuation of each member's capital rights by means of an internal capital account, in contrast, represents a substantial departure from the conventional capital structure of corporations. While a conventional corporation or traditional co-op can be significantly restructured at the by-law level,<sup>24</sup> the new Massachusetts law provides a helpful statutory basis for the new and more complex capital structure of internal capital accounts.

## 2. *American Law and the Mondragon Model*

Prior to the enactment of MGL chapter 157A, Massachusetts statutes provided an unsatisfactory basis for incorporating worker cooperatives. The business corporation statute<sup>25</sup> offers no guidelines for a cooperative membership structure, and the general cooperative statute<sup>26</sup> is essentially designed for agricultural cooperatives. Neither of the two expressly authorizes the specialized capital structure and internal accounting system of the Mondragon model. Prior to the enactment of 157A, the best way to adopt that model in Massachusetts was to incorporate in the shell of a business corporation and then restructure the by-laws to transform the corporation into a worker cooperative.<sup>27</sup>

Corporation laws in most American states reflect the same inadequacy as the pre-157A statutory framework in Massachusetts. Most business corporation statutes, although flexible enough to build a cooperative within the traditional corporate shell, provide no guidance for democratic structure. Most cooperative statutes apply primarily to agricultural co-ops, and sec-

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24. See INDUSTRIAL COOPERATIVE ASSOCIATION, ICA MODEL BY-LAWS FOR A WORKER COOPERATIVE (1980, revised 1983).

25. MASS. GEN. LAWS ANN. ch. 156B (West 1970 & Supp. 1982) (Business Corporation Law).

26. MASS. GEN. LAWS ANN. ch. 157, c. 273 § 1 (West Supp. 1982) (Cooperative Corporations).

27. See *supra* note 24; see also *infra* note 51 and accompanying text for discussion of Massachusetts statutory framework for corporations.

ondarily to consumer, housing, utility, or credit cooperatives.<sup>28</sup> Even the handful of sophisticated cooperative statutes, expressly recognizing worker co-ops and allocation of earnings on the basis of work, fail to authorize the unique capital structure of the Mondragon model.<sup>29</sup>

### 3. Political Environment and Worker Ownership

In recent years, worker ownership has emerged as a response to plant closings and as a vehicle for positive economic development.<sup>30</sup> Congress<sup>31</sup> and several states<sup>32</sup> have enacted legislation promoting employee ownership. Local governments and unions have turned to worker ownership to fight job loss.<sup>33</sup> Foundations, church organizations, and financing institutions have funded employee ownership and cooperative development.<sup>34</sup> Universities

28. See I. PACKEL, *THE ORGANIZATION AND OPERATION OF COOPERATIVES* 10-44 (1970) for discussion of the wide range of cooperative forms, classifications, and laws; see also P. HONIGSBERG, B. KAMOROFF & J. BEATTY, *WE OWN IT* 133-47 (1982) (describing state-by-state cooperative corporation laws).

29. See, e.g., Oregon Cooperative Corporation Act, ORE. REV. STAT. § 62 (1981) (Section 62.415(1) authorizes allocation of earnings on the basis of patronage in a worker cooperative: "work performed as a member in a workers' cooperative shall be deemed patronage of that cooperative."); see also COLO. REV. STAT. § 7-55-101-121 (1973) (earnings of cooperative may be distributed on basis of labor provided to cooperative).

30. See *supra* note 3; see also D. JENKINS, *JOB POWER* (1973); D. ZWERDLING, *supra*, note 18.

31. See, e.g., The Small Business Employee Ownership Act of 1980, 15 U.S.C. §§ 631, 632, 636 (Supp. V 1981); 127 CONG. REC. S4435-37 (daily ed. May 6, 1981) (remarks of Sen. Long); see also 29 U.S.C. §§ 1107, 1108 (1976 & Supp. V 1981) (original ESOP provisions in Employee Retirement Income Security Act (ERISA)); 26 U.S.C. § 4975(c)(7) (1976) (tax code definition of ESOP); Economic Recovery Tax Act of 1981, 26 U.S.C. § 446 (Supp. V 1981) (provision for ESOP tax credit); *infra* notes 42 & 43.

32. See, e.g., MD. ANN. CODE art. 41, § 41J (1982); MICH. COMP. LAWS ANN. §§ 450.751-59 (West Supp. 1981); N.J. STAT. ANN. § 34:1B-30-35 (West Supp. 1982).

33. See, e.g., Olson, *Union Experiences with Worker Ownership*, 1982 WIS. L. REV. 729; Moberg, *A Big Step Toward Worker Ownership*, IN THESE TIMES, June 2, 1982, at 2 (UFCW effort in Philadelphia); LABOR UPDATE, July-August, 1982, at 2 (overview of unions and worker ownership). Numerous local government agencies have helped to finance worker buy-outs (e.g., the Blackhawk County Economic Development Committee loaned \$3 million of federal funds to the worker-owned Rath Packing Company in Waterloo, Iowa), and have provided technical assistance in worker buy-outs (e.g., the Mohawk Valley Economic Development District helped arrange a 1976 worker-community purchase of the Library Bureau, a library furniture manufacturer in Herkimer, New York).

34. For example, the Campaign for Human Development (Washington, D.C.), a Catholic church foundation, has provided loan capital to low-income worker-owned companies. The National Consumer Cooperative Bank, created by Congress during the Carter Administration (National Consumer Cooperative Bank Act of 1978, Pub. L. No. 95-351, 92 Stat. 499 (1978)) and given quasi-private status during the Reagan Administration (National Consumer Cooperative Bank Act Amendments of 1981, Pub. L. No. 97-35, 95 Stat. 433 (1981)), is chartered to make loans to a variety of cooperatives including worker cooperatives. See 12 U.S.C. § 3015 (Supp. V 1981). The ICA Revolving Loan Fund (Somerville, Mass.), created to provide financing assistance to worker cooperatives, has itself been capitalized with grants and low-interest loans from a wide array of foundations and church organizations. Some large worker buy-outs have attracted more conventional financing institutions, a notable



and professional schools have promoted (or permitted) the study of worker ownership,<sup>35</sup> and organizations have been created to support the nascent movement.<sup>36</sup>

Much of the recent worker ownership activity has been in response to economic crisis. As large corporations shift capital away from low-return industries, more and more workers faced with shutdowns try to save their jobs through employee buy-outs. While some attempts have been thwarted by inadequate financing options or by unwilling corporate sellers,<sup>37</sup> others have actually been promoted by multinational corporations in attempts to divest marginal operations without the costs and negative publicity of plant closings.<sup>38</sup> Still other companies have employed a variety of employee ownership financing schemes in an effort to avoid bankruptcy.<sup>39</sup>

Worker ownership also appears in healthier contexts. A substantial portion of the northwest plywood industry is organized as worker cooperatives.<sup>40</sup> More isolated examples of worker ownership are scattered throughout the United States in both manufacturing and service industries.<sup>41</sup>

As a long-term strategy, worker ownership is receiving increased attention. This is visible in buy-outs from retiring owners, start-up of worker-

example being Hyatt-Clark Industries, Clark, New Jersey, purchased with financing assistance from Prudential Insurance, Chemical Bank, Fidelity Union Bank, and the seller, General Motors.

35. The Harman Program at the Kennedy School of Government at Harvard, the Boston College Social Economy Program, the Program on Participation and Labor-Managed Systems at Cornell, the New Systems of Work and Participation Program at the Cornell School for Industrial and Labor Relations, and special courses at the Yale School of Organization and Management are examples of such programs. In addition, the Public Interest Law Foundation at New York University School of Law and the Berkeley Law Foundation at Boalt Hall School of Law have provided grants to the Industrial Cooperative Association to support legal assistance to worker cooperatives.

36. A number of nonprofit organizations have emerged to support the worker ownership movement, including the Industrial Cooperative Association (ICA, Somerville, Mass.), the Philadelphia Association for Cooperative Enterprise (PACE, Philadelphia, Pa.), the Center for Community Self-Help (CCSH, Durham, N.C.) and the National Center for Employee Ownership (NCEO, Washington, D.C.).

37. See, e.g., S. LYND, *THE FIGHT AGAINST SHUTDOWNS—YOUNGSTOWN'S STEEL MILL CLOSINGS* (1982).

38. One dramatic example of a large corporation attempting to divest a marginal operation by selling it to the workers is in Weirton, W. Va., where National Steel Corporation is negotiating a worker buy-out of its Weirton Steel Division. See, e.g., *A Steel Town's Bid to Save Itself*, *FORTUNE*, April 18, 1983, at 103; Moberg, *At Weirton Steel, It's Buy It or Lose It*, *IN THESE TIMES*, Dec. 15-21, 1982 at 3; Williams, *The Weirton Steel That Was and May Yet Be*, *THE PROGRESSIVE*, Nov. 1982, at 30.

39. For example, Jeannette Sheet Glass Corporation (Jeannette, Pa.) averted bankruptcy by a combination of direct stock purchase by workers and financing through an ESOP. See Powell, *A Worker Buyout Saves A Factory*, *Bus. Wk.*, March 17, 1980, at 30B. Similarly, Workers' Owned Sewing Company (Windsor, N.C.), a minority garment manufacturer, was organized in the wake of a bankruptcy of another garment firm. See M. Miller, *Workers' Owned*, *SOUTHERN EXPOSURE*, Winter 1980, at 12.

40. See *supra* note 20.

41. Cf. *supra* notes 3 & 30.

owned enterprises, and regional job-creation policies by governments, unions, and community organizations. Local control of capital, industry, and jobs has been a primary motivation for long-term worker ownership strategies. Enterprises controlled by their workforce are more likely to value optimum working conditions and job security than most enterprises with outside owners. Employee-owned enterprises are also likely to require a lesser total profit margin than distant corporate owners due to lower corporate overhead.

Much of the increased attention to employee ownership has focused on conventional structures, most notably the Employee Stock Ownership Plan (ESOP).<sup>42</sup> An ESOP is a specialized employee benefit plan in which employer stock is held in trust with employees as beneficiaries. Thousands of corporations have used ESOPs, usually as a tax-favored financing mechanism.<sup>43</sup>

In this Article, we essentially sidestep the discussion of more conventional structures such as ESOPs in favor of Mondragon-style worker cooperatives for several reasons. The worker cooperative form, unlike the ESOP, is designed to provide for democratic worker control. This element of local control is intrinsic to a Mondragon-style worker cooperative. In contrast, local control in conventional employee-ownership plans is extrinsic, incidental and often short-lived. Only in a worker cooperative do the "membership rights" (voting rights and rights to net earnings) become personal rights attached to the functional role of working in the company. This allows control to be retained in the hands of the workforce, even after generations and changes in personnel. In other forms of ownership, those same membership rights are considered property rights still attached to the ownership of shares and investment of capital. In a worker cooperative, instead of capital

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42. Employee Stock Ownership Plan (ESOP) is defined in I.R.C. § 4975(e)(7) (1980). See also Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. § 1107 (1975). See generally J. BACHELDER, *EMPLOYEE STOCK OWNERSHIP PLANS* (Practicing Law Institute 1979); *Olson, supra* note 33.

43. In a typical "leveraged ESOP," a bank or other financial institution loans money to the ESOP trust, and the ESOP uses that money to buy employer stock. The loan money thus passes through the trust to the employer, and the employer pays off the loan gradually by repayments through the ESOP to the lender—payments which are tax deductible as deferred labor compensation. This deduction of both the interest and principal represents a substantial tax break, since the employer ordinarily could deduct only the interest on repayment of a loan.

As the loan is paid off, stock shares in the ESOP become vested in the employees. Stock held in the ESOP ordinarily is voted by a trustee chosen by management or by the lenders, until employees take the stock out of the trust on retirement. Most ESOPs hold only a small portion of employer stock. Nevertheless, given the opportunity for a majority of stock to be held in the trust and voted by the employees, ESOPs have emerged in some cases as a vehicle for employee ownership and control. Although most existing ESOPs were established by management for tax-favored financing, a small percentage of ESOPs have been formed with the express purpose of worker control. Lawyers and financiers often draw clients toward the ESOP form primarily as a vehicle for attracting outside financing.

hiring labor, labor hires capital.<sup>44</sup> Thus, we concentrate on the democratic corporation, as a fundamental restructuring grounded in principle and not as a mere shift in nominal ownership.

Our focus also results from lessons learned while examining recent experiences in worker ownership. Worker buy-outs have indeed saved jobs, but some of these jobs have been saved only temporarily. Other buy-outs have resulted in reduced wages and benefits, have undercut job classifications, and have threatened the security of pension plans.<sup>45</sup> Too often, ESOP buy-outs have increased workers' financial risk while insulating them from control—the opposite of what one would find in a democratically based system. Yet other worker-owned companies, structured through direct stock ownership, have demonstrated an inherent tendency to drift away from democratic workforce control.<sup>46</sup>

Legislation embodying the principles of democratic work can deal structurally with the social problems created by capital mobility. Political responses to current economic distress have tended to be defensive and reactive in their attempts to reduce the pain and frequency of plant closings and job loss. Most proposed plant closing legislation imposes prior notification requirements on employers who intend to close a facility or lay off a large number of workers. Some such legislation imposes additional shutdown costs, such as severance payments to workers and penalty payments to a local economic development agency.<sup>47</sup> The practical problem with such legislation is that, thus far, it has been defeated virtually across the board.<sup>48</sup>

The mixed record of plant closing bills has coincided with the emergence and growth of a worker ownership movement. The same economic distress that gave impetus to plant closing legislative proposals also has generated interest among legislators who view worker ownership as an

44. For an in-depth discussion of the Mondragon model as labor hiring capital and as a vehicle for local control, *see supra* Part III.

45. Pitegoff & Lynd, *Workers Can be Choosers*, N.Y. Times, Oct. 27, 1982, at A27, col. 5.

46. *See supra* notes 20 & 21 and accompanying text.

47. *See, e.g.*, 1983 Cal. Legis. Serv. 952 (West). This bill (introduced Feb. 24, 1983 by Assemblywoman Maxine Waters) would require large employers planning partial or total shutdowns to pay severance benefits, relocation expenses, and transfer rights. It would also require them to give at least three months prior notice, upon receipt of which the Department of Industrial Relations would be required to do a study of the feasibility of establishing a community-owned, worker-owned, or jointly-owned business (bill on file at ICA).

Laws have been enacted in Michigan and Illinois to "encourage" worker-ownership in order to prevent job loss resulting from plant shutdowns. P.A. 82-991, 1982 Ill. Legis. Serv. 2584 (West); MICH. COMP. STAT. ANN. § 450.751 (Callaghan Supp. 1982-83).

48. Unfortunately, the bills that have actually been enacted are weak. Maine requires a severance payment (except in the case of bankruptcy) of one week's pay per year employed, and sixty days prior notice to be given the employees, the municipal officers, and the director of the Bureau of Labor. Wisconsin does not even require severance pay, and only requires notice to the state agency, not to the employees. ME. REV. STAT. ANN. tit. 26, § 655-13 (1982); WIS. STAT. ANN. § 109.07 (West Supp. 1982-83).

alternative job creation and preservation strategy. As a complement to plant closing legislation, legislation to facilitate job creation through worker ownership presents an attractive opportunity to politicians. It is a partial response to the problems of plant closings and job loss, novel enough to attract attention, and requires no immediate expenditure of public funds.

Perhaps for these reasons, Representative Timothy Bassett introduced worker cooperative legislation in Massachusetts.<sup>49</sup> With its introduction, he could respond to the high unemployment facing his constituents in Lynn, Massachusetts.

### *C. M.G.L. Chapter 157A: Content and Legislative History*

In its 1982 session, the Massachusetts Legislature enacted the "Employee Cooperative Corporations Law."<sup>50</sup> To the legislators, it was a no-cost, uncontroversial bill to facilitate job creation. To the drafters (the authors of this Article), it was the crafting of a corporate model unique in American law.

#### *1. Statutory Framework<sup>51</sup>*

Massachusetts already had a cooperative statute prior to the passage of MGL ch. 157A.<sup>52</sup> Although most of the earlier statute applies to agricultural cooperatives, two thin provisions apply to "cooperative business corporations."<sup>53</sup> However, these sections clearly were never intended for use by Mondragon-type cooperatives. They provide, at best, an archaic agglomeration of restrictions with little clear or useful guidance for democratic membership or capital structure.<sup>54</sup>

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49. 1982 Mass. Adv. Legis. Serv. 104 (Law Co-op).

50. See Appendix for complete text of the Act.

51. The statutory framework for Massachusetts corporations is similar to that of most states, and consists primarily of separate chapters for Business Corporations (MGL ch. 156B), Co-operative Corporations (MGL ch. 157), Professional Corporations (MGL ch. 156A), Charitable and Non-profit Corporations (MGL ch. 180), and, now, Employee Cooperative Corporations (MGL ch. 157A). In addition to these chapters, other statutes relevant to corporations exist. See *generally* CORPORATIONS DIVISION OF OFFICE OF THE SECRETARY OF THE COMMONWEALTH, MASSACHUSETTS CORPORATION LAWS (West 1982).

52. MGL ch. 157 (Co-operative Corporations).

53. *Id.* at §§ 1, 2. In 1866, Massachusetts became the first state to require one person-one vote in the election of directors of a cooperative business. See M. ABRAHAMSEN, COOPERATIVE BUSINESS ENTERPRISE 185 (1976).

54. The first two sections of MGL ch. 157 are entitled "Co-operative Business Corporations." Section one simply enables a corporation issuing shares bearing a par value to organize under chapter 156B (Business Corporations) "for the purpose of co-operation in carrying on any business or of co-operative trade." Section two requires distribution of earnings at least once a year, prohibits any distribution unless at least ten percent of net profits are "appropriated for a contingent or sinking fund," (but only until the accumulated

In practice, worker cooperatives have tended to bypass chapter 157 in favor of the ordinary business corporation statute.<sup>55</sup> As in most states, the business corporation statute provides sufficient flexibility to fit the basic Mondragon worker cooperative model within the traditional corporate shell by adopting appropriate by-laws.<sup>56</sup> Worker cooperatives technically could be established as closely held corporations whose shareholders were the employees. Articles of Organization could be drafted to restrict transfer of stock shares, and the by-laws could require a formula price for stock redemption that was tied to internal capital account balances.

Although this method could operate legally, it lacked the precision and credibility that could result from incorporating under a statute expressly authorizing the Mondragon model. Conventional corporate lawyers, accustomed to capital stock that reflected a corporation's net worth, were uneasy with nonmarketable membership shares and with a system of internal capital accounts to reflect corporate net worth. Moreover, a worker cooperative incorporated under chapter 156B, the business corporation law, was prohibited from using the word "co-operative" in its corporate name,<sup>57</sup> and did not qualify for the automatic exemption from state securities registration afforded small cooperatives.<sup>58</sup> Finally, the worker cooperative corporate form lacked the legitimacy accorded by express statutory authority.

The new worker cooperative statute was intended to give such enterprises legitimacy and familiarity in the eyes of lenders, suppliers, customers, government officials, managers, and workers. The statute was built upon the business corporation statute familiar to many practitioners. Chapter 157A therefore retains most of the features of chapter 156B, while also introducing novel protections for worker cooperative membership rights, for equitable apportionment of earnings and losses, and for a new type of capital structure. The legislation avoided tampering with the existing coop-

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amount equals at least thirty percent of the value of the outstanding capital stock), prohibits any person from holding shares whose par value exceeds one thousand dollars, and prohibits a stockholder from having more than one vote on any one subject.

Except for the per capita voting provision, § 2 imposes uncertain and inappropriate limits upon cooperatives. For example, it is unclear whether the "sinking fund" is to be an actual asset or just a subaccount of equity on the balance sheet (and thus only a restriction on dividends). Ordinarily "contingent or sinking fund" refers to a liquid asset account maintained for liquidity purposes. However, chapter 157 § 5 permits the investment of the cooperative's reserve fund in the "building where it is doing business, or, second, in a first mortgage of real estate owned and occupied as a dwelling by any of its stockholders." It would be difficult to imagine a more illiquid use of a reserve or contingent fund. The intent and limits on the use of the fund are little guidance in ensuring viable cooperative structure.

55. MGL ch. 156B (Certain Business Corporations).

56. See, e.g., *supra* note 24.

57. MGL ch. 157 § 8.

58. MGL ch. 110A § 402(a)(12) (exempting from state level securities registration certain statutory cooperatives with authorized capital stock no greater than \$50,000).

erative statute by providing cooperatives the option of organizing under either the old or new provisions.<sup>59</sup>

Organizing a worker cooperative under chapter 157A is simple. "Any corporation organized under chapter one hundred and fifty-six B [business corporation law] may elect to be governed as an employee cooperative under the provisions of [157A] . . . , by so stating in its articles of organization or articles of amendment . . . ." <sup>60</sup> Thus, a new worker cooperative incorporates as a business corporation and simultaneously elects to be governed as a worker cooperative. An existing business corporation can convert to a worker cooperative by amending its articles of organization. In either case, the corporation must integrate into its articles and by-laws the membership provisions required by chapter 157A. Also, the cooperative is permitted to revoke its election by amending its articles after a two-thirds vote of the membership.<sup>61</sup>

## 2. Membership

One basic difference between a Massachusetts business corporation and a 157A worker cooperative is that the latter must be built upon a membership structure. Specifically, a 157A corporation must issue a class of voting stock to "members." Each cooperative corporation establishes its own membership criteria, but the statute limits membership to persons employed by the corporation and requires that members vote their membership shares on a one person-one vote basis. The key membership criterion is contribution of labor, although members can be full-time or part-time workers.<sup>62</sup>

The Mondragon model limits voting power to members; no voting stock exists other than the membership shares. However, for flexibility in financing, and to ensure support from the organized bar, chapter 157A allows a worker cooperative to issue other classes of stock to members or non-members, but only if expressly permitted by the articles of organization. Moreover, no stock other than membership shares can be given voting power, with two exceptions. First, the members (but only the members) may amend the articles and by-laws to authorize the issuing of voting stock other than membership shares. Second, holders of nonvoting stock have a right to vote as a class on any article or by-law amendment that would adversely affect their rights.<sup>63</sup> Thus, only if the members authorize the issuance of stock other than membership shares may outside investors vote on corporate matters. A class of membership shares will always exist, with membership

59. MGL ch. 157. In the new statutory framework, business co-operatives organized under ch. 157 can remain governed by 157, or they can elect to be governed instead by ch. 157A.

60. MGL ch. 157A § 3.

61. *Id.* at §§ 4, 11.

62. *Id.* at § 6.

63. *Id.* at § 7.

veto power over significant corporate actions. Thus, with some flexibility, chapter 157A thereby codifies a fundamental attribute of the worker cooperative: ultimate worker control on the basis of one worker-one vote.

### 3. Patronage Allocations

Chapter 157A expressly authorizes allocation of net earnings in accordance with the relative amount of work performed by members.<sup>64</sup> The typical corporation, in contrast, allocates net earnings on the basis of relative capital investment. This "patronage allocation" provision codifies a second basic attribute of the worker cooperative: apportionment of earnings and losses to members on the basis of their relative amount of work, usually measured by hours of work or total wages.

This notion of "patronage allocations" is well established in American law (e.g., in the federal Internal Revenue Code).<sup>65</sup> Ordinarily, corporate earnings are subject to double taxation. The corporation pays corporate income tax on its taxable income and individual shareholders pay personal income tax on their share of corporate earnings distributed as dividends. Subchapter T of the Tax Code enables a cooperative, through the use of patronage allocations, to avoid this double taxation. Using subchapter T, the worker cooperative, currently or in the future, deducts from corporate taxable income any earnings allocated to members on the basis of work performed.<sup>66</sup> These allocations or "patronage dividends" may be in the form of cash distributions, or in the form of written obligations ("written notices of allocation") credited to members' individual capital accounts.<sup>67</sup> Thus, subchapter T can provide a dual benefit: the cooperative can avoid double taxation and simultaneously retain and reinvest a portion of the earnings allocated to members.<sup>68</sup>

64. *Id.* at § 8. In this section, the relative amount of work performed by members is defined as "patronage," a term of art drawn from subchapter T of the Internal Revenue Code, codified at 26 U.S.C. § 1388.

65. I.R.C. §§ 1381-1388 (subchapter T "Cooperatives and Their Patrons"). In the Tax Code, "patronage dividend" is defined, in part, as the amount paid to a patron by an organization "on the basis of quantity or value of business done with or for such patron . . .", I.R.C. § 1388(a); when applied to a worker cooperative, patronage means the amount of work done for the cooperative. *See cases cited infra* note 69.

66. I.R.C. §§ 1382(b); § 1388 as interpreted by case law cited *infra*, note 69; *cf. supra* note 65. For a general treatment of subchapter T and worker cooperatives, *see Pitegoff, Taxation of Worker Cooperatives, EMPLOYEE OWNERSHIP, Dec. 1982 at 5.*

67. *Id.*

68. A worker cooperative can use subchapter T in at least two different ways, which have different cash-flow implications depending on the tax brackets of the co-op and the members. Patronage dividends in the form of "qualified" written notices of allocation are currently deductible by the corporation. However, the member must pay personal tax currently on any allocations, and the corporation must pay at least twenty percent of the dividend in cash to the member immediately, presumably to pay the personal tax. Alternatively, the "nonqualified" written notices require no upfront personal tax payment, but also

Subchapter T benefits are available to "any corporation operating on a cooperative basis."<sup>69</sup> Although the IRS and the courts have produced no precise definition of "operating on a cooperative basis," two criteria appear to be most important. First, the corporation must allocate a portion of earnings on the basis of patronage, rather than on relative capital investment. Second, the cooperative must be democratically controlled by the members.<sup>70</sup>

The Massachusetts worker cooperative statute creates state law guidance for a corporate form and operation likely to qualify for the federal subchapter T tax benefits. Although the particular state incorporation statute is not controlling for federal tax purposes, chapter 157A includes the two primary criteria for subchapter T eligibility: patronage allocations and democratic membership control.<sup>71</sup>

#### 4. Internal Capital Accounts

The most innovative aspect of chapter 157A is its authorization of a new type of capital structure. A 157A corporation "may establish . . . a system of internal capital accounts, to reflect the book value and to determine the redemption price of membership shares, capital stock, and written notices of allocation."<sup>72</sup> This system enables a cooperative to maintain a fixed membership entry fee (legal consideration for a membership share), while allocating any increase in the corporation's net worth to the workers whose labor contributed to such growth. The internal accounts, rather than shares of stock, reflect any appreciation in value of the corporation.<sup>73</sup>

offer no current corporate deduction for the patronage dividend. In a later year, when the nonqualified written notice is paid out in cash to the member, the member pays personal tax, and the cooperative deducts from taxable income the amount of the cash pay-out. See generally I.R.C. §§ 1382, 1383, and 1388(a)-(d).

69. I.R.C. § 1381(a)(2). Despite the absence of any express statutory provision for worker cooperatives in the Tax Code, subchapter T has been extended to worker cooperatives in a series of cases beginning in 1964. See, e.g., *Puget Sound Plywood, Inc. v. Commissioner*, 44 T.C. 305 (1965); *Linnton Plywood Ass'n v. United States*, 236 F. Supp. 227 (D. Ore. 1964); *Astoria Plywood Corp. v. U.S.*, 43 A.F.T.R.2d (P-H) 79-1114, 43 A.F.T.R. 79-816 (D. Ore. 1979); *Brookings Plywood Corp. v. U.S.*, 40 A.F.T.R.2d (P-H) 77-6119 (D. Ore. 1977); *Linnton Plywood Ass'n v. United States*, 410 F. Supp. 1100 (D. Ore. 1976).

70. See cases *supra* note 69. See generally, ACCOUNTING AND TAXATION FOR COOPERATIVES (1978); Memoranda by B. Knauss, D. Bradlow, and P. Pitegoff (on file at the Industrial Cooperative Association, Somerville, Mass.).

71. MGL ch. 157A § 10 defines an "internal capital account cooperative," implementing the pure Mondragon-type structure, in such a way that § 10 serves as a homespun safe harbor for subchapter T qualification. Although both 157A and subchapter T are flexible enough to permit hybrid co-op-capitalist firms, subchapter T qualification becomes less certain as the corporation strays away from the 157A § 10 model. See *infra* Part II.B.6 for further discussion of the variations on the hybrid model; cf. *supra* note 69.

72. MGL ch. 157A § 9(a).

73. Use of internal accounts to reflect the corporation's net worth is crucial to the long-term survival of the cooperative structure. For discussion of this point, see *supra* Part II.B.1.



When a membership share is redeemed, the redemption price is determined in accordance with the internal capital account balance.<sup>74</sup> As a self-insurance mechanism, the cooperative can allocate a portion of its retained earnings to a collective account which is never paid out to individuals during the life of the corporation.<sup>75</sup>

### 5. *Incidental Benefits of 157A Election*

As discussed above, a corporation organized under chapter 157A is likely to qualify for subchapter T benefits. In Massachusetts, this tax benefit in part flows through to state level taxation. Massachusetts taxable income is determined on the basis of the federal taxable income figure, with certain adjustments.<sup>76</sup> None of the adjustments affect the subchapter T deductions. Thus, Massachusetts taxable income is based upon a figure that fully reflects the cooperative tax break.

The new law offers two additional benefits to worker cooperatives. First, a 157A corporation may use the term "cooperative" in the corporate name,<sup>77</sup> thereby permitting the cooperative to use a name appropriate to its organizational form. Second, a small worker cooperative is exempted from state registration of securities offerings under the existing "cooperative" exemption,<sup>78</sup> lessening its paperwork and reporting burdens.

### 6. *Flexibility: The Internal Capital Account Cooperative vs. the Hybrid*

Initial drafts of the worker cooperative statute reflected a "pure" cooperative structure: all capital stock held by employee-members, voting control by members on a one worker-one vote basis, and the entire corporate net worth reflected in internal capital accounts.<sup>79</sup> However, the organized bar resisted this model for at least two reasons. First, the exclusive limitation of capital stock and voting power to members precluded creative financing schemes built upon stock sales to nonmembers. Second, the pure cooperative structure presented greater obstacles to the gradual conversion of existing business corporations to employee cooperatives. The result of legislative compromise is a statute that authorizes, but does not prescribe, the Mondragon model for structuring a worker cooperative. It also autho-

74. MGL ch. 157A §§ 9, 10.

75. *Id.* at §§ 9(d), 10. In the event of liquidation, any collective account balance remaining would be allocated in accordance with the by-laws, which may provide for allocation of liquidation proceeds to the members on the basis of patronage.

76. *See* MGL ch. 63 §§ 30.5, 38, 38A. Excise taxes on Massachusetts corporations consist of a property-type tax and an income-type tax; a reduction in the latter results from the flow-through of subchapter T benefits. Note also that any Massachusetts business corporation (including those that elect 157A status) must pay a minimum annual excise tax of \$228.

77. MGL ch. 157A § 5; MGL ch. 157 § 8.

78. MGL ch. 110A § 402(a)(12) (Supp. 1982); *cf. supra* note 58.

79. *See, e.g.,* Massachusetts House Bill No. 1122 (1982), An Act Further Amending the Corporate Laws; *see supra* note 1 for reference to complete legislative history.

rizes hybrid corporate forms, which combine cooperative attributes with a typical capital structure. Regardless of the mix in the capital structure, however, the corporation must at the very least maintain a separate class of one worker-one vote voting stock held by the workforce.<sup>80</sup>

Since chapter 157A is designed, in part, to provide guidance for a worker cooperative structure, a separate section defines the "pure" Mondragon model.<sup>81</sup> This section (10) defines an "internal capital account cooperative" as:

[a section 157A corporation] whose entire net book value is reflected in internal capital accounts, one for each member, and a collective reserve account, and in which no persons other than members own capital stock. In an internal capital account cooperative, each member shall have one and only one vote in any matter requiring voting by stockholders.<sup>82</sup>

The section also describes a procedure for maintaining this structure over time.

The "internal capital account cooperative" defined in section 10 codifies relevant lessons drawn from Mondragon. Using the shell of American corporation law, it converts the corporation from an enterprise based on property rights to a social institution based on personal rights.

### III

#### THEORY OF LEGAL STRUCTURE UNDERLYING THE WORKER CO-OP LAW<sup>83</sup>

The following section of the article lays out some of the theoretical justifications of the worker cooperative structure.

##### *A. Restructuring the Bundle of Ownership Rights*

A bundle of rights attaches to the corporate shares of the shareholders or members of a corporation. Among these rights are the right to control the corporation by voting, to elect the board of directors, and to receive value from the corporation (first, in the form of dividends while the stock is held and second in the form of capital gains when the stock is sold at a higher price). The total value accruing to the shareholders can be analyzed as the sum of (1) the present value of the present and future economic net income plus (2) the net book value or net worth (assets minus liabilities) of the corporate assets. Hence the total value of this bundle of rights is represented by:

$$\text{Voting Rights} + \text{Net Income Rights} + \text{Net Book Value}$$


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80. MGL ch. 157A §§ 6(b), 7; see also *supra* note 63 and accompanying text.

81. MGL ch. 157A § 10.

82. *Id.*

83. Major portions of the following section may be found in D. ELLERMAN, *THEORY OF LEGAL STRUCTURE: WORKER COOPERATIVES* (1982).

If we define membership rights as voting rights plus net income rights, and capital rights as rights to the net book value then we have the following equation:

$$\text{Conventional Share Rights} = \text{Membership Rights} + \text{Capital Rights}$$

These concepts can be used to characterize both a conventional capital-based corporation and a worker cooperative corporation. A corporation is capital-based or capitalist if the membership rights (defined above) are property rights, i.e., rights that are transferable and marketable. In contrast, a corporation is a worker cooperative (or "self-managed firm") if the membership rights are personal rights attached to the functional role of working in the company.

### *B. Personal Rights*

Personal rights are rights assigned to an individual because that individual qualifies for them, for example, by having a certain functional role—like legally residing within the city limits of a municipality. Personal rights are not marketable because the rights are assigned to all those people and only those people who have the qualifying role. A personal right may not be "sold" because the "buyer" might not have the qualifying role, and if the would-be "buyer" did have the qualifying role, then he or she would not need to "buy" the right. Hence personal rights and property rights are fundamentally different. Examples of personal rights include:

- (1) basic human rights, where the functional role is simply that of being human,
- (2) voting rights in a township or municipality, where the functional role is residing within the town or city limits,
- (3) union membership rights, where the functional role is working in the bargaining unit, and
- (4) membership rights in a worker cooperative or self-managed firm, where the functional role is working in the firm.

A worker cooperative corporation is a democratic work-community, an industrial democracy, which assigns the membership rights to the people who work in it just as a township or municipality is a democratic living-community which assigns the voting rights to the people who live or reside in it.

One acid test to distinguish between personal and property rights is the inheritability test. Personal rights assigned to a functional role are extinguished when a person ceases to play that role. When a person dies, the voting rights he or she may have had as a citizen, a co-op member, or a union member are not transferable to the person's estate or heirs. However, voting rights in a capital-based corporation will pass to the person's heirs under estate law.

Many of the different characteristics of conventional corporations and worker cooperative firms result from the fact that the membership rights are transferable property rights in the former case and personal rights attached to the functional role of working in the firm in the latter. For example, the one person-one vote principle precludes a single person from gaining disproportionate impact. However, when the membership rights are marketable property rights, then anyone with sufficient wealth can buy many shares, be a multiple-member, and cast many votes. Thus the multiple voting in a conventional corporation, in violation of a one person-one vote principle, is a result of the membership rights being marketable commodities.

Structures implement principles. The legal structure of the worker cooperative, which assigns membership rights (the voting and net income rights) to the worker's role, implements two fundamental normative principles: the democratic theory of government and the labor theory of property. We shall separately examine the two principles behind this treatment of the voting rights and the net income rights.

### *C. The Democratic Principle of Government (as applied to the industrial enterprise)*

The structural assignment of the voting rights to the worker's role implements the democratic principle of government: all and only the people who are governed should be entitled to vote. Much of the discussion in the literature on corporate governance has centered on another principle concerning stakeholders or affected interest groups. This principle might be formulated as the principle of affected interests: "Everyone who is affected by the decisions of a government should have the right to participate in that government."<sup>84</sup>

There are several interest groups or groups of stakeholders affected by a firm:

- (1) the workers (blue and white collar),
- (2) the input suppliers (including capital suppliers, e.g., stockholders),
- (3) the consumers, and
- (4) the people living in the vicinity of the firm's facilities.

Note that two or more interest groups or stakeholder groups cannot each have majority control on the board of directors of a corporation, and that a minority position does not afford effective protection of legitimate affected interests. It is the right to constrain or veto corporate actions, not the voting right to elect the board, which gives more effective protection to legitimate outside interests. This illuminates the distinction between two quite different types of control rights:

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84. See R. DAHL, *supra* note 4, at 64.

- (1) *indirect or negative control rights* which are the rights to veto or otherwise constrain the decisions of another party, and
- (2) *direct or positive control rights* which are the rights to make the decisions of the party in question within the constraints imposed by the affected outside interests.

Direct control rights and indirect control rights are much confused in the current debate on corporate structure. The principle of affected interests is a principle for the assignment of indirect or negative control rights, while the democratic principle is concerned with the assignment of direct or positive control rights. The affected interests principle does not address the question of direct control even though it is often misapplied to that question. For example, the argument for the nationalization of industry on the grounds that "everyone is affected," or the arguments for trying to protect outside interests by representing all stakeholders on corporate boards are inapplicable. The alleviation of the affected interests problem lies in the creation of more effective outside controls as well as more responsible inside direct control, rather than in the direction of misassigning direct control to new absentee owners such as the government, consumers, or capital suppliers.

In an industrial enterprise, the democratic principle would assign the direct control rights to those who are not just indirectly affected by the firm but who also fall under the command, authority, and jurisdiction of the firm's management. Democracy is not a technique of managing property; it is a system of governing people—the system of people governing themselves. Only by assigning the direct control rights to those people who are actually governed by (i.e., those who take orders from) the management would a legal structure implement the principle of self-government. The consumers, the input suppliers (including capital suppliers such as the stockholders), and the local residents do not take orders from and are not under the authority of the management. Of all the stakeholders, it is only the people who work in the firm who are under the authority (within the scope of their employment) of the firm's management.

The democratic principle of self-government implies that the direct control rights, mainly the voting rights to elect the firm's board of directors, should be assigned to the functional role of being governed, that is, to the people working in the firm. Hence in a worker cooperative or self-managed firm, the voting rights are personal rights assigned to the worker's functional role.

#### *D. The Labor Theory of Property*

One traditional value theory in economics was the "labor theory of value" symbolized by such slogans as "Only labor is productive" or "Only

labor is creative.”<sup>85</sup> But other factors of production, such as capital and land, are “productive” because they are essential to production. Labor, however, is unique in not merely being essential but in being solely responsible. All the factors are “productive,” but only labor is responsible. Capital goods, natural resources, and other material inputs to production, no matter how useful they may be, can never be responsible for anything. Only human beings can be responsible for anything, and thus only the people involved in production can be responsible for the positive and negative results of production.<sup>86</sup>

We are concerned with “responsibility” in the *ex post* sense of the question “Who did it?”, not with “responsibilities” in the *ex ante* sense of one’s duties or tasks in an organizational role. A person or group of people are said to be *de facto* or factually responsible for a certain result if it was the purposeful result of their intentional (joint) actions. The assignment of *de jure* or legal responsibility is called imputation. The basic juridical principle of imputation is that *de jure* or legal responsibility is to be imputed in accordance with *de facto* or factual responsibility. Thus, people should have the legal responsibility for the positive and negative results of their intentional actions.<sup>87</sup> For example, the legal responsibility for a civil or criminal wrong should be assigned to the person or persons who intentionally committed the act, *i.e.*, to the *de facto* responsible party.

In a productive enterprise, the intentional human actions of the people working in the enterprise are their labor services, and the assignment of legal responsibility is the assignment of property rights and obligations. Hence, in the productive context, the juridical principle of imputation is reformulated as the labor theory of property: people should legally appropriate the positive and negative fruits of their labor.<sup>88</sup>

The products or outputs of a firm are the positive fruits of the labor jointly performed by all the people working in the firm. The used-up nonlabor inputs, such as the consumed raw materials and intermediate goods and the expended services of the machines, buildings, and land, represent the negative fruits of the labor of the firm’s workers. From the legal viewpoint, it is the corporation itself as a legal entity that owns the produced outputs and that is liable for the used-up nonlabor inputs. Since the labor theory of property states that the workers should jointly appropriate the positive fruits (the produced outputs) and be jointly liable for the

85. See A. Menger, *The Right to the Whole Produce of Labour* (1899) in G.D.H. Cole, *Socialist Thought: The Forerunners 1789-1850* (1953); G. Lichtheim, *British Socialist Economics, 1820-1840*, in *The Origins of Socialism* 124 (1969).

86. See Ellerman, *On Property Theory and Value Theory*, XIV *Economics Analysis and Workers’ Management* 105, 120 (1980); D. Ellerman, *The Labor Theory of Property and John Locke* (1981); see also R. Dahl, *supra* note 4.

87. See D. Ellerman, *supra* note 86.

88. *Id.*

negative fruits (the used-up, nonlabor inputs) of their combined labor, the labor theory implies that the workers should "be" the corporation, that is, that the workers should be the legal members of the corporation.

In terms of market value, the net value of the positive and negative fruits of the labor jointly performed by the workers is revenues minus nonlabor costs, which in the conventional firm amounts to "wages" plus "profits". Since the wages and salaries already accrue to the workers in any corporation, the labor theory suggests that the rights to the remaining value of the fruits of their labor, namely, the rights to the economic net income, should also be assigned to the workers. Hence the democratic principle of self-government and the labor theory of property imply that, in a corporation, the voting rights and the rights to the revenues net of nonlabor costs ("wages plus profits") should be assigned to the functional role of working in the company. Since wages already go to the workers, a corporation can be transformed into a worker cooperative by changing the membership rights (voting rights plus net income rights) from salable property rights into personal rights attached to the workers' role.

#### *E. The Corporation: From Property to a Democratic Institution*

The conversion of corporate membership rights (voting and net income rights) from marketable property rights to nontransferable personal rights precipitates a change in the nature of the corporation itself. A worker cooperative is not just a capital-based corporation that is employee-owned. The worker-members of a worker cooperative are really neither "employees" nor "owners." While remaining "employees" for some legal purposes (for example, Social Security), the worker-members of a worker cooperative are not employees in the sense of sellers of labor. They sell not their labor but the fruits of their labor. Instead of being "employees" of a worker cooperative corporation, the workers are the corporation; it is their legal embodiment. The workers, in their corporate body, own the positive fruits of their labor (the produced outputs) and are liable for the negative fruits of their labor (the exhausted nonlabor inputs). Instead of selling their labor for a wage or salary, the worker-members are selling their outputs in return for the revenues and are paying the costs of the nonlabor inputs. The labor income of the worker-members is not the market value of their labor as a commodity but is the net market value of the positive and negative fruits of their labor (revenues minus nonlabor costs).

The worker-members are also not "owners" because membership rights are not property rights. Any right attached to a person's functional role obviously cannot be treated as a marketable property right. Like the citizenship rights in a political democracy, the membership rights in an industrial democracy are held, not owned. The workers are members, not owners. Workers' cooperatives have worker-members, not employee-owners.

The conventional capital-based or capitalist corporation is, indeed, the only major human organization in present-day society which has owners who may buy and sell it as a piece of property. A conventional capital-based corporation is itself a piece of property with certain owners, the shareholders. Indeed, a corporation is often thought of as a piece of property, a chunk of capital, like a machine, a building, a parcel of land, or an amount of money. This is peculiar. A corporation is an organization; a machine, a building, a plot of land, or an amount of financial capital is not. A corporation has a built-in system of governance, members (stockholders) who vote to elect representatives (directors) who, in turn, appoint governors (managers) to govern the affairs of the organization. Machines, buildings, and other chunks of property also have owners but no members, directors, or managers. Other institutions and organizations are not even conceived of as property at all. Universities, hospitals, churches, and other nonprofit corporations are not property. Labor unions, clubs, and other unincorporated associations are not property. The units of civic government, such as townships and municipalities, are not property. All these are human organizations or institutions. All have a system of governance with certain members who vote directly or indirectly to select the governors or managers of the organization. All these organizations may own property, but none are themselves property. None have owners who may buy or sell the organization. The capitalist corporation is the peculiar institution of our time.

Conversion of corporate membership rights from property rights to personal rights assigned to the worker's role converts the corporation from a piece of property into an industrial democracy. A worker cooperative or self-managed firm is neither privately owned nor publicly owned, so it is neither a capitalist firm nor a socialist firm. It is not owned at all; it is a democratic social institution.

#### *F. The Implementation of the Worker Cooperative Structure*

The definition of a worker cooperative corporation given above, i.e., the assignment of the membership rights to the workers' role, is a conceptual and generic definition. The new Massachusetts worker cooperative statute is designed to allow concrete implementation of that definition of a worker cooperative. The strategy is to attach membership rights to the shares and to allow creation of a new capital structure—the system of internal capital accounts—to take over the function of carrying the property rights to the net worth. With capital rights removed from the shares, the shares can be treated as carriers of only the membership rights, as membership certificates, attached to the functional role of working in the firm.

One of the flaws in traditional statutory workers' cooperatives (for example, the plywood co-ops) is that the co-op shares continue to carry the net book value, so they cannot be used as membership certificates.<sup>89</sup> To give

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89. *Cf. supra* text accompanying note 21.



each newly qualified and accepted member a traditional co-op share as a membership certificate would be to make an unwarranted gift of a proportionate part of the net worth to each new member. Thus a new worker is required to buy at least one share to become a member, and this may become prohibitively expensive (\$60,000 or more in some plywood cooperatives). Moreover, membership should ideally be designed in such a way that a person qualifies for membership by working in the firm (even though, as specified below, there are financial obligations of membership).

The Massachusetts solution is to allow a worker cooperative to split off the net worth or net book value from the shares using a system of internal capital accounts, with one account for each member recording that member's share of the net worth. When a person leaves the firm or retires, the balance in his or her account is paid out by the firm over a period of years. A new worker does not have to individually pay off a retiring worker—as would be the case if a new worker had to buy a share with the accumulated value from a retiring member. With the rights to the portions of net worth recorded in internal capital accounts, the shares can then be treated as nontransferable membership certificates issued to new members and collected from exiting members. The new member would not be getting a portion of net worth, since the balance in the new member's account would start at zero.

Rights usually come with obligations. For example, one does not have to "buy" the rights of union membership or the rights of political citizenship, but one must pay union dues and government taxes. Similarly, in a worker cooperative, one does not "buy" membership but each new member must pay a fixed membership investment fee. The paid-in membership fee is recorded in the new member's account. At the end of each fiscal year, interest is added to the account<sup>90</sup> and the member's share of the retained positive or negative surplus (computed after interest on the accounts) is then added to or subtracted from the account's balance. Each member's share of the surplus is proportional to her labor as measured by her hours of work or by her pay.

In the pure Mondragon model there would usually also be a collective account that is unindividuated in the sense that it never has to be paid back to anyone during the life of the company. By having a certain portion of the net worth that never has to be turned over or revolved as the membership turns over, the cooperative is helping to insure that it can eventually pay off the individual accounts. Hence the allocation to the collective account is a form of self-insurance. The individual and collective accounts should be adjusted each year to reflect the retained net income, paid-in membership fees, and paid-off accounts so that the sum of the account balances always equals the net worth.

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90. This follows the economic principle of treating interest as the opportunity cost of using capital regardless of its source in debt or equity financing. See D. ELLERMAN, *ECONOMICS, ACCOUNTING, AND PROPERTY THEORY* (1982); R. ANTHONY, *ACCOUNTING FOR THE COST OF INTEREST* (1975).

*G. Summary of Theory of Legal Structure*

The various types of legal structures for worker-owned firms can now be summarized according to the treatment of the conventional bundle of ownership rights (see Figure 1).

FIGURE 1

*Conventional Capital-Based Corporation*

(A) voting rights,		Owned by the
(B1) net income rights, and	→	shareholders
(B2) net book value rights.		(property rights).

*Employee-Owned Corporation*

(A) voting rights,		Owned by the
(B1) net income rights, and	→	shareholders
(B2) net book value rights.		(property rights).

*Traditional Worker Cooperative*  
(e.g. Plywood Cooperatives)

(A) voting rights		Partially treated as personal rights held by workers who own at least
(B1) net income rights.	→	
(B2) net book value rights.	→	one ownership share (property rights).

*Non-profit Self-Managed Firm*  
(e.g. Yugoslavian firms)

(A) voting rights,		Membership rights held by the workers (personal rights).
(B1) net income rights.	→	
(B2) net book value rights.	→	Social property.

*Mondragon-type Worker Cooperative*

(A) voting rights,		Membership rights held by the workers (personal rights).
(B1) net income rights.	→	
(B2) net book value rights.	→	Internal capital accounts (property rights).

Employee-owned corporations (for example, majority or one hundred percent ESOPs) are based on the conventional structure wherein the membership rights are property rights—albeit rights owned by the employees—so such a company is still a piece of property, an employee-owned piece of property.

The traditional worker co-ops moved part way toward the treatment of the membership rights as personal rights by allowing shareholders only one vote regardless of the number of shares held and by distributing certain net income (“partronage dividends”) in accordance with labor rather than by reference to the capital invested in shares. But since the net worth is not partitioned off from the shares by a system of internal accounts, the shares continue to function as carriers of net worth. Thus a worker who could not afford individually to pay off the accumulated net worth due a retiring member by buying a share would not receive the membership rights to vote and to receive a portion of the net earnings.

The system of Mondragon-type internal accounts takes the function of carrying the net worth away from the shares so that the membership rights, as evidenced by the shares, can be fully transformed into personal rights assigned to the workers’ functional role. The net worth due to each worker-member, representing the reinvested fruits of her labor, is not thereby sacrificed since it remains a property right evidenced by the balance in the member’s internal account. In this manner, an appropriate legal structure can transform a company from a piece of property into a productive and stable social institution wherein people receive the fruits of their labor and have democratic control over their worklives.

#### IV

#### CONCLUSION

In 1760, a Scottish jurist, G. Wallace, gave a clear expression of the natural rights philosophy which was to guide the radical abolitionism of the Enlightenment.

[E]very one of those unfortunate men, who are pretended to be slaves, has a right to be declared to be free, for he never lost his liberty; he could not lose it; his prince had no power to dispose of him. Of course, the sale was *ipso jure* void. This right he carries about with him, and is entitled every where to get it declared.<sup>91</sup>

But how are these rights implemented and institutionalized? How does one carry a right about with oneself? For example, how does one carry the right to self-government about with oneself? We have seen an answer to this question.

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91. G. WALLACE, *A SYSTEM OF THE PRINCIPLES OF THE LAW OF SCOTLAND (1760)*, quoted in D.B. DAVIS, *THE PROBLEM OF SLAVERY IN THE AGE OF REVOLUTION 1770-1823* 269 (1975).

Rights are implemented in the structure of organizations and institutions. The right to democratic self-government is implemented by structuring each organization so that the right to govern the organization is a personal right attached to the functional role of being governed by the organization. Our topic has been the structuring of economic organizations and institutions so that individuals shall "carry about" with themselves two basic rights which, in the parlance of the 17th and 18th centuries, are natural rights: the right of democratic self-government and the right to the fruits of one's labor. People will carry about these two rights if organizations are structured so that (1) the right to govern is assigned to the functional role of being governed, and (2) the rights to the fruits of production are assigned to the functional role of producing those products. We have considered two specific examples of institutions embodying these rights: the Mondragon cooperatives and the corporate form authorized by the new Employee Cooperative Corporation Law in Massachusetts. These democratic models serve to inform the larger debate on restructuring the modern corporation.

Of more immediate concern is the need to address the problems of plant closings and capital hypermobility,<sup>92</sup> and to foster cooperative economic development and reindustrialization. The new law will help address these issues in Massachusetts and will provide a model for similar legislation in other states.<sup>93</sup> The Mondragon model and its embodiment in the new Massachusetts law provide a structural way to address the questions of local accountability<sup>94</sup> and social responsibility—by converting a corporation into a democratic social institution.

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92. See B. BLUESTONE & B. HARRISON, *supra* note 3.

93. A statute almost identical to MGL 157A was enacted in Maine by 1983 Maine Public Law Chapter 136 (H.P. 215-L.D. 258, An Act to Provide for the Establishment of Employee Cooperative Corporations) to be codified as ME. REV. STAT. ANN. tit. 13, § 85 (1983). In early 1983, legislation almost identical to the Massachusetts legislation enacting MGL ch. 157A was introduced in the Vermont State Senate. See Vt. S. 101, 57th Legis., 1st Sess. 1983 ("An Act to Add 11 U.S.A. Chapter 8 Relating to Employee Cooperative Corporations" (Sen. Parker, Caledonia County); public hearings on the bill before the Senate Finance Committee, March 10, 1983).

94. Cf. C. MACKIN, STRATEGIES FOR LOCAL OWNERSHIP AND CONTROL: AN ICA WORKING PAPER (1983).

*Appendix*

## MASSACHUSETTS

## 1982 REGULAR SESSION

## Ch. 104

EMPLOYEE COOPERATIVE CORPORATIONS—  
ESTABLISHMENTChap. 104. AN ACT PROVIDING FOR THE ESTABLISHING OF EMPLOYEE  
COOPERATIVE CORPORATIONS*Be it enacted, etc., as follows:*

SECTION 1. Clause (12) of paragraph (a) of section 402 of chapter 110A of the General Laws, as appearing in section 1 of chapter 694 of the acts of 1972, is hereby amended by inserting after the word "fifty-seven", in line 2, the words:—or organized under chapter one hundred and fifty-seven A.

SECTION 2. Chapter 157 of the General Laws is hereby amended by striking out section 8, as amended by section 32 of chapter 750 of the acts of 1962, and inserting in place thereof the following section:—

*Section 8.* Any person, partnership, association or corporation, domestic or foreign, except employee cooperatives organized under chapter one hundred and fifty-seven A and co-operative banks and corporations organized under section ten, transacting business for profit in the commonwealth under any name or title containing the word "co-operative", unless the net earnings thereof are distributed in a manner permitted for a co-operative corporation by this chapter, shall forfeit to the commonwealth not more than ten dollars for every day or part thereof during which such name or title is so used. Such forfeiture may be recovered by an information brought in the supreme judicial or superior court by the attorney general, at the relation of the state secretary. Upon such information, the court may issue a temporary or permanent injunction restraining such person, partnership, association or corporation from doing business in the commonwealth, or from so using such name or title, and may make such other orders and decrees as justice and equity may require.

SECTION 3. The General Laws are hereby amended by inserting after chapter 157 the following chapter:—

CHAPTER 157A.  
EMPLOYEE COOPERATIVE CORPORATIONS.

Section 1. This chapter shall be known and may be cited as the Employee Cooperative Corporations Act.

*Section 2.* As used in this chapter the following words shall, unless the context clearly requires otherwise, have the following meanings:

“Employee cooperative”, a corporation which has elected to be governed by the provisions of this chapter.

“Member”, a natural person who has been accepted for membership in, and owns a membership share issued by an employee cooperative.

*Section 3.* Any corporation organized under chapter one hundred and fifty-six B may elect to be governed as an employee cooperative under the provisions of this chapter, by so stating in its articles of organization or articles of amendment filed in accordance with said chapter one hundred and fifty-six B.

A corporation so electing shall be governed by all provisions of said chapter one hundred and fifty-six B other than sections seventy-eight to eighty-five, inclusive, except as otherwise provided in this chapter.

*Section 4.* An employee cooperative may revoke its election under this chapter by a vote of two-thirds of the members and through articles of amendment filed in accordance with section seventy-two of said chapter one hundred and fifty-six B.

*Section 5.* An employee cooperative may include the word “cooperative” or “co-op” in its corporate name.

*Section 6. (a)* The articles of organization or the by-laws shall establish qualifications and the method of acceptance and termination of members. No person may be accepted as a member unless employed by the employee cooperative on a full time or part time basis.

*(b)* An employee cooperative shall issue a class of voting stock designated as “membership shares”. Each member shall own only one such membership share, and only members may own such shares.

*(c)* Membership shares shall be issued for a fee as shall be determined from time to time by the directors. Sections twenty-four, twenty-five, twenty-eight and thirty of said chapter one hundred and fifty-six B shall not apply to such membership shares. Sections seventy-six and eighty-five to ninety-eight, inclusive, of said chapter one hundred and fifty-six B shall not apply to membership shares whose redemption price is determined by reference to internal capital accounts as defined in section nine.

*(d)* Members of an employee cooperative shall have all the rights and responsibilities of stockholders of a corporation organized under said chapter one hundred and fifty-six B, except as otherwise provided in this chapter.

*Section 7. (a)* No capital stock other than membership shares shall be given voting power in an employee cooperative, except as otherwise provided in this chapter or in the articles of organization.

*(b)* Notwithstanding the provisions of section seventeen of said chapter one hundred and fifty-six B, the power to amend, or repeal by-laws of an employee cooperative shall be in the members only, except to the extent that directors are authorized to amend or repeal the by-laws in accordance with said section seventeen.

*(c)* Sections seventy, seventy-one and seventy-four of said chapter one hundred and fifty-six B shall be construed to limit voting on any amendment

of the articles of organization of an employee cooperative to the members, except that amendments adversely affecting the rights of stockholders as defined in section seventy-seven of said chapter one hundred and fifty-six B may not be adopted without the vote of such stockholders as provided in section seventy-one of said chapter one hundred and fifty-six B.

*Section 8. (a)* The net earnings or losses of an employee cooperative shall be apportioned and distributed at such times and in such manner as the articles of organization or by-laws shall specify. Net earnings declared as patronage allocations with respect to a period of time, and paid or credited to members, shall be apportioned among the members in accordance with the ratio which each member's patronage during the period involved bears to total patronage by all members during that period. As used in this chapter, "patronage" means the amount of work performed as a member of an employee cooperative, measured in accordance with the articles of organization and by-laws.

*(b)* The apportionment, distribution, and payment of net earnings required by subsection *(a)* may be in cash, credits, written notices of allocation, or capital stock issued by the employee cooperative.

*Section 9. (a)* Any employee cooperative may establish through its articles of organization or by-laws a system of internal capital accounts, to reflect the book value and to determine the redemption price of membership shares, capital stock, and written notices of allocation. As used in this chapter, "written notice of allocation" means a written instrument which discloses to a member the stated dollar amount of such member's patronage allocation and the terms for payment of that amount by the employee cooperative.

*(b)* The articles of organization or by-laws of an employee cooperative may permit the periodic redemption of written notices of allocation and capital stock, and must provide for recall and redemption of the membership share upon termination of membership in the cooperative. No redemption shall be made if such redemption would result in the liability of any director or officer of the employee cooperative under section sixty-one of said chapter one hundred and fifty-six B.

*(c)* The articles of organization or by-laws may provide for the employee cooperative to pay or credit interest on the balance in each member's internal capital account.

*(d)* The articles of organization or by-laws may authorize assignment of a portion of retained net earnings and net losses to a collective reserve account. Earnings assigned to the collective reserve account may be used for any and all corporate purposes as determined by the board of directors.

*Section 10. (a)* An internal capital account cooperative is an employee cooperative whose entire net book value is reflected in internal capital accounts, one for each member, and a collective reserve account, and in which no persons other than members own capital stock. In an internal

capital account cooperative, each member shall have one and only one vote in any matter requiring voting by stockholders.

(b) An internal capital account cooperative shall credit the paid-in membership fee and additional paid-in capital of a member to the member's internal capital account, and shall also record the apportionment of retained net earnings or net losses to the members in accordance with partronage by appropriately crediting or debiting the internal capital accounts of members. The collective reserve account in an internal capital account cooperative shall reflect any paid-in capital, net losses, and retained net earnings not allocated to individual members.

(c) In an internal capital account cooperative, the balances in all the individual internal capital accounts and collective reserve account, if any, shall be adjusted at the end of each accounting period so that the sum of the balances is equal to the net book value of the employee cooperative.

(d) Sections seventy-six and eighty-five to ninety-eight, inclusive, of said chapter one hundred and fifty-six B shall not apply to an internal capital account cooperative.

*Section 11.* (a) When an employee cooperative revokes its election in accordance with section four, the articles of amendment shall provide for conversion of membership shares and internal capital accounts or their conversion to securities or other property in a manner consistent with said chapter one hundred and fifty-six B.

(b) An employee cooperative which has not revoked its election under this chapter may not consolidate or merge with another corporation other than an employee cooperative. Two or more employee cooperatives may consolidate or merge in accordance with sections seventy-eight, eighty, eighty-one, eighty-four and eighty-five of said chapter one hundred and fifty-six B.

Approved May 26, 1982.