

DEVELOPING COOPERATIVES AS A JOB CREATION STRATEGY FOR LOW-INCOME WORKERS

SCOTT L. CUMMINGS*

I. INTRODUCTION

By all popular accounts, the United States is experiencing a period of dazzling economic growth and unprecedented prosperity.¹ After almost a decade of economic expansion, the country is enjoying the lowest unemployment rate in recent memory, a booming stock market, and reduced welfare rolls.² Yet, as the economy hurtles forward, there is mounting evidence that low-income communities are being left behind.³ In contrast to stock market-fueled wealth accumulation among the super-rich,⁴ the real income and overall wealth of the working poor have declined during this boom period.⁵ The poverty rate is still thirteen percent nationwide and closer to twenty percent in major metropolitan areas such as Los Angeles.⁶

* Skadden Fellow, Public Counsel Law Center, Los Angeles, California. B.A., University of California, Berkeley, 1992; J.D., Harvard Law School, 1996. Special thanks to Sameer Ashar, Ingrid Eagly, Susan Butler Plum, and the Skadden Fellowship Foundation.

1. See, e.g., Jonathan Peterson, *Will Fed Lower Boom on Booming Economy?*, L.A. TIMES, Feb. 1, 2000, at A1.

2. See Richard W. Stevenson, *In a Time of Plenty, The Poor Are Still Poor*, N.Y. TIMES, Jan. 23, 2000, § 4 (Week in Review), at 3 (noting that the “drumbeat of good economic news is becoming so familiar that the nation might be excused for taking the prosperity for granted”).

3. See Bruce Raynor, Editorial, *Serfs of the Service Economy*, N.Y. TIMES, Nov. 16, 1999, at A27 (citing study by Fiscal Policy Institute, an Albany-based non-profit group, showing that the number of working poor families in New York has increased by 60% in the 1990s); Louis Uchitelle, *Rising Incomes Lift 1.1 Million Out of Poverty*, N.Y. TIMES, Oct. 1, 1999, at A20 (citing Census Bureau study finding that, despite an overall increase in median household income over the past decade, income inequality has remained virtually unchanged).

4. See Richard W. Stevenson, *Fed Reports Family Gains from Economy*, N.Y. TIMES, Jan. 19, 2000, at C1; see also *Gates Remains King on Forbes' List of Richest Americans*, L.A. TIMES, Sept. 24, 1999, at C1 (citing report in *Forbes* that the 400 richest Americans are worth over \$1 trillion combined—more than the gross domestic product of China).

5. See Mark Arax et. al., *California Income Gap Grows amid Prosperity*, L.A. TIMES, Jan. 9, 2000, at A1 (citing study by the California Poverty Institute finding that California's poorest working families now bring home 22% less in real dollars than they did in 1969); Stevenson, *supra* note 4 (citing a study by the Federal Reserve that showed declining net worth among families earning less than \$25,000 despite gains among other income groups); see also Louis Uchitelle, *The Sounds of Silence*, N.Y. TIMES, Dec. 19, 1999, § 4 (Week in Review), at 4 (stating that the minimum wage has declined over two dollars an hour in real terms since its peak in 1968).

6. See Jim Newton, *L.A.'s Growing Pay Gap Looms as Political Issue*, L.A. TIMES, Sept. 7, 1999, at A1 (citing United Way study showing that more than 20% of Los Angeles

Unemployment rates in distressed neighborhoods reach levels many times the national average.⁷

The advent of welfare reform⁸ and declining rates of unionization⁹ have further contributed to the marginal economic status of low-income communities. The “work first” era ushered in by welfare reform has meant the end of the traditional safety net and has forced increasing numbers into a workforce with scarce opportunities for living wage employment. The situation is especially precarious for immigrant workers who bore the brunt of welfare reform¹⁰ and, despite aggressive efforts by unions to increase immigrant recruitment,¹¹ continue to occupy positions in nonunionized,

County residents live below the official poverty line); Stevenson, *supra* note 2 (stating that the poverty rate for 1998, the most recent year for which data are available, was 12.7%, according to a Census Bureau report). In addition, recent studies have suggested that the figures currently used to determine the poverty level understate living costs and, therefore, undercount the poor. See Kimberly Blanton, *25% of Mass. Families Struggling*, BOSTON GLOBE, Jan. 13, 2000, at C1 (noting that the Women’s Educational and Industrial Union believes a “self-sufficiency” standard would better account for the poor); Louis Uchitelle, *Devising New Math to Define Poverty*, N.Y. TIMES, Oct. 18, 1999, at A1 (describing Census Bureau proposal to increase the poverty level threshold from \$16,000 to \$19,500, which would increase the percentage of Americans living in poverty from 12.7% to 17%).

7. See Charles Babington, *Clinton Urges Corporate Investments to Fight Pockets of Poverty*, WASH. POST, July 6, 1999, at A2 (noting that unemployment rates in some parts of Appalachia are at least one and one-half times the national average); Peter T. Kilborn, *Clinton, amid the Despair on a Reservation, Again Pledges Help*, N.Y. TIMES, July 8, 1999, at A16 (stating that unemployment on some Native American reservations, according to tribal leaders, is as high as 85%); Todd S. Purdum, *Clinton Ends Visit to Poor with an Appeal for Support*, N.Y. TIMES, July 9, 1999, at A10 (citing unemployment rates of three times the national average in Watts, California).

8. In 1996, Congress enacted welfare reform, which imposed a five-year lifetime limit on welfare benefits for adults, as well as the requirement that states must have 50% of their caseload working at least 30 hours per week by the year 2002. See Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (“PRWORA”), Pub. L. No. 104-193, 110 Stat. 2129, 2137 (codified as amended in scattered sections of 42 U.S.C.).

9. See Stephen Franklin, *Union Refrain Starts to Move to Ethnic Beat*, CHI. TRIB., Oct. 13, 1999, at 1 (citing statistics showing that union membership now stands at 13.9% of the workforce, down from 20.1% in 1983).

10. There have been a number of reports detailing the negative consequences of welfare reform for immigrants. See, e.g., William Branigin, *“Chilling Effects” Seen from Welfare Reform: Caseload Drop Sharper Among Immigrants*, WASH. POST, Mar. 9, 1999, at A6; Jonathan Curiel, *Welfare Reform Hurts Immigrants’ Children, New Research Says*, S.F. CHRON., June 24, 1999, at A7; Ana Mendieta, *Welfare Reform Is Hitting Immigrants Hard*, CHI. SUN-TIMES, Aug. 11, 1999, at 71; Carolyne Zinko, *Welfare Reform Study Describes Immigrant Women’s Problems*, S.F. CHRON., Apr. 14, 1999, at A17. The 1996 welfare reform law severely restricted legal immigrants’ use of food stamps, welfare, and Supplemental Security Income (“SSI”). See Illegal Immigrant Reform and Immigrant Responsibility Act of 1996, Pub. L. No. 104-208, 110 Stat. 3009 (codified as amended in scattered sections of 8 U.S.C. and 18 U.S.C.). However, the federal government has since softened the impact of these restrictions by allowing certain immigrants to qualify for expanded benefits. See Michael Fix & Wendy Zimmerman, *The Legacies of Welfare Reform’s Restrictions*, 75 INTERPRETER RELEASES 1577, 1579-80 (1998).

11. See, e.g., Nancy Cleeland, *Unionizing Is Catch-22 for Illegal Immigrants*, L.A. TIMES, Jan. 16, 2000, at A1; Franklin, *supra* note 9; Steven Greenhouse, *Labor, Revitalized with New Recruiting, Has Regained Power and Prestige*, N.Y. TIMES, Oct. 9, 1999, at A14.

low-wage sectors of the economy.¹² The economic insecurity in low-income communities generated by the looming threat of terminated welfare benefits and the dearth of stable, living wage jobs poses the central challenge to anti-poverty advocates today.

To address this challenge, many legal services practitioners have turned to community economic development ("CED") as a strategy to reduce poverty.¹³ Stung by restrictions on federally-funded legal services programs,¹⁴ and forced to rethink the efficacy of traditional poverty law strategies in light of welfare reform,¹⁵ practitioners have started to provide transactional legal assistance to organizations and individuals working to revitalize low-income neighborhoods.¹⁶ These CED programs have sought

12. See generally Lora Jo Foo, *The Vulnerable and Exploitable Immigrant Workforce and the Need for Strengthening Worker Protective Legislation*, 103 YALE L.J. 2179 (1994); see also Nurith C. Aizenman, *INS Raids Follow Union Organizing; Aliens Say Law Is Being Misused*, WASH. POST, Dec. 6, 1999, at A3 (describing how employers have used immigration laws to thwart union organizing among undocumented immigrants).

13. See generally Brian Glick & Matthew J. Rossman, *Neighborhood Legal Services as House Counsel to Community-Based Efforts to Achieve Economic Justice: The East Brooklyn Experience*, 23 N.Y.U. REV. L. & SOC. CHANGE 105 (1997); Peter Pitegoff, *Law School Initiatives in Housing and Community Development*, 4 B.U. PUB. INT. L.J. 275 (1995); Ben Quinones, *CED on the Job*, 27 CLEARINGHOUSE REV. 773 (1993); Ben Quinones, *Redevelopment Redefined: Revitalizing the Central City with Resident Control*, 27 U. MICH. J.L. REF. 689 (1994); Michael H. Schill, *Assessing the Role of Community Development Corporations in Inner City Economic Development*, 22 N.Y.U. REV. L. & SOC. CHANGE 753 (1996-1997); Janine Sisak, *If the Shoe Doesn't Fit . . . Reformulating Rebellious Lawyering to Encompass Community Group Representation*, 25 FORDHAM URB. L.J. 873 (1998); Lucie White, "Democracy" in *Development Practice: Essays on a Fugitive Theme*, 64 TENN. L. REV. 1073 (1997) [hereinafter White, "Democracy" in *Development Practice*]; Lucie E. White, *Feminist Microenterprise: Vindicating the Rights of Women in the New Global Order?*, 50 ME. L. REV. 327 (1998). Note that the trend toward CED among poverty law advocates reflects a broader anti-poverty policy shift away from welfare and toward CED strategies. See, e.g., David Barstow, *Invest in Poor Areas, Clinton Urges*, N.Y. TIMES, Jan. 14, 2000, at B4; Kilborn, *supra* note 7. See also Michael S. Barr, *Using CRA in Affordable Housing*, 9 J. AFFORDABLE HOUS. & COMMUNITY DEV. L. 13 (1999) (describing Clinton's policies to promote growth and economic opportunity in low-income communities).

14. See Ingrid V. Eagly, *Community Education: Creating a New Vision of Legal Services Practice*, 4 CLINICAL L. REV. 433, 436-43 (1998) (discussing history of Legal Services Corporation and recent restrictions on the type of work the program can carry out).

15. See, e.g., Greg Volz & Brad Castel, *Jobs Strategies in the Era of Welfare Reform: A Community-Based Model of Legal Services*, 33 CLEARINGHOUSE REV. 569 (2000).

16. See, e.g., Debbie Chang & Brad Castel, *Creating Opportunities Through Litigation: Community Economic Development Remedies*, 26 CLEARINGHOUSE REV. 1057 (1993); William C. Kennedy et al., *Cultural Changes and Community Economic Development Initiatives in Legal Services: What Happened in Two Programs*, 33 CLEARINGHOUSE REV. 440 (1999); Jeffrey S. Lehman & Rochelle E. Lento, *Law School Support for Community-Based Economic Development in Low-Income Urban Neighborhoods*, 42 WASH. U. J. URB. & CONTEMP. L. 65 (1992); National Economic Development and Law Center & John Little, *Practicing Community Corporate Law*, 23 CLEARINGHOUSE REV. 889 (1989); Elena Popp & Francisca Gonzalez Baxa, *Creating, Preserving, and Improving Housing Through Community Economic Development*, 33 CLEARINGHOUSE REV. 668 (2000); William P. Quigley, *Reflections of Community Organizers: Lawyering for Empowerment of Community Organizations*, OHIO N. U. L. REV. 455 (1994); Ann Southworth, *Business Planning for the Destitute? Lawyers as Facilitators in Civil Rights and Poverty Practice*, 1996 WIS. L. REV.

to promote local efforts to create jobs through business development and increased private investment.¹⁷ In particular, CED practitioners have worked closely with community-based organizations to create economic opportunities for low-income people who face an array of obstacles to employment, including inadequate job skills, substance abuse problems, domestic violence, limited English proficiency, undocumented immigration status, and the unavailability of child care. Practitioners and scholars have highlighted microenterprise programs as examples of such job creation strategies,¹⁸ but have focused little attention on less familiar models.

As CED has evolved as poverty law practice, it has also gained prominence among legal scholars as a new paradigm of collaborative lawyering designed to promote community empowerment.¹⁹ Scholars have emphasized the radical potential of a legal services practice where lawyers facilitate client projects instead of subordinating client voices, and have attempted to situate CED squarely within the framework of "rebellious" lawyering.²⁰ However, with few exceptions,²¹ accounts of CED work have not convincingly demonstrated the nexus between CED practice and community empowerment; to the contrary, recent scholarship has suggested that CED lawyering has actually operated to undermine locally-controlled community development efforts.²²

1121 [hereinafter Southworth, *Business Planning for the Destitute?*]; Louise G. Trubek, *Lawyering for Poor People: Revisionist Scholarship and Practice*, 48 U. MIAMI L. REV. 983 (1994). See generally NATIONAL ECONOMIC DEVELOPMENT AND LAW CENTER, COUNSELING ORGANIZATIONS IN COMMUNITY ECONOMIC DEVELOPMENT (1998).

17. For an overview of the evolution of CED policies, see Daniel S. Shah, *Lawyering for Empowerment: Community Development and Social Change*, 6 CLINICAL L. REV. 217 (1999).

18. See, e.g., SUSAN R. JONES, A LEGAL GUIDE TO MICROENTERPRISE DEVELOPMENT: BATTLING POVERTY THROUGH SELF-EMPLOYMENT (1998); Brad Caftel, *Helping Microenterprise Programs Succeed*, CED EXCHANGE, June 1993, at 1; Margaret Beebe Held, *Developing Microbusinesses in Public Housing: Notes from the Field*, 31 HARV. C.R.-C.L. L. REV. 473 (1996); Susan R. Jones, *Self-Employment: Possibilities and Problems*, in HARD LABOR 76 (Joel F. Handler & Lucie White eds., 1999); Susan R. Jones, *Small Business and Community Economic Development: Transactional Lawyering for Social Change and Economic Justice*, 4 CLINICAL L. REV. 195 (1997) [hereinafter Jones, *Small Business and Community Economic Development*]; Lewis D. Solomon, *Microenterprise: Human Reconstruction in America's Inner Cities*, 15 HARV. J.L. & PUB. POL'Y 191 (1992); Robert E. Suggs, *Bringing Small Business Development to Urban Neighborhoods*, 30 HARV. C.R.-C.L. L. REV. 487 (1995).

19. See, e.g., Louise G. Trubek, *The Worst of Times . . . And the Best of Times: Lawyering for Poor Clients Today*, 22 FORDHAM URB. L.J. 1123, 1131, 1135 (1995) (citing client empowerment as an important aspect of CED lawyering). For a general discussion of empowerment theory, see Anita Hodgkiss, *Petitioning and the Empowerment Theory of Practice*, 96 YALE L.J. 569, 581-584 (1987).

20. See generally Sisak, *supra* note 13; White, "Democracy" in *Development Practice*, *supra* note 13.

21. See Glick & Rossman, *supra* note 13 (describing the CED practice of Brooklyn Legal Services Corporation A); Sisak, *supra* note 13, at 882-93 (same).

22. See Shah, *supra* note 17, at 220-21.

This Article highlights how worker-owned cooperative businesses can be used by CED practitioners as an effective job creation strategy for low-income workers—particularly for low-income immigrant workers, who play an increasingly important role in the revitalization of urban economies.²³ It focuses on the role of the CED lawyer in the initial stages of structuring a worker cooperative, analyzing the interplay between the legal and organizing components of cooperative formation. This analysis suggests that cooperative development—to a greater degree than more conventional business development strategies—has the potential to create jobs while promoting the type of client-controlled, grassroots community-building efforts that have often been depicted as the goal of successful CED work.

Section II of this Article provides an overview of the advantages and disadvantages of cooperative business development, evaluates cooperative development as a CED strategy, and presents a case study of a domestic workers' cooperative. Section III then provides a detailed analysis of the legal issues involved in forming a cooperative, focusing particular attention on the cooperative's choice of legal entity and how this decision may affect cooperatives comprised of immigrant workers.

II.

COOPERATIVE DEVELOPMENT AND ECONOMIC JUSTICE

A. Overview of Worker Cooperatives

A worker cooperative is a business organization that is owned and democratically controlled by the workers.²⁴ Like all cooperative businesses, a worker cooperative adheres to fundamental principles, such as

23. See Linda J. Wong, *The Role of Immigrant Entrepreneurs in Urban Economic Development*, 7 STAN. L. & POL'Y REV. 75 (1996) (arguing that local manufacturing networks comprised of immigrant-owned enterprises are crucial to economic development efforts in Los Angeles).

24. See GARY B. HANSEN ET. AL., *STEPS TO STARTING A WORKER CO-OP 7* (1997) (providing basic information relevant to starting a cooperative). See generally FRANK ADAMS & GARY B. HANSEN, *PUTTING DEMOCRACY TO WORK: A PRACTICAL GUIDE TO STARTING AND MANAGING WORKER-OWNED BUSINESSES* (1992); KIRK BAKER & ANTHONY NAKAZAWA, *ORGANIZING FOR BUSINESS AS A COOPERATIVE* (1995); ALASTAIR CAMPBELL, *THE DEMOCRATIC CONTROL OF WORK* (1969); CHRIS CORNFORTH ET. AL., *DEVELOPING SUCCESSFUL WORKER CO-OPERATIVES* (1988); DAVID P. ELLERMAN, *WHAT IS A WORKER COOPERATIVE?* (1984); CHRISTOPHER GUNN, *WORKERS' SELF-MANAGEMENT IN THE UNITED STATES* (1984); GARY B. HANSEN, *LESSONS FROM THE PAST: SELECTED READINGS ON THE SYSTEMATIC DEVELOPMENT OF WORKERS' COOPERATIVES TO GENERATE EMPLOYMENT AND INCOME* (1993); GARY B. HANSEN & E. MOGENSEN, *WORKING TOGETHER TO CREATE JOBS: A GUIDE TO WORKER-OWNED COOPERATIVE DEVELOPMENT* (1994); PETER JAN HONIGSBERG ET. AL., *WE OWN IT* (1991); LEN KRIMERMAN & FRANK LINDEFELD, *WHEN WORKERS DECIDE: WORKPLACE DEMOCRACY TAKES ROOT IN NORTH AMERICA* (1992); MARY MELLER ET. AL., *WORKER COOPERATIVES IN THEORY AND PRACTICE* (1988); JOHN PEARCE, *RUNNING YOUR OWN COOPERATIVE* (1984); JANET H. SAGLIO & J. RICHARD HACKMAN, *THE DESIGN OF GOVERNANCE SYSTEMS FOR SMALL WORKER COOPERATIVES* (Industrial Cooperative Assoc. Working Paper, 1982); *WORKER COOPERATIVES IN AMERICA* (Robert Jackall & Henry M. Levin eds., 1984); *WORKER OWNERSHIP*

voluntary and nondiscriminatory membership, democratic member control, equitable economic participation by members, and a commitment to ongoing member education.²⁵ Workers are accepted as cooperative members according to internal membership criteria and each member becomes a legal owner of the business with the right to participate in management decisions and receive income distributions.²⁶ The rights to vote and receive value from the cooperative are deemed “personal rights” attached to the functional role of working in the company and generally may not be transferred as individual property.²⁷

Workers who decide to form a cooperative must agree to operate under a type of business structure that is unfamiliar. Unlike conventional businesses that are owned by investors who pay wages to employees in return for their services,²⁸ cooperative workers agree to take the full risks and benefits of owning their business.²⁹ Typically, each worker makes an initial capital contribution to the cooperative in order to become a member, and is thereafter entitled to receive a proportional share of the cooperative’s profits.³⁰ The most radical feature of the cooperative structure is its requirement of democratic worker control. This requirement ensures that each worker has an equal vote to influence critical business decisions, such as the allocation of profit and loss, acceptance and expulsion of other members, and approval of loans and contracts.³¹

There are several advantages to starting a worker cooperative. First, by coming together as a group, workers may be able to demand higher

DEVELOPMENT FOUNDATION, *STARTING A WORKER CO-OPERATIVE: AN INTRODUCTION* (1985).

25. See HANSEN ET. AL., *supra* note 24, at 6 (describing cooperative principles articulated in 1996 by the International Cooperative Alliance).

26. *Id.* at 7.

27. See David Ellerman & Peter Pitegoff, *The Democratic Corporation: The New Worker Cooperative Statute in Massachusetts*, 11 N.Y.U. REV. L. & SOC. CHANGE 441, 460 (1982-83) (“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.”).

28. See *id.* at 459, 466 (defining a conventional capital-based corporation as one in which the rights to vote and participate in the distribution of corporate income are property rights owned by the holders of capital (i.e., shareholders), rather than employees).

29. HANSEN ET. AL., *supra* note 24, at 8.

30. See *id.*

31. See Ellerman & Pitegoff, *supra* note 27, at 461 (explaining that “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”).

wages than they could as individuals by leveraging their collective bargaining strength.³² In addition, cooperatives can offer workers significant opportunities for advancement, as members who demonstrate the desire and commitment can work to take on greater managerial responsibilities.

The formation of a cooperative business can also increase job security for workers who would otherwise be subject to market exploitation based on their vulnerable economic position.³³ The collective nature of the cooperative enterprise provides mechanisms that foster this security. For example, the workers can provide each other mutual support in finding and maintaining stable jobs for all cooperative members. Moreover, the formality of the cooperative business may deter unscrupulous employers from taking advantage of the vulnerable market position of some workers, since employers may be less inclined to withhold payment from a business entity with the power to resort to legal action to enforce its rights.

Another advantage of the cooperative structure is that it provides the opportunity for worker ownership and democratic control.³⁴ Workers exercise final decision-making authority over the way the work is organized, performed, and managed. They are given a stake in the business, and must work collaboratively in order to achieve success. This participation can lead to other benefits. For instance, by taking full responsibility for operating the business, workers may develop more confidence in their abilities to be strong participants in creating economic and social change.

Perhaps most importantly, cooperatives offer workers unique opportunities for to acquire and upgrade job skills. By bearing the responsibility of running a business, the workers commit themselves to a continuing process of self-education in the development of business-related skills such as accounting, marketing, management, and literacy. In fact, many cooperatives are formed primarily to facilitate job training, and seek to attract seed money from foundations and government agencies to promote this mission.

The advantages of worker cooperatives can be particularly strong for low-income workers. For instance, cooperatives may promote economic opportunities for unskilled and isolated workers through its structure of mutual support. Some advocates have also used cooperatives as a vehicle for integrating other social services to alleviate some of the barriers to employment that low-income workers face.³⁵ In addition, cooperatives may

32. See NATIONAL ECONOMIC DEVELOPMENT AND LAW CENTER, MUTUAL BENEFIT SERVICE SECTOR COOPERATIVES 5 (Sept. 1992) (on file with the *Review of Law & Social Change*) [hereinafter NEDLC, COOPERATIVES]; WOMEN'S ACTION TO GAIN ECONOMIC SECURITY, COOPERATIVE CASE STUDY 7 (March 1998) (on file with the *Review of Law & Social Change*) [hereinafter WAGES, COOPERATIVE CASE STUDY].

33. See HANSEN ET.AL., *supra* note 24, at 8.

34. See *id.*

35. See WAGES, COOPERATIVE CASE STUDY, *supra* note 32, at 2 (describing a project where child care and domestic violence counseling were offered to cooperative members).

allow the most marginalized workers—those who are undocumented immigrants—to become effective market participants despite their immigration status.

However, these advantages must be weighed against the practical drawbacks of operating a business in a cooperative form. A cooperative's democratic decision-making structure, while promoting collective action, may hamstring effective business management by hindering the cooperative's ability to respond swiftly to market opportunities. Also, as in any non-hierarchical collective, there is a potential for intra-organizational disputes.³⁶ The cooperative structure thus tends to require a greater investment of resources to mediate member conflict, which also could reduce economic efficiency.³⁷ In addition, it is more difficult for cooperatives to become economically self-sufficient since they require a great deal of ancillary organizing support. That is, cooperatives often arise as projects of community-based organizations that provide the organizational and technical resources necessary to start and maintain the cooperative structure. Once this support is withdrawn, cooperatives that have come to rely on these outside resources may find it difficult to become economically independent.

A significant drawback of the cooperative form is the potential for conflict between its job training and job creation missions. In particular, lower-skilled, less efficient workers—while gaining skills through their participation in the cooperative—are often unable to generate their share of business clients or participate on an equal footing with other members of the group. This can create resentment in the higher-skilled members, causing intra-group conflict. If low-skilled members continue to act as a drain on cooperative resources, they may jeopardize the economic viability of the group, and, in serious cases, precipitate the dissolution of the business.

B. Cooperative Development as a Job Creation Strategy

Although cooperative development may offer an opportunity to effectively create living wage jobs for low-income workers, it has not been carefully evaluated as a CED strategy. In fact, despite the recent interest in promoting economic development as part of a broader anti-poverty agenda,³⁸ scant attention has been paid to the development of worker-owned cooperative businesses.³⁹ Instead, scholars and policymakers have

36. See JUDY WAJCMAN, *WOMEN IN CONTROL: DILEMMAS OF A WORKERS CO-OPERATIVE* 56-84 (1983) (describing the internal and external obstacles to achieving profitability in a women-owned worker cooperative).

37. See *id.*

38. See generally Barr, *supra* note 13; Purdum, *supra* note 7.

39. For exceptions to this general trend, see WILLIAM ALVARADO-GREENWOOD, *ORGANIZING PRODUCTION COOPERATIVES: A STRATEGY FOR COMMUNITY ECONOMIC DEVELOPMENT* (1998); BRETT FAIRBARN, ET AL., *COOPERATIVES AND COMMUNITY DEVELOPMENT: ECONOMICS IN SOCIAL PERSPECTIVE* (1991); NEDLC, *COOPERATIVES,*

focused on more conventional business expansion strategies.⁴⁰ One problem with these strategies is that they tend to reinforce a free enterprise model that employs the type of market practices that generate income inequality. That is, the conventional CED model—with its focus on entrepreneurial development, venture capital, and leveraged private sector investment—continues to promote individual capital accumulation without critically assessing whether this approach can effectively ignite a broader movement for economic equality. This tension has led to a nascent critique of CED practice, with some scholars arguing that CED lawyers have unwittingly reinforced market subordination and elite control of CED projects by creating complex legal structures that leave no room for meaningful community involvement.⁴¹

In contrast, cooperatives present an opportunity to challenge free market values and build democratic community institutions, while still providing sustainable jobs for low-income workers.⁴² In this way, cooperative development is consistent with an emerging model of CED practice that departs from conventional market-based strategies and instead seeks to use CED to promote grassroots community mobilization and political action.⁴³ This model builds upon the evolving conception of progressive lawyering that challenges the subordination of marginalized groups by integrating legal advocacy and community-based organizing in order to build political power.⁴⁴ In the context of this model of progressive legal practice, cooperative development has generated interest as a CED strategy because it of

supra note 32; Ellerman & Pitegoff, *supra* note 27; Lewis D. Solomon & Melissa B. Kirgis, *Business Cooperatives: A Primer*, 6 DEPAUL BUS. L.J. 233 (1994). See generally Stimulating Cooperative Economic Development in Low-Income Communities (Patricia Logan et al. eds., 1981).

40. See, e.g., Jones, *Small Business and Community Economic Development*, *supra* note 18; Southworth, *Business Planning for the Destitute?*, *supra* note 16; Ann Southworth, *Taking the Lawyer Out of Progressive Lawyering*, 46 STAN. L. REV. 213 (1993).

41. See Shah, *supra* note 17, at 220-21 (“The legal structures brought about through partnership agreements with private investors, loan and mortgage agreements with financial institutions like banks and municipal governments, and real property development agreements with cities all enforced dependence, lack of control, and reorientation of community goals.”).

42. See Peter Pitegoff, *Organizing Worker Cooperatives*, 7 L. & POL’Y 45, 49 (1985) (describing the organization of worker cooperatives as the “rare synthesis of economic development, democratic values, and the law”).

43. Other examples of this emerging model include organizing campaigns to leverage job training and placement programs from publicly-subsidized commercial development projects, see Nona Liegeois et. al., *Helping Low-Income People Get Decent Jobs: One Legal Services Program’s Approach*, 33 CLEARINGHOUSE REV. 279, 286-89 (1999), and living wage campaigns, see Selena Spain & Jean Wiley, *The Living-Wage Ordinance: A First Step in Reducing Poverty*, 32 CLEARINGHOUSE REV. 252 (1998).

44. See, e.g., GERALD LÓPEZ, *REBELLIOUS LAWYERING: ONE CHICANO’S VISION OF PROGRESSIVE LAW PRACTICE* (1992); Jennifer Gordon, *We Make the Road by Walking: Immigrant Workers, the Workplace Project, and the Struggle for Social Change*, 30 HARV. C.R.-C.L. REV. 407 (1995); Quigley, *supra* note 16; Lucie E. White, *To Learn and Teach: Lessons from Driefontein on Lawyering and Power*, 1988 WIS. L. REV. 699 (1988).

its potential to serve as the locus for incipient community organizing that may empower cooperative members to become more engaged in broader struggles for economic justice.⁴⁵

Another distinguishing feature of the cooperative model is that it promotes business development by fostering the type of collective action and support that is lacking in the traditional market-based CED model. This collective spirit can be critical to the success of fledgling businesses, especially those owned and operated by persons who have little or no previous business management experience, or by immigrant workers who are generally less familiar with United States cultural and business practices.

Nonetheless, it must be emphasized that although cooperatives lend themselves to integrating more equitable, community-building principles, these ideas are not inherent in the cooperative structure and must be chosen by the membership. This highlights the need for a strong organizational base and capable leaders who are able to effectively balance the cooperative's profit-making and social justice missions.

C. Case Study

1. Cooperatives, Domestic Workers, and Community Organizing

Increasingly, advocates across the country have used cooperatives as a vehicle for organizing low-income women working as domestic workers.⁴⁶ This has occurred for a variety of reasons, chief among them the economic vulnerability of domestic workers and the potential for a well-organized cooperative business to significantly increase workers' wages and economic security.⁴⁷ However, although there is great interest in expanding the development of domestic worker cooperatives among CED practitioners, there are few model projects to guide the direction of this work.

45. Pitegoff, *supra* note 42, at 48; see also Stuart Henry, *Community Justice, Capitalist Society, and Human Agency: The Dialectics of Collective Law in the Cooperative*, 19 L. & SOC'Y REV. 303, 324 (1985) (noting the potential for cooperatives and other "alternative institutions" to transform the "capitalist order" through "incremental reformulations").

46. See *Freedom's Promise at Work*, L.A. TIMES, Oct. 11, 1998, at B14 (discussing Miracle Workers house-cleaning cooperative in the San Fernando Valley). Other nonprofit organizations have domestic worker cooperative projects, such as the Coalition for Humane Immigrant Rights of Los Angeles and the Workplace Project in Hempstead, New York. For an analysis of issues relating to domestic workers generally, see Melanie Ryan, *Swept Under the Carpet: Lack of Legal Protections for Household Workers—A Call for Justice*, 20 WOMEN'S RTS. L. REP. 159 (1999); Peggie R. Smith, *Regulating Paid Household Work: Class, Gender, Race, and Agendas of Reform*, 48 AM. U. L. REV. 851 (1999).

47. In addition, many domestic worker cooperatives are being formed by immigrants, for whom the idea of democratic work structures may have greater cultural resonance. See, e.g., JEFFREY H. COHEN, *COOPERATION AND COMMUNITY: ECONOMY AND SOCIETY IN OAXACA* (1999); Richard Klatwiter, *¡La Tierra Es Nuestra! The Campesino Struggle in El Salvador and a Vision of Community-Based Lawyering*, 42 STAN. L. REV. 1625, 1671 (1991) (describing the use of cooperative organizational structures by campesinos in community organizing campaigns in El Salvador).

The following description of one group of women struggling to start a cooperative business may provide some insights into the promise, and potential problems, of the cooperative model.⁴⁸ This case study is meant to highlight the broader organizing context of the cooperative development process, focusing on the intensive non-legal work that must be done before legal counsel becomes necessary. At these initial stages, the CED lawyer plays a limited role in the cooperative organizing project, primarily helping to coordinate technical assistance resources to facilitate business planning and fundraising, as well as addressing any legal issues that may emerge as potential impediments to the cooperative's organization. As the case study indicates, it is only after a period of intra-group strengthening and focused strategic planning that the CED lawyer's expertise on business law issues is enlisted by the cooperative members.

2. "*Las Domésticas*"⁴⁹

For the past year, a group of fifteen women have met every Monday afternoon in a cramped community center in Los Angeles, educating themselves about the steps necessary to form a cooperative business. Some come by bus from miles away; others rely on the center's employees for rides. A few walk from their nearby apartments. The reason these women make the journey every week is simple: they are united by their desire to improve their economic situation and their belief that forming a cooperative business is the way to achieve a measure of economic independence.

The women are domestic workers, which means that they work in other people's homes, typically for very meager pay, and often without the security that their jobs will be there the next day.⁵⁰ Many of the women work only sporadically; it is difficult to maintain a full schedule of clients, and most workers make less than a few hundred dollars per month. Since they are working in an informal (and largely underground) economic sector, it is not unusual for domestic workers to earn less than the minimum wage. The work is hazardous because the women are constantly exposed to harsh chemical agents as they clean their clients' homes. None of the women have health insurance.

The women are immigrants from different parts of Latin America—primarily México, El Salvador, and Guatemala. Some are recent arrivals, here for only one or two years, while others have been here for as many as twenty. Many, but not all, are undocumented. Only one speaks English with any proficiency. In addition, the women face a multitude of other barriers that complicate their efforts to participate in the development of

48. The following description is based on representative cases. All names have been omitted for the purposes of confidentiality.

49. This is the Spanish translation of "domestic workers."

50. See Kevin Baxter, *She Made It to the U.S. Only to Face Another Border*, L.A. TIMES, Sept. 25, 1997, at E5 (profiling a domestic worker).

the cooperative. All have to juggle work schedules and child care. Many confront more serious obstacles, such as substance abuse or domestic violence.

During the first year of organizing the cooperative, the women participated in an intensive training program in general business education and cooperative development sponsored by a local community-based organization ("CBO"). During this formative period, the CBO sought to incubate the cooperative, providing it with the type of start-up technical assistance and resources necessary to become an independent, viable business entity. For the first several weeks, the women learned basic business skills. They attended trainings focusing on how to write a business plan, make financial projections, implement marketing strategies, and keep appropriate records. A neighborhood legal services organization that had established connections with other technical assistance providers helped the CBO coordinate specific training sessions on business management, marketing, and accounting. These trainings ended with the women developing their own business plan for a domestic worker cooperative.

The next training series concentrated on educating the women about cooperative principles. During these trainings, they participated in group exercises designed to simulate democratic decision-making processes and learned the distinctions between conventional businesses and worker cooperatives.

The remainder of the first year focused on the personal and leadership development of the individual women. The group found that one of the greatest impediments to participation in the cooperative was the women's lack of self-confidence and their inability to envision themselves as strong market actors. In order to strengthen their self-perceptions, the group engaged in leadership development trainings designed to help the women to participate fully in the collective projects necessary for an effective cooperative system. These meetings often focused on fostering communication between the women, and frequently touched on more intimate subjects, such as overcoming domestic violence and the negative self-images imposed by the Latin American culture of "machismo." At the domestic violence session, the neighborhood legal services organization arranged for a domestic violence attorney to make a presentation to the group about available legal remedies. Another session was devoted to informing the women about child care options, and included a presentation from a staff attorney at the legal services agency. The main goal of these sessions was to help the women understand that the cooperative was an integrated development strategy designed to promote economic empowerment.

In addition, much of the first year was spent building the participants' employment skills. The women entered the group with a wide range of cleaning experience. Although some were very skilled, others had never

been employed as domestic workers. This disparity in experience was directly reflected in the women's income: while the most experienced took home as much as \$1300 per month, those with the least experience had trouble earning \$200 per month. The trainings tried to address this inequality by teaching the women a variety of skills. For instance, the women were instructed on how to conduct "walk-throughs" of homes, assess costs, and make bids on potential cleaning jobs. They were also trained in particular types of cleaning processes, such as how to clean delicate surfaces like marble. In addition, the women were taught customer service skills to maintain clients. These sessions focused on basic issues such as making sure that the clients' needs were satisfied by taking the initiative to communicate with them.

After participating in these training programs for one year, the women voted to structure themselves as a worker cooperative. They made this decision because they thought the cooperative model offered several advantages.

First, based on their market research, the women believed that by organizing collectively they would be able to demand higher wages from their clients. At the beginning of the organizing phase, many of the women had clients who would pay for a half day's work, but not for a full day. These clients were considered less desirable because they often requested services at odd hours that prevented the women from taking more than one client per day.

By organizing, the women thought they could generate more full-time clients who were willing to pay a premium for their services. This was because their research indicated that many current clients were reluctant to hire full-time workers for fear of violating immigration laws prohibiting the employment of undocumented persons. The clients felt more comfortable sporadically hiring part-time workers, because they believed the government was less likely to monitor whether the workers employed were undocumented. These same clients expressed a willingness to pay more to hire full-time workers directly from a cooperative business that was an independent legal entity. This was because the clients would no longer be responsible for determining the workers' immigration status, since (depending on how the cooperative was structured) they would contract directly with the cooperative business. As a result, the women hoped that by organizing the cooperative they would increase the number of full-time clients and thus increase the wages of cooperative members.

In addition, the women developed a marketing strategy targeted to attract those clients willing to pay a premium to hire domestic workers in a socially responsible manner. In their flyers and other promotional materials, the women made it clear that their cooperative was organized to promote economic justice for low-income immigrant women, and that its goal

was to provide a living wage for the members.⁵¹ They found that many clients supported this goal and were willing to pay extra for a domestic worker who was a member of the cooperative. Again, the women hoped to tap into this market to increase their earning power.

The women also determined that forming a cooperative with a formal legal structure would provide greater job security by deterring clients from refusing payment. It often happened that clients would take advantage of a worker's vulnerable legal and economic status by refusing to pay for services rendered. Clients did this because they knew that the workers—many of whom were undocumented—would be unlikely to pursue the matter in court. A legally structured cooperative business would minimize or eliminate this risk, since clients would be contractually obligated to the business (as opposed to an individual domestic worker), which could sue clients for nonpayment.

Finally, through the cooperative the women hoped to purchase a group health insurance policy in order to provide much-needed benefits to the members. This was an additional attraction of the cooperative model, since the women were individually unable to afford insurance and their clients generally did not provide it.

Based on these potential advantages, the women decided to formalize their cooperative business by choosing a legal structure. Once this decision was made, the cooperative organizers worked with the staff attorneys at the neighborhood legal services organization to make presentations to the women on the different legal options available for structuring their business. The following section describes and analyzes the legal issues that were addressed during this process.

III.

LEGAL ISSUES IN COOPERATIVE DEVELOPMENT AND HOW THEY AFFECT LOW-INCOME WORKERS

A. *The Role of CED Lawyers in the Development of Worker Cooperatives*

As the case study suggests, CED lawyers can play a variety of important roles to promote cooperative development as a job creation strategy for low-income workers. Most importantly, as will be discussed in more depth below, establishing a worker cooperative involves complex legal issues—such as choosing the appropriate legal entity, drafting bylaws, and structuring a board of directors—that are typically beyond the cooperative organizers' expertise. CED lawyers skilled in transactional practice are therefore critical to the successful formation of cooperative businesses.⁵²

51. For a general discussion of the living wage movement, see ROBERT POLLIN & STEPHANIE LUCE, *LIVING WAGE: BUILDING A FAIR ECONOMY* (1998).

52. See generally Southworth, *Business Planning for the Destitute?*, *supra* note 16.

Second, low-income people generally, and immigrants in particular,⁵³ face multiple barriers to accessing legal services. This problem is magnified in the context of CED work, where the number of poverty lawyers offering free transactional legal assistance is relatively small. To the extent that CED lawyers make themselves available to clients with scarce resources, they can facilitate their movement toward greater economic independence.

It is important to emphasize that acting as a lawyer for worker cooperatives requires conceptualizing transactional legal practice in a way that goes beyond narrow legal consultation. As the case study makes clear, a CED lawyer must collaborate with group members and external organizers to achieve a variety of "non-legal" goals. For example, it is crucial that the lawyer bring in outside business consulting or marketing resources to ensure the economic viability of the cooperative. In addition, the lawyer should participate in community education and consensus-building meetings with the members to determine the cooperative's operating principles and to develop organic dispute resolution mechanisms.

Keeping this broader conception of CED practice in mind, it is nevertheless critical that the lawyer properly advise the cooperative in choosing the appropriate legal structure.⁵⁴ The choice of which structure to use is important because it affects the ease and cost of start-up, the forms of ownership and governance, the extent of individual member liability, and the tax treatment of the business. Thus, the type of structure that is chosen will depend on issues such as what type of legal risks will be generated by the business operation and what kind of management arrangement is envisioned. Also, when the decision to form a worker cooperative is made by a group of immigrant workers, special immigration law issues may be involved that make the selection of the formal legal structure more complex.⁵⁵

53. See generally Robert L. Bach, *Building Community Among Diversity: Legal Services for Impoverished Immigrants*, 27 U. MICH. J.L. REF. 639 (1994).

54. The following analysis of legal issues related to cooperative formation is based on California law. For a more general description of some of these issues, see NATIONAL ECONOMIC DEVELOPMENT AND LAW CENTER, *A LAWYER'S MANUAL ON COMMUNITY-BASED ECONOMIC DEVELOPMENT* 177-214 (1974) [hereinafter, NEDLC, *LAWYER'S MANUAL*].

55. For example, as a practical matter, one legal issue that frequently arises in the context of starting a cooperative is determining which legal structure would be best when there at least some members who are undocumented immigrants. This is because, under the Immigration Reform and Control Act of 1986 ("IRCA"), it is illegal for a business "to hire, or recruit or refer for a fee, for employment in the United States an alien knowing the alien is an unauthorized alien with respect to such employment," 8 U.S.C. § 1324a(a) (1999), or to hire an individual without complying with the document verification requirements set forth in 8 U.S.C. § 1324a(b). An employer who violates IRCA may receive a criminal penalty of \$3000 for each undocumented worker. See 8 C.F.R. § 274a.10(a) (1999). In addition, an employer can face up to six months in jail for violating IRCA. See *id.* Further, an employer may receive a civil penalty between \$250 and \$10,000 depending on how many undocumented persons are employed. See *id.* § 274a.10(b).

Although there are cooperative corporation statutes in many states, cooperatives may be formed under different types of legal structures. The purpose of the following analysis is to evaluate the adaptability of different legal structures to the cooperative model and assess each structure in light of the issues faced by low-income workers.⁵⁶ This analysis will concentrate on the three structures that are most frequently used: the unincorporated association, cooperative corporation, and limited liability company.⁵⁷

B. *Unincorporated Association*

1. *Structure of Cooperative Established as Unincorporated Association*

Many groups interested in forming worker cooperatives choose to operate—at least initially—as an unincorporated association of independent contractors. An unincorporated association is a group of persons who have joined together for a common purpose.⁵⁸ The workers, or “members,” who participate in the cooperative implement a democratic management structure with member rights and responsibilities specified in the association’s bylaws.

Typically, cooperatives that use the association form will distribute flyers and conduct other outreach efforts on behalf of the members in order to publicize their services.⁵⁹ Potential clients contact the association, which is usually staffed by an intake worker. Upon receiving client calls, the intake worker refers the clients to the association’s members under a mutually agreed upon system. For example, some domestic worker cooperatives use a point system for allocating work assignments. Under this system, members earn points by attending meetings and trainings, helping with publicity, and doing extra work for the cooperative. Points are deducted for missing meetings and for already having work assignments. The members with the most points during the month are given priority in client referrals. Once referrals are made, the individual members contract directly with clients, who pay the workers for their labor. The members then pay dues to the association to cover its administrative costs and thereby maintain its economic viability.

56. It should be noted that the following analysis has been developed in the specific context of domestic worker cooperatives and therefore presents the structural issues under the assumption that the worker cooperative in question provides customer services. However, the analysis would be readily applicable to worker cooperatives that produce goods for sale.

57. For a discussion of other legal structures that may be used for cooperatives but that are not presented here, see UCLA Worker Ownership Comprehensive Project, *Legal Forms of Organization for Worker Owned Businesses* (1996) (unpublished manuscript, on file with the *Review of Law & Social Change*).

58. See Brad Caftel, *Choosing the Appropriate Business Entity* 23 (Feb. 1996) (unpublished manuscript, on file with the *Review of Law & Social Change*).

59. For an overview of the structure of cooperatives operating as associations of independent contractors, see NEDLC, *COOPERATIVES*, *supra* note 32, at 11-13.

Although no formal legal documents are required to start an unincorporated association,⁶⁰ it is advisable that written documents be drafted that outline the basic structure of the association and incorporate cooperative principles of democratic self-governance. This process involves drafting membership agreements whereby members commit to adhere to the rules and regulations of the association in exchange for membership rights. Generally, these agreements will include a description of any membership fees. In addition, the association should adopt written bylaws that establish the procedures for democratic governance. It is recommended that the bylaws include a description of the objectives and purposes of the cooperative, an outline of the management structure, the procedure for allocating work assignments, the qualifications for membership and rules for membership meetings and voting, a description of any committees and their functions, and the procedure for amending bylaws and dissolving the cooperative. Finally, members of an unincorporated association should enter into written independent contractor agreements with clients stating the service to be rendered, and the amount and method of payment.⁶¹

To low-income workers interested in starting a cooperative business, the unincorporated association has the main advantage of being inexpensive to form. The start-up costs are minimal in comparison with other legal structures. The association typically only needs to obtain a "fictitious business name statement" and pay a nominal fee.⁶² In addition, the individual members must comply with the requirements for operating as sole proprietors, which means, among other things, that they must purchase their own business licenses. It also means that members must report and pay personal income taxes on all revenue earned through the cooperative, and may be required to pay self-employment taxes.

Many immigrant worker groups decide to form cooperatives as unincorporated associations because they avoid creating an employer-employee relationship, which could pose potential problems under immigration laws.⁶³ Under the association structure, the members are not employed by the association, but rather are self-employed. Further, by requiring members to pay dues rather than pay for client referrals, the association does not refer workers for a fee.⁶⁴

60. See generally CAL. CORP. CODE §§ 20000-24007 (West 1999).

61. Members of an unincorporated association must understand, however, that for tax purposes the Internal Revenue Service will not accept a worker's self-characterization as an independent contractor. Instead, it will make its own determination based on whether the client exercises control over the worker sufficient to create an employment relationship. For a detailed discussion of the independent contractor-employee distinction, see Jack E. Karns, *Current Federal and State Conflicts in the Independent Contractor Versus Employee Classification Controversy*, 22 CAMPBELL L. REV. 105, 111 (1999).

62. See CAL. BUS. & PROF. CODE § 17900(a)(2) (West 1999).

63. See IRCA, 8 U.S.C. § 1324(a) (1999); see generally NEDLC, COOPERATIVES, *supra* note 32, at 11-13.

64. See IRCA, 8 U.S.C. § 1324a(a)(1)(A) (1999).

The main disadvantage of forming a cooperative as an unincorporated association is that individual members are fully responsible for debts or liabilities incurred in the course of their own business activities. In addition, members may be held personally responsible for association liabilities, depending upon how the association is structured.⁶⁵ However, the importance of the liability issue should not be overstated. Each member could obtain insurance, although this would be expensive. Alternatively, the members could contribute to an insurance fund that any member could use in case of emergency. In addition, the likelihood of cooperative clients suing members (who typically have few resources) may be small.

Another potential disadvantage of the unincorporated association form is its loose legal structure.⁶⁶ Since there are no formal legal requirements for starting and operating associations, they can be disorganized, hindering their ability to function as a viable entity. Even when membership agreements and bylaws are drafted, the relative lack of legal formality may cause the participants to take their obligations less seriously. For example, the members of one association expressed frustration that their loose legal structure weakened member accountability.⁶⁷ They complained that members who benefited by receiving new client referrals left the cooperative once they started to make enough money, because they did not want to have to continue paying dues and attending meetings. Their departure undermined the purpose of the cooperative, which was to gain economic independence through collective organizing. In addition, the members were frustrated at having to waste their time and energy retraining new members to replace those who departed. Although the cooperative had written bylaws, the members attributed these problems to the fact that the association lacked the type of structural formality that would impress upon members the importance of fulfilling their obligations.

Finally, the unincorporated association does not offer workers the same type of financial protection as would a more formal legal entity. Since the members of the association contract directly with clients, they are exposed to the risk of client nonpayment and have little recourse if this occurs—especially if they are undocumented or accepting payment under the table. Members of an association are therefore more vulnerable and easily exploited by unscrupulous clients.

65. See B.E. WITKIN, *SUMMARY OF CALIFORNIA LAW*, Corporations § 46, at 554-55 (9th ed. 1989).

66. Interview with Caron A. Caines, Staff Attorney, San Fernando Valley Neighborhood Legal Services, Inc. (May 21, 1999).

67. *Id.*

2. *Comparison of Unincorporated Association with Other Legal Structures*

In conclusion, since an unincorporated association can easily adopt the principles of open membership and equal member rights and responsibilities, it is a popular legal structure for nascent cooperatives. Specifically, it may be the optimal organizational structure for an immigrant worker cooperative, or when the business is operating on a very small margin, and cannot afford to pay the fees associated with starting and maintaining a more recognized legal entity. In addition, an unincorporated association may be appropriate on an interim basis, when it is unclear whether the cooperative is viable, and when only a few members are involved. However, for more evolved cooperative businesses, the association structure is less advantageous than more established corporate forms, such as the cooperative corporation or limited liability company, due to its lack of legal formality and the members' exposure to individual liability. In addition, a more recognized legal entity would provide greater worker protection than an association by minimizing the risk of nonpayment by clients.

C. *Cooperative Corporation*

1. *Structure of Cooperative Corporation*

Worker groups seeking legal formality and limited liability, and that have sufficient resources to defray the initial filing costs, may consider forming a cooperative corporation. A cooperative corporation is a special type of corporation organized under the state corporations statute for the mutual benefit of its members.⁶⁸

A worker cooperative operating under the corporate form functions differently than an unincorporated association. Generally, members of the cooperative corporation conduct outreach to potential clients and process new client intakes. Clients are referred to cooperative members according to rules established in the bylaws. Clients pay the corporation directly (instead of paying the workers), and the corporation then distributes profits to members, either through "dividends" on member shares or "patronage refunds."

Like traditional corporations, cooperative corporations are comprised of shareholders, directors, officers, and discretionary committees. A cooperative corporation shareholder is called a "member"⁶⁹ and acquires her ownership status through the purchase of a "membership" in the cooperative.⁷⁰ Subject to the articles or bylaws, memberships may either be free or

68. For the law on California cooperative corporations, see the Consumer Cooperative Corporation section of the California Corporations Code, CAL. CORP. CODE §§ 12200-12704 (West 1999). For general overviews of cooperative corporation statutes, see NEDLC, LAWYER'S MANUAL, *supra* note 54, at 177-214; Solomon & Kirgis, *supra* note 39.

69. See CAL. CORP. CODE § 12247 (West 1999).

70. See *id.* §§ 12238, 12239.

issued for consideration.⁷¹ Membership status confers voting rights,⁷² which include the power to elect directors and approve major corporate decisions such as the amendment of articles, sale of assets, and voluntary dissolution.⁷³ The main distinction between cooperatives and traditional corporations is that, unless otherwise stated in the articles of incorporation, member voting rights are equal—that is, voting power is not weighted according to member capital contributions.⁷⁴ In addition, memberships may not generally be transferred.⁷⁵

Since membership status confers equal voting rights on individual members, cooperative corporations will likely seek to limit the number of memberships issued to those who take an active role in corporate governance, rather than those who are simply seeking a return on their investment. As a result, the sale of memberships is typically an insufficient mechanism for generating substantial equity investment. Therefore, in order to more effectively raise capital, a cooperative corporation may decide to issue non-voting classes of shares in addition to voting memberships.⁷⁶ In other words, the cooperative may permit members to make additional capital contributions in exchange for additional ownership interests—or shares—in the corporation. In order for the cooperative to be able to do this, it must state in its articles of incorporation that the members' ownership interests may be unequal.⁷⁷ However, each member is only entitled to one vote on corporate matters, irrespective of the number of shares she holds.⁷⁸ In this way, the issuance of shares operates as a means of raising capital for the cooperative, but does not disrupt the democratic principle of one-member, one-vote.⁷⁹

71. *See id.* § 12400.

72. *See id.* § 12238.

73. *See id.* §§ 12238, 12502, 12521, 12630.

74. *See id.* §§ 12404, 12480.

75. *See id.* § 12410.

76. *See* VAN P. BALDWIN, CO-OP INCORPORATION SOURCEBOOK 65 (1994) (describing this course of conduct).

77. *See* CAL. CORP. CODE § 12310(d) (West 1999) (stating that the articles of incorporation must state “[w]hether the . . . proprietary interests of the members are equal or unequal” and, if such interests are unequal, the articles must either set forth “(i) the general rule or rules by which the . . . proprietary interests of the members shall be determined or (ii) that such rule or rules shall be prescribed in the corporation’s bylaws”).

78. *See id.* §§ 12404, 12480; *but see id.* § 12310(d) (permitting the corporation to change the default rule of one-member, one-vote by including a statement in the articles of incorporation that member voting rights shall be unequal).

79. In addition, it should be noted that in order to avoid potential securities regulation problems, share transferability should be restricted. *See* BALDWIN, *supra* note 76, at 65. A detailed analysis of the securities issues involved in the issuance of cooperative memberships and non-voting corporate shares is beyond the scope of this discussion. However, a few general observations may be useful. Although securities laws vary from state to state, in California, unless a specific exemption applies, no issuer may sell its securities without first having qualified the issue with the California Department of Corporations. *See* CAL. CORP. CODE § 25110 (West 1999). Cooperative corporations issuing shares most frequently qualify for the cooperative exemption, *see id.* § 25100(r) (stating that no permit is needed from the

A board of directors sets corporate policy and authorizes corporate actions not taken in the ordinary course of business.⁸⁰ Generally, directors owe the corporation a fiduciary duty, which means that they must act in good faith, in a manner they believe to be in the best interests of the corporation, and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances.⁸¹ Generally, directors are elected by the members at their regular annual meeting for a term fixed in the articles or bylaws.⁸² However, all or a portion of the directors may hold office by designation.⁸³ While cooperatives often require that directors are members of the cooperative, this is not mandatory under the statute. The board may create standing committees of two or more directors that have all the authority of the board except with respect to such aspects as filling board vacancies, fixing director compensation, amending or repealing bylaws, and appointing committees.⁸⁴

Cooperative corporations, like their conventional counterparts, must have a chairperson of the board or president (or both), a secretary, and a chief financial officer.⁸⁵ Other officers may be elected pursuant to the bylaws or by board resolution.⁸⁶ Officers act as agents of the corporation and manage the day-to-day business under the direction of the board. Any number of offices may be held by the same person unless the articles or bylaws provide otherwise.⁸⁷ Officers are elected and may be terminated by the board.⁸⁸

One of the main distinctions between the cooperative corporation and the unincorporated association is that the corporation may distribute business profits to its members. Unless the articles or bylaws change the default rules, the cooperative's surplus (defined as the excess of revenues over expenses) can be either retained as working capital, distributed as profits on the basis of the members' capital contributions, or distributed to members as "patronage refunds."⁸⁹

California Department of Corporations for the sale of shares or memberships by a cooperative corporation provided that the aggregate investment of any shareholder or member does not exceed \$300), or the limited offering exemption, *see id.* § 25102(f) (exempting the sale of securities from qualification where there are no more than 35 purchasers, the purchasers each have a preexisting relationship with the issuer or the ability to protect their interests in the transaction, and there is no public advertising or general solicitation). In addition, federal laws relating the issuance of securities typically would not apply to the intrastate sale of shares by a small worker cooperative. *See Securities Act of 1933*, 15 U.S.C. § 77a-77aa (1999).

80. *See CAL. CORP. CODE* § 12353(a) (West 1999).

81. *See id.* § 12371.

82. *See id.* § 12360(a).

83. *See id.* § 12360(d).

84. *See id.* § 12352.

85. *See id.* § 12353(a).

86. *See id.*

87. *See id.*

88. *See id.* § 12353(b).

89. *See BALDWIN, supra* note 76, at 70.

A "distribution" is defined as the "distribution of any gains, profits or dividends to any member as such."⁹⁰ In practice, distributions are made in the form of "dividends" paid on membership or other corporate "shares."⁹¹ Subject to statutory restrictions on maximum distributions,⁹² dividends may be distributed at any time the directors, in their discretion, find that there is sufficient surplus to do so.⁹³ In addition, the bylaws may provide for the time and manner of making "patronage distributions" (also referred to as "patronage refunds").⁹⁴ In a worker cooperative, patronage is generally determined by the value of the services provided to the cooperative by the member (this can be the total hours worked for the cooperative).⁹⁵ Unlike dividends which are based on capital contributions, patronage refunds are "proportionately and equitably" distributed to cooperative members solely on the basis of their participation.⁹⁶ Patronage refunds may be distributed only from surplus available after dividends have been issued.⁹⁷

The steps required to form a cooperative corporation mirror those required for a conventional corporation. First, the corporation must execute and file articles of incorporation with the state.⁹⁸ The cooperative should also approve written bylaws that establish the procedures for governing and operating the corporation. The bylaws must set forth (unless contained in the articles) the number of directors of the corporation, or that the number of directors shall not be less than a stated minimum (which, in any event, may not be less than three) or more than a stated maximum with the exact number to be fixed by the board.⁹⁹ In practice, a cooperative should provide for an odd number of directors to avoid the possibility of ties. In addition, it is advisable to include the following provisions:¹⁰⁰ the qualifications and duties of members and directors; requirements for the sale of shares to members; rules concerning the withdrawal, suspension,

90. CAL. CORP. CODE § 12235 (West 1999).

91. BALDWIN, *supra* note 76, at 70.

92. *See* CAL. CORP. CODE § 12451 (West 1999).

93. *See id.* §§ 12376, 12451, 12453, 12454.

94. *See id.* § 12331(c)(9); *see also id.* § 12244 (defining "patronage distribution").

95. *See* BALDWIN, *supra* note 76, at 71.

96. *See id.*; CAL. CORP. CODE § 12201 (West 1999).

97. *See* BALDWIN, *supra* note 76, at 71.

98. The California Corporations Code requires that the articles include the following information: (1) the corporate name; (2) a statement that the "corporation is a cooperative corporation organized under the Consumer Cooperative Corporation Law" and that "[t]he purpose of t[he] corporation is to engage in any lawful act or activity for which a corporation may be organized under such law"; (3) the name and address of the corporation's initial agent for service of process; and (4) whether the voting power or the proprietary interests of the members are equal or unequal. *See* CAL. CORP. CODE § 12310 (West 1999). The corporate name must include the word "cooperative," *see id.* § 12311(a); a cooperative that is not incorporated under this section may not use the word "cooperative" in its business name. *See id.* § 12331(b). The articles may include several optional provisions, some of which must be included in order to be effective. *See id.* §§ 12312, 12313.

99. *See id.*

100. *See* BALDWIN, *supra* note 76, at 17-38.

and expulsion of members and directors; the manner of calling and conducting members' and directors' meetings; the appointment of committees and their responsibilities; the appointment, duties, compensation, and tenure of officers; the time and manner of distributing dividends upon shares and patronage refunds; and the manner of adopting, amending, or repealing bylaws.

Like other corporations, a cooperative corporation must obtain an employer identification number ("EIN") from the Internal Revenue Service ("IRS"), and should establish and maintain a corporate records book to keep the corporation's documents accessible and orderly. Further, prior to beginning operations, the cooperative must hold a first meeting of its initial directors, in which the directors resolve to: approve the bylaws, elect officers, approve the issuance of shares to members, approve the procurement of necessary licenses and permits, approve the selection of a banking institution, adopt a corporate seal (many banks require this before allowing a business to open an account), and establish a principal executive office.¹⁰¹ As a final organizational step, a cooperative corporation must issue memberships and, if it chooses, additional corporate shares to its members.

One of the main advantages afforded by the corporate form is that a member of a corporation is not personally liable for the debts, liabilities, or obligations of the corporation.¹⁰² Another advantage is that the corporate form offers a cooperative a greater opportunity to raise capital funds through the sale of memberships and issuance of shares.

One disadvantage of the cooperative corporation—especially to fledgling cooperatives struggling to make ends meet—is its initial cost. Generally, it is relatively more expensive to form a cooperative corporation than some other legal structures.¹⁰³ In addition, many immigrant cooperatives are wary of the cooperative corporation because it is not clear whether members who work on behalf of the cooperative and receive patronage refunds would be considered employees under immigration laws.¹⁰⁴

101. *See id.* at 58-64.

102. *See* CAL. CORP. CODE § 12440(a) (West 1999).

103. For instance, in 1999, a California corporation had to pay \$100 to file its articles of incorporation, and make an additional prepayment of the minimum franchise tax at the time of incorporation (\$300 if gross receipts were expected to be less than \$1,000,000; \$800 if gross receipts were expected to be greater than \$1,000,000). An unincorporated association had no initial start-up fees. An LLC was required to pay a \$70 filing fee, but was not subject to the franchise tax prepayment at its inception. However, corporations that incorporate in California after January 1, 2000 are not required to pay the minimum franchise tax payment for the first taxable year, significantly reducing the financial disincentive to start a cooperative corporation. *See* California Franchise Tax Board (visited May 5, 2000) <<http://www.ftb.ca.gov>>.

104. There is no case law dealing with the treatment of undocumented cooperative corporation members under IRCA. However, a review of the few cases that address the applicability of federal employment laws to cooperative corporation members tends to support the conclusion that members would be considered employees subject to IRCA. *See*,

2. Tax Considerations

As with a regular corporation, the cooperative corporation is “taxed twice”—that is, the corporation pays tax on corporate income and individual members pay taxes on any dividends or patronage refunds they receive. It should be noted, however, that a cooperative corporation may avoid some of the negative consequences of double taxation by distributing patronage refunds, which, under certain circumstances, are tax deductible.¹⁰⁵ When the cooperative makes a patronage refund distribution and takes the deduction, it avoids double taxation by passing corporate revenue through to the members, who then pay taxes on their distributive share.¹⁰⁶ Of course, if members are also employees, they must report their income as

e.g., *Goldberg v. Whitaker House Coop.*, 366 U.S. 28 (1961) (holding that, under the “economic reality” test, members of a homeworkers cooperative who received a form of patronage refunds were considered “employees” under the Fair Labor Standards Act). Some courts have also determined that members of a cooperative corporation may be treated as employees under state laws. *See, e.g.*, *Employment Div. v. Surata Soy Foods, Inc.*, 63 P.2d 810 (Or. Ct. App. 1983) (finding that cooperative members who performed services for the corporation in exchange for patronage refunds were employees under the state’s workers’ compensation law). Lending support to the treatment of cooperative corporation members as employees, one court noted that before *Goldberg*, “the Administrator of the Wage and Hour Division of the U.S. Department of Labor stated that a cooperative is more like a corporation than a partnership and that generally members of a cooperative are employees of the cooperative for purposes of the FLSA.” *Wheeler v. Hurdman*, 825 F.2d 257 n.34 (10th Cir. 1987) (citing a 1941 Wage and Hour Manual, as quoted in *Mitchell v. Whitaker House Coop.*, 275 F.2d 362, 365 n.1 (1st Cir. 1960), *rev’d sub nom.*, *Goldberg v. Whitaker House Coop.*, 366 U.S. 28 (1961)). However, despite this authority, the law regarding the employment status of cooperative corporation members remains unsettled. For example, courts analyzing close corporations—which bear some important similarities to cooperative corporations—have been split on the issue of whether a shareholder who is active in her company’s day-to-day operations should be treated as an employee. *See Daniel S. Kleinberger, “Magnificent Circularity” and the Churkendoose: LLC Members and Federal Employment Law*, 22 OKLA. CITY U. L. REV. 477, 539-57 (1997) (providing a comprehensive review of the conflicting treatment of shareholders in close corporations under federal employment laws). In addition, courts that use a fact-intensive “economic reality” test to evaluate the employment status of corporate actors may be apt to find that cooperative corporation members who exercise significant managerial control are not employees. *See, e.g.*, *Fountain v. Metcalf, Zima & Co.*, 925 F.2d 1398 (11th Cir. 1991); *Devine v. Stone, Leyton & Greshman*, 100 F.3d 928 (8th Cir. 1985). Due to the unsettled nature of the law on this point, some cooperatives with undocumented immigrant members have opted not to form corporations.

105. Patronage refunds are generally tax-deductible to the cooperative where the following requirements are met: (1) the cooperative has a pre-existing obligation to pay the refunds; (2) the total refund is based on the cooperative’s current surplus; (3) the amount paid to each member is based on his or her patronage; (4) at least 20% of the refunds are distributed in cash or by check within eight and one-half months of the end of the fiscal year; and (5) each member receives a “qualified” written notice of allocation of any non-cash portion of a refund. *See BALDWIN, supra* note 76, at 71.

106. It should be noted that when a cooperative corporation makes distributions on the basis of member capital contributions or patronage, it may raise sensitive issues if the cooperative has members who are undocumented immigrants. A cooperative corporation that makes a distribution to its members must complete IRS Form 1099-DIV and send copies of the form to the IRS and the recipients of the distribution (i.e., the members of the cooperative), who then use the information to report their personal income on IRS Form 1040.

wages and the corporation must pay employment taxes. The cost of health insurance and some other fringe benefits such as life insurance are tax deductible.

3. *Comparison of Cooperative Corporation with Other Legal Structures*

It may be advisable for cooperatives to incorporate when they are able to afford the initial start-up costs and potential double taxation, since it offers members the protection of limited liability while providing the type of formal legal arrangement that will deter client nonpayment. The administrative complexity of this structure may make it less desirable for small start-ups with few resources. Additionally, immigrant worker cooperatives may be reluctant to select this legal structure, and may find that the limited liability corporation offers greater member security.

D. *Limited Liability Corporation ("LLC")*

1. *Structure of Cooperative Established as LLC*

Some worker cooperatives seeking the formality and liability protection of the corporate form along with the flexibility of the unincorporated association are turning to LLCs as an alternative structure. An LLC is a special type of legal structure that is treated like a partnership for tax purposes, but which also gives its owners the corporate-like protection of limited liability from business debts and obligations.¹⁰⁷ The governing legal document of an LLC, the operating agreement, can be easily adapted to include cooperative principles. Typically, this is done by according equal participation rights to all cooperative members regardless of the level of their capital contribution.

Worker cooperatives established as LLCs generally operate in a manner similar to cooperative corporations. The LLC publicizes the workers' services and attempts to solicit clients for the business. Potential clients

Form 1099-DIV requires that the corporation include the "recipient's identification number." In order to provide this information, the corporation has to list either the Social Security number or taxpayer identification number ("TIN") of each member. A member who does not have legal documents to work in the United States cannot have a Social Security number and must therefore obtain a TIN from the IRS. See INTERNAL REVENUE SERVICE, UNDERSTANDING YOUR INDIVIDUAL TAXPAYER IDENTIFICATION NUMBER (1999), at 1. In order to get a TIN from the IRS, an applicant must file IRS Form W-7 and provide one piece of identification. See *id.* Identification may be obtained from the consulate office of a member's country of origin. Obtaining a TIN is not without risks for undocumented workers. The IRS will not guarantee that the information a person provides to get a TIN will be kept confidential, and not shared with other government agencies. However, according to immigration law advocates, there have been no reported instances of the Immigration and Naturalization Services ("INS") using information gained from a TIN application to deport an undocumented worker. Telephone Interview with Sheila Neville, Staff Attorney, National Immigration Law Center (May 19, 1999).

107. See generally CAL. CORP. CODE §§ 17000-17705 (West 1999). See also Allan Karnes, et. al., *The Limited Liability Company: A State by State Look at the New Pass-Through Entity*, 1997 DET. C.L. REV. 1 (1997) (examining LLC provisions of various states).

contact the LLC directly, and an intake worker refers clients to members according to a system established either in the operating agreement or by a separate vote of the members. As with the cooperative corporation, the main functional difference between the LLC and unincorporated association is that clients pay the LLC directly (instead of paying the workers), and the LLC then regularly distributes business profits to members based on their contributions to the business.

An LLC is generally composed of members, managers, and officers. The owners of an LLC are referred to as "members" and are admitted to ownership in accordance with the criteria set forth in the articles of organization or operating agreement. An LLC may, but need not, provide for an initial capital contribution from members.¹⁰⁸ Unless the articles state otherwise, the business and affairs of an LLC are managed by the members.¹⁰⁹ Finally, the operating agreement may provide for the appointment of officers, including a chairperson or president (or both), a secretary, a chief financial officer, and any other specified officers.¹¹⁰

Forming a cooperative as an LLC requires filing the same types of documents as with a cooperative corporation. For instance, articles of organization must be filed with the state in order to give the LLC its existence. The articles must identify the cooperative's name, purpose, and initial agent for service of process.¹¹¹

It is advisable, although not required, that the LLC draft and adopt an operating agreement.¹¹² The operating agreement, like the corporate bylaws, establishes the ownership rules and structural framework of the business. For a cooperative operating as an LLC, it is important to include the criteria for admitting members; the amount (if any) of member capital contributions; the procedure for amending the articles of organization and operating agreement, the criteria governing the withdrawal and removal of members, and the procedure for dissolution or liquidation.

Perhaps most importantly, the operating agreement should specify the timing and procedure for allocating and distributing profits to members.¹¹³ For example, in one representative cooperative, the members agree to meet every month to determine each member's "percentage interest" of the previous month's profits. Generally, this percentage is determined according to the "contribution" made by each member during that month.

108. See CAL. CORP. CODE § 17200(a) (West 1999).

109. See *id.* § 17150.

110. See *id.* § 17154.

111. See *id.* § 17051(a). It is important to note that an LLC operating as a cooperative cannot include the term "cooperative" in its name, as that designation is reserved for cooperatives operating under the cooperative corporation statute. See *id.* § 12311(b).

112. See *id.* §§ 17001(a), 17059.

113. See *id.* § 17250 (stating that "[i]f the operating agreement does not otherwise provide, distributions that are a return of capital shall be made in proportion to the contributions made by each member and distributions that are not a return of capital shall be made in proportion to the allocation of profits").

Two-thirds of the members must agree to determine the percentage interests. In practice, each member submits her time sheet at the monthly meetings and the hours that the member worked for the preceding month are taken to be her contribution. However, the terms "percentage interest" and "contribution" are left intentionally vague in the agreement in order to allow the members to vote to make distributions based on other factors, such as time spent performing administrative duties or outreach on behalf of the cooperative. Or, in some instances, the cooperative could vote to make a distribution to a member who had worked hard, but failed to obtain clients and generate income for the group. Once the percentage interests are calculated, a "cash distribution" is made to each member.¹¹⁴ Typically, this amount is equal to the total amount worked during the previous month multiplied by an agreed upon wage rate.

In addition to filing articles and drafting an operating agreement, a cooperative LLC must follow the other standard requirements for starting a business, such as requesting an EIN from the IRS, obtaining the requisite business licenses and permits for the particular type of business activity, and filing a fictitious business name statement if required.¹¹⁵

For workers interested in starting a cooperative, the LLC shares many advantages with the cooperative corporation. Significantly, a member of an LLC enjoys limited personal liability against any debt, obligation, or liability of the LLC.¹¹⁶ Liability of LLC members is, therefore, the same as for shareholders of a corporation.¹¹⁷ In addition, the LLC offers the same type of legal formality as does the corporation. Like the corporation, the LLC is able to contract directly with cooperative clients and distributes profits to the members in the manner provided in the operating agreement.

Despite these similarities, some cooperatives find that the LLC offers certain advantages over the cooperative corporation. One advantage is the LLC's low initial cost of formation. An LLC pays only a minimal initial filing fee, and does not prepay the franchise tax at the time of its creation.¹¹⁸ In addition, some immigrant worker cooperatives have preferred the LLC as a legal structure because it may not establish an employer-

114. *See id.* § 17253(a).

115. In California, an LLC must file a fictitious business name statement when it operates under a name that is different than that stated in its articles of organization. *See CAL. BUS. & PROF. CODE* § 17900(a)(5) (West 1999).

116. *See CAL. CORP. CODE* § 17101(a) (West 1999).

117. *See id.* § 17101(b). Members of LLCs are therefore generally protected from liability unless they issue personal guarantees, *see id.* § 17101(e), participate in tortious conduct, *see id.* § 17101(c), or, as in the case of corporate shareholders, if the court "pierces the corporate veil" for failure to maintain the company as a separate legal entity, *see ROBERT C. CLARK, CORPORATE LAW* 71-85 (1986).

118. Note that this advantage has been diminished in California by the elimination of the minimum franchise tax prepayment for corporations that took effect on January 1, 2000. *See supra* note 103. Also, it should be noted that an LLC must pay the minimum franchise tax by the fifteenth day of the fourth month after its creation, further reducing any cost savings. *See id.*

employee relationship with its members under immigration laws. Although there is no legal authority that speaks directly to the issue, rulings from courts interpreting other federal employment laws suggest that so long as members of an LLC have a “proprietary” interest in the business—as demonstrated by their degree of ownership, their control over management decisions, and the extent to which their compensation is contingent on the business’s profits—they should not be considered “employees” of the LLC.¹¹⁹

119. A strong argument can be made for this position. It first requires that LLC members are viewed as functional equivalents of partners in a partnership. This view is supported by the fact that an LLC is treated as a partnership for tax purposes, *see* Rev. Proc. 95-10, 1995-1 C.B. 501, and, in many ways, resembles a partnership in its operating structure, *see generally* Scott R. Anderson, *The Illinois Limited Liability Company: A Flexible Alternative for Business*, 25 LOY. U. CHI. L.J. 55, 91 (1993); Karen C. Burke, *The Uncertain Future of Limited Liability Companies*, 12 AM. J. TAX POL’Y 13, 15 (1995); James M. Jorissen, *Member Bankruptcy Under the New Minnesota Limited Liability Company Act: An Executory Contract Analysis*, 77 MINN. L. REV. 953 (1993); Susan Kalinka, *Assignment of an Interest in a Limited Liability Company and the Assignment of Income*, 64 U. CIN. L. REV. 443, 453 (1996); Craig J. Langstraat & K. Dianne Jackson, *Choice of Business Tax Entity After the 1993 Tax Act*, 11 AKRON TAX J. 1, 11 (1995); Sally S. Neely, *Partnerships and Partners and Limited Liability Companies and Members in Bankruptcy: Proposals for Reform*, 71 AM. BANKR. L.J. 271, 283 (1997). If the analogy between LLCs and partnerships holds, then LLC members—treated as partners—would likely not be viewed as employees under federal employment laws. This is because the majority of courts have found that genuine “partners” cannot be employees for federal employment law purposes. *See* Troy D. Ferguson, *Partners as Employees Under the Federal Employment Discrimination Statutes: Are the Roles of Partner and Employee Mutually Exclusive?*, 42 U. MIAMI L. REV. 699, 700 (1996); Kleinberger, *supra* note 104, at 520; *see also* Hishon v. King & Spalding, 467 U.S. 69, 79 (1984) (Powell, J., concurring) (stating that partners do not stand in an employment relationship with their law firm for the purposes of Title VII). Courts evaluating this issue have focused on identifying the characteristics that must be present to create a genuine partnership situation. Generally, courts have applied an “economic reality” test and have looked to the partner’s involvement in the management, control, and ownership of the business in order to determine whether she was a true partner or simply an “employee” entitled to sue under various employment laws. *See, e.g.,* Fountain v. Metcalf, Zima & Co., 925 F.2d 1398, 1400-01 (11th Cir. 1991) (finding a member of a professional corporation to be functionally equivalent to a partner, and therefore not entitled to protection as an employee under the Age Discrimination in Employment Act (“ADEA”)); *accord* EEOC v. Dowd & Dowd, Ltd., 736 F.2d 1177 (7th Cir. 1984) (en banc) (holding that shareholders in a law firm organized as a professional corporation were not employees for the purposes of Title VII). *See also* Wheeler v. Hurdman, 825 F.2d 257, 276 (10th Cir. 1987), *cert. denied*, 484 U.S. 986 (1987) (finding that a partner in a national accounting firm was not an employee entitled to the protections of Title VII, ADEA, or Equal Pay Act). Where there is strong evidence of partner ownership of the business and partner participation in firm governance, and where partner compensation is based on a percentage of the firm’s profits, a partner is deemed to have a “proprietary” interest in the business that precludes her treatment as an “employee.” *See* Serapion v. Martinez, 119 F.3d 982, 990 (1st Cir. 1997) (holding that Title VII does not apply to genuine partners). The Ninth Circuit adopted this type of approach in a recent Fair Employment and Housing Act case. *See* Strother v. Southern Cal. Permanente Med. Group, 79 F.3d 859, 867 (9th Cir. 1996). Note, however, that when a partner in a partnership lacks meaningful control, does not share in the profits and losses, and otherwise lacks any indicia of ownership rights, courts do not hesitate to apply federal employment laws. *See, e.g.,* Simpson v. Ernst & Young, 850 F. Supp. 648 (S.D. Ohio 1994); Caruso v. Peat, Marwick, Mitchell & Co., 717 F. Supp. 218 (S.D.N.Y. 1989).

However, with respect to the cooperative's ability to raise capital, an LLC may be less desirable than a cooperative corporation. With an LLC, capital is generally raised through member contributions and from loans made by members and third parties. Since cooperative members in LLCs are typically given equal ownership rights and do not receive distributions on the basis of their capital contributions, they are less able than corporations to raise additional funds from members seeking to make a return on their investments. Although it is possible to structure operating agreements that integrate corporate-like shareholder arrangements to raise additional capital from members, these can be highly complex and therefore are not widely used in the cooperative context.

2. Tax Considerations

There are several tax issues that workers forming an LLC must evaluate. An LLC, like a partnership, does not pay federal income tax. Instead, LLC members report and pay taxes on distributions they receive from the LLC as personal income. In this regard, an LLC avoids the double taxation that may arise when operating as a cooperative corporation. However, an LLC is double-taxed at the state level, which may be a deterrent for some small cooperatives that anticipate being unable to pay the annual minimum state tax.¹²⁰ In addition, federal income tax reporting requirements may make the LLC less desirable to some immigrant worker cooperatives.¹²¹

As a general rule, the IRS does not treat members of an LLC as employees of the business.¹²² Therefore, the LLC is not responsible for withholding federal income, Social Security, and Medicare taxes, nor is it responsible for withholding taxes under the Federal Unemployment Tax

120. In California, the minimum annual state franchise tax is \$800. See Instructions for Franchise Tax Board Form 100-ES, Corporation Estimated Tax, at E (2000).

121. When filing federal tax returns, an LLC, like a partnership, must annually file an informational return (IRS Form 1065), including Schedule K-1, on which the LLC reports the distributive share of each member. When the LLC files its 1065, it must attach original Schedule K-1s for each member. The LLC must send each individual member a copy of her Schedule K-1, which the member then uses to compute her own taxes on IRS Form 1040, Schedule E. As with cooperative corporations filing Form 1099s, an LLC must provide member personal information when it files Schedule K-1. Again, this may be problematic for cooperatives with undocumented members. On Schedule K-1, the LLC is required to provide each member's "identifying number" (which, in the case of an undocumented member, would be her TIN), name, address, and zip code. Thus, an LLC would be required to forward a member's TIN and other personal information to the IRS, which would give rise to the same risks discussed above with respect to the cooperative corporation.

122. See INTERNAL REVENUE SERVICE PUBLICATION 541, at 6 (1997).

Act.¹²³ However, a member of an LLC, who is treated as a general partner in a partnership for tax purposes, may be considered to be “self-employed” and responsible for paying self-employment taxes in addition to paying regular income taxes on distributions from the LLC.¹²⁴ In addition, each member may be required to withhold estimated taxes on a periodic basis throughout the year. An LLC would not be liable for its members’ failure to report their own taxes.

3. *Comparison of LLC with Other Legal Structures*

Worker cooperatives are increasingly electing to structure themselves as LLCs. The LLC form is easily adaptable to cooperative principles, since the operating agreement can be drafted to require that each member has an equal voice in managing the cooperative. The cooperative can also be structured so as to permit regular income distributions to members based on their participation in the enterprise. It may be less expensive to form than the cooperative corporation, can provide a more coherent legal structure than the unincorporated association, and offers limited legal liability to each of the members. Immigrant worker cooperatives may find the LLC preferable under immigration laws. For small cooperatives operating at a loss or on a very slim margin, one disadvantage of the LLC is that it is required to pay a minimum state tax each year.

IV. CONCLUSION

In this era of welfare reform, declining real wages for the poor, and dramatic income inequality, legal services lawyers have been forced to reevaluate traditional poverty law strategies and explore alternative methods for increasing the ability of low-income workers to participate meaningfully in the marketplace and earn decent wages. As this Article has suggested, cooperative development is a limited, but important, tool that CED practitioners can employ to help low-income workers achieve economic stability. In particular, CED lawyers can assist workers to legally structure cooperatives that promote economic autonomy, generate higher wages, and increase job security.

As a job creation strategy, cooperatives may provide greater opportunities for marginalized workers than other business development projects due to the mutual support and collective bargaining strength afforded by the cooperative structure. However, cooperatives face unique challenges

123. Where an LLC has members who are nonresident aliens who do not have a “substantial presence” in the United States, the business may be responsible for withholding taxes. See 26 U.S.C. §§ 1441, 7701(a) (1999); 26 C.F.R. § 1.1441.1(b) (1999).

124. See Rev. Rul. 69-184, 1969-1 C.B. 256; Priv. Ltr. Rul. 9525058 (June 23, 1995); INTERNAL REVENUE SERVICE PUBLICATION 533, at 5 (1998).

to becoming self-sustaining as viable economic enterprises. In addition, although cooperatives may provide some job opportunities for otherwise hard-to-employ workers, they cannot fundamentally alter the market dynamics that continue to produce economic inequities.

Yet, as this Article has suggested, the potential of cooperative development as an innovative CED strategy may lie beyond its direct economic impact on low-income workers. Cooperatives may be used by poverty law practitioners to advance a new paradigm of CED work, one that integrates job creation goals with a broader vision of economic reform. In particular, by providing a forum for low-income workers to organize and act collectively, cooperatives may empower their members as agents of social change. In this way, cooperative development may be viewed not as an end in itself, but rather a starting point for mobilizing community members around issues of economic justice.

