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COOPERATIVES: THE FIRST SOCIAL ENTERPRISE

*Elaine Waterhouse Wilson**

I. INTRODUCTION

Whether it is racial inequality,¹ gun control,² or reforming democracy,³ commentators urge philanthropy to solve seemingly intractable social problems. This is also true with one of the most talked-about current global issues: income inequality.⁴

Many in the charitable sector view income inequality as an issue they must address and one in which the sector has a significant role to play.⁵ If charitable organization⁶ is so inclined to tackle the issue of income inequality, there are a number of ways it can proceed. Tradi-

* Associate Professor of Law, West Virginia University College of Law. Many thanks to my research assistants, Zachary McCoy, Christopher L. Bauer, Allisyn Monteleone, and Jackson Butler, who worked tirelessly and without whom, this Article would not have been finished. In addition, I am grateful for the opportunity to workshop this Article as part of the New Scholars Series at the August 2016 meeting of the Southeastern Association of Law Schools, which was moderated by Neil Buchanan and mentored by Terri Helge. Thanks to those friends, mentors, and colleagues that suffered through this process with me, especially Joshua Fershée, Atiba Ellis, Jena Martin, Valarie Blake, Kendra Huard Fershée, Melanie Stimling, and Anthony Ray for his insightful commentary on the structure of law review articles. Finally, I would like to thank the Bloom Fund (officially, the Kanawha County Class Action Settlement 2009 Charitable Trust) for its support of this research project.

1. Amy Schiller, *How Philanthropy Can Show that Black Lives Matter*, CHRON. PHILANTHROPY (July 21, 2016), <https://www.philanthropy.com/article/Opinion-How-Philanthropy-Can/237202>.

2. Pablo Eisenberg, *Grant Makers Could Help Push Gun Control to Forefront of Public Policy*, CHRON. PHILANTHROPY (Aug. 11, 2016), https://www.philanthropy.com/article/Opinion-No-Matter-What-Your/237432?cid=pt&utm_source=pt&utm_medium=en&elqTrackId=630b80b6c80d46258244b86d0406e3cf&elq=4ca8e45b19a043feab6e239835589333&elqaid=10219&elqat=1&elqCampaignId=3817.

3. Robert L. Gallucci, *Philanthropy Must Help Heal the Breakdown in Democracy*, CHRON. PHILANTHROPY (Oct. 14, 2013), <https://www.philanthropy.com/article/Philanthropy-Must-Help-Heal/154215>.

4. Mark Rosenman, *Fighting Income Inequality Should Be Top Nonprofit Priority*, CHRON. PHILANTHROPY (Jan. 21, 2014), <https://www.philanthropy.com/article/Fighting-Income-Inequality/153773>; Dane Stangler, *Philanthropies Should Address Inequality, Seriously*, REAL CLEAR MKTS. (Aug. 6, 2015), http://www.realclearmarkets.com/articles/2015/08/06/philanthropies_must_address_inequality_seriously__101769.html.

5. See Rosenman, *supra* note 4 (“There is no policy area in which the voice of nonprofit organizations is more critical than in affecting legislators’ deliberations regarding economic inequality and poverty.”); Brad Smith, *Philanthropy’s Difficult Dance with Inequality*, PHILANTHROPY NEWS DIG. (June 16, 2015), <http://pndblog.typepad.com/pndblog/2015/06/philanthropys-difficult-dance-with-inequality.html> (“[Private foundations are] free to take risks, experiment, support

tionally, a private foundation could fund scholarship or empirical studies on the issues of divisions of wealth and poverty. For example, the Russell Sage Foundation has an extensive grant program supporting research on “the extent to which increased inequality has affected equality of opportunity, social mobility, and the intergenerational transmission of advantage.”⁷ Alternatively, organizations like Dçmos engage in direct activity designed to fight income inequality, including advocacy, public interest litigation, education, and social services.⁸

Other charities, however, prefer to support businesses that provide innovative solutions to income inequality directly by offering economic opportunity and sustainability to at-risk populations. Referred to as mission-related investing, this type of support can take the form of loans or direct equity investments in for-profit entities that offer an alternative to traditional business models. For example, the recent market crash caused the H.B. Heron Foundation to fundamentally alter its approach when addressing poverty issues by moving away from traditional grant making and instead “focus[ing] primarily on investing in enterprises that create reliable income streams for people striving to get out of poverty.”⁹

innovators, and stick with seemingly intractable challenges for the long haul. This makes them ideally suited to tackle what may be the most intractable challenge of all—inequality.”)

6. For purposes of this Article, except as otherwise noted, the term “charitable organization” or “charity” means an entity that is organized as a non-profit organization under applicable state law and which has obtained Internal Revenue § 501(c)(3) status, recognizing that an organization may be exempt under § 501(c)(3) as educational or scientific, as opposed to charitable, specifically. All references to the Code mean the Internal Revenue Code of 1986, as from time to time amended.

7. *Funding Opportunity: Social Inequality*, RUSSELL SAGE FOUND., <http://www.russellsage.org/research/funding/social-inequality> (last visited Jan. 14, 2017). Following the lead of the Ford Foundation, the Weingart Foundation recently announced that it would focus its grant program on issues of equity, including “serving those low-income people and communities most impacted by inequity.” Ruth McCambridge, *Another Foundation Goes All In on Equity—Not Only the What and Why, But the How*, NONPROFIT Q. (Aug. 17, 2016), <https://nonprofitquarterly.org/2016/08/17/another-foundation-goes-all-in-on-equity-not-only-the-what-and-why-but-the-how/>; Ruth McCambridge, *Inequality, the Ford Foundation, and Humility*, NONPROFIT Q. (June 15, 2015), <https://nonprofitquarterly.org/2015/06/15/inequality-the-ford-foundation-and-humility/>.

8. See, e.g., Amy Traub, *Poverty Pay and CEO Windfalls: Why Fast Food Is the Most Unequal Industry in the US Economy*, DEMOS (Jan. 11, 2017), <http://www.demos.org/publication/poverty-pay-and-ceo-windfalls-why-fast-food-most-unequal-industry-us-economy>; see also Rick Pender, *Win/Win: Collective Impact Brings Employers and Workers Together to Build a Stronger Community*, SOAPBOX CIN. (July 19, 2016), <http://www.soapboxmedia.com/features/071916-GCF-special-report-collective-impact-workforce-2.aspx>.

9. *The Evolution of Heron*, HERON, <http://heron.org/enterprise> (last visited Jan. 14, 2017); see *Impact Investing*, MCKNIGHT FOUND., <https://www.mcknight.org/impact-investing> (last visited Jan. 14, 2017); see also *Find, Fund and Support Exceptional Leaders with Passion, Tenacity and Vision*, DRAPER RICHARDS KAPLAN FOUND., <http://www.drkfoundation.org/model.html> (last visited Jan. 14, 2017). More generally, a recent study by Commonfund and the Council on Foundations shows that eighty-three percent of all private foundations responding to the survey said

From the charity's perspective, engaging an issue such as income inequality through investment is no easy task. First, the organization must determine that the project it wants to fund has a charitable element, which can be problematic in the area of economic development.¹⁰ Then, if a charity is willing to forgo normal market investment returns in order to further charitable goals, the charity must establish that the investment furthers its tax-exempt purposes in a manner other than simply earning income.¹¹ It can be difficult to separate a charity's investment return needs from its tax-exempt purpose; it can be similarly difficult to separate a business's charitable activities from its profit-oriented ones.

As charities increasingly pursue mission-related investing, for-profit entities attempt to make a profit while having positive impacts on the community and the environment. This desire for businesses to have a positive community impact has given rise to the concept of "social enterprise," which is loosely defined as the use of for-profit business models and methods to achieve results that are beneficial to the general public.¹² Striving for this double or triple bottom line return, however, is not without its own problems; there is an inherent tension between providing a profit for shareholders while spending money on charitable endeavors. In order to alleviate these concerns, many states have recently adopted two new types of business entities specifically designed to operate social enterprises: low profit limited liability companies (L3Cs) and benefit corporations.¹³

their investment policies contemplated mission-related investing. COMMONFUND INST. & COUNCIL ON FOUNDS., STUDY OF RESPONSIBLE INVESTING 3–5 (2016), <https://www.commonfund.org/wp-content/uploads/2016/07/Foundations-Responsible-Investing-Press-Release-07-14-16.pdf>.

10. For discussion of charitable economic development under § 501(c)(3), see *infra* Section III.B.

11. While traditional notions of the fiduciary duty of care required the managers of a charitable endowment only to consider returns when making an investment, the modern trend allows an endowment to consider environmental, social, and governance (ESG) factors when investing. See Susan N. Gary, *Values and Value: University Endowments, Fiduciary Duties, and ESG Investing*, 42 J.C. & U.L. 247, 248–51 (2016). Notably, a charity engaged in ESG investing is not necessarily settling for a lower return on investment in order to accomplish non-investment goals; rather, "an investor with no interest in addressing social or environmental problems could use ESG investing as a strategy to seek better returns . . ." *Id.* at 263.

12. Dana Brakman Reiser uses the term "blended enterprise" to refer to "an entity that intends to pursue profits and social good both in tandem and by making considered choices to pursue one over the other." Dana Brakman Reiser, *Blended Enterprise and the Dual Mission Dilemma*, 35 VT. L. REV. 105, 105 (2010). Anthony Page and Robert Katz state that "'Social Enterprise' is a loose term for business that aim to generate profits while advancing social goals." Anthony Page & Robert Katz, *Is Social Enterprise the New Corporate Social Responsibility?*, 34 SEATTLE U. L. REV. 1351, 1353 (2011).

13. For discussion of social enterprise and each new entity, see *infra* Section IV.B. While the benefit corporation is the most popular of the social enterprise models in corporate form, some

Especially in the context of income inequality, however, the opportunity to invest directly in alternative for-profit solutions has a third option: cooperatives. The modern cooperative business model developed in direct response to social unrest, unemployment, poverty, and inequality.¹⁴ Community benefit is not just a consequence of the cooperative business model; it is a fundamental part of its structure. Yet the cooperative is a for-profit entity, and therefore not exclusively charitable. As a result, the charitable sector can look to cooperatives as a social enterprise-based solution to important and seemingly intractable social issues, such as income inequality.

A cooperative is a business entity that is owned and managed by its members—those individuals for whose benefit the cooperative was organized. These members may be individual laborers in a workers' cooperative,¹⁵ farmers in an agricultural marketing coop,¹⁶ or consumers in search of organic and fair trade produce at the local food coop.¹⁷ Unlike the standard investor capital-based business organization (sometimes referred to as an investor-owned firm or IOF), a cooperative's mission is not necessarily to make a profit or to increase shareholder value;¹⁸ rather, the cooperative's mission is to serve the needs of its members, whomever and whatever they may be. Historically, these members have often been a class of individuals in need of assistance, such as the unemployed weavers of the Rochdale cooperative or the poor farmers in California studied by Aaron Sapiro.¹⁹ Because the history of the cooperative is rooted in social change, the coopera-

states have developed a different model for social enterprise corporations. For example, California has a "social purpose corporation" (formerly known as a flexible purpose corporation"). CAL. CORP. CODE §§ 2600–2605 (West 2014). Delaware has the public benefit corporation. DEL. CODE ANN. tit. 8, § 362 (2015). While these alternative forms differ substantively from benefit corporations, the term "benefit corporation," as used in this Article, includes these other variations of social enterprise corporate forms for purposes of brevity.

14. For the history of the modern cooperative movement, see *infra* Section II.A.3.

15. The world's largest workers' cooperative is widely believed to be The Mondragon Cooperative Group in the Basque region of Spain, which started in 1956 with twenty-four workers. Mondragon now has eight-five thousand workers and worldwide assets worth \$33 billion. CLAUDIA SANCHEZ BAJO & BRUNO ROELANTS, *CAPITAL AND THE DEBT TRAP* 176–77 (2013).

16. See, e.g., *About Us*, W.V. FARMERS, INC., <https://wvhemp.org/about-us/> (last visited Jan. 14, 2017).

17. See, e.g., MOUNTAIN PEOPLE'S CO-OP, <https://mountainpeoplescoop.com/> (last visited Jan. 14, 2017).

18. Stephen Bainbridge, *A Duty to Shareholder Value*, N.Y. TIMES (Apr. 16, 2015), <http://www.nytimes.com/roomfordebate/2015/04/16/what-are-corporations-obligations-to-shareholders/a-duty-to-shareholder-value> ("[C]orporate directors are bound by 'fiduciary duties and standards' which include 'acting to promote the value of the corporation for the benefit of its stockholders.'")

19. For discussion of the Rochdale Pioneers, see *infra* Section II.A.1. For discussion of Aaron Sapiro's marketing cooperatives, see *infra* Section II.B.1.

tive movement has developed a set of internationally recognized values that emphasize democracy, community, equality and sustainability, which are inherent to all cooperatives.

Due to their member-focused mission, cooperatives have difficulty obtaining capital from profit-oriented sources. Foundations and other charitable organizations looking to make social enterprise investments may be able to fill this funding gap. By definition, the goal of a mission-related investment by a charity is to achieve a charitable goal, sometimes while making a profit and sometimes while intentionally sacrificing profit.²⁰ While a charitable investor is still just an investor in, and not a member of, a cooperative, the charitable investor's goals and the member-owners' goals can still be in alignment. If the charitable investor can assure itself that the cooperative business model is, at least in part, "charitable," then it can find a way to invest in cooperatives in the same manner as it might invest in a benefit corporation or a L3C (or for that matter, any for-profit business with a distinct charitable activity).²¹

This is not to say that cooperatives, specifically, or social enterprises, generally, are the solution to all that ails; rather, the intention is to find a place for cooperatives in the dialogue about social enterprise. As the cooperative and social enterprise movements merge, it is necessary to examine the legal and tax structures governing the entities to see if they help or hinder growth. If the ultimate decision is to support the growth of cooperatives as social enterprise, then those legal and tax structures that might impede this progress need to be re-examined.

This Article considers some of the issues that may impede the charitable sector in supporting the growth of the cooperative business model as a potential solution to issues of income inequality. To do so, the Article first defines a "cooperative." Part II examines the definition of a cooperative from three different viewpoints: cooperative as social movement, cooperative as economic arrangement, and cooperative as legal construct. From these definitions, it is possible to identify those elements inherent in the cooperative model that might qualify as a tax-exempt purpose under the Internal Revenue Code (the Code) § 501(c)(3). Part III reviews the definition of "charitable" for § 501(c)(3) purposes, specifically in the context of economic develop-

20. See, e.g., Susan N. Gary, *Is It Prudent to Be Responsible? The Legal Rules for Charities that Engage in Socially Responsible Investing and Mission Investing*, 6 Nw. J.L. & Soc. POL'Y. 106, 108 (2011) [hereinafter *Is It Prudent to Be Responsible*].

21. For a discussion of charitable investments in L3Cs and benefit corporations, see *infra* Section IV.B.

ment and the support of workers. This Part demonstrates that many of the values inherent in the cooperative model are, in fact, charitable as that term is understood for federal tax purposes.

If a cooperative has charitable elements, however, then it should be possible for the charitable sector to support the cooperative movement. Part IV analyzes the possibilities and limitations of direct support by the charitable sector, including mission-related investing by charities and program-related investing by private foundations. In this regard, the cooperative can be viewed in many respects as an existing analog to the new social enterprise forms, such as the benefit corporation or the L3C. Finally, Part V provides recommendations for changing both federal and state law to further support the cooperative movement in the charitable sector.

II. WHAT IS A COOPERATIVE?

Any discussion of cooperatives begs the question: What exactly is a cooperative? Historically, cooperatives are an integral part of a social movement to address issues of sustainable and socially-responsible business practices in response to the perceived excesses of capitalism. Alternatively, a cooperative is a specific type of economic arrangement undertaken by individuals with a common need and a social bond. Finally, a cooperative is a legal construct—a business entity as defined for purposes of a specific law or as authorized by state statute. These three distinctly different approaches to defining the cooperative ultimately result in at least one area of agreement: The cooperative, as a matter of structure and not merely of consequence, embraces the goal of benefitting the community, both directly and indirectly through bettering the circumstances of its members. The following parts of this Part II review the three different ways one can define a cooperative: as a social movement, as an economic relationship, and as a legal construct.

A. *Cooperatives as Social Movement*

1. *The Birth of Cooperatives*

While cooperative forms of business enterprises date back to the seventeenth and eighteenth centuries,²² the concept of the modern cooperative originated in England with the Rochdale Pioneers in 1844.²³

22. KIMBERLY A. ZEULI & ROBERT CROPP, COOPERATIVES: PRINCIPLES AND PRACTICES IN THE 21ST CENTURY 1 (2004).

23. See *Time Machine*, ROCHDALE PIONEERS MUSEUM, <http://www.rochdalepioneersmuseum.coop/time-machine/#fifth> (last visited Jan. 14, 2017); see also History of the Co-operative Move-

Many of the Rochdale Pioneers were weavers or otherwise involved in the textile industry.²⁴ As tradesmen, the Pioneers “suffer[ed] from the social dislocations of the industrial revolution” and depended upon “merchants who were sometimes unscrupulous, who exploited the helplessness of the poor by selling at high prices [and] by adulterating goods.”²⁵ To address these issues, the Pioneers established what we would now know to be a purchasing cooperative, opening a general store that was available to and run by all of its members.

The cooperative was specifically set up “to form arrangements for the pecuniary benefit and improvement of the social and domestic condition of its members”²⁶ According to the Rochdale Pioneer Museum, which conserves the original coop store building, Rochdale is widely regarded as the home of the modern worldwide cooperative movement.²⁷ This is not because it was the first consumer cooperative venture, but because its Pioneers (the cooperative’s founders) laid down the first comprehensive, written model of the values and principles that set out how, and why, to run a cooperative society.²⁸ The original model of the Rochdale Principles was as follows:

- That capital should be of their own providing and bear a fixed rate of interest.
- That only the purest provisions procurable should be supplied to members
- That full weight and measure should be given.
- That market prices should be charged and no credit given nor asked.
- That profits should be divided pro rata upon the amount of purchases made by each member.
- That the principle of ‘one member one vote’ should obtain in government and the equality of the sexes in membership.
- That the management should be in the hands of officers and committee elected periodically.
- That a definite percentage of profits should be allotted to education.

ment, INT’L COOPERATIVE ALLIANCE, <http://ica.coop/en/whats-co-op/history-co-operative-movement> (last visited Jan. 14, 2017). Soon thereafter, Germans formed cooperative credit unions in 1862. See Erdis W. Smith, *Federal Credit Unions: Origin and Development*, SOC. SEC. BULL., Nov. 1955, at 3, 3–4.

24. See *The Rochdale Pioneers*, ROCHDALE PIONEERS MUSEUM, <http://www.rochdalepioneer-smuseum.coop/about-us/about-the-pioneers/> (last visited Jan. 14, 2017).

25. BRETT FAIRBAIRN, *THE MEANING OF ROCHDALE: THE ROCHDALE PIONEERS AND THE CO-OPERATIVE PRINCIPLES 2* (1994), <http://usaskstudies.coop/documents/occasional-papers/Meaning%20of%20Rochdale.pdf>.

26. *Id.* at 5.

27. See *The Rochdale Pioneers*, *supra* note 24.

28. *The Pioneers’ Rule Book 1844*, ROCHDALE PIONEERS MUSEUM, <http://www.rochdalepioneer-smuseum.coop/about-us/1844-rule-book/> (last visited Apr. 13, 2017).

- That frequent statement and balance sheets should be presented to members.²⁹

As one commentator noted, the problems faced by the Pioneers in 1844 in some ways resemble those in developing countries and less developed communities today.³⁰ “The solutions in Rochdale look something like the modern idea of socially sustainable development: in the most general terms, Rochdale stands for development in the long-term interests of people and communities—development controlled by the people it affects. Rochdale is a vision of participation in social change.”³¹

2. *Cooperatives in the United States*

In the United States, the cooperative business model has historically enjoyed more limited success. “Cooperatives are neither indigenous to the United States, nor are they an American invention. . . . [C]ooperatives in the United States are both an artifact of early settlers’ European heritage and a collective response to harsh living conditions.”³² As a matter of historical artifact, the most accomplished cooperatives in the United States are primarily active in agriculture.³³ However, it may be that the limited success of cooperatives in the non-agricultural sectors in the United States is about to change. Cooperatives are attracting greater attention as a solution to social issues and an alternative economic arrangement to traditional capitalism.³⁴

As new immigrants came to the United States, they brought the Rochdale Principles with them. While the first cooperative business in the United States was a mutual fire insurance company founded in

29. *The Rochdale Principles*, ROCHDALE PIONEERS MUSEUM, <http://www.rochdalepioneersmuseum.coop/about-us/the-rochdale-principles/> (last visited Jan. 17, 2017).

30. FAIRBAIRN, *supra* note 25, at 1.

31. *Id.*

32. See ZEULI & CROPP, *supra* note 22, at 15.

33. See *id.* (“[S]ome of the most significant contributions Americans have made to the cooperative model and movement have been in the agricultural sector . . .”). See generally *Cooperatives in the U.S.*, CTR. FOR COOPERATIVES, www.UWCC.wisc.edu/whatisacoop/history (last visited Jan. 14, 2017). For further discussion of the development of the agricultural marketing cooperative in the United States, see ZEULI & CROPP, *supra* note 22, at 16.

34. See, e.g., E.G. NADEAU, *THE COOPERATIVE SOLUTION: HOW THE UNITED STATES CAN TAME RECESSIONS, REDUCE INEQUALITY, AND PROTECT THE ENVIRONMENT* 4–6 (2012); Christopher Wright, *Worker Cooperatives and Revolution: History and Possibilities in the United States* (Dec. 2010) (unpublished M.A. thesis, University of Massachusetts Boston), http://scholarworks.umb.edu/cgi/viewcontent.cgi?article=1020&context=masters_theses.

1752 by Benjamin Franklin,³⁵ it was generally followed by a series of local dairy and agricultural cooperatives formed by European immigrants primarily located in the Northeast.³⁶

By 1875, the Order of the Patrons of Husbandry—more popularly known as the Grange—adopted the Rochdale Principles set forth in the United Kingdom earlier in the decade.³⁷ During the 1920s and into the Great Depression, Congress repeatedly supported agricultural cooperatives. Early federal support included exempting cooperatives from the application of the federal antitrust laws,³⁸ enacting the Cooperative Marketing Act of 1926 and the Agricultural Marketing Act of 1929 to support cooperative organization and infrastructure,³⁹ and passing the Farm Credit Act in 1933, which created a lending system⁴⁰ that addressed the needs of agricultural cooperatives during the Great Depression.⁴¹

3. *Cooperatives Today*

Throughout nineteenth and twentieth centuries, cooperatives developed as tools for social movement. This growth continues to this day, when cooperatives are even more prevalent as vehicles of social initiatives.

Today, the cooperative movement is internationally represented by the International Co-operative Alliance (ICA), which “unites co-operatives worldwide.”⁴² The ICA defines a cooperative as “an autono-

35. See NAT'L COOP. MONTH PLANNING COMM., *COOPERATIVE BUSINESSES IN THE UNITED STATES: A 2005 SNAPSHOT 2* (2005), <http://www.uwcc.wisc.edu/info/stats/uscoopbus05.pdf>; see also ZEULI & CROPP, *supra* note 22, at 15.

36. BOB CROPP & TRUMAN GRAF, *THE HISTORY AND ROLE OF DAIRY COOPERATIVES 2-3* (2001), <http://www.uwcc.wisc.edu/info/dairy/history.pdf>; ZEULI & CROPP, *supra* note 22, at 16.

37. ZEULI & CROPP, *supra* note 22, at 16.

38. Capper-Volstead Act, 7 U.S.C. §§ 291, 292 (2012). For further discussion, see ZEULI & CROPP, *supra* note 22 at 17-19.

39. Cooperative Marketing Act, 7 U.S.C. §§ 451-457 (2012). For further discussion, see ZEULI & CROPP, *supra* note 22, at 18.

40. Agricultural Marketing Act, 12 U.S.C. §§ 1141-1141j (2012). For further discussion, see ZEULI & CROPP, *supra* note 22, at 18.

41. This history of private, public, and legislative support is not found, however, for other types of non-agricultural cooperatives in the United States, such as worker and consumer cooperatives. See generally Wright, *supra* note 34, at 81-130 (providing a brief history of workers' cooperatives in the United States from a Marxist perspective); see also *USFWC History*, U.S. FED'N WORKER COOPERATIVES, <https://usworker.coop/about/usfwc/> (last visited Jan. 17, 2017).

42. *Vision and Mission*, INT'L CO-OPERATIVE ALLIANCE, <http://ica.coop/en/basics/vision-mission> (last visited Jan. 14, 2017). The ICA's full mission statement is stated as follows:

It is the custodian of co-operative values and principles and makes the case for their distinctive values-based economic business model which also provides individuals and communities with an instrument of self-help and influence over their development. The ICA advocates the interests and success of co-operatives, disseminates best prac-

mous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspiration through a jointly-owned and democratically-controlled enterprise.”⁴³ According to the ICA, cooperatives are “member-owned, member-run, and member-serving businesses.”⁴⁴ Under its definition, a cooperative is not a specific type of business entity for legal purposes; rather, it could be any legal entity formed by persons united by a common need that is jointly-owned and democratically controlled. The ICA posits that cooperatives are “business driven by values not just profit,” and that they share “internationally agreed principles and act together to build a better world through co-operation.”

The ICA sets forth six cooperative values—self-help, self-responsibility, democracy, equality, equity, and solidary—and state that “co-operative members believe in the ethical values of honesty, openness, social responsibility, and caring for others.”⁴⁵ In furtherance of these values, the ICA adopted seven cooperative principles, which are based in significant part on the principles originally set forth by the Rochdale Pioneers: (1) voluntary and open membership; (2) democratic member control (3) member economic participation; (4) autonomy and independence; (5) education, training and information; (6) cooperation among cooperatives; and (7) concern for community.⁴⁶

As such, the goal of the movement cooperative is not simply profit or economic development. Rather, the ICA articulates sustainable development goals for cooperatives that are based on people-centered messages.⁴⁷ The cooperative is more than simply a way to organize economic activity or to govern business arrangements; it is a collective way to encourage community betterment and social change.

tics and know-how, strengthens their capacity building and monitors their performance and progress over time.

Id. Additionally, the ICA’s vision is “[t]o be prized as the organisation of reference which provides an effective and efficient global voice and forum for knowledge, expertise and co-ordinated action for and about co-operatives.” *Id.*

43. *What Is a Co-operative?*, INT’L CO-OPERATIVE ALLIANCE, <http://ica.coop/en/what-co-operative> (last visited Jan. 14, 2017).

44. *Facts and Figures*, INT’L CO-OPERATIVE ALLIANCE, <http://ica.coop/en/facts-and-figures> (last visited Jan. 14, 2017).

45. *Co-operative Identity, Values & Principles*, INT’L CO-OPERATIVE ALLIANCE, <http://ica.coop/en/whats-co-op/co-operative-identity-values-principles> (last visited Jan. 14, 2017).

46. *What Is a Co-operative?*, *supra* note 43; *see also* JAMES R. BAARDA, U.S. DEP’T AGRIC., CURRENT ISSUES IN COOPERATIVE FINANCE AND GOVERNANCE 11–12 (2006).

47. *See Sustainable Development Goals*, INT’L COOPERATIVE ALLIANCE, <http://ica.coop/en/sustainable-development-goals> (last visited Jan. 14, 2017). The five messages include poverty eradication and zero hunger, food security, gender equality, decent work and economic growth, and combating climate change. *Id.*

B. The Cooperatives as Economic Arrangement

1. Historical Development

The Rochdale Pioneers founded their cooperative for distinctly economic reasons: They explicitly intended to better the economic circumstances of their members. The Rochdale cooperative's mission was "to form arrangements for the pecuniary benefit, and improvement of the social and domestic condition of its members"48 By all accounts, they were quite successful in doing so.⁴⁹

From its inception in 1844, the cooperative had an inherently dual mission—to serve the social needs of its community and to serve as an economic arrangement among its members. One commentator has referred to this as the "double nature" of cooperatives, originally attributed to the German economist Georg Draheim: "According to this concept, every cooperative represents simultaneously (1) an association of persons in the sense of sociology and social psychology (i.e., social group), and (2) a joint enterprise, owned and operated by the same members of the group."⁵⁰

This dichotomy of purpose explains the difference between the cooperative as social movement and the cooperative as economic arrangement. "Social philosophers emphasize democratic control in the form of one-person, one-vote as the cardinal principle of cooperation. Economic philosophers on the other hand emphasize the distribution of benefits in proportion to use as the cardinal principle."⁵¹ "These differences have been frequently articulated by cooperative leaders such as Jerry Voorhis, who felt the service component of the cooperative would be lost if a cooperative strictly advocates a 'bottom line' orientation."⁵²

In the United States, the debate over the role of the cooperative as economic arrangement dates back to the post-industrial revolution era economy and, specifically, to the agriculture sector. At that time, two influential commentators, Aaron Sapiro and Edwin G. Nourse, debated the appropriate structure of U.S. agricultural cooperatives.⁵³

48. *The Pioneers' Rule Book 1844*, *supra* note 28.

49. *Id.*

50. Vladislav Valentinov, *Toward a Social Capital Theory of Cooperative Organization*, 37 J. COOPERATIVE STUD. 5, 5 (2004).

51. Randall E. Torgerson et al., *Evolution of Cooperative Thought, Theory, and Purpose*, U. WIS. CTR. COOPERATIVES, <http://www.uwcc.wisc.edu/info/torg.html> (last visited Jan. 14, 2017) (citations omitted) (citing PAUL LAMBERT, *STUDIES IN THE SOCIAL PHILOSOPHY OF CO-OPERATION* (1963)).

52. Torgerson et al., *supra* note 51. See generally JERRY VOORHIS, *COOPERATIVE ENTERPRISE: THE LITTLE PEOPLE'S CHANCE IN A WORLD OF BIGNESS* (1975).

53. See *Cooperatives in the U.S.*, *supra* note 33.

Sapiro advocated for farmer cooperatives organized around a single commodity.⁵⁴ In his view, commodity-focused cooperatives centered on joint marketing efforts would “allow producers to capture greater market share and achieve better prices for the farmer.”⁵⁵ To further this view, Sapiro (a lawyer) developed one of the first uniform laws addressing cooperatives—the Standard Marketing Act.⁵⁶ Alternatively, Nourse advocated for smaller, locally-owned cooperatives that were geographically based, rather than commodity-based, with a strong emphasis on community.⁵⁷

Whether one subscribed to either Shapiro’s monopolistic view or Nourse’s competitive view of cooperatives, “[a] characteristic of American thought is that it is steeped in pragmatism in contrast to some European schools that were immersed in great social reforms and associated philosophies of the times.”⁵⁸ Unlike the European model, the American view of cooperatives at the turn of the century emphasized the economic half, rather than social half, of the cooperative’s “double nature.”⁵⁹ That does not mean, however, that American cooperatives did not play a role in social development. At the end of his seminal work, *True Farmer Cooperation*, Aaron Sapiro, stated:

But the solving of the financial problems for the growers of our great crops is not the primary accomplishment of cooperative marketing.

. . . .

Money accumulated in a banking institution for the sole purpose of the interest accruing is an infirmity; but an increasing bank account helping to realize higher dreams is a moral asset.

The justification of cooperative marketing is that it has been the means of a more progressive form of living and superior type of citizenship, as well as an economic remedy.⁶⁰

54. See generally Aaron Sapiro, *True Farmer Cooperation: The California Plan of Cooperative Marketing. How It Differs from the Rochdale Plan. “Locality” vs. “Commodity.” Organization and Financing*, 8 J. AGRIC. COOPERATION 81, 81 (1993).

55. *Cooperatives in the U.S.*, *supra* note 33; see also Sapiro, *supra* note 54, at 81.

56. For a more in-depth discussion, see *supra* Section II.C.3. The law formed the basis for many early state statutes, as well as the Capper–Volstead Act—the federal law that exempted farmers’ cooperatives from the federal antitrust laws. See ZEULI & CROPP, *supra* note 22, at 19.

57. The goal of these cooperatives was not to monopolize the market and drive up commodity prices; rather, Nourse envisioned cooperatives as competitors in the commodity market, capturing “only enough market share to promote competition.” *Cooperatives in the U.S.*, *supra* note 33; see also ZEULI & CROPP, *supra* note 22, at 20.

58. Torgerson et al., *supra* note 51.

59. See *id.*

60. Sapiro, *supra* note 54, at 93.

2. Modern Economic Thought

From its roots in economic agricultural thought, modern economists have developed a number of theories underlying the development of the cooperative business model.⁶¹ Current economic thought emphasizes a transaction cost approach to business arrangements such as cooperatives.⁶² Under this model, “the main benefits of collective organization derived by cooperatives are achieved by internalizing crucial transactions into a firm jointly owned by the holders of transaction-specific resources.”⁶³ This model emphasizes joint ownership and democratic control as key drivers in reducing transaction costs, thereby making transactions more efficient for the members of the cooperative than they would have been acting individually.

Democracy is, however, messy—and expensive. A cooperative’s transaction costs may in fact be higher than a traditional IOF because of the one member, one vote management model. According to one commentator, the high cost of cooperative democracy is offset by the cooperative’s “social capital.”⁶⁴ Social capital is defined as that set of common norms and experiences among the stakeholders of a firm that give rise to value within a firm.⁶⁵ As a result, the homogeneity of the membership of a cooperative gives the cooperative entity social capital, which smooths the way (and lowers the cost) of democratic management mechanisms. Under this theory, the social element of the cooperative is critical to the success of the business arrangement. Without a set of common goals and a shared commitment to the gen-

61. See Vlanetinov *supra* note 50, at 5. Emilianoff, Robotka, and Phillips viewed the cooperative as a pure agency among members. *Id.* at 5 nn.4, 5 & 6 (citing IVAN V. EMELIANOFF, ECONOMIC THEORY OF COOPERATION: ECONOMIC STRUCTURE OF COOPERATIVE ORGANIZATIONS (Ctr. for Cooperatives, Univ. of Cal. 1995) (1948); Frank Robotka, *A Theory of Cooperation*, 29 J. FARM ECON. 94, 94–114 (1947); Richard Phillips, *Economic Nature of the Cooperative Association*, 35 J. FARM ECON. 74, 74–98 (1953)). Enke, and then Helmberger and Hoos, saw the cooperative as a firm. *Id.* at 5 nn.7 & 8 (citing Stephen Enke, *Consumer Cooperatives and Economic Efficiency*, 35 AM. ECON. REV. 148, 148–155 (1945); Peter Helmberger & Sidney Hoos, *Cooperative Enterprise and Organization Theory*, 44 J. FARM ECON. 275, 275–90 (1962)). Additionally, another theory, known as the “cooperative as nexus of contracts” approach, concentrated on the nature of business relationships among the various cooperative stakeholders through explicit and implicit contracts between them. *Id.* at 5 & n.10 (citing John M. Staatz, *The Structural Characteristics of Farmer Cooperatives and Their Behavioral Consequences*, in COOPERATIVE THEORY: NEW APPROACHES, ACS SERVICE REPORT 18 (Jeffrey S. Royer ed., 1987)).

62. The transaction cost theory of the firm was developed by Nobel Prize winning economist Ronald Coase. See R. H. Coase, *The Nature of the Firm*, 4 ECONOMICA 16, 386–405 (1937); R. H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 15–19 (1960).

63. Vlanetinov, *supra* note 50, at 6 (quoting Holger Bonus, *The Cooperative Association as a Business Enterprise*, 142 J. INSTITUTIONAL & THEORETICAL ECON. 310, 335 (1986)).

64. *Id.* at 18.

65. *Id.* at 10; see also *About Social Capital*, HARV. KENNEDY SCH., <https://www.hks.harvard.edu/programs/saguaro/about-social-capital> (last visited Jan. 17, 2017).

eral well-being of the members of the cooperative, the cooperative could not function democratically in a sufficiently efficient manner to be successful. As succinctly stated by Professor Frank Groves of the University of Wisconsin's Center for Cooperatives, "Cooperatives that forget their social responsibility are doomed to failure."⁶⁶

The fundamental economic relationship established by a cooperative is distinct from that of an IOF in that they are "designed to serve the needs of members rather than general profits for investors."⁶⁷ As a cooperative grows, however, it faces the challenge of remaining responsive to its members, as opposed to following the interest of the cooperative itself as a separate entity. According to one commentator, there is a danger that the cooperative members can become "the 'residual' claimant [of the cooperative,] in the sense of crumbs left over after all other agent groups receive their due."⁶⁸ In effect, when the cooperative ceases to abide by its member-centered focus and dual mission, it loses part of its inherent value. If a cooperative is to be viewed as a social enterprise, it needs to consider the manner in which economics and structure can cause it to lose its member-service focus.

C. *The Cooperatives as Legal Construct*

Finally, the cooperative form is not just a social movement or an economic arrangement—in many cases, it is defined in the law for a variety of purposes, including classification as a specific type of state law entity. These definitions grow out of the common historical understanding of the cooperative as it developed in the United States, primarily as a form of agricultural association. Accordingly, each definition contains at least some the primary touchstones of the cooperative as established under the Rochdale Principles: democracy, equality, common mission for the betterment of members, and division of profits on the basis of use, not capital.

1. *The Capper–Volstead Definition of a Cooperative*

Part of the legal rationale for special treatment of the cooperative as a separate legal entity is to address antitrust liability concerns. At first glance, many cooperatives, especially a producer cooperative,

66. See Frank Groves, *The Philosophy of Cooperation and Its Relationship to Cooperative Structure and Operations* (Oct. 1985) (Univ. of Wis. Ctr. for Coop Occasional Paper No. 6), <http://www.uwcc.wisc.edu/info/ocpap/groves.html>.

67. Vlanetinov, *supra* note 50, at 5.

68. Torgerson et al., *supra* note 51.

would violate antitrust laws.⁶⁹ By definition, a cooperative is a place where various producers of goods gather with the intention to market their products collectively in order to obtain better prices. After all, under Aaron Sapiro's vision of the cooperative, a cooperative should not even exist unless it can control a sufficient market share to dictate pricing.⁷⁰

In 1922, Congress enacted a specific exception from the Clayton Act of 1914. This exception is found in section 1 of the Capper-Volstead Act,⁷¹ which specifically states,

Persons engaged in the production of agricultural products as farmers, planters, ranchmen, dairymen, nut or fruit growers may act together in associations, corporate or otherwise, with or without capital stock, in collectively processing, preparing for market, handling, and marketing in interstate and foreign commerce, such products of persons so engaged.⁷²

By its terms, the Capper-Volstead definition only applies to cooperatives that have agricultural producers as members and that engage only in the collective processing and marketing of these agricultural products in interstate or foreign commerce.⁷³ In addition, a cooperative that qualifies for the Capper-Volstead exemption must (1) be operated for the mutual benefit of the members, (2) not grant a member more than one vote in governance matters due to stock ownership or capital contributions, (3) not pay dividends on stock in excess of eight percent annually, and (4) not deal in the products of non-members in an amount in excess of the value handled for members.⁷⁴ Thus, the antitrust exemptions of the Capper-Volstead Act are extremely limited.

Importantly to the non-agriculture cooperative, the Capper-Volstead Act reaffirms some of the basic tenants of cooperative

69. In its original format, the Sherman Act appeared to cover cooperatives. Christine A. Varney, *The Capper-Volstead Act, Agricultural Cooperatives, and Antitrust Immunity*, ANTITRUST SOURCE, Dec. 2010, at 1–2, http://www.americanbar.org/content/dam/aba/publishing/antitrust_source/Dec10_Varney12_21.authcheckdam.pdf. In 1914, the Clayton Act was amended to exempt nonprofit, non-stock cooperatives, but it was not until the passage of Capper-Volstead Act that it was clear that for-profit or stock-issuing cooperatives were also exempt. *Id.* at 2.

70. See Sapiro, *supra* note 54, at 87–88 (explaining that when a cooperative association is started, the cooperative must establish a minimum delivery amount from each member so as to have a set amount of the commodity to go to market because a cooperative is ineffective until the total set amount is reached).

71. Donald M. Barnes & Christophe E. Ondeck, *The Capper-Volstead Act: Opportunity Today and Tomorrow*, U. WIS. CTR. FOR COOPERATIVES (Aug. 5, 1997), <http://www.uwcc.wisc.edu/info/capper.html> (detailing the history of the Capper-Volstead Act); Varney, *supra* note 69.

72. 7 U.S.C. § 291 (2012).

73. *Id.*

74. *Id.*

organization originally enshrined in the Rochdale Principles: It requires a cooperative to act for the mutual benefit of its members first and foremost;⁷⁵ to run on a one-member, one-vote principle; and to significantly limit the payment of dividends on capital.⁷⁶

2. Federal Income Taxation of Cooperatives

The Internal Revenue Code has its own definition of a cooperative.⁷⁷ As a for-profit entity, a cooperative could be taxed under the three most common business entity regimes: C corporation, S corporation, or partnership. Unknown to many, however, there is a fourth business tax regime specifically for cooperatives buried in Subchapter T of the Code.⁷⁸ In addition, some cooperatives can qualify for tax-exempt status as a farmers' cooperative under § 521⁷⁹ or under certain specialized sections of § 501.⁸⁰

a. Choice of Entity

Historically, a cooperative was organized as a corporation for state law purposes; as a result, the Code originally initially taxed a cooperative as a C corporation.⁸¹ Any cooperative formed in a state in which it is required to be a corporation, the cooperative is classified as a corporation for federal tax purposes.⁸² In the absence of special cooperative provisions, cooperative corporations was taxed as C corporations.⁸³ In those states that have adopted Next Generation Cooperative statutes,⁸⁴ a cooperative is not automatically a corpora-

75. ZEULI & CROPP, *supra* note 22, at 24.

76. *Id.*; see also BAARDA, *supra* 46, at 151.

77. I.R.C. § 1381 (2012).

78. See *infra* Section II.C.2.b.

79. I.R.C. § 521 (2012).

80. Section 501(a) exempts organizations described in § 501(c) from the federal income tax, including organizations described in § 501(c)(12) (cooperative telephone and electric companies); § 501(c)(14) (certain cooperative banks); and § 501(c)(16) (farmers' cooperative crop financing organizations).

81. For further discussion, see *infra* Section II.C.3.a. Under § 7701, a corporation for tax purposes is "a business entity organized under a Federal or State statute, or under a statute of a federally recognized Indian tribe, if the statute describes or refers to the entity as incorporated or as a corporation, body corporate, or body politic." Treas. Reg. § 301.7701-2(b)(1) (2016).

82. Treas. Reg. § 301.7701-2(a).

83. A cooperative corporation conceivably might qualify for S corporation status if it could meet the requirements for such classification, although the one-class-of-stock rule of § 1361-1(b)(1)(iv) might prove troublesome. See *generally* Treas. Reg. § 1.1361-1(l) (2016).

84. Next Generation Cooperatives are discussed more fully *infra* Section II.C.3.b.

tion for state law purposes and, therefore, it is not automatically considered a corporation for federal income tax classification purposes.⁸⁵

b. Subchapter T

Subchapter T⁸⁶ applies to “corporation[s] operating on a cooperative basis,” subject to specific exemptions.⁸⁷ A cooperative corporation under Subchapter T is also subject to the corporate income tax under § 11.⁸⁸ Thus, Subchapter T starts with the proposition that a qualifying cooperative is taxed as a C corporation, except as otherwise provided.

In order to benefit from taxation under Subchapter T, a cooperative must be “operating on a cooperative basis.”⁸⁹ The Treasury Regulations state that Subchapter T applies “to any corporation operating on a cooperative basis and allocating amounts to patrons on the basis of the business done with or for such patrons.”⁹⁰ In *Puget Sound Plywood v. Commissioner*,⁹¹ the Tax Court explicitly references the Rochdale Pioneers⁹² when crafting a definition of the term “operating on a cooperative basis” under the prior version of this Regulation. The Tax Court cites to at least three of the Rochdale Principles that “persist as the core of economic cooperative theory”: subordination of

85. Wyoming’s Next Generation Cooperative statute, for example, was designed to allow a cooperative to form as a limited liability company (LLC) in order to obtain pass-through taxation. Such a cooperative would not be eligible for Subchapter T taxation. See DONALD A. FREDERICK, U.S. DEP’T AGRICULTURE, INCOME TAX TREATMENT OF COOPERATIVES: BACKGROUND 8–9, (2005), <https://www.rd.usda.gov/files/cir44-4.pdf>.

86. I.R.C. § 1381(a). In addition, Subchapter T applies to farmers’ cooperatives exempt under § 521. See I.R.C. § 1381(b). Farmers’ cooperatives receive special tax treatment under § 521 and Subchapter T. See I.R.C. § 521 (2012). Although § 521 says, ostensibly, that farmers’ cooperatives are exempt from tax, § 1381(b) states that a § 521 farmers’ cooperative is actually subject to the taxes as if it were a C corporation. See I.R.C. § 1381(b). In addition, § 521 farmers’ cooperatives can deduct any dividends paid, as well as certain patronage distributions made, during the year. See I.R.C. § 1362(c) (2012).

87. These exemptions include cooperatives that are otherwise exempt from tax, certain mutual savings banks and insurance companies, and cooperative electric and telephone companies. I.R.C. § 1381(a)(2).

88. *Id.* § 1381(b). In addition, the corporate alternative minimum tax of § 1201 applies to Subchapter T cooperatives. See *id.*

89. *Id.*

90. Treas. Reg. § 1.381-1 (2016). Prior to the enactment of Subchapter T in 1962, the taxation of non-exempt cooperatives was governed by § 522 of the Internal Revenue Code of 1954, which was at issue in *Puget Sound Plywood, Inc. v. Commissioner*, 44 T.C. 305, 305–06 (1965). *Puget Sound* cites to Treasury Regulation section 1.522-1(b)(1), which is the precursor to current Treasury Regulation section 1.1381-1. The old Treasury Regulation states “the term cooperative association includes any corporation operating on a cooperative basis and allocating amounts to patrons on the basis of the business done with or for such patrons.” Treas. Reg. § 1.522-1(b)(1).

91. *Puget Sound Plywood*, 44 T.C. 305.

92. *Id.* at 307.

capital, democratic control, and allocation on the basis of use.⁹³ As a result, *Puget Sound Plywood* requires a cooperative to satisfy the following requirements: (1) Allocation of patronage distributions based on a legal obligation; (2) Allocations must be made out of income from transactions with its patrons; and (3) Allocations must be equitably made.⁹⁴

Assuming that an organization meets the definition of a cooperative under Subchapter T, it is subject to different treatment under Subchapter T based on the nature of the patronage dividends allocated to members. C corporations normally distribute corporate earnings “to shareholders on a basis having some relationship to the number or value of shares owned.”⁹⁵ One of the traditional cooperative principles, however, is that distributions should not be based on capital ownership, but rather on some measure of the member’s use of the cooperative.⁹⁶ To the extent that the taxation of C corporation distributions is based on a pro rata relationship to equity, that taxation structure is inappropriate in a cooperative context.⁹⁷

Subchapter T recognizes the unique relationship between the cooperative and its patrons, employing a different standard for defining income for cooperative members. In so doing, even the Tax Code recognizes the importance of the Rochdale Principles in defining the outlines of cooperative business organizations.

93. *Id.* at 308.

94. *Id.* at 322 (citing *United States v. Miss. Chem. Co.*, 326 F.2d 569, 573–74 (5th Cir. 1964); *Pomeroy Coop. Grain Co. v. Comm’r*, 288 F.2d 326, 328 (8th Cir. 1961)).

95. Treas. Reg. § 1.368-1(e)(iii) (2016).

96. A. Richard Kimbrough, *Report of Special Committee on Cooperatives*, 22 TAX LAW. 754, 754–55 (1969).

97. The hallmark of the C corporation is the denial of a deduction for dividends paid when calculating gross income. The dividends are also taxed in the hands of the shareholders, resulting in the much-maligned “double tax” regime inherent in C corporation taxation. John N. Evans & Maria L. Castilla, *Despite Higher Rates, S Corporations Retain Advantages over C Corporations*, 91 PRAC. TAX STRATEGIES 271, 272 (2013) (explaining the disadvantages of double taxation); *cf.* I.R.C. § 243 (2012) (explaining that dividends received by a parent corporation from a controlled domestic corporation are entirely tax free under I.R.C. § 243). In lieu of the double tax regime of Subchapter C, Subchapter T sets up a pass-through entity regime specifically applicable only to qualified cooperatives. Essentially, the entity is allowed a deduction for amounts paid to patrons, but its patrons include the amounts received in income. A cooperative’s gross income is defined without any adjustment for any allocation or distribution to a patron of the net earnings of the cooperative, subject to certain exceptions for patronage dividends and certain retained allocations of revenue. *See* I.R.C. § 1382(b) (2012). This clarifies that these items are included in the gross income in the cooperative and then deducted, while retained earnings are deducted from gross income. These cooperative distributions are typically included in the income of the recipient patrons. *See* I.R.C. § 1385(a) (2012).

3. State Law Entity Definitions of Cooperatives

Every state has some type of cooperative enabling statute; some states have multiple statutes depending upon the type of cooperative.⁹⁸ “The nonuniform development of agricultural co-ops and cooperative law has resulted in significant variations in state cooperative statutes—many of which were enacted from 1910 to 1925. In fact, few states have the same cooperative statute.”⁹⁹ Despite this patchwork development of state law, there are some common themes to cooperative enabling statutes that stem from their historical relationship with agricultural development, dating back to the first cooperatives in the United States that were based on the Rochdale model.

Under some state statutes, a cooperative is a separate entity; however, under other statutes, a cooperative is a “flavor” of corporation.¹⁰⁰ In West Virginia, for example, a cooperative is incorporated under the Cooperative Association Act, but is then governed by the Business Corporation,¹⁰¹ Benefit Corporation,¹⁰² or Nonprofit Corporation Acts to the extent the Cooperative Association Act is silent.¹⁰³ For those corporations that elected to be treated as cooperative associations, the cooperative statute then limits the purposes and powers of the corporation in order to fulfill its cooperative purpose of service to members.¹⁰⁴

a. Early Cooperative Law and the Standard Act

One commentator points to the Michigan statute in 1865 as the first cooperative law.¹⁰⁵ Massachusetts passed its cooperative enabling legislation in 1866, which allowed for the incorporation of agricultural cooperatives.¹⁰⁶ A number of states followed the Massachusetts

98. BAARDA, *supra* note 46, at 103. “All states have recognized cooperatives’ special characteristics by enacting statutes specifically designed for incorporating cooperatives. The 50 States have approximately 85 such statutes” as of the time of Baarda’s article. *Id.*

99. Mark J. Hanson, *Legal Framework of Cooperative Development*, in COOPERATIVES AND LOCAL DEVELOPMENT: THEORY AND APPLICATIONS FOR THE 21ST CENTURY 95, 107 (Christopher D. Merrett & Norman Walzer eds., 2004).

100. See UNIF. LTD. COOP. ASS’N ACT comment to Section 101 (NAT’L CONFERENCE OF COMM’RS ON UNIF. STATE LAWS 2008), http://www.uniformlaws.org/shared/docs/limited%20cooperative%20association/ulcaa_final_07.pdf (The title of this Act indicates a limited cooperative association is a type of cooperative different from cooperatives modeled on a corporate form).

101. Business Corporation Act, W. VA. CODE § 31D-3-301 (2014).

102. Benefit Corporation Act, W. VA. CODE § 31F-3-301 (2014).

103. Nonprofit Corporation Act, W. VA. CODE § 31E-3-301 (2014).

104. W. VA. CODE § 19-4-1 to -29 (2015) (regarding Cooperative Associations).

105. See BAARDA, *supra* note 46, at 107.

106. CHARLES T. AUTRY & RONALD F. HALL, THE LAW OF COOPERATIVES 15 (2009).

model, such that there were at least ten states with cooperative incorporation statutes by the turn of the century.¹⁰⁷

The cooperative economist Aaron Sapiro¹⁰⁸ supported his concept of a product-centered, monopolistic agricultural marketing cooperative by drafting the Standard Marketing Act (widely known as the “Standard Act”),¹⁰⁹ which was adopted in a number of jurisdictions during the early 1920s.¹¹⁰ For example, the Bingham Act in Kentucky is widely identified as an example of the Standard Act as actually enacted by a state legislature.¹¹¹ According to James Baarda of the U.S. Department of Agriculture, forty-six different states had adopted some variation of the Standard Act by 1930.¹¹²

Sapiro’s Standard Act was specifically designed to coordinate with the requirements of the Capper–Volstead Act.¹¹³ Much like the Capper–Volstead Act itself, the Standard Act is limited to agricultural cooperatives¹¹⁴ and adopts three of the Rochdale Principles, which are incorporated into the Capper–Volstead Act: organization for the mutual benefit of the members; one member, one vote; and dividends on the basis of use and not capital.¹¹⁵ Early statutes that may have incorporated some cooperative values into the structure of the entity, however, were rapidly replaced or augmented by the Standard Act.¹¹⁶

107. *Id.* at 15. This includes Pennsylvania, Minnesota, Michigan, California, and New Jersey. *Id.* The Massachusetts model allowed for capital stock but did not place any restrictions on voting rights or distributions. *Id.*

108. See Roger G. Ginder, *Aaron Sapiro Theory of Cooperatives: A Contemporary Assessment*, J. AGRIC. COOPERATION 93, 99 (1993).

109. BAARDA, *supra* note 46, at 109.

110. See Amy M. Nagler et al., *Institutions and Agricultural Cooperatives in Wyoming 16* (Univ. of Wis. Ctr. for Cooperatives Staff Paper No. 4, 2004), <http://www.uwcc.wisc.edu/pdf/staff%20papers/staff04.pdf>. Baarda states that these jurisdictions included Alabama, Arizona, Arkansas, Georgia, Idaho, Kansas, Montana, North Carolina, North Dakota, Oregon, South Carolina, Texas, Washington, Kentucky, Louisiana, Maryland, Mississippi, Virginia, California, Colorado, Florida, Illinois, Maine, Minnesota, Ohio, Oklahoma, South Dakota, Tennessee, Utah, West Virginia, Wyoming, New Jersey, New York, Indiana, Nebraska, New Hampshire, New Mexico, and Rhode Island. BAARDA, *supra* note 46, at 110 nn.126–31.

111. BAARDA, *supra* note 46, at 109; NAGLER ET AL., *supra* note 110, at 16.

112. BAARDA, *supra* note 46, at 110.

113. NAGLER ET AL., *supra* note 110, at 16.

114. *Id.*

115. Harlan Huntley, *Historical Study of Wisconsin Cooperative Statutes*, 1954 WIS. L. REV. 571, 576 (1954).

116. Based on the success of the Standard Act, the National Conference of Commissioners for Uniform State Laws (NCCUSL) tried to introduce a “Uniform Agricultural Cooperative Association Act” in 1936 but it was only adopted in three states and was eventually withdrawn. BAARDA, *supra* note 46, at 110–11.

Over time, the states updated the Standard Act to expand the use of cooperatives.¹¹⁷ Wisconsin is a good example of a state law innovator in cooperative law. In 1911, Wisconsin allowed cooperatives to function in sectors beyond agriculture.¹¹⁸ The Wisconsin law allowed five persons to “associate” (as a cooperative) in the fields of dairy, mercantile, mining, and manufacturing;¹¹⁹ however, it continued to treat the cooperative as a “flavor” of corporation.¹²⁰ In 1921, as a result of a conference between representatives of the farm organizations and members of the Wisconsin Division of Markets, Wisconsin made some key revisions to its statute, including clarifying stock and nonstock associations and defining membership, voting rights, and new rules on earnings apportionment.¹²¹ The Wisconsin law was generally adopted by sixteen states in the following eight years.¹²²

b. Next Generation Cooperatives¹²³

One of the fundamental obstacles to the growth of cooperatives in the United States (and elsewhere) is the need for capital.¹²⁴ The cooperative’s primary mission to serve its members can hinder its ability to raise capital. If equity ownership in the cooperative is legally limited to its members, then using equity to raise capital is only possible if the individual members have capital to contribute. For a cooperative that is focused on addressing the needs of members who may be socially or economically disadvantaged, it seems unlikely that the individual members could provide sufficient funding to start a capital-intensive business.

117. Diane Rizzuto Suhler & Michael L. Cook, *Origins of a Current Conflict? An Examination of Stock-Nonstock Cooperative Law*, 8 J. COOPERATIVES 54, 57 (1993) (“The basic provisions of these laws mirrored the Rochdale Principles. Some of the common provisions included: cooperatives could issue shares but could limit the number of shares held by each member; voting was on the basis of members, not shares; each member had one vote; the basis of distributing earnings was established by individual cooperatives.”); see also Huntley, *supra* note 115, at 571–72.

118. 20 GEORGE HAROLD POWELL, COOPERATION IN AGRICULTURE 45 (1913).

119. *Id.*

120. See Huntley, *supra* note 115, at 575.

121. Suhler & Cook, *supra* note 117, at 60.

122. BAARDA, *supra* note 46, at 107–08 & n.113 (citing NOURSE, THE LEGAL STATUS OF FARMER COOPERATION 46 n.23 (1927)) (indicating Michigan, Minnesota, South Dakota, New York, Kansas, Washington, Massachusetts, Virginia, Iowa, Wyoming, North Carolina, South Carolina, Oregon, Rhode Island, Kentucky, and Oklahoma and later, Nebraska, Colorado, Indiana, North Dakota, and Florida adopted the Wisconsin law).

123. These cooperatives are also referred to as “new generation,” “new age,” or “value added” cooperatives. See ZEULI & CROPP, *supra* note 22, at 22; see also AUTRY & HALL, *supra* note 106, at 20–22; BAARDA, *supra* note 46, at 110 (including Wyoming, Minnesota, and Tennessee).

124. ZEULI & CROPP, *supra* note 22, at 4.

In order to address difficulties experienced by traditional cooperatives in raising capital, some states have adopted “Next Generation Cooperative” (NGC) legislation.¹²⁵ In 1999, a group of Wyoming lamb farmers wanted to process “value-added product”¹²⁶—for example, breaking down the lamb in to marketable cuts and processing pelts.¹²⁷ This plan required a significant capital expenditure, which appeared to be unavailable through loans or additional membership capital.¹²⁸ In 2001, the lamb producers successfully obtained a change to Wyoming’s cooperative enabling statute,¹²⁹ which now allows for investment and management by non-member-patrons.¹³⁰ Minnesota followed in 2003,¹³¹ with others coming soon thereafter.¹³²

In an effort to address the problem of raising capital that haunts the traditional cooperative, NGCs generally allow for some type of capital investments by non-members.¹³³ Some percentage of the cooperative’s annual profit must be reserved for patron-member¹³⁴ distributions. Wyoming’s statute requires a cooperative to allocate at least fifteen percent of its annual profits to patron-members,¹³⁵ while Min-

125. *Id.* at 22.

126. Shermain D. Hardesty, *New State Statutes Allow Nonmember Equity Capital for Cooperatives*, U. CALIFORNIA SMALL FARM PROGRAM, <http://sfp.ucdavis.edu/cooperatives/Reports/wyoming/> (last updated May 22, 2012).

127. See Sue Rosler, *Lamb Producer Cooperative Purchases Processing Plant*, FARM & RANCH GUIDE (Dec. 16, 2015), http://www.farmandranchguide.com/news/livestock/lamb-producer-cooperative-purchases-processing-plant/article_49911d02-a04c-11e5-8e30-67576aafc859.html.

128. As more cooperatives try to vertically integrate the processing, marketing, and delivery of their product, this capital issue repeatedly arises. Hanson, *supra* note 99, at 12.

129. WYO. STAT. ANN. §§ 17-10-201 to -253. (2013).

130. *Id.*; see Hardesty, *supra* note 126; see also NAGLER ET AL., *supra* note 110, at 22–23.

131. Hardesty, *supra* note 126; see MINN. STAT. §§ 308B.001–.975 (2016).

132. The Prefatory Note to the ULCAA drafted in 2007, discussed in Section I.C.3.d., specifically examined the next generation cooperative statutory provisions of Wyoming (WYO. STAT. ANN. §§ 17-10-201 to -253), Minnesota (MINN. STAT. ANN. §§ 308B.001–.975), Tennessee (TENN. CODE ANN. §§ 43-38-101 to -1109 (2014)), Iowa (IOWA CODE ANN. §§ 501A.101–.1216 (2016)), Wisconsin (WIS. STAT. ANN. §§ 193.001–.971 (2016)), and Nebraska (NEB. REV. STAT. §§ 21-2901 to -29,134 (2015)).

133. “This may range from preferred stock with no rights to vote on the one hand to actual non-patronage membership and representation on the board of directors on the other.” BAARDA, *supra* note 46, at ii.

134. For purposes of discussions of NGCs in this article, the term “patron-member” refers to an owner of a cooperative that is also part of the class of persons that the cooperative was formed to serve. In this context, the term “member” is no longer adequate to describe this set of individuals as an investor can now be a member of the cooperative and because under NGCs, a cooperative can be in limited liability company form.

135. See WYO. STAT. ANN. § 17-10-233. Tennessee’s statute contains the same requirement. See TENN. CODE ANN. § 43-38-901.

nesota's default rule is that fifty percent of the annual profits must be reserved to patron-members.¹³⁶

In a traditional cooperative, the cooperative is not only owned but also exclusively managed by its member-patrons.¹³⁷ In the NGC, the investors may participate in the management of the cooperative although there is usually a minimum threshold for member-patrons voting. For example, in Minnesota and Iowa, the cooperative's governing documents may not reduce the vote of the member-patrons to below fifteen percent of total voting power,¹³⁸ while Wisconsin's NCG statute appears to require member-patrons to have not less than fifty-one percent of the total vote collectively.¹³⁹

The provisions of NGC enabling statutes that allow non-members to both own equity and participate in management clearly runs afoul of more traditional, Rochdale-inspired notions of the cooperative business model. Traditional cooperatives avoided the inevitable tension that would arise between cooperative member-owners and profit-oriented investors by simply not having investors other than members. By reintroducing an investor class into the cooperative, this fundamental tension reappears.

In order to resolve this tension as a legal matter, it must be determined whether the governing body of an NGC owes a duty of care to all of the members, the patrons-members, or some other subset of stakeholders in the cooperative. Does the presence of investors in a NGC (especially a NGC in business corporation form) now mean that the traditional for-profit fiduciary duty to maximize shareholder profit applies? If it does apply, is it tempered in whole or in part by the cooperative's duty to further the interests of its patron-members?

The Wyoming Processing Cooperative statute is silent on the matter; the Minnesota statute provides the director must act "in a manner the director reasonably believes to be in the best interests of the cooperative."¹⁴⁰ While the Minnesota's provision resembles the standard

136. That amount can be lowered to as little as fifteen percent if the cooperative's governing documents or a vote of the patron-members so provides. *See* MINN. STAT. ANN. § 308B.721; *see also* IOWA CODE ANN. § 501A.1005; NEB. REV. STAT. § 21-2980. Wisconsin provides for a fifty-one percent default rule for patron-members, which may be lowered to thirty percent. Wis. STAT. ANN. § 193.601(4).

137. *See History of the Co-operative Movement, supra* note 23.

138. Generally, the member-patrons and the investors vote as separate blocks and/or classes. Additionally, the governing body of the cooperative must have representatives who are elected by the member-patrons. *See, e.g.,* IOWA CODE ANN. § 501A.810; MINN. STAT. ANN. § 308B.545(1).

139. WIS. STAT. ANN. § 193.545.

140. MINN. STAT. ANN. § 308B.455(1); *see also* IOWA CODE ANN. § 501A.712; NEB. REV. STAT. § 21-2970(1)(c); TENN. CODE ANN. § 43-38-616.

formulation of the duty of care for most for-profit corporations,¹⁴¹ the Wisconsin NGC statute takes a different approach. The Wisconsin statute starts with the same formula of the duty of care reflected in Minnesota and Iowa's legislation, but then provides as follows:

- (b) In discharging his or her duties to the cooperative and in determining what he or she believes to be in the best interests of the cooperative, a director may consider any of the following:
1. The effects of the action on employees, suppliers, creditors, and customers of the cooperative.
 2. The effects of the action on communities in which the cooperative operates.
 3. The effects of the action on members and stockholders.
 4. The economy of this state.
 5. The long-term and short-term interests of the cooperative and its patron members, including the possibility that these interests may be best served by the continued independence of the cooperative.
 6. Any other factors the director considers pertinent.¹⁴²

In this regard, the Wisconsin's duty of care for cooperatives parallels traditional corporate constituency statutes.¹⁴³

Constituency statutes purport to amend a corporate board of directors' traditional fiduciary duty of care to maximize shareholder value.¹⁴⁴ Typically, courts will invoke the business judgment rule to give rise to a rebuttable presumption that a board's decisions are in the best interests of the corporation, so long as those decisions are informed, reasonable, and in good faith.¹⁴⁵ This grants boards some latitude of discretion in making decisions.¹⁴⁶ In the everyday administration context, a board could probably consider non-profit maximization factors so long as the action was in the best interests of the company overall, although the extent of that discretion has never been clear.¹⁴⁷ In the context of a takeover, however, the board is much

141. See MINN. STAT. ANN. § 308B.455.

142. WIS. STAT. ANN. § 193.455(1)(b).

143. Compare, for example, Illinois' constituency statute, which states "In discharging the duties of their respective positions, the [governing body] may, in considering the best interests of the corporation, consider the effects of any action upon employees, suppliers, and customers of the corporation, communities in which officers or other establishments of the corporation are located and all other pertinent factors." 805 ILL. COMP. STAT. 32/8.85 (2014).

144. See Stephen M. Bainbridge, *Interpreting Nonshareholder Constituency Statutes*, 19 PEPP. L. REV. 971, 976 (1992) (citing *Dodge v. Ford Motor Co.*, 170 N.W. 668 (Mich. 1919)); see also Richard B. Tyler, *Other Constituency Statutes*, 59 MO. L. REV. 373, 375 (1994); Nathan E. Standley, Note, *Lessons Learned from the Capitulation of the Constituency Statutes*, 4 ELON L. REV. 209, 219 (2012).

145. Bainbridge, *supra* note 144, at 977.

146. Anthony Bisconti, Note, *The Double Bottom Line: Can Constituency States Protect Socially Responsible Corporations Stuck in Revlon Land*, 42 LOY. L.A. L. REV. 765, 787 (2009).

147. Bainbridge, *supra* note 144, at 976.

more constrained. In 1986, the Delaware Supreme Court in *Revlon, Inc. v. MacAndres & Forbes Holdings, Inc.*,¹⁴⁸ held that the board has a duty to pursue the highest possible price per share and cannot sacrifice shareholder value for other considerations.¹⁴⁹ *Revlon* “sharply limits directors’ ability to consider non-shareholder interests”¹⁵⁰ in the takeover or similar structural change contexts.¹⁵¹

In order to allow governing bodies to consider factors other than price per share (such as the effects on the community or employees), many states enacted so-called “constituency statutes.” The first such statute was passed in 1983 by Pennsylvania,¹⁵² with a majority of states following thereafter.¹⁵³ Generally, a constituency statute amends the directors’ traditional duty of care¹⁵⁴ to allow (but not require)¹⁵⁵ the board to consider the interests of corporate stakeholders other than just the shareholders when determining whether an action is in the best interest of the corporation.¹⁵⁶ This typically allowed a director to consider the interest of employees, the community, and other pertinent interests.

In its NGC statute, Wisconsin adapted the traditional corporate constituency statute to cooperative use. The NGC statute clearly recognizes that members, stockholders, and patrons are different stake-

148. 506 A.2d 173 (Del. 1986).

149. Bisconti, *supra* note 146, at 779–80.

150. In *Revlon*, the board took into consideration the interests of certain debt holders when deciding to accept a bid that offered a lower price per share to the shareholders. *Revlon*, 506 A.2d at 177–78.

151. Bainbridge, *supra* note 144, at 983.

152. 15 PA. CONS. STAT. 515(a) (2016). The statute reads as follows:

(a) General rule. In discharging the duties of their respective positions, the board of directors, committees of the board and individual directors of a domestic corporation may, in considering the best interests of the corporation, consider to the extent they deem appropriate:

(1) The effects of any action upon any or all groups affected by such action, including shareholders, members, employees, suppliers, customers and creditors of the corporation, and upon communities in which offices or other establishments of the corporation are located.

(2) The short-term and long-term interests of the corporation, including benefits that may accrue to the corporation from its long-term plans and the possibility that these interests may be best served by the continued independence of the corporation.

(3) The resources, intent and conduct (past, stated and potential) of any person seeking to acquire control of the corporation.

(4) All other pertinent factors.

Id. (emphasis added).

153. Bisconti, *supra* note 146, at 781.

154. For an example of the corporate duty of care, see REVISED MODEL BUSINESS CORPORATION ACT § 8.30(a) (1984).

155. Except Connecticut, which is mandatory. See CONN. GEN. STAT. § 33-313(e) (2016).

156. Bainbridge, *supra* note 144, at 986.

holders in the cooperative organization, with potentially different interests.¹⁵⁷ The statute further allows for the consideration of the needs of employees or customers, who may also be patrons of the cooperative.¹⁵⁸ Finally, the statute permits a board to consider the needs of its immediate community and the state, emphasizing the ability of the cooperative to consider public impacts in a manner consistent with the ICA's cooperative principle of "concern for community."¹⁵⁹

The structure of these NGCs raises the issue of whether cooperative law has strayed too far from its principled beginnings. "Sharing cooperative control may sooner or later undermine the strengths of cooperatives as sole representatives"¹⁶⁰ of the interests of the members. "Conflicts in motivations and objectives between those who wish to benefit from use and those who wish to benefit from returns on investment will make good governance difficult if not impossible."¹⁶¹ Indeed, the entire point of the traditional Rochdale cooperative was to be responsive to the needs of members, even if those needs do not involve or even run contrary to a profit motive.

While it is too early to tell, some in the cooperative community are concerned that the interests of the members are no longer aligned with the interests of this new class of cooperative capital. "Some new generation businesses appear to have adopted more of an 'investor' rather than 'user' culture."¹⁶² In the case of the first generation of NCGs, the danger is that cooperatives are drifting away from Draheim's "dual-natured" cooperative¹⁶³ by so de-emphasizing the social nature of the cooperative that the cooperative's social capital¹⁶⁴ is eroded to the point of inconsequence. While Wisconsin's constituency statute language may be helpful in this regard, its language is merely permissive in nature and still requires the governing body to act in the best interests of the cooperative as a whole.¹⁶⁵

157. Compare WIS. STAT. ANN. § 193.455(1)(b)(3) (2016), with WIS. STAT. ANN. § 193.455(1)(b)(5).

158. WIS. STAT. ANN. § 193.455(1)(b)(1).

159. *Id.* § 193.455(1)(b)(2), (4), (6); see *supra* Section II.A.3 (discussing the ICA principles).

160. BAARDA, *supra* note 46, at iii.

161. *Id.*

162. Torgerson et al., *supra* note 51; Bruce J. Reynolds & Thomas W. Gray, *Evolution of Cooperative Thought, Theory, and Purpose*, UNIV. OF WISCONSIN CENTER FOR COOPERATIVES, <http://www.uwcc.wisc.edu/info/torg.html> (last visited Sept. 8, 2016).

163. See *supra* Part I.B.1.

164. See *supra* Part I.B.2.

165. WIS. STAT. ANN. § 193.455(b) ("in determining what he or she believes to be *in the best interest of the cooperative*, a director *may* consider any of the following" (emphasis added)).

c. Uniform Limited Cooperative Association Act¹⁶⁶

In response to the growth of Next Generation Cooperatives, the National Conference of Commissioners for Uniform State Laws (NCCUSL) made a second attempt at drafting uniform cooperative legislation.¹⁶⁷ In 2003, NCCUSL created a drafting committee to address the possibility of developing a new cooperative law¹⁶⁸ based upon the efforts in Wyoming and Minnesota.¹⁶⁹

The Uniform Limited Cooperative Association Act (ULCAA),¹⁷⁰ approved in 2007, “recognizes a growing trend toward the ‘New Generation Cooperative’ (NGC), which can include features not readily available under traditional cooperative law.”¹⁷¹ As with other NGC statutes, the ULCAA allows for cooperative ownership and management by non-member investors.¹⁷² Unlike the first NGCs in Wyoming and Iowa, however, the ULCAA makes great efforts to understand and incorporate the social nature of the cooperative into the enabling legislation to offset the potential issues raised by having a non-patron investor class. As a result, the ULCAA tries to minimize the damage to the social side of the cooperative and establish the primacy of member-patron interests even in the face of outside investors.

Cooperatives under the ULCAA do not necessarily “piggy back” on to existing corporate statutes. The ULCAA Drafting Committee indicated that one of the primary influences on its definition of a co-

166. UNIFORM LIMITED COOPERATIVE ASSOCIATION ACT (NAT’L CONFERENCE OF COMM’RS ON UNIF. STATE LAWS 2007), http://www.uniformlaws.org/shared/docs/limited%20cooperative%20association/ulcaa_final_07.pdf.

167. For a discussion of NCCUSL’s first attempt, see UNIFORM LIMITED COOPERATIVE ASSOCIATION ACT prefatory note at 1 (NAT’L CONFERENCE OF COMM’RS ON UNIF. STATE LAWS 2013).

168. The study committee’s early efforts focused solely on agricultural cooperatives, but in 2005 NCCUSL voted to expand the scope of the drafting committee’s charge to address non-agricultural cooperatives as well. BAARDA, *supra* note 46, at 127.

169. UNIFORM LIMITED COOPERATIVE ASSOCIATION ACT prefatory note at 5 (NAT’L CONFERENCE OF COMM’RS ON UNIF. STATE LAWS 2013).

170. See generally *id.*; Thomas Earl Geu & James B. Dean, *The New Uniform Limited Cooperative Association Act: A Capital Idea for Principled Self-Help Value Added Firms, Community-Based Economic Development, and Low-Profit Joint Ventures*, 44 REAL PROP. TR. & EST. L.J. 55 (2009) (providing an extensive discussion of the ULCAA written by two NCCUSL reporters).

171. *Why States Should Adopt ULCAA*, UNIFORM LAW COMM’N, <http://www.uniformlaws.org/Narrative.aspx?title=Why%20States%20Should%20Adopt%20ULCAA> (last visited Jan. 14, 2017).

172. See UNIFORM LIMITED COOPERATIVE ASSOCIATION ACT § 601 cmt. ¶ 2(c) (NAT’L CONFERENCE OF COMM’RS ON UNIF. STATE LAWS 2013) (“This act does not prevent a limited cooperative association from engaging in business or other activities with non-members.”). As of 2016, ULCAA has been adopted in Utah, Colorado, Nebraska, Oklahoma, Vermont, and the District of Columbia.

operative was the federal income tax definition.¹⁷³ As with the other NGC statutes, the ULCAA allows for unincorporated cooperatives, which would allow a cooperative to form as a LLC or partnership.¹⁷⁴ A NGC formed as a LLC or partnership would qualify for pass-through taxation rather than traditional C corporation taxation, making qualification for the Subchapter T cooperative modifications unnecessary.¹⁷⁵ Because of the broad definitions and flexibility built into the ULCAA, a cooperative that took full advantage of the non-member ownership and management provisions of the ULCAA might not qualify for antitrust exemption under the Capper–Volstead Act.¹⁷⁶ While ULCAA cooperatives that are not concerned about Subchapter T or the Capper–Volstead Act retain the operational flexibility, these ULCAA cooperatives do not automatically adopt the Rochdale-type values that are inherent in the definition of a cooperative for purposes of the tax and antitrust laws.

In spite of the fact that the ULCAA veers away from the traditional Rochdale Principles¹⁷⁷ by allowing ownership, management and voting by non-patron investors, the Drafting Committee specifically states that it sought to “provide an alternative which accounts for cooperative principles to a greater extent, with less room for design abuse”¹⁷⁸ In its Prefatory Note, the Drafting Committee specifically listed the cooperative principles enumerated by the ICA as the touchstone for cooperative organization.¹⁷⁹

This adoption of the ICA’s restatement of traditional cooperative values is evident in the ULCAA’s duty of care. The ULCAA directs cooperatives to look to its underlying applicable corporate statute for the appropriate standard of conduct.¹⁸⁰ This general direction, however, is specifically subject to the provisions of section 820 of the ULCAA, which states as follows:

173. UNIFORM LIMITED COOPERATIVE ASSOCIATION ACT prefatory note at 2 (2007).

174. *Id.* at 1–5; *see also id.* § 101 cmt.

175. Subchapter T applies to farmers’ cooperatives exempt under § 521. *See* I.R.C. § 1381. For more information on the C corporation and Subchapter T taxation, *see supra* Section II.C.2.

176. *See* UNIFORM LIMITED COOPERATIVE ASSOCIATION ACT prefatory note at 6 (2007).

177. This is acknowledged by NCUSL: “While New Generation cooperatives involve some significant departures from traditional cooperative structure, they have been organized under traditional cooperative statutes.” UNIFORM LIMITED COOPERATIVE ASSOCIATION ACT prefatory note at 5 (NAT’L CONFERENCE OF COMM’RS ON UNIF. STATE LAWS 2007), http://www.uniformlaws.org/shared/docs/limited%20cooperative%20association/ulcaa_final_07.pdf.

178. *Id.* at 2.

179. *Id.* at 4 (citing Gene Ingalsbe & Frank Groves, *Historical Development, in COOPERATIVES IN AGRICULTURE* 106, 110–11 (David Cobia ed., 1989)).

180. UNIFORM LIMITED COOPERATIVE ASSOCIATION ACT § 818. This appears to be the case even if even if the cooperative ultimately determines to remain unincorporated.

Unless the articles of organization otherwise provide, in considering the best interests of a limited cooperative association, a director of the association in discharging the duties of director, in conjunction with considering the long and short term interest of the association and its patron members, may consider:

- (1) the interest of employees, customers, and suppliers of the association;
- (2) the interest of the community in which the association operates; and
- (3) other cooperative principles and values that appropriately can be applied in the context of the decision.¹⁸¹

Similar to the Wisconsin NGC statute,¹⁸² section 820 of the ULCAA specifically allows the governing body of a cooperative to consider the impact of its actions on constituencies other than its equity owners. Both section 820 of the ULCAA and the Wisconsin statute allow the governing body to take into consideration ICA cooperative principle number 7, the impact on the community. Unlike the Wisconsin statute, however, the ULCAA allows the cooperative to consider additional traditional cooperative principles and values, such as those enumerated by the Rochdale Pioneers and the ICA.¹⁸³

Section 820 of the ULCAA essentially acts as a cooperative constituency statute, allowing the governing body of the cooperative to consider factors other than maximization of value for the cooperative's equity holders. The notes accompanying section 820 state that this provisions allow the cooperative to be governed "in keeping with traditional cooperative values and principles, *e.g.*, community interests, interests of persons related to the cooperative, and other appropriate cooperative principles such as education"¹⁸⁴ In keeping with the flexible approach of the ULCAA, a cooperative with a heavy investor focus could delete or limit the impact of section 820 in its governing documents. Adopting this language, however, would allow the governing body of a NGC formed under the ULCAA to continue to observe the social values inherent in a traditional Rochdale cooperative,¹⁸⁵ such as education and community betterment.¹⁸⁶

The ULCAA offers the modern cooperative a choice of identity. On the one hand, if the cooperative is primarily concerned with capital formation and issues of investment and return, it can fully avail

181. *Id.* § 820 (emphasis added).

182. WIS. STAT. ANN. § 193.455 (2016).

183. UNIFORM LIMITED COOPERATIVE ASSOCIATION ACT § 820(3); *see also supra* Section II.A.

184. UNIFORM LIMITED COOPERATIVE ASSOCIATION ACT § 820 notes.

185. History of the Co-operative Movement, *supra* note 23.

186. For discussion of the cooperative principles, see *supra* Section II.A.

itself of the new features of NGC enabling statutes and elect not to adopt the constituency provisions of the ULCAA's duty of care. Alternatively, a cooperative can choose to follow the traditional path that originated with the Rochdale Pioneers and was embodied in the ICA standards and early cooperative enabling legislation. This path allows a traditional cooperative the flexibility not to have non-patron members and to continue adhering to the democratic membership voting. Finally, a cooperative could draft the constituency statute utilizing provisions of the ULCAA, which would allow it to continue to emphasize the traditional cooperative values of community benefit, education, concern for labor, and sustainability.

III. DOES THE COOPERATIVE HAVE A CHARITABLE PURPOSE?

As envisioned by the Rochdale Pioneers, a traditional cooperative is not just another business enterprise. Rather, the cooperative should be an arrangement "for the pecuniary benefit, and improvement of the social and domestic condition of its members . . ." ¹⁸⁷ The ICA, in adapting the Rochdale Principles to the modern cooperative movement, stresses social responsibility, opportunity, education, and joint cultural needs. If one views cooperatives as a social movement, there are clearly values and activities inherent in that movement that would be charitable in nature, even if those values and activities exist in concert with a desire for pecuniary gain among the cooperative's members.

A. Section 501(c)(3)'s Definition of Charitable

Section 501(a) of the Internal Revenue Code exempts from federal income taxation those organizations described in § 501(c). ¹⁸⁸ Most notably, § 501(c)(3) describes organizations that are organized and operated exclusively for charitable, educational, and similar purposes. ¹⁸⁹

The Treasury Regulations define the term "charitable" for § 501(c)(3) purposes by incorporating the general understanding of charity as developed under the common law. ¹⁹⁰ The Regulations also enumerate specific purposes that fall within the definition of charita-

187. *The Pioneers' Rule Book 1844*, *supra* note 28.

188. I.R.C. § 501(a) (2012).

189. I.R.C. § 501(c)(3). This section specifically exempts organizations that are "religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition . . . or for the prevention of cruelty to children or animals . . ." *Id.*

190. Treas. Reg. § 1.501(c)(3)-1(d)(2) (2016).

ble, including the “relief of the poor and distressed or of the underprivileged . . . [and the] promotion of social welfare by organizations designed . . . to combat community deterioration and juvenile delinquency.”¹⁹¹ Similarly, the Treasury Regulations define the term “educational” for § 501(c)(3) purposes to include “[t]he instruction or training of the individual for the purpose of improving or developing his capabilities”¹⁹²

The statutory language of § 501(c)(3) requires an exempt organization to be both organized and operated exclusively to further its enumerated charitable and educational purposes.¹⁹³ Under the Regulations, an organization is “not organized or operated exclusively for one or more of the [tax-exempt purposes] . . . unless it serves a public rather than a private interest.”¹⁹⁴ “Exclusively” for these purposes does not necessarily mean that no private benefit exists; rather,

[a]n organization will be regard as *operated exclusively* for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes . . . [a]n organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.¹⁹⁵

That being said, private individuals frequently benefit from charitable organizations—one need look no further than a scholarship recipient or an individual receiving disaster relief funds.¹⁹⁶ In these circumstances, the organization accomplishes its charitable mission by benefiting individual recipients; the recipients are the “instruments” through which the charity acts.¹⁹⁷ Accordingly, providing benefits to a

191. *Id.*; see also Matthew J. Rossman, *Evaluating Trickle Down Charity: A Solution for Determining When Economic Development Aimed at Revitalizing America's Cities and Regions Is Really Charitable*, 79 BROOK. L. REV. 1455, (2014). The Regulations specifically state, “Such term includes: Relief of the poor and distressed” Treas. Reg. § 1.501(c)(3)-1(d)(2). As a technical matter, the charitable purposes that are enumerated in the regulations should only be examples, and not the exclusive definition of charity. In practice, the IRS and courts tend to frame arguments about the definition of “charitable” around the enumerated purposes in the Regulation, even if a particular item could fall within the “broad outlines of charity as developed by judicial decisions.” *Id.*

192. Treas. Reg. § 1.501(c)(3)-1(d)(3)(a).

193. I.R.C. § 501(c)(3) (2012).

194. Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii).

195. Treas. Reg. § 1.501(c)(3)-1(c)(1). *Id.*; see also *Ky. Bar Found. v. Comm’r*, 78 T.C. 921, 923 (1982) (citing *Church in Boston v. Comm’r*, 71 T.C. 102, 107 (1978)) (“‘[E]xclusively’ is given a connotation different from its ordinary meaning. It does not mean ‘solely’ or ‘absolutely without exception.’”); Rossman, *supra* note 191, at 1474.

196. *Am. Campaign Acad. v. Comm’r*, 92 T.C. 1053, 1074 (1989) (“[The IRS] recognizes that an educational organization exists to confer primary private benefits by instructing or training individuals for the purpose of improving or developing his or her capabilities.”).

197. *Aid to Artisans v. Comm’r*, 71 T.C. 202, 214 (noting that the charity’s activities of import and sale of handcrafted goods “are not an end unto themselves, but rather undertaken in order to accomplish certain exempt purposes”); see also Rev. Rule 72-559, 1972-2 C.B. 247.

charitable class of individuals is not a prohibited private benefit so long as the benefit specifically furthers the organization's tax-exempt purpose.¹⁹⁸ This includes the provision of private benefits to such individuals when they are "focused on furthering a particular targeted private interest" such that the "secondary benefit ceases to be incidental."¹⁹⁹

Such private benefits are incidental and collateral to the charity's tax-exempt activities²⁰⁰ if a two-part test is met: (1) the benefit is a qualitatively incidental because it is a necessary result of the charitable activity, and (2) the benefit is quantitatively incidental because it is insubstantial in comparison to the charitable benefit to the public.²⁰¹

In many instances, an organization that loses its tax-exempt status due to private benefit issues may be engaging in otherwise charitable behavior. An organization may undertake charitable activities, but because of the existence of non-incidental private benefit, the charity no longer meets the "organized and operated exclusively" test. In *American Campaign Academy v. Commissioner*,²⁰² the IRS conceded that the organization was actually running a school that trained individuals in political fieldwork that would have been "educational" for § 501(c)(3) purposes, but for the substantial private benefit running to the Academy's organizers (the Republican party).²⁰³ The Tax Court in *American Campaign Academy*²⁰⁴ noted, "The presence of a single

198. *Aid to Artisans*, 71 T.C. at 213 (examining a charity that purchased handmade items from disadvantaged artists through an artist cooperative); see also *Am. Campaign Acad.*, 92 T.C. at 1076; *Ky. Bar Found.*, 78 T.C. at 926.

199. *Am. Campaign Acad.*, 92 T.C. at 1074.

200. *Better Bus. Bureau of Wash., D.C., Inc. v. United States*, 326 U.S. 279, 283–84 (1945); see *Am. Campaign Acad.*, 92 T.C. at 1061–62; *Columbia Park & Recreation Ass'n v. Comm'r*, 88 T.C. 1, 18 (1987), *aff'd*, 838 F.2d 465 (4th Cir. 1988) (per curiam); see also Rossman, *supra* note 191, at 1459.

201. I.R.S. Gen. Couns. Mem. 39,862 (Nov. 22, 1991); Rossman, *supra* note 191, at 1475. For a critique of the private benefit doctrine, see generally John D. Colombo, *In Search of Private Benefit*, 58 FLA. L. REV. 1063 (2006) [hereinafter *In Search*]; John D. Colombo, *Private Benefit, Joint Ventures and the Death of Healthcare as an Exempt Purpose*, 34 J. HEALTH L. 505 (2001).

202. 92 T.C. 1053 (concerning a school that otherwise provided educational benefits to students was denied tax-exempt status due to a "secondary" private benefit to the school's organizers, the Republican Party).

203. *Id.* at 1056; see Treas. Reg. § 1.501(c)(3)-1(d)(3)(ii) (2016), ex.1 & 3 (exempting trade schools and correspondence courses, respectively); see also Rev. Rul. 2006-27; Colombo, *In Search*, *supra* note 201, at 1074.

204. *Am. Campaign Acad.*, 92 T.C. at 1065 (citing *Better Bus. Bureau v. United States*, 326 US 279, 283 (1945)).

substantial nonexempt purpose destroys the exemption regardless of the number or importance of the exempt purpose.”²⁰⁵

Clearly, the organizational test would prohibit a for-profit entity, such as a cooperative, from obtaining tax-exempt status, as it would be operated for the substantial private interests of the members of the cooperative.²⁰⁶ That does not mean, however, that charitable and educational activities within the meaning of § 501(c)(3) cannot occur in a cooperative context even if the cooperative is not itself tax-exempt. A charity looking to further its tax-exempt mission by investing in a cooperative must identify those charitable activities that it can support and to tailor its assistance to further those activities.

B. *Economic Development as Charitable Activity*

Although the regulations under § 501(c)(3) do not expressly mention it, the IRS has long held that economic development can further tax-exempt charitable purposes. In most cases, economic development activities combat community deterioration or provide relief to the poor and underprivileged, which explicitly allows the activities to fall within the regulatory definition of charitable.

Charitable economic development can encompass a number of different activities. For example, economic development can include providing technical assistance, training, and counseling to businesses in blighted areas.²⁰⁷ It can even include loans to or equity investments in businesses, so long as those loans or investments are designed to combat community deterioration, provide relief to the poor, or otherwise further an enumerated charitable purpose.²⁰⁸ Typically, these types of investments are allowed if the business will provide training or employment to under-employed communities.²⁰⁹ Key to these rulings is that the organization funding economic development must have a “clear and independent charitable purpose . . . in making funds available to organizations not themselves exempt.”²¹⁰

205. *Am. Campaign Acad.*, 92 T.C. at 1065; *see also* *Ky. Bar Found. v. Comm’r*, 78 T.C. 921, 923 (1982) (citing *Ohio Teamsters Trust Fund v. Comm’r*, 77 T.C. 189, 196 (1981) and *Prof’l Standards Review v. Comm’r*, 74 T.C. 240 (1980)).

206. *Treas. Reg.* § 1.501(c)(3)-1(d)(3)(ii). Of course, it would also fail the statutory private inurement test as well. *Id.*

207. *Rev. Rul.* 74-587, 1974-2 C.B. 162 at 2; *see also* *Gen. Couns. Mem.* 33,992; *Gen. Couns. Mem.* 35,076; *Gen. Couns. Mem.* 35,936.

208. *Rev. Rul.* 74-587, 1974-2 C.B. 162.

209. *Rev. Rul.* 81-284, 1981-2 C.B. 130.

210. *I.R.S. Gen. Couns. Mem.* 35,966 at 4; *see also* *I.R.S. Gen. Couns. Mem.* 36,744 at 1 (“*Rev. Rul.* 74-587 deals with an organization that had a clear and independent charitable purpose in making funds available to organization not themselves exempt.”).

Because economic development activities typically involve the provision of services or funds to for-profit business, they often raise serious private benefit concerns. "The theory behind recognizing economic development corporations as exempt under IRS 501(c)(3) is that although services are provided directly to for-profit businesses, the ultimate good received by the general public outweighs the private benefit accorded to the direct beneficiaries."²¹¹ In these cases, the businesses are "merely the instruments by which the charitable purposes are sought to be accomplished."²¹²

In Revenue Ruling 74-587, a § 501(c)(3) organization planned to provide loans to or make equity investments in businesses in economically depressed urban areas, the residents of which were primarily minorities or other disadvantaged groups.²¹³ The funds would provide working capital to businesses that were "not able to obtain funds from conventional commercial sources because of the poor financial risks involved in establishing and operating enterprises in these communities."²¹⁴ The charitable organization represented that any loan terms would be designed to meet the needs of the business, and that equity investments would only be held as long as necessary to provide for the success of the business.²¹⁵ Revenue Ruling 74-587 makes it clear that a charity's loan or investment in a business cannot be motivated by profit, but rather it must be motivated by the accomplishment of its tax-exempt mission.²¹⁶

211. Robert Louthian & Marvin Friedlander, *G. Economic Development Corporations: Charity Through the Back Door*, EXEMPT ORGANIZATIONS—CONTINUING PROFESSIONAL EDUCATION ARTICLES (1992).

212. Rev. Rul. 74-587, 1974-2 C.B. 162.

213. *Rev. Rul. 74-587, 1974-2 C.B. 162*; see also I.R.S. General Couns. Mem. 35,936 (Aug. 7, 1974) approving of Rev. Rul. 74-587. According to Gen. Couns. Mem. 35,936, the organization in question in Rev. Rul. 74-587 was a Minority Enterprise Small Business Investment Company organized on a nonprofit basis.

214. Rev. Rul. 74-587, 1974-2 C.B. 162.

215. Rev. Rul. 74-587, 1974-2 C.B. 162.

216. Rev. Rul. 74-587, 1974-2 C.B. 162. This requirement was amplified by Revenue Ruling 81-284, which stated that an organization that was classified as a nonprofit small business investment company (SBIC) could qualify as tax-exempt under § 501(c)(3). Rev. Rul. 81-284, 1981-2 C.B. 130. SBICs were authorized by § 301(d) of the Small Business Investment Act of 1958, now found at 15 U.S.C. § 681(d). SBICs can make loans to or investments in and otherwise support qualified small businesses subject to various limitations. SBICs "are privately owned and operated to provide capital and long-term loans to small business . . .". GCM 35,966 (August 27, 1974) at 1. Under Small Business Administration regulations, a SBIC must set its loan rates in a manner that, in the aggregate, would recover the costs of the organizations for making the loans. The SBIC in Revenue Ruling 81-284 was organized and operated in an identical manner as the organization described in Rev. Rul. 74-587, except for the additional limitations imposed on its economic development activities by the SBIC regulations.

When considering whether economic development activity is charitable, one of the key factors identified by the IRS is whether the activity will provide opportunities for full time employment in an area that is chronically under-employed.²¹⁷ For example, in Revenue Ruling 76-419, the IRS recognized the exempt status of an organization that purchased blighted land and renovated for use as an industrial park in an economically depressed area. In selecting tenants for the industrial park, the charity intended to select businesses that aimed to employ and train otherwise unemployed individuals, with an emphasis on low skill workers.²¹⁸ Importantly, nothing in the Revenue Ruling required the businesses themselves to be owned by minority or economically challenged individuals. Rather, providing opportunities for employment is seen as a way to combat community deterioration and to fight poverty within the meaning of the definition of charitable for § 501(c)(3) purposes.²¹⁹

The scope of permissible economic development activities is not unlimited. In GCM 35966,²²⁰ the IRS did not recognize a non-profit minority enterprise SBIC (ME SBIC) as tax-exempt. A ME SBIC is a SBIC²²¹ that only loans money to or invests in businesses that are “at least 50 percent owned and managed by members of disadvantaged groups.”²²² The business need not be located in a depressed geographical area, however, and there is no requirement that the business be unable to access capital through conventional sources.²²³ Thus, the mere fact that the businesses are owned by a disadvantaged group would not be sufficient to establish that the ME SBIC operated for

217. See e.g., Rev. Rul. 74-587, 1974-2 C.B. 162 (1974), discussed *supra* notes 213–227 and accompanying text, which highlighted the need for employment opportunities in distressed areas; see also I.R.S. Gen. Couns. Mem. 39,047 (Nov. 2, 1983) (emphasizing the ability “to provide permanent full-time employment to area residents” as loan criteria).

218. Rev. Rul. 76-419, 1976-2 C.B. 146; see also I.R.S. Gen. Couns. Mem. 36,298; I.R.S. Gen. Couns. Mem. 39,883 (Oct. 16, 1992) (emphasizing the role of providing employment to residents in distressed areas in I.R.S. Gen. Couns. Mem. 39,047).

219. Rev. Rul. 76–419, 1976–2 C.B. 146 (“The organization’s activities serve not only to relieve poverty, but also to lessen neighborhood tensions caused by the lack of jobs and job opportunities in the area.”); Treas. Reg. § 1.501(c)(3)-1(d)(2); see also Rossman, *supra* note 191, at 1463 (“An important subset of many [community development corporation’s] activities also included local economic development as a mechanism for creating economic activity and jobs within the community.”); I.R.S. Gen. Couns. Mem. 39,883 (Oct. 16, 1992) (“Potential for job creation as a criterion in a proposal to take part in an economic development program in an areas of high unemployment.”).

220. I.R.S. Gen. Counsel. Mem. 35,966 (Aug. 27, 1974). The underlying ME SBIC statute was later amended in a manner that allowed the IRS to recognize some ME SBICs as exempt. See I.R.S. Gen. Couns. Mem. 38,401 (Jun. 5, 1980).

221. For a description of the SBIC program, see *supra* note 216 and accompanying text.

222. I.R.S. Gen. Couns. Mem. 35,966, at 3 (Aug. 27, 1974).

223. *Id.*

charitable purposes.²²⁴ Similarly, Revenue Ruling 77-111²²⁵ held that improving the general economic conditions in a depressed area is not charitable, as the benefits of such actions would accrue to the disadvantaged and the well-off indiscriminately. In distinguishing Revenue Ruling 74-587, Revenue Ruling 77-111 noted that the improvement of economic conditions as a general matter could not specifically target businesses that could not get conventional financing or to those that are owned by minorities or otherwise disadvantaged.²²⁶ Therefore, the for-profit businesses that would benefit from the improvement in economic conditions were neither owned by a charitable class, nor did they serve as instruments to benefit a charitable class.²²⁷

In the case of a community development organization,²²⁸ General Counsel Memorandum 39,883 helpfully summarizes these rulings into a set of criteria for exemption as charitable:

- 1) whether assistance is being provided to help local businesses or to attract new local facilities of established outside business, 2) whether the type of assistance provided by the community development organization has noncommercial terms and the potential to revitalize the disadvantaged area, and 3) whether there is a nexus between the business entities assisted and relieving the problems of the disadvantaged area or between the businesses and a disadvantaged group, like a minority, in the area.²²⁹

The General Counsel Memorandum specifically notes that, with regard to the second prong of the test, the assistance provided can be in the form of loans or the purchase of equity interests.²³⁰ Sadly, neither the General Counsel Memorandum, nor the private letter ruling to which it relates are precedential,²³¹ and this test has not been incorporated into other guidance.²³²

224. *Id.*

225. Rev. Rul. 77-111, 1977-1 C.B. 144.

226. *Id.*

227. *See also* Rev. Rul. 75-286, 1975-2 C.B. 210 (denying exemption to a block beautification program on the basis that the residents of the block were not numerous enough to constitute a charitable class, thereby providing a private benefit to the residents).

228. A community development organization—or CDC—was established as charitable § 501(c)(3) corporation empowered to meet a broad range of a distressed community's needs. *See* Rossman, *supra* note 191, at 1463.

229. I.R.S. Gen. Couns. Mem. 39,883, at 9 (Oct. 26, 1992).

230. *Id.*

231. *General Counsel Memoranda (GCM)*, IRS, <https://www.irs.gov/uac/general-counsel-memoranda-gcm> (last updated Mar. 7, 2017) (“It is important to note that [General Counsel Memoranda] cannot be used or cited as precedent.”); *Tax Exempt Bonds Private Letter Rulings: Some Basic Concepts*, IRS, <https://www.irs.gov/tax-exempt-bonds/teb-private-letter-ruling-some-basic-concepts> (last updated May 3, 2016) (“A PLR may not be relied on as precedent by other taxpayers or by IRS personnel.”).

232. Rossman, *supra* note 191, at 1482 (citing I.R.S. Priv. Ltr. Rul. 92-40-001 (May 1, 1992)).

For a cooperative activity to qualify as charitable economic development, the activity must benefit an objectively identifiable charitable class (either directly or indirectly) and must target that activity in such a manner to minimize any benefits accruing to private third parties. Furthermore, a key to the various Revenue Rulings in the economic development area is the inability of the benefitted business to obtain conventional financing. As discussed previously, cooperatives suffer from a lack of capital due to their member service orientation and their lack of preferential investor treatment.²³³ To some degree, it is almost a given that a cooperative (especially a cooperative working in areas of unemployment or poverty, or one that focuses on cottage industries with low margins) would be unable to obtain conventional financing.

Proving employment opportunities to a charitable class that is chronically under-employed clearly appears to qualify as charitable economic development, whether directly or through investment in an intermediary such as the employing business itself.²³⁴ By way of example, consider a workers' cooperative composed of recent immigrants from Central America that wish to roast and distribute fair-trade coffee obtained from farms in their home countries. While the cooperative itself is for-profit, and therefore violates both the private inurement and private benefit prohibitions of § 501(c)(3), which would prevent the entity from qualifying as tax exempt. That disqualification of the entity from exempt status that does not prohibit some of the cooperative's underlying activities as being classified as charitable. If immigrants from Central America constitute a charitable class, then it may be that the act of improving the employment opportunities for this class is, in isolation, a charitable activity.

C. Support of Labor as Charitable Activity

Clearly, charitable economic development activity focuses on job creation in areas of underemployment as a way to combat poverty and community deterioration. Tax-exempt activity in support of labor is not, however, limited to job creation. The terms "charitable" and "educational" with the meaning of § 501(c)(3) encompass job training,²³⁵

233. For discussion of capital formation difficulties in the discussion of next generation cooperatives, see *supra* Section I.C.3.c.

234. For a critique of the state of the law for evaluating charitable economic development, see generally Rossman, *supra* note 191.

235. For example, Goodwill Industries, while famous for its thrift stores, is exempt because it provides employment opportunities and job training to difficult-to-employ populations, such as the disabled and the recently incarcerated. Arlene McCrehan, *Goodwill's Heritage, Mission,*

job search assistance and education of laborers regarding workers' rights,²³⁶ and public interest litigation on labor issues.²³⁷

Worker centers are a fairly recent trend in the non-profit sector's support of labor. Worker centers²³⁸ are "non-profit organizations that typically provide services (like legal representation, know-your-rights trainings, and sometimes job-search assistance) their low-wage members."²³⁹ For example, the National Day Laborer Organizing Network (NDLON)²⁴⁰ is a § 501(c)(3) public charity²⁴¹ that works to improve the lives of day laborers in an effort "to protect and expand their civil, labor and human rights" and to seek "safer, more humane environments for day laborers, both men and women, to earn a living, contribute to society, and integrate into the community."²⁴² NDLON is a membership organization, which currently consists of at least forty²⁴³ regional non-profit organizations that work with day laborers.²⁴⁴ The organization sponsors research on labor issues and posts a number of reports on its website.²⁴⁵ It has prepared a number of

Vision, and Values, GOODWILL, <http://www.goodwill.org/about-us/goodwills-heritage-mission-vision-and-values/> (last visited Jan. 14, 2017).

236. See, e.g., *What Is VOZ?*, VOZ WORKERS' RIGHTS EDUC. PROJECT, <http://portlandvoz.org/> (last visited Jan. 14, 2017).

237. See, e.g., *About Us*, IMPACT FUND, <http://www.impactfund.org/aboutus/> (last visited Sept. 2, 2016) ("We provide strategic leadership and support for litigation to achieve economic and social justice. We provide funds for impact litigation in the areas of civil rights, environmental justice, and poverty law. We offer innovative technical support, training, and expertise on issues that arise in large scale impact litigation. We serve as lead counsel, co-counsel, and amicus counsel in select class action and impact litigation.").

238. Rebecca J. Livengood, *Organizing for Structural Change: The Potential and Promise of Worker Centers*, 48 HARV. C.R.-C.L. L. REV. 325, 326 (2013).

239. Benjamin Sachs, *Worker Centers and the "Labor Organization" Question*, ON LABOR (Sept. 1, 2013) <https://onlabor.org/2013/09/01/worker-centers-and-the-labor-organization-question/>; see also Steven Greenhouse, *The Workers Defense Project, a Union in Spirit*, N.Y. TIMES (Aug. 10, 2013), http://www.nytimes.com/2013/08/11/business/the-workers-defense-project-a-union-in-spirit.html?pagewanted=all&_r=2; Kris Maher, *Worker Centers Offer a Backdoor Approach to Union Organizing*, WALL STREET J. (July 24, 2013), <http://www.wsj.com/articles/SB10001424127887324144304578622050818960988>.

240. See generally *About Us*, NDLON, ndlon.org/en/about-us (last visited Sept. 2, 2016). Another example includes the Workers Defense Project. See *About Us*, WORKERS DEFENSE PROJECT, <http://www.workersdefense.org/> (last visited Sept. 2, 2016).

241. A search of the "National Day Laborer Organizing Network" in the Exempt Organization Select Check Tool is available on the irs.gov website listed the organization as a public charity out of Los Angeles, California.

242. *About Us*, *supra* note 240.

243. *Id.*

244. *Apply for NDLON Membership*, NDLON, ndlon.org/en/apply (last visited Sept. 2, 2016).

245. *Resources*, NDLON, ndlon.org/en/resources (last visited Sept. 2, 2016).

trainings and fact sheets regarding workers' rights²⁴⁶ and participated in public interest litigation involving rights of immigrant workers.²⁴⁷

Educational activities that benefit labor can be similarly tax-exempt, even if they are in connection with a particular industry. In Revenue Ruling 67-72,²⁴⁸ the IRS granted exemption to an apprentice training program, which was created as a result of a collective bargaining agreement. Although the program was funded and administered by a specific union and company, the program was open to all applicants, and graduates were not required to work for the company.²⁴⁹ Similarly, Revenue Ruling 72-101²⁵⁰ granted exemption to an organization that administered a training program, which was also created as a result of collective agreements and funded by industry employers to train individuals working or desiring to work in that industry. In each case, it appears that the industry would have benefitted as a whole from the increase in the number of qualified workers available for employment; however, neither Revenue Ruling identified the private benefit issues that would later be litigated in *American Campaign Academy*.²⁵¹

As with economic development organizations, workers' centers and training programs can run into private benefit issues.²⁵² In Revenue Ruling 76-31²⁵³ and Private Letter Ruling 2008-09-038,²⁵⁴ the IRS denied exempt status to an organization working on behalf of school teachers and school administrators, respectively, in a specific public school district. Although each organization engaged in some training and issue advocacy activities, the IRS held that the organizations were really unions²⁵⁵ in that they were bettering the employment opportunities of a specific group of individuals working for a common employer. In Private Letter Ruling 2011-20-036,²⁵⁶ the IRS denied

246. *Know Your Rights*, NDLO, <http://ndlon.org/en/resources/know-your-rights> (last visited Sept. 2, 2016).

247. *Litigation*, NDLO, <http://ndlon.org/en/litigation> (last visited July 4, 2017).

248. Rev. Rul. 67-72, 1967-1 C.B. 125.

249. *Id.*

250. Rev. Rul. 72-101, 1972-1 C.B. 144.

251. See *supra* Section III.A (discussing *American Campaign Academy*).

252. For a critique of workers centers as union organizing in disguise, see Heidi Abegg, *Worker Centers: Charities or Labor Organizations Masquerading as Charities?—and the Impact of an IRS*, FEDERALIST SOC'Y (Feb. 28, 2014), <http://www.fed-soc.org/publications/detail/worker-centers-charities-or-labor-organizations-masquerading-as-charitiesand-the-impact-of-an-irs>.

253. Rev. Rul. 76-31, 1976-1 C.B. 157 (Jan. 1, 1976) (concerning public school teachers in a specific school system).

254. I.R.S. Priv. Ltr. Rul. 2008-09-038 (Feb. 29, 2008) (concerning public school administrators in a specific school district).

255. See I.R.C. § 501(c)(5) (2012).

256. I.R.S. Priv. Ltr. Rul. 2011-20-036 (May 20, 2011).

exempt status to an association of LGBT employees that worked for a specific identified employer. While educating the public about homosexuality and advocating for LGBT rights are charitable and educational purposes,²⁵⁷ the fact that the association primarily advocated for better working conditions on behalf of the employees of a certain company violated the private benefit rule.²⁵⁸ As with *American Campaign Academy*, it appears that the LGBT organization engaged in tax-exempt educational activities, but the private benefit to the limited group of employees as well as their specific employer was sufficient to overwhelm the otherwise tax-exempt purpose.

In order to qualify as a tax-exempt organization dedicated to promoting labor, the labor force in question should constitute a charitable class. For example, Goodwill Industries works primarily with the disabled and previously incarcerated, while NDLOM works with day laborers, who are primarily recent immigrants (both legal and undocumented).²⁵⁹

For workers' cooperatives and producer cooperatives, these types of activities may regularly occur. In the case of the workers' cooperative focusing on Central American immigrants roasting fair trade coffee, the cooperative may need to assist its workers with a variety of compliance issues, as well as cultural integration issues (such as language classes). For a producer cooperative such as the West Virginia Hemp Farmers' Cooperative,²⁶⁰ the cooperative may provide training in legal compliance or sustainable growing techniques. Although these activities benefit the cooperatives' members and raise private benefit issues, this does not negate the existence of the otherwise charitable and educational activities undertaken on behalf of the cooperative.

IV. THE ROLE OF THE CHARITABLE SECTOR IN FUNDING COOPERATIVES

Because a cooperative is generally a for-profit entity, it can only very rarely be exempt from tax under § 501(c)(3).²⁶¹ The purpose of

257. Rev. Rul. 78-305, 1978-2 CB 172.

258. Rev. Rul. 78-305, 1978-2 CB 172.

259. Arlene McCrehan, *Goodwill's Heritage, Mission, Vision, and Values*, GOODWILL, <http://www.goodwill.org/about-us/goodwills-heritage-mission-vision-and-values/> (last visited Jan. 14, 2017).

260. See *supra* note 19 and accompanying text.

261. The statutory language of § 501(c)(3) specifically states that "no part of the net earnings of which inures to the benefit of any private shareholder or individual." I.R.C. § 501(c)(3) (2012). There are specific exceptions for cooperatives of which all of the members are themselves § 501(c)(3) organizations. See, e.g., I.R.C. § 501(e) (regarding cooperative hospital associations); I.R.C. § 501(f) (regarding cooperative educational associations).

establishing the dual charitable/for-profit nature of the cooperative is not to qualify it for tax-exempt status; rather, the purpose is to allow a charitable organization to invest in a cooperative in the same manner as it might approach any other social enterprise.

A. Direct Support of Social Enterprise by Charities

Fundamentally, social enterprises (whether L3Cs, benefit corporations, cooperatives, or otherwise) are for-profit entities. While “social enterprise” may be a new concept, the old rules regarding investing in and awarding grants to for-profit entities have not changed. The nature of these rules will depend on the investing charity’s tax: public charity (with or without donor advised funds) or private foundation.

1. Section 501(c)(3) Investing Generally

For purpose of this Article, there are four different types of investing in which a § 501(c)(3) charity might engage: portfolio investing, socially responsible investing, mission-related investing, and program-related investing.²⁶² For these purposes, portfolio investing merely means investing assets purely on the basis of total return, which is primarily governed by the requirements of the fiduciary duty of care imposed by state law.²⁶³ With a standard portfolio investment, the charity simply generates income to support its other charitable activities, but the investment itself is not charitable.²⁶⁴

If a charity invests assets, not just on the basis of return but also on the basis of social concerns, then its investment approach falls into

262. Gary, *Is It Prudent to Be Responsible*, *supra* note 20, at 108.

263. For charitable trusts, typically the Uniform Prudent Investor Act § 1 applies; for non-profit corporations, the Uniform Prudent Management of Institutional Funds Act applies. See Gary, *Values and Value*, *supra* note 11; see also Gary, *Is It Prudent to Be Responsible*, *supra* note 20, at 117.

264. For state law purposes, a charitable trustee has a duty to make trust property productive. See UNIFORM PRUDENT INVESTOR ACT §§ 2, 7 cmt. (NAT’L CONFERENCE OF COMM’RS. ON UNIF. STATE LAWS 1995). Similarly, the Uniform Prudent Management of Institutional Fund Act imposes a duty of prudent investment on covered charitable organizations. *Id.* § 3. That said, producing income destined for charity is not, in and of itself, charitable activity. See I.R.C. § 513 (2012); C.F. Mueller Co. v. Comm’r, 190 F.2d 120 (3d Cir. 1951). The provisions of the unrelated business income tax appear to take the position that investment activities generally do not constitute trade or business activities under § 162 and therefore usually would not be subject to the UBIT; to the extent that one could argue investment is a trade or business, the comprehensive exceptions for investment income found in § 512 make the question somewhat irrelevant. Moreover, the debt-financed income rules of § 514 apply even if the underlying activity does not rise to the level of a trade or business. See, e.g., Bartels Trusts v. United States, 617 F.3d 1357 (Fed. Cir. 2010); Henry E. & Nancy Horton Bartels Trust v. United States, 209 F.3d 147 (2d Cir. 2000) (stating that income from trading on margin is subject to the unrelated trade or business income tax even if the underlying investment activity does not rise to the level of a trade or business).

one of the three other categories. Generally speaking, socially responsible investing requires the charity to consider the social impact of the company in which it is investing as well as the financial return of the company.²⁶⁵ For example, the movement to drive investors to divest of South African companies in response to apartheid was socially responsible investing.²⁶⁶ When engaging in socially responsible investment, the charity still intends to invest for returns—it just chooses to do so in a manner that encourages good societal behaviors (or discourages bad ones).

The mission-related investment furthers a charity's particular charitable purpose while still earning a return on the investment.²⁶⁷ The mission-related investor intends to accomplish specific charitable goals with its investment, rather than simply weigh the societal impacts of its investment as would be the case with a socially responsible investment. For example, a foundation looking to further goals of increased employment opportunities and security for a particular population might elect to invest in a workers' cooperative in a blighted area. With the mission-related investment, however, the charity is once again still looking for some return on its investment.²⁶⁸

While the Internal Revenue Code does not define socially responsible investing or mission-related investing, a program-related investment is a definite product of the Code. As more fully defined below, a program-related investment is an investment made by a private foundation primarily to accomplish charitable goals and not for the production of income.²⁶⁹ When engaging in program-related investment, the private foundation's desire for an investment return must be subordinated to the accomplishment of charitable goals.²⁷⁰

265. Gary, *Values and Value*, *supra* note 11.

266. Susan N. Gary, *Is Mission Investing Prudent?*, 2008 A.B.A. SEC. PUB. UTIL. L. REP. 6 [hereinafter *Mission Investing*]. See generally Paul Lansing, *The Divestment of United States Companies in South Africa and Apartheid*, 60 NEB. L. REV. 304 (1981). More recent examples include movements to divest from tobacco companies or companies that make land mines. See, e.g., Madison Marriage, *Pension Funds Review Tobacco Divestment*, FIN. TIMES (Apr. 24, 2006, 10:02 AM), <https://www.ft.com/content/e87a9b3c-0708-11e6-9b51-0fb5e65703ce>; *Recommendation on Divestment from Arms Manufacturing Companies*, U. OXFORD (Apr. 2012), https://www.admin.ox.ac.uk/councilsec/governance/committees/srirc/report_march_2010/. A socially responsible investor may choose to only invest in companies with environmentally friendly policies or fair labor standards.

267. Gary, *Is Mission Investing Prudent*, *supra* note 266, at 21.

268. *Id.* at 20–21.

269. See I.R.C. § 4944 (2012). For a more complete discussion, see *supra* Section IV.B.

270. See I.R.C. § 4944(c) (2012) (“[I]nvestments, the primary purpose of which is to accomplish one or more of the purposes described in § 170(c)(2)(B), and no significant purpose of which is the production of income or the appreciation of property, shall not be considered as investments which jeopardize the carrying out of exempt purposes.”).

2. Public Charities

A public charity is a § 501(c)(3) organization that is not classified as a private foundation because it is described in § 509(a)(1), (2), or (3).²⁷¹ In general, a public charity is required to make sure that its assets are used for its tax-exempt purposes. In addition, state law generally imposes a fiduciary duty on a charity to make its assets productive.²⁷²

When any § 501(c)(3) organization invests in a for-profit entity, such as a cooperative, it must make sure that the investment furthers its charitable mission. With a standard portfolio investment, the charity generates income to support its other charitable activities. If the return is so low that it must be justified in part by the accomplishment of charitable goals, the investment might be treated as part investment, part charitable expenditure.²⁷³

When an equity investment in a company is not solely made for the sake of return, but to further the charity's mission through the direct act of investment, then the charity is obligated to make sure that its charitable goals will actually be accomplished.²⁷⁴ From a fiduciary standpoint, the charity has sacrificed return on investment in exchange for a social benefit; accordingly, the charity ought to take steps to ensure that social benefit is actually achieved.²⁷⁵ Allowing charitable assets to be used for private purposes under the guise of investment would be a breach of the governing body's fiduciary duty to

271. Thomas Kelley, *Rediscovering Vulgar Charity: A Historical Analysis of America's Tangled Nonprofit Law*, 73 *FORDHAM L. REV.* 2437, 2458 (2005).

272. See, e.g., UNIF. TRUST CODE § 801 (2000) (“[T]he trustee shall administer the trust in good faith, in accordance with its terms and purposes and the interests of the beneficiaries”); *id.* § 802(a) (“A trustee shall administer a trust solely in the interest of the beneficiaries.”). The explanatory notes to Uniform Trust Code § 802(a) states as follows: “The duty of loyalty applies to both charitable and noncharitable trusts, even though the beneficiaries of charitable trusts are indefinite. In the case of a charitable trust, the trustee must administer the trust solely in the interests of effectuating the trust’s charitable purposes.” *Id.* § 802 cmt. (citing RESTATEMENT (SECOND) OF TRUSTS § 379 cmt. a (1959)).

273. Gary, *Is It Prudent to Be Responsible*, *supra* note 20, at 111 (“If the charity decides to accept somewhat lower financial returns in order to obtain mission-related benefits, then the investment may be considered an expenditure decision as well as an investment decision”).

274. *Id.* at 116–17 (“[S]ocial considerations may be taken into account in investing the funds of charitable trusts to the extent the charitable purpose[] . . . justifi[es] an expenditure of trust funds for the social issue . . . or . . . the investment . . . can be justified on grounds of advancing . . . a charitable activity conducted by the trust.” (quoting RESTATEMENT (THIRD) OF TRUSTS § 90 cmt. c (2007))).

275. That said, failure to achieve intended goals does not mean that an investment was flawed. UNIF. PRUDENT INVESTOR ACT § 8 (NAT’L CONF. OF COMMISSIONERS ON UNIF. STATE LAWS 1995).

uphold the mission of the charity²⁷⁶ as well as a violation of § 501(c)(3).²⁷⁷

Accordingly, when making a mission-related investment, a public charity can make a grant to or invest in a for-profit business, but only if it takes steps to ensure that the funds are used for charitable purposes. Part of the rationale behind the creation of the social enterprise organizations is that they, by definition, pursue some level of social benefit. Therefore, a charity investing in a social enterprise should have some level of assurance that a social benefit is being accomplished, purely by reason of the form of the organization.²⁷⁸ As many commentators have noted, however, it can be difficult to quantify the amount of benefit to be derived from a social enterprise,²⁷⁹ which may make it difficult for a governing body to rely solely on form in complying with its legal obligation to safeguard charitable assets.

3. *Public Charities with Donor Advised Funds*

Most public charities are subject only to the general limitations on investments applicable to all § 501(c)(3) organizations. If a public charity, such as community foundation, manages donor advised funds (DAFs) as part of its charitable program, additional rules apply.²⁸⁰ While the public charity that holds the DAFs are subject to the standard public charity rules, the DAFs themselves are subject two excise taxes that govern to the investment and distribution of funds held in the DAFs.²⁸¹

Section 4966 imposes an excise tax on any “taxable distributions” by a DAF, which includes any distribution for a charitable purpose from a DAF to any non-public charity, unless the DAF’s sponsor exercises “expenditure responsibility” over the grant.²⁸² As described in more detail below,²⁸³ expenditure responsibility is a comprehensive series of administrative rules that are specifically designed to ensure

276. UNIF. TRUST CODE § 5 (UNIF. LAW COMM’N 2010); *cf.* UNIF. TRUST CODE § 5 cmts.

277. Treas. Reg. § 1.501(c)(3)-1(c)(2) (2016); *see also id.* § 1.501(c)(3)-1(b)(4).

278. Gary, *Is It Prudent to Be Responsible*, *supra* note 20, at 117 (“[A] trustee can consider the charitable purpose of a trust as a factor in making investment decisions.”).

279. *See, e.g.*, Brian Galle, *Social Enterprise: Who Needs It?*, 54 B.C.L. REV. 2052 (2013).

280. Donor advised funds are defined as “a fund or account, which is separately identified by reference to contributions of a donor or donors, owned and controlled by a sponsoring organization, and where the donor (or a person appointed or designated by the donor) has or reasonably expects to have advisory privileges over the distribution or investments of the assets. I.R.C. § 4966(d)(2) (2006).

281. I.R.C. §§ 4966–4967 (2006).

282. I.R.C. § 4966(c) (2006).

283. *See supra* Part III.B.

that private foundation distributions to non-public charities further charitable purposes; § 4966 applies these private foundation rules to DAF distributions.²⁸⁴ By definition, a cooperative (or any other social enterprise for that matter) is a non-public charity.²⁸⁵ As a result, any DAF making a distribution to a cooperative would clearly need to follow the expenditure responsibility rules over the distribution.²⁸⁶ What is unclear, however, is whether an equity investment in a cooperative (or other for-profit entity) made to further charitable purposes constitutes a “distribution” within the meaning of § 4966.²⁸⁷ If the equity investment is in the nature of a part investment/part charitable distribution mission-related investment, then there is a danger that the investment could be treated as a “distribution” for § 4966 purposes.

In addition, § 4967 imposes an excise tax on “prohibited benefits,” those being a distribution from a DAF on the advice of a person if that person (or related entities) receives more than an incidental benefit as a result of such distribution.²⁸⁸ Consequently, any distribution from a DAF to a cooperative in which a person related to the DAF is an equity owner, employee, or contractor, might raise prohibited benefit issues. While this may be a relatively rare situation, the charity must implement provisions to screen for related person ownership, thus raising the administrative costs of implementing a mission-related investing program.

Sections 4966 and 4967 were enacted as part of the Pension Protection Act of 2006.²⁸⁹ Although these provisions have now been law for ten years, the IRS has not yet issued regulations under this section. As a result, it is difficult to determine the full extent of the application

284. “[E]xpenditure responsibility . . . means that the private foundation is responsible to exert all reasonable efforts and to establish adequate procedures (1) to see that the grant is spent solely for the purpose for which made, (2) to obtain full and complete reports from the grantee on how the funds are spent, and (3) to make full and detailed reports with respect to such expenditures to the Secretary.” I.R.C. § 4945(h) (2014).

285. See I.R.C. § 509 (2006).

286. I.R.C. § 4966 (2006).

287. A taxable distribution under this section is defined as “any distribution from a donor advised fund to an natural person or to any other person if such distribution is for any purpose other than one specified in § 170(c)(2)(B) or the sponsoring organization does not exercise expenditure responsibility with respect to such distribution . . .”. I.R.C. § 4966(c) (2012). One might look to the minimum distribution rules of § 4942 for the definition of a distribution; however, § 4942 specifically treats program-related investments (or PRI) as distributions for these purposes. See I.R.C. § 4942(d) (2012). For the definition of a program-related investment, see I.R.C. § 4944(c) (2012). § 4942 would treat a mission-related investment that did not qualify as a PRI under § 4944 as simply an investment, and not a distribution.

288. I.R.C. § 4967(a)(1) (2012).

289. *Donor-Advised Funds Guide Sheet*, IRS, https://www.irs.gov/irm/part7/irm_07-020-008.html (last updated Oct. 28, 2016).

of § 4966 and § 4967 until further administrative guidance is forthcoming. Given the severity of the penalties under these provisions, most practitioners are taking a cautious approach in the interim.²⁹⁰ For those reasons, community foundations and other sponsors of DAFs have been loath to allow DAF investments in cooperatives or other types of social enterprise.

4. *Private Foundations*

Private foundations, in addition to complying with the general rules of § 501(c)(3), must comply with the special rules contained in the Chapter 42 private foundation excise taxes.²⁹¹ A private foundation is a § 501(c)(3) organization that is not a public charity (that is, it is not described in § 509(a)(1), (2), or (3)).²⁹² A private foundation often receives the majority of its donations from a single source, such as an individual, a family, or a company. To prevent these donors from taking advantage of their special position, the Code imposes a series of excise taxes designed to police private foundation behavior.²⁹³ A number of these excise taxes can come into play when a private foundation wishes to make a grant to or invest in a cooperative or other social enterprise.

5. *Section 4944 and Program-Related Investments*

A private foundation can take one of two approaches to an investment in a social enterprise. As with a public charity, the private foundation can treat an investment in a social enterprise as just another part of its investment portfolio. If it takes this approach, the private foundation needs to consider the fiduciary duty issues associated with mission-related investing,²⁹⁴ described above, as well as § 4944.

Section 4944 prohibits investments that “jeopardize the carrying out of” the charitable purpose of the foundation,²⁹⁵ which essentially acts as a prudent investor rule for foundations.²⁹⁶ The Regulations place special scrutiny on advanced investment products, such as commodity

290. For example, donors should check resources like Fidelity Charitable and the large foundations for investment guidance especially those that allow donor discretion in investing. See, e.g., *Giving Strategies*, FIDELITY CHARITABLE, <https://www.fidelitycharitable.org/guidance/giving-strategies/> (last visited Jan. 14, 2017).

291. I.R.C. ch. 42 (2012).

292. I.R.C. § 509(a) (2012).

293. See generally Elaine Waterhouse Wilson, *Better Late than Never: Incorporating LLCs into Section 4943*, 48 AKRON L. REV. 485, 489–90 (2015).

294. Gary, *Is It Prudent to Be Responsible*, *supra* note 20, at 108–28.

295. I.R.C. § 4944(a) (2012).

296. See Wilson, *supra* note 293, at 489–90.

swaps and derivatives,²⁹⁷ although the Regulations do make it clear that any particular investment can be appropriate in the context of the allocation of its overall portfolio.²⁹⁸ If an investment in a cooperative is made a part of the foundation's overall investment strategy, the foundation would need to ensure that the investments do not jeopardize the charitable purpose of the foundation.²⁹⁹

Governing bodies may have a difficult time reconciling their obligation to not jeopardize the charitable purposes of the foundation with their desire to engage in mission-related investing.³⁰⁰ In some instances, mission-related investments can be more speculative, offer lower rates of return and have a longer horizon for return on investment than a standard portfolio investment.³⁰¹ While some large portfolios may have a sufficiently diversified allocation of investments to absorb the impact of a more speculative mission-related investment, foundations with smaller investment portfolios may be leery of the volatility and lack of cash flow that such investments might bring.³⁰²

For a foundation that is worried that a social enterprise investment might violate the jeopardizing investment rules, there is an option. Section 4944(c) provides that a "program-related investment" does not jeopardize a foundation's tax-exempt purpose. A "program-related investment" has the following characteristics:

- (1) The primary purpose of the investment is to accomplish charitable purposes;³⁰³
- (2) No significant purpose of the investment is the production of income or the appreciation of property;³⁰⁴ and
- (3) No part of the investment is used for political campaign or lobbying purposes.³⁰⁵

297. Treas. Reg. § 53.4944-1(a)(2) (2016).

298. *Id.*

299. *Id.*

300. *See id.* § 53.4944-1(c) ex. 1. Investment in Corporation Z, which "has been in business for a short period of time and manufactures a product that is new, is not sold by others, and must compete with a well-established alternative product that serves the same purpose" may be classified as a jeopardizing investment. *Id.*

301. *See generally* SARAH MAHLAB & BRAD HARRISON, COUNCIL ON FUNDS., EFFECTIVE AND EMERGING APPROACHES TO MISSION-RELATED INVESTING (2016), http://www.cof.org/sites/default/files/documents/files/COF_WP_MRI.pdf; *see also* *Commonfund Study of Responsible Investing: A Survey of Endowments and Their Affiliated Foundations*, COMMONFUND INST. 15 (2015); COMMONFUND INST. & COUNCIL ON FUNDS., *supra* note 9, at 17 (discussing perceived lower investment performance as an impediment to MRIs).

302. Gary, *Is It Prudent to Be Responsible*, *supra* note 20.

303. I.R.C. § 4944(c) (2012); Treas. Reg. § 53.4944-3(a)(1)(i) (2016).

304. I.R.C. § 4944; Treas. Reg. § 53.4944-3(a)(1)(ii).

305. Treas. Reg. § 53.4944-3(a)(1)(iii) ("No purpose of the investment is to accomplish one or more of the purposes described in section 170(c)(2)(D)"). Section 170(c)(2)(D) describes

Under the regulations, an investment is made for the primary purpose of accomplishing charitable goals if the investment “significantly furthers the accomplishment of the private foundation’s exempt activities” and “the investment would not have been made but for” the relationship to these exempt activities.³⁰⁶ The regulations further clarify that a program-related investment can produce a positive rate of return and still qualify as such; it is the intent of the foundation when making the investment that is critical.³⁰⁷

Historically, the Regulations contained a number of examples of program-related investments that date back to 1972.³⁰⁸ More recently, the Treasury added additional examples that demonstrate the modern trends in program-related investing.³⁰⁹ Example 1 in the Regulations describes loans to a small business in a “deteriorated urban area” that is “owned by members of an economically disadvantaged minority group,” for which “conventional sources of funds” are unavailable.³¹⁰ This example tracks Revenue Ruling 74-587,³¹¹ which found that investments in such a business would be charitable economic development activities.

Similarly, Example 3 of the Regulations describes a loan to a business that is not owned by a disadvantaged group, but that operates in a blighted area and “is made pursuant to a program run by [the investing foundation] to assist low-income persons by providing increased economic opportunities and to prevent community deterioration.”³¹² The facts in this example closely track Revenue Ruling 76-419, which found an investment in an industrial park in a blighted area for purposes of providing employment opportunities to be charitable economic development activity.³¹³

Example 6 describes an investment in a non-profit community development corporation that would market agricultural products of low

§ 501(c)(3)’s limitation on lobbying activities and the prohibition on political campaign activities. See Treas. Reg. § 53.4944-3(a)(2)(iv).

306. Treas. Reg. § 53.4944-3(a)(2)(i).

307. Treas. Reg. § 53.4944-3(a)(2)(iii).

308. See Treas. Reg. § 53.4944 (1972).

309. See Treas. Reg. § 53.4944(c) (2016) (“Paragraphs (a)(2)(ii) and (b), Examples 11 through 19 of this section, apply on or after April 25, 2016.”).

310. Treas. Reg. § 53.4944-3(b) ex. 1; see also Treas. Reg. § 53.4944-3(b) ex. 2 (extension of time to pay allowable); Treas. Reg. § 53.4944-3(b) ex. 3 (purchase of stock to increase capitalization to allow for conventional financing allowable).

311. See *supra* Section III.B.

312. Treas. Reg. § 53.4944-3(b) ex. 3.

313. See *supra* Section III.B.

income farmers.³¹⁴ In reality, most early agricultural marketing cooperatives were in corporate form;³¹⁵ accordingly, this example clearly indicates that supporting marketing cooperatives can be a charitable activity if the farmers constitute a charitable class.

One of the new examples, Example 16, indirectly discusses cooperatives. In Example 16, the business itself is not a cooperative; however, it purchases coffee from poor farmers residing in a developing country, either directly or through farmer-owned cooperatives.³¹⁶ The foundation makes the PRI in order to fund training in environmentally sustainable farming practices for the farmers in directly through the business. This example tracks the circumstances in *Aid for Artisans*,³¹⁷ where the charity at issue purchased handicrafts from local artisans through an artisans' cooperative.³¹⁸

Accordingly, a private foundation might be able to qualify its mission-related investment in a cooperative as a PRI.³¹⁹ Not only will qualification as a PRI protect a private foundation from the § 4944 excise tax, PRI classification can assist the foundation with compliance with other private foundation excise tax requirements. If a particular cooperative investment does not qualify as a PRI, then the private foundation can still make the investment; it merely means that the governing body of the foundation must evaluate the investment within the context of its larger investment allocation for purposes of § 4944 compliance. Fortunately, Treasury made this decision somewhat easier in 2015, when it issued guidance indicating that an investment made for charitable purposes that does not qualify as a PRI is not automatically a jeopardizing investment.³²⁰ Rather, the governing body must exercise ordinary care and prudence when evaluating the investment, but it may take in to account “the relationship between a particular investment and the foundation’s charitable purposes” when exercising that care.³²¹

6. Section 4945 and Expenditure Responsibility

A public charity is free to set whatever parameters it deems appropriate to make sure that a mission-related investment is used for chari-

314. Treas. Reg. § 53.4944-3(b) ex. 6; *see also* Treas. Reg. § 53.4944-3(b) ex. 15 (discussing farmers' roadside fruit stand for poor farmers as a program-related investment).

315. *See supra* Section II.C.3.a.

316. Treas. Reg. § 53.4944-3(b) ex. 16.

317. 71 T.C. 202 (1978).

318. *See supra* notes 258 and 259 and accompanying text.

319. Treas. Reg. § 53.4944-3(a) (2016).

320. I.R.S. Notice 2015-62, 2015-39 I.R.B. 411.

321. *Id.* at 3.

table purposes. For a private foundation, § 4945 sets forth the procedures required for grants to for-profit entities such as cooperatives. These procedures, referred to as “expenditure responsibility,” are found in § 4945(h) and its accompanying regulations.³²² The expenditure responsibility requirements are extremely technical;³²³ as a result, many private foundations will not make expenditure responsibility grants.³²⁴ Failure to meet the expenditure responsibility requirements for a grant to a for-profit entity will cause the grant to be classified as a taxable expenditure subject to excise tax.³²⁵

A private foundation must exercise expenditure responsibility over any grant to an organization that is not a public charity under § 509, with limited exceptions.³²⁶ In order to comply with the expenditure responsibility rules, a private foundation must “exert all reasonable efforts” and “establish adequate procedures” to

- (1) ensure that the grant is used solely for charitable purposes;³²⁷
- (2) obtain full reports on the manner in which the grant funds are spent;³²⁸ and
- (3) make full reports on the grants to the IRS as part of its annual information filing.³²⁹

By virtue of § 4966, the expenditure responsibility rules apply to distributions from DAFs to for-profit entities, which may include mission-related investments.³³⁰ Because the expenditure responsibility rules constitute a statement from Congress and the IRS of what constitutes adequate procedures to ensure that the charity is accomplish-

322. I.R.C. § 4945 (2012); Treas. Reg. § 53.4945-5.

323. See generally Treas. Reg. § 53.4945-5(b).

324. See, e.g., *Grant Program*, RGK FOUND., <http://www.rgkfoundation.org/public/guidelines> (last visited Jan. 14, 2017) (“Grants are made only to nonprofit organizations certified as tax-exempt under Sections 501(c)(3) or 170(c) of the Internal Revenue Code and are classified as ‘not a private foundation’ under Section 509(a).”). For more info, see *Grants by Private Foundations: Expenditure Responsibility*, IRS, <https://www.irs.gov/Charities-&-Non-Profits/Private-Foundations/Grants-by-Private-Foundations:-Expenditure-Responsibility> (last updated June 10, 2016).

325. See I.R.C. § 4945(a) (2012).

326. Technically, § 4945 does not require expenditure responsibility for grants to public charities described in § 509(a)(1) or (2), to supporting organizations described in § 509(a)(3) other than certain controlled and Type III non-functionally integrated supporting organizations described in § 4942(g)(4)(A), or exempt operating foundations described in § 4940(d)(2). See I.R.C. § 4945(d)(4).

327. I.R.C. § 4945(h)(1).

328. I.R.C. § 4945(h)(2).

329. I.R.C. § 4945(h)(3); Treas. Reg. § 53.4945-5(d) (2016).

330. See *infra* note 362 and accompanying text.

ing a charitable purpose, many public charities use the expenditure responsibility rules as voluntary best practices.³³¹

For purposes of § 4945, the term “grant” includes loans made for charitable purposes and PRIs, which are therefore subject to the expenditure responsibility rules.³³² In order to meet the first requirement of the expenditure responsibility rules, it is necessary to establish that the PRI was used solely for charitable purposes³³³—once again, it is necessary to identify the underlying charitable purpose served by the investments and to take appropriate steps to make sure that the funds are used for those charitable purposes. Under the Regulations, this requires three steps: a pre-grant inquiry, tailoring the terms of the grant to make sure that the funds are used appropriately, and obtaining appropriate reporting.³³⁴

First, the Regulations require a foundation to make an inquiry into the potential recipient that should be “complete enough to give a reasonable man assurance” that the fund will be used for charitable purposes.³³⁵ The inquiry will vary depending upon the nature of the organization.³³⁶ In the context of a PRI, the foundation should specifically consider the identity, prior history, experience of organization and its managers, and any other information “which is readily available concerning the management, activities, and practices of the grantee organization.”³³⁷ Additional factors to consider include the size of the grant, its purpose, the pay period, and the grantor’s prior experience with the grantee’s use of grants for the proper purposes.³³⁸

All expenditure responsibility grants, including PRIs, must have a written grant agreement that contains certain terms,³³⁹ specifically including the purpose of the grant and an agreement to use the grant funds only for the stated purposes.³⁴⁰ In addition to the general ex-

331. See Karen Dunn, *Public Charity Grant Making—Due Diligence and Reporting*, CLARK NUBER (Apr. 29, 2015), <https://clarknuber.com/articles/public-charity-grant-making-due-diligence-and-reporting/> (“Commonly recognized best practices recommend that charities develop policies, systems, and procedures for pre-grant inquiry, grant monitoring, and post-grant reporting similar to the “expenditure responsibility” requirements for private foundations.”).

332. Treas. Reg. § 53.4945-5(a)(2).

333. For example, a traditional grant made to further the activities of an economic development organization would be treated as made for charitable purposes. See, e.g., I.R.S. Gen. Couns. Mem. 39,883 (Oct. 16, 1992).

334. See generally Treas. Reg. § 53.4945-5(b).

335. Treas. Reg. § 53.4945-5(b)(2).

336. *Id.*

337. *Id.*; see also David A. Levitt, *Investing in the Future: Mission-Related and Program-Related Investments for Private Foundations*, PRACTICAL TAX LAW, 33, 38 (2011).

338. Treas. Reg. § 53.4945-5(b)(2).

339. Treas. Reg. § 53.4945-5(b)(3).

340. *Id.*

penditure responsibility grant agreement rules, there are specific rules for PRIs.³⁴¹ PRI funds must be used only for the purposes of the investment; as a result, it is necessary to clearly identify the purpose of a PRI. Identifying the purpose of a PRI can be difficult in the context of a for-profit business entity; therefore, it is incumbent on a foundation to develop specific definitions and deliverables in order to make sure that the funds are used for a charitable purpose. For example, if a foundation were to make an investment in a cooperative that would market the products of low income farmers (as provided in Example 6 of the PRI regulations under § 4944),³⁴² it would need to provide a definition of “low income” in the grant agreement. This may (or may not) coincide with the cooperative’s own definition of who may be a member of the cooperative.

A mission-related investment that does not qualify as a PRI, however, is merely another part of a charity’s investment portfolio.³⁴³ § 4945 would not require a foundation to exercise expenditure responsibility over its investment in Microsoft; similarly, it would not require a foundation to exercise expenditure responsibility over an investment in a cooperative.³⁴⁴ This leaves a foundation with a choice: (1) qualify the cooperative investment as a PRI, which gives the foundation the benefit of exemptions from the general rule of § 4944 (as well as § 4942³⁴⁵ and § 4943³⁴⁶) but comply with the requirements of expendi-

341. Treas. Reg. § 53.4945-5(b)(4).

342. Treas. Reg. § 53.4944-3 ex. 6; *see also infra* note 387 and accompanying text.

343. *See* David A. Levitt, *Investing in the Future: Mission-Related and Program-Related Investments for Private Foundations*, 3 PRACTICAL TAX LAW 33, 39 (2011).

344. It may be, however, that the rules applicable to DAFs may be more stringent than the rules applicable to private foundations in this regard, as there is little guidance over what types of transactions § 4966 was designed to cover.

345. Section 4942 generally requires a private foundation to make annual expenditures and distributions for charitable purposes equal to five percent of the fair market value of its investment portfolio. *See generally* Elaine Waterhouse Wilson, *Private Foundations—Distributions (Section 4942)*, BNA TAX MGMT. PORTFOLIO 472 (2015). If an investment is just a portfolio investment, it does not count toward the five percent distribution requirement. A “qualifying distribution” is:

(A) any amount (including that portion of reasonable and necessary administrative expenses) paid to accomplish one or more purposes described in section 170(c)(2)(B), other than any contribution to (i) an organization controlled (directly or indirectly) by the foundation or one or more disqualified persons (as defined in section 4946) with respect to the foundation, except as provided in paragraph (3), or (ii) a private foundation which is not an operating foundation (as defined in subsection (j)(3)), except as provided in paragraph (3), or

(B) any amount paid to acquire an asset used (or held for use) directly in carrying out one or more purposes described in section 170(c)(2)(B).

I.R.C. § 4942(g) (2012). Any private foundations that want to get credit for investments made for charitable purposes in the same way that they are credited for distributions must qualify the investment as a program-related investment. I.R.C. § 4942 (g)(4).

ture responsibility, or (2) treat the investment not as a mission-related investment that is not covered by the expenditure responsibility rules but as any other portfolio investment for purposes of the other private foundation excise tax rules.

B. Investing in the “New” Social Enterprises

The tax rules associated with investing in for-profit entities such as cooperatives for mission purposes are complicated to say the least—even more so in the case of private foundations. The complex rules can discourage a charity from pursuing more mission-relating (or for foundations, program-related)³⁴⁷ investing.³⁴⁸ In spite of this complexity, mission-related investing is attractive to charities because it allows them to impact their respective areas of interest in a holistic way.³⁴⁹ More pragmatically, these investments allow a charity to impact an issue in a way that minimizes the need for cash available for

346. Section 4943 generally limits the amount of equity holdings a private foundation may own in an active business enterprise. See I.R.C. § 4943. Section 4943(d)(3) provides an exception from the excess business holdings rules for “functionally related businesses.” I.R.C. § 4943(d)(3). By regulation, a functionally related business includes PRIs, as well as related businesses that are carried on within a larger complex of other endeavors that are related to accomplishing the private foundation’s charitable mission. Treas. Reg. § 53.4943-10(b) (citing Treas. Reg. 53.4942(a)-2(c)(3)(iii)). Clearly, an investment in a cooperative that qualifies as a PRI would not need to worry about the excess business holdings rules.

If an investment in a cooperative did not qualify as a PRI (i.e., it is a mission-related investment that was made to accomplish a double bottom line), then the foundation would need to either treat it as a functionally related business or comply with the standard excess business holdings rules applicable to all operating business entities. There is very little in the way of precedent with regard to the exception for functionally related business that are not qualified as PRIs, so a private foundation would need to consider this route carefully. See generally Wilson, *supra* note 293.

347. See, e.g., THOMAS REUTERS FOUND., STRATEGIES TO MAXIMIZE YOUR PHILANTHROPIC CAPITAL: A GUIDE TO PROGRAM RELATED INVESTMENTS 20–21 (2012), <https://www.mission-investors.org/system/files/tools/ximize-your-philanthropic-capital-a-guide-to-program-related-investments-lucia-benabentos-justin-storms-carlos-teuscher-and-jon-van-loo-linklaters-llp.pdf> (regarding the procedures for making PRIs in the form of loans).

348. Rick Cohen, *Social Responsibility or Marketing Ploy? The Branding of L3Cs*, NPQ (May 27, 2014), <https://nonprofitquarterly.org/2014/05/27/social-responsibility-or-marketing-ploy-the-branding-of-l3cs/> (“The reluctance of many foundations to make PRIs is fundamental: the aforementioned predisposition toward making grants rather than debt or equity investments (which they can make from their endowments as mission-related investments with more flexibility than the strictures of PRIs); discomfort with the notion of underwriting debt and equity (more of a banker’s skill set than a grantmaker’s); and an aversion to assuming the monitoring and reporting requirements involved in fulfilling the expenditure responsibility dimensions of PRIs.”).

349. Steven Godeke & Doug Bauer, *Philanthropy’s New Passing Gear: Mission-Related Investing A Policy and Implementation Guide for Foundation Trustees*, ROCKEFELLER PHILANTHROPY ADVISORS 13 (2008), <http://docplayer.net/17329194-Rockefeller-mission-related-investing-a-policy-and-implementation-guide-for-foundation-trustees-philanthropy-s-new-passing-gear.html> (“There is an idea that values are divided between the financial and the societal, but this a fundamentally wrong way to view how we create value.”).

distribution. After all, an investment in a social enterprise is still an investment and it remains on the charity's balance sheet as such. To the extent that the social enterprise earns any rate of return, the charity is able to impact its mission area without expending assets but while earning income.³⁵⁰ This is an especially great advantage to private foundations, which can comply with the five percent distribution requirement of § 4942³⁵¹ without actually parting with assets.³⁵²

While all businesses are on a continual search for capital, social enterprises quickly identify charities with investment assets (e.g., private foundations, DAFs, and university endowments) as sources for that capital.³⁵³ This search for capital can be especially problematic for social enterprises (such as cooperatives) that may not attract traditional venture capital investors that are solely interested in the investment's rate of return.³⁵⁴ This fundamental economic issue is exacerbated by the unique legal and tax limitations imposed upon mission investing by charities. In recognition of the significant hurdles to accessing charitable investment pools, businesses with a dual bottom line mission looked for ways to smooth the entry of charitable capital.³⁵⁵

By definition, an investment in a social enterprise may have a lower and more difficult to measure rate of return than a standard market investment.³⁵⁶ In addition, social enterprises often require what is referred to as "patient capital"—that is, the social enterprise will not have excess profit to distribute for a significant amount of time, so investors must wait to realize any returns.³⁵⁷ While a charity can jus-

350. THOMAS REUTERS FOUND., *supra* note 347, at 3–4.

351. *See supra* note 345 and accompanying text.

352. *See* I.R.C. § 4942 (2012); Levitt, *supra* note 343, at 37; *see also* Godeke & Bauer, *supra* note 349, at 12.

353. Cohen, *supra* note 348 ("Marketing a brand leads a business to sources of investment. Where might the nation's L3Cs find capital to advance their programs, which are ostensibly geared toward a core commitment to achieving charitable missions? The answer lies in private investment and PRIs.").

354. Robert Lang, the self-proclaimed creator of the L3C, estimates that the "low profit" in the "low profit limited liability company" should equal a return on investment between 1 and 5%. *See* Cohen, *supra* note 348.

355. Cohen, *supra* note 348.

356. Deb Lavoy, *Social Enterprise ROI: Measuring the Immeasurable*, CMS WIRE (Apr. 12, 2012), <http://www.cmswire.com/cms/social-business/social-enterprise-roi-measuring-the-immeasurable-015149.php>.

357. Brian Trelstad, *Patient Capital in an Impatient World*, in 1 KAUFFMAN FELLOWS REPORT (2010).

tify a mission-related investment with a lower rate of return,³⁵⁸ it does so on the understanding that it is achieving a charitable benefit.

The L3Cs were specifically designed to meet the criteria for program-related investments, the rules set forth in § 4944, thereby making it easier for foundation money to capitalize social enterprises.³⁵⁹ Vermont passed the first L3C statute in 2008.³⁶⁰ Under the Vermont statute, a duly organized limited liability company (LLC) can elect to be governed by the additional statutory limitations applicable to L3Cs.³⁶¹ In order to qualify as a L3C, the LLC organized for a business purpose³⁶² must at all times:

- (1) “Significantly further “one or more charitable or educational purposes”;³⁶³
- (2) “Would not have been formed but for the company’s relationship to the accomplishment of charitable and educational purposes”;³⁶⁴
- (3) “No significant purpose of the company is the production of income or the appreciation of property; provided, however, that the fact that a person produces significant income or capital appreciation shall not, in the absence of other factors, be conclusive evidence of a significant purpose involving the production of income or the appreciation of property”;³⁶⁵ and
- (4) “No purpose of the company is to accomplish one or more political or legislative purposes within the meaning of 26 U.S.C. § 170(c)(2)(D).”³⁶⁶

Quite intentionally, the language of the Vermont L3C mirrors exactly the language of the PRI Treasury Regulations.³⁶⁷ L3C organizers intended that an investment in a duly organized L3C would automati-

358. *But see* Gary, *ESG Investing*, *supra* note 11 describing various studies showing returns on socially responsible funds and impact investing funds

359. *See infra* Part III.A.

360. Daniel S. Kleinberger, *A Myth Deconstructed: The “Emperor’s New Clothes” On the Low-Profit Limited Liability Company*, 35 DEL. J. CORP. L. 879, 879 (2010).

361. VT. STAT. ANN. tit. 11 § 4161 (2015).

362. *Id.* § 4162.

363. *Id.* § 4162(1)(A).

364. *Id.* § 4162(1)(B).

365. *Id.* § 4162(2).

366. *Id.* § 4162(3).

367. *Compare* VT. STAT. ANN. tit. 11, § 4162, *with* Treas. Reg. § 53.4944-3 (2016). *See, e.g.*, Anne Field, *Court Ruling Means L3Cs Should Vet Their Social Mission Carefully*, FORBES (May 31, 2015, 12:08 PM), <http://www.marciplane.com/news/2015/06/01/in-the-news/court-ruling-means-l3cs-should-vet-their-social-mission-carefully/> (“[The L3C] was created with the idea that the companies could serve as Program-Related Investments (PRIs), which are entities with a charitable or educational purpose that can receive foundation money.”).

cally qualify as a PRI, as the regulatory PRI requirements were incorporated into the very structure of the entity.³⁶⁸

Unfortunately for the proponents of L3Cs, the IRS has not agreed with their contention that an investment in a L3Cs would automatically qualify for PRI status.³⁶⁹ The primary issue is that § 4944 focuses upon the intent of the foundation in making the investment, not on the intent of the business in running its operations. The Vermont statute provides that the company “would not have been formed but for “the relationship to the charitable purpose and that “no significant purpose of the company” is the production of income or appreciation. On the other hand, § 4944(c) states that a PRI is an “investment[] . . . no significant purpose of which is the production of income.”³⁷⁰ Because the motivations of the creators of the company cannot be attributed to the charitable investors, L3Cs cannot automatically qualify as PRIs under current law. In response, legislation has been introduced to make it easier for L3Cs to obtain automatic PRI status, which has to date not gathered significant support.³⁷¹ In the absence of further federal guidance, the growth in L3Cs has slowed, with at least one jurisdiction repealing its statute.³⁷²

Benefit corporations took a different approach toward encouraging charitable capital. Historically, a business corporation could engage in some level of charitable activity consistent with its obligation to its shareholders to maximize value if the activity was in the best interest of the corporation in the judgment of the board.³⁷³ The public battles

368. Cohen, *supra* note 348 (“Some L3C advocates want foundations’ awarding of PRIs to L3Cs to be easier and more automatic. They decry the need, for instance, of the IRS opinion letters that foundations frequently seek as legal cover for making PRIs—presumably seeing them as a reason why foundations do not often make such investments in general, much less PRIs to L3Cs.”); *see also* Lloyd Hitoshi Mayer & Joseph R. Ganahl, *Taxing Social Enterprise*, 66 STAN. L. REV. 387, 395–96 (2014).

369. Jamie Patrick Hopkins, *Low-Profit Limited Liability Companies: High-Risk Tax Fad or Legitimate Social Investment Planning Opportunity?*, CARDOZO L. REV. DE NOVO 35, 42 (2014) (“[T]he IRS has never expressly announced that L3Cs will qualify as PRIs.”); Mayer & Ganahl, *supra* note 368, at 397–98 (“Moreover, the Internal Revenue Service has refused requests to issue rulings that would deem an equity investment or loan to an L3C as a PRI automatically.”).

370. I.R.C. § 4944(c) (2012) (emphasis added); *see also* Treas. Reg. § 53.4944-3(a)(1)(ii) (2016) (“No significant purpose of the investment is the production of income or the appreciation of property.” (emphasis added)).

371. *See, e.g.*, Philanthropic Facilitation Act, H.R. 2832, 113th Cong. § 2(c)(3) (2013) (providing a process where by an L3C can obtain a safe harbor determination that investments in it would be a PRI).

372. North Carolina repealed its L3C statute effective January 1, 2014. *See* N.C. GEN. STAT. §§ 57C-2-01–57C-2-19 (repealed 2014); *see also* Cohen, *supra* note 348.

373. *See, e.g.*, A.P. Smith Mfg. Co. v. Barlow, 98 A.2d 581 (1953) (holding that the plaintiff could give money to charities providing that the total did not exceed the statutory maximum because corporate gift-giving increases the goodwill of the corporation).

of Craigslist and Ben & Jerry's, however, demonstrated the potential primacy of shareholder value (at least in a takeover-type transaction)³⁷⁴ and the limits on the traditional business judgment rule as the defender of board decision making.³⁷⁵ Whether or not their fears were warranted, these battles at least put risk-adverse boards of directors on notice that the pursuit of social goals would not always be tolerated by shareholders or supported by courts.³⁷⁶

In response, states took two different paths. The first path involved the passage of constituency statutes.³⁷⁷ Constituency statutes allowed a business corporation's board to consider the interests of various stakeholders other than just the shareholders' when making corporate decisions.³⁷⁸ These statutes, however, have been criticized as being permissive and in some cases, as only being applicable in takeover-type situations.³⁷⁹ In addition, some argue that constituency statutes still require the board of directors to act in the best interests of the corporation when considering the interests of other stakeholders, which effectively negates the board's ability to elevate these other interests over shareholder value.³⁸⁰

The other path was the creation of the benefit corporation.³⁸¹ The Model Benefit Corporation legislation³⁸² provides that a benefit corporation "shall" have a purpose of creating a general public benefit in addition to its traditional business purpose.³⁸³ The statute then attempts to negate shareholder primacy by stating that the creation of the public benefits is in the best interests of the corporation and, thus, can be valued by a board of directors when contemplating corporate

374. Mayer & Ganahl, *supra* note 368, at 393–94.

375. *See supra* Section II.C.3.c.

376. For a discussion of both the Craigslist and the Ben & Jerry's fiduciary duty fights, see Mayer & Ganahl, *supra* note 368, at 393–94; J. Haskell Murray, *Choose Your Own Master: Social Enterprise, Certifications, and Benefit Corporation Statutes*, 2 AM. U. BUS. L. REV. 1, 13-15 (2012).

377. *See* Mayer & Ganahl, *supra* note 368, at 394.

378. *Id.*

379. *See id.*

380. *Id.*; *see also* Edward S. Adams & John H. Matheson, *A Statutory Model for Corporate Constituency Concerns*, 49 EMORY L.J. 1085, 1087–88 (2000).

381. For a history of the Model Benefit Corporation statute, see Mayer & Ganahl, *supra* note 368, at 398; Matthew J. Dulac, Note, *Sustaining the Sustainable Corporation: Benefit Corporations and the Viability of Going Public*, 104 GEO. L. J. 171, 175 (2015). In this regard, some states have not adopted a version of this benefit corporation legislation but have developed their own varieties, such as California's social purpose corporation and the Washington social purpose corporation. CAL. CORP. CODE §§ 2500–2517 (West 2012); WASH. REV. CODE §§ 23B.25.005–23B.25.150 (2012).

382. MODEL BENEFIT CORP. LEGISLATION § 201(a) (B LAB 2016).

383. *Id.* It may also have specific enumerated public benefits. *See id.* § 201(b).

actions.³⁸⁴ The Model Benefit Corporation statute also includes a mandatory constituency-type provision, which requires the board to consider the interests of shareholders, employees, the workforce generally, suppliers, beneficiaries of its public benefit, community, society at large, and the environment in the decision-making process.³⁸⁵ In order to oversee and measure this public benefit, benefit corporations are required to file an annual benefit report,³⁸⁶ which includes an assessment of the public benefits provided as compared to a third-party benchmark.³⁸⁷

Unlike the L3C, a benefit corporation does need to generate “low profit,” presumably making it more attractive to a charitable investor looking to generate a return as well as further its mission. Moreover, the requirement of a general public good³⁸⁸ and the provisions requiring consideration of stakeholders other than shareholders are mandatory, unlike the L3C or constituency legislation.³⁸⁹ The benefit corporation statutes presumably require a business to take into account goals other than pure profit generation, which should theoretically make it easier for a charity to argue that its investment accomplishes charitable goals. Practically, that may always be the case.³⁹⁰

C. *The Cooperative as the First Social Enterprise*

Upon a review of the new social enterprise hybrid entities, it appears that cooperatives have been functioning as a form of social en-

384. *Id.* § 201(c) (B LAB 2016).

385. MODEL BENEFIT CORP. LEGISLATION § 301(a) (B LAB 2016). *See, e.g.*, W. VA. CODE ANN. § 31F-4-401(a)(1) (LexisNexis 2014); *see also* Murray, *supra* note 376, at 16–25 (comparing benefit corporations with constituency statutes).

386. MODEL BENEFIT CORP. LEGISLATION § 401(a) (B LAB 2016). Note that West Virginia did not adopt the public filing provision.

387. In this regard, the most popular third party standard has been developed by B Lab and branded as the “B Corp” or “B Corporation.” Matthew J. Dulac, Note, *Sustaining the Sustainable Corporation: Benefit Corporations and the Viability of Going Public*, 104 GEO. L. J. 171, 174–175 (2015). Although the names are similar, a benefit corporation is not the same as a B Corporation, which is an entity (which need not be a corporation) that has met B Lab’s propriety standard. *Id.* Not surprisingly, B Lab assisted in the creation of the Model Benefit Corporation statute. *Id.*; Murray, *supra* note 376, at 21.

388. One of the critiques of the benefit corporation is that there no sense of how important the general public good need be in comparison to the profit motive. Mayer and Ganahl, *supra* note 368, at 428 (“[M]otive itself is really irrelevant to the granting of subsidy and the measurable public benefit flowing from an activity is the proper object of public subsidy, not benevolent motives regardless of their value.”).

389. While mandatory, the governing body need only consider it, not give it any particular required weight. *See* Mayer and Ganahl, *supra* note 368, at 426.

390. *Id.* (discussing the perils inherent in balancing the interests of the multiple stakeholders of a benefit corporation).

terprise for roughly one hundred fifty years before the first appearance of the L3C in Vermont in 2008.³⁹¹ Both today's social entrepreneurs and the originators of the modern cooperative share the ethos of social movement.³⁹² Proponents of social enterprise posit that the combination of for-profit methods and the charitable outcomes can enhance, not distract from, the organization's charitable mission.³⁹³ In fact, social enterprise advocates highlight the opportunity for "individual experimentation and the exercise of creative imagination"³⁹⁴ in the entrepreneurial-minded.³⁹⁵

And yet, the cooperative, with its concurrent social and economic goals, has been operating in this space in the United States since the Civil War. From its inception with the Rochdale Pioneers, the cooperative has always had a dual bottom line orientation. The Rochdale cooperative was born to address the social upheavals, displacement, and poverty caused by the Industrial Revolution. The values and lesson learned by the Rochdale Pioneers were ultimately embedded into the organizational principles of the cooperative: democracy, equality, fair dealing, and a commitment to economic opportunity for its struggling members and their neighborhoods.³⁹⁶ At its inception, Rochdale was always more than a way to get unadulterated food; it was a social experiment in self-help for struggling communities.³⁹⁷

Economists in the United States and elsewhere recognized this dual nature. At the turn of the twentieth century, both Aaron Sapiro and Edwin Nourse viewed cooperatives as a way to assist impoverished farm communities to compete with larger growers and find a better

391. See *The Rochdale Principles*, *supra* note 29; see also Thomas A. Kelley, *Law and Choice of Entity on the Social Enterprise Frontier*, 84 TUL. L. REV. 337, 340 n.6 (2009) (citing James J. Fishman, *Wrong Way Corrigan and Recent Developments in the Nonprofit Landscape: A Need for New Legal Approaches*, 76 FORDHAM L. REV. 567, 603–06 (2007)).

392. Kelley, *supra* note 391, at 338 (citing David Gergen, *The New Engines of Reform*, U.S. NEWS & WORLD REP 48 (2006)).

393. The Social Enterprise Alliance is one of the primary organizations promoting social enterprise, stating that social enterprise is the "Missing Middle," combining efficiency, sustainability, creativity, and generosity in a way not seen in the traditional sectors of the economy. See *Social Enterprise*, SOC. ENTERPRISE ALLIANCE, <https://socialenterprise.us/about/social-enterprise/> (last visited Jan. 14, 2017); see also Kelley, *supra* note 391, at 374.

394. STAFF OF S. COMM. ON FIN., 89TH CONG., 1ST SESS., TREASURY DEP'T REP. ON PRIVATE FUNDS. 35 (Comm. Print 1965).

395. Mayer & Ganahl, *supra* note 368, at 427 ("Social entrepreneurs . . . desire the flexibility to seek non-traditional approaches in conducting their business and to access a broad range of capital.").

396. See *supra* Section II.A.1.

397. See *supra* Section II.A.1; see also GEORGE JACOB HOLYOAKE, *THE HISTORY OF THE ROCHDALE PIONEERS, 1844–1892* (2013).

way.³⁹⁸ The work of economist Georg Draheim in the 1950s clearly established the dual nature of the cooperative as part social association, part firm.³⁹⁹ Even today, some social-capital-economic theorists believe that the strength of the cooperative is its dual nature: Without its social commitment to members' interests, its alternative capital nature might not be workable.⁴⁰⁰

Today, the modern cooperative movement explicitly recognizes public good and social values as principles inherent to the cooperative movement. The ICA's cooperative principles clearly include concern for community, education, and sustainability among its core values.⁴⁰¹ The cooperative principles of democracy and a commitment to member interest at the expense of profit have always been embedded in the legal structures that form cooperatives. From the Rochdale Principles to Sapiro's Marketing Act, the Capper-Volstead Act, and Subchapter T of the Code, these principles define the legal cooperative. With the inception of the constituency provisions in the Wisconsin NGC statute and the Uniform Limited Cooperative Association Act, the concern for community, economic development, and equal opportunity that have always been a part of the cooperative movement are now explicitly incorporated into the legal entity structure of the cooperative.

Much like the L3C, the cooperative structure explicitly recognizes that that the entity is formed not merely to pursue profit, but to accomplish other goals that may, in fact, sacrifice profit. Cooperative legislation has always acknowledged the need to consider constituencies other than capital interests; these provisions are paralleled in benefit corporation legislation, which explicitly empowers boards to consider the needs of the workforce, the community, and the environment. When compared side-by-side, the constituency provisions of the Model Benefit Corporation Statute and the Uniform Limited Cooperative Association Act are strikingly similar.

All three organizations purport to be responsive to third-party standards of public benefit. The L3C incorporates the standards of charity set forth in the Internal Revenue Code through its explicit adoption of the program-related investment provisions of § 4944.⁴⁰² The Model Benefit Corporation statute requires a benefit

398. See *supra* Section II.B.1 (“The justification of cooperative marketing is that it has been the means of a more progressive form of living and superior type of citizenship, as well as an economic remedy.”).

399. See *supra* Section II.B.1.

400. See *supra* Section II.B.2.

401. For discussion of the ICA cooperative principles, see *supra* Section II.A.3.

402. See *supra* Sections IV.A & IV.B.

corporation to file a benefit report annually, which incorporates third-party standards regarding general public benefit.⁴⁰³ While the cooperative movement held to the Rochdale principles for much of its early history, the modern cooperative can explicitly adhere to the ICA principles through the constituency provisions of the ULCAA, which allow a cooperatives governing body to take into account “other cooperative values and principles.”⁴⁰⁴

Accordingly, as the conversation regarding the benefits and limitations of social enterprise and specifically, the hybrid entities designed to facilitate social enterprise continues, cooperatives should not be forgotten. Supporters and critics alike continue to debate the benefits and viability of social enterprise. Some jurisdictions have considered providing special income tax and other benefits to hybrid entities;⁴⁰⁵ some commentators have gone as far as recommending for-profit charity.⁴⁰⁶ Of course, commentators will continue to pursue obtaining clarity from the IRS regarding the treatment of social enterprise under the tax code, including easing PRI rules for social enterprise entities.⁴⁰⁷

V. RECOMMENDATIONS FOR FACILITATING CHARITABLE INVESTMENTS IN COOPERATIVES

Critics of social enterprise entities rightfully point out a number of potential issues with the new legal structures designed to encourage investment in these enterprises.⁴⁰⁸ These issues are certainly present in cooperative acting as a social enterprise in the same manner as they would be with a benefit corporation or a L3C. In addition, there are challenges unique to cooperatives that can be clarified so as to continue encouraging experimentation and charitable investment in this area.

403. For discussion of the Model Benefit Corporation Statute, see *supra* Section IV.B.

404. For discussion of section 720 of the ULCAA, see *supra* Section II.C.3.d.

405. Mayer & Ganahl, *supra* note 368, at n.12 (2014) (“For example, in Hawaii the initial legislation that would have created benefit corporations in that state included exemption from state income tax, but the governor vetoed the final version of that legislation[.]”). In addition, Philadelphia offers a local tax credit to B Lab certified corporations. *Id.* at 421; see also THOMAS J. BILLITTERI, NONPROFIT SECTOR RESEARCH FUND, MIXING MISSION AND BUSINESS: DOES SOCIAL ENTERPRISE NEED A NEW LEGAL APPROACH? 6 (2007).

406. See generally Anup Malani & Eric A. Posner, *The Case for For-Profit Charities* (John M. Olin L. & Econ. Working Paper No. 304, 2006).

407. Kelley, *supra* note 391, at 355–58.

408. Mayer & Ganahl, *supra* note 368, at 392.

A. *Cleaning up State Statutes*

The enabling statutes in many states create a confusing maze of overlapping laws coupled with a lack of clarity.⁴⁰⁹ Due to the history of haphazard growth of cooperative legislation, many states have adopted multiple cooperative statutes. A state may have adopted a limited agricultural marketing cooperative statute based on the Standard Marketing Act, and then later enacted a general cooperative statute.⁴¹⁰ Some states have individual statutes for different types of cooperatives: As of August 2015, twelve states had a specific statute solely governing workers' cooperatives.⁴¹¹ As pointed out by at least one commentator, "the large variation in cooperative laws among states invariably leads to shopping for the best state statute."⁴¹²

Additionally, many cooperative statutes are grafted on to the state's business corporation act for gap-filling provisions. Again, much of this is a historical relic, as it dates back to a time when the corporate form was generally the only form of organization available. These interactions lead to confusion as to whether the cooperative is its own type of entity or just a "flavor" of another type of corporation, and how those different laws should interact.

In West Virginia,⁴¹³ for example, a cooperative must comply with the underlying statutes applicable to a business corporation,⁴¹⁴ a benefit corporation,⁴¹⁵ or a nonprofit corporation.⁴¹⁶ The provisions of the Cooperative Association Act then limit the purposes and powers of the corporate entity in order to fulfill its cooperative purpose.⁴¹⁷ If the cooperative chose to organize as a benefit corporation, it is argua-

409. See MARK J. HANSON, LAW OF COOPERATIVES: LEGAL FRAMEWORK OF COOPERATIVE DEVELOPMENT 10, http://www.agmrc.org/media/cms/legal_framework_21ae93b457eb7.pdf (last visited Sept. 8, 2016).

410. For example, Missouri has separate stock and non-stock cooperative statutes, dating to 1923 and 1925. It also has a commodity marketing act applicable to agricultural producers. See *id.* at 95–96.

411. *Update: Governor Brown Signs Worker Cooperative Law in California*, DEMOCRACY AT WORK INST. (Aug. 12, 2015), <http://institute.coop/news/update-governor-brown-signs-worker-cooperative-law-california>. Massachusetts, for example, has a general cooperative corporation statute (MASS. GEN. LAWS ch. 157 (2014)), an employee cooperative statute (MASS. GEN. LAWS ch. 157A (2014)), and a cooperative housing statute (MASS. GEN. LAWS ch. 157B (2014)).

412. Hanson, *supra* note 99, at 95–96.

413. West Virginia's statute defines a cooperative association as "any corporation organized under this article. Each association shall also comply with the requisite business corporation provisions of [business corporation act or the benefit corporation act] or the nonprofit corporation provisions . . ." W. VA. CODE § 19-4-1(d) (2015).

414. See *generally* Business Corporation Act, W. VA. CODE ch. 31D (2015).

415. See *generally* Benefit Corporation Act, W. VA. CODE ch. 31F (2015).

416. See *generally* Nonprofit Corporation Act, W. VA. CODE ch. 31E (2015).

417. W. VA. CODE § 19-4-1 (2015) (regarding cooperative associations).

ble that the benefit corporation's constituency statute provisions⁴¹⁸ would be incorporated into the cooperative's structure.

Any conflict between the benefit corporation statute and the cooperative statute, however, is resolved in favor of the cooperative statute.⁴¹⁹ Although the benefit corporation constituency statute in West Virginia is mandatory,⁴²⁰ the cooperative allows the cooperative's articles of incorporation to "contain any provisions managing, defining, limiting or regulating the powers and affairs of the association, the directors, the stockholders or the members of the association."⁴²¹ As a result, a conflict may arise between the cooperative statute and the benefit statute through provisions in the cooperative's articles and bylaws that alter the application of an otherwise mandatory constituency statute. In that case, it would be difficult to rely on incorporation of the benefit corporation constituency provisions into the cooperative as any structural evidence of charitability.

B. Follow the Path Set by the ULCAA

The Uniform Law Commission has already started the process of consolidation and clarification of cooperative laws through the promulgation of the ULCAA. In this regard, the drafting committee utilized two very important guideposts in drafting the uniform statute: recognition of traditional cooperative principles and flexibility. In the Prefatory Notes, the ULCAA specifically states that "Cooperative values undergird and animate many of the Acts provisions" and specifically references the cooperative principles set out by the ICA.⁴²² It further states that the intention of the Act "is to expand the use of entities recognizing cooperative principles."⁴²³ The drafters explained that the ULCAA "provides an efficient default template that encourages planners to utilize tested cooperative principles that reflect traditional cooperative values at a deeper level than provided in those other structures."⁴²⁴

418. W. VA. CODE § 31F-4-401.

419. Sections 19-4-20 and 19-4-29 specifically state that if there is a conflict with the cooperative association statute provisions, then the conflicting law shall be construed as not applicable to the cooperative.

420. W. VA. CODE § 31F-4-401 ("[D]irectors of a benefit corporation . . . shall consider the effect of any corporate action . . ." (emphasis added)).

421. W. VA. CODE § 19-4-6; *see also id.* § 19-4-8 (allowing the bylaws to set "the qualifications, compensation, duties, and terms of officers and directors . . ." (emphasis added)).

422. ULCAA prefatory note at 4-5; *see also supra* Section II.C.3.c.

423. ULCAA prefatory note at 27.

424. *Id.* at 1.

In addition, the Prefatory Note states that the Act “attempts to provide a flexible breastwork of mandatory and default rules that are grounded in cooperative values and member governance.”⁴²⁵ As a result, the outlines of a cooperative organized under the statute are not guaranteed to meet the Subchapter S definition or the Capper–Volstead Act’s definition of a cooperative. On the other hand, the cooperative can tailor its terms to its specific needs.

C. Choosing between the NGC and the Traditional Cooperative

One of the downsides of modern NGC legislation and the ULCAA is that they allow an organization to deviate from some traditional cooperative principles by allowing for a class of non-member capital that has a vote in management. On the other hand, the Wisconsin NGC and the ULCAA contain the most explicit legislative adoption of the core cooperative values of community, economic opportunity, and sustainability.

Because the ULCAA is designed for flexibility, it can accommodate a cooperative that is organized under traditional cooperative principles, as well as a cooperative that takes advantage of NGC features for purposes of capital formation.⁴²⁶ For a cooperative that wants to function in the social enterprise area, it can draft its purpose and membership provisions specifically to incorporate the hallmarks of charitable economic development set forth by the various IRS administrative guidance and emphasize employment, community revitalization, and education. Similarly, it could tailor its membership requirements to make sure that the cooperative is primarily serving a charitable class so as to avoid private benefit issues.

As a result of this tailoring, a social enterprise cooperative could eschew the ability to take on most non-member capital. One of the critiques of the NGC legislation is that there is an inherent conflict between the traditional cooperative purpose of member service and the needs of capital—a conflict avoided when the membership *is* the capital. If member capital is insufficient and venture capital is inappropriate, then charitable capital can fill the gap. By definition, part of the purpose of a mission-related (or the primary reason, for a PRI)⁴²⁷ is to accomplish a charitable purpose. If the cooperative’s member service accomplishes the charitable purpose, then there is no

425. *Id.* at 26.

426. *Id.* at 3 (“Importantly, this draft is flexible enough to form a limited cooperative which operates like a traditional cooperative. Indeed, none of the new features are required; rather, they are permitted.”).

427. *See supra* Section IV.A.

conflict between the needs of the members and the needs of the charitable investor.

To facilitate charitable investment, the ULCAA could be more obvious in the creation of a traditional cooperative path in the statute. As currently drafted, there are so many options available to a cooperative that can be difficult to determine what is a “traditional” provision and what is a “NGC” provision. For smaller cooperatives, this might be more detail than needed. Similarly, a charity making a mission-related or program-related investment in a cooperative will need to develop a significant amount of internal expertise in cooperative structure to navigate through the various options. One of the strengths of the benefit corporation or the L3C is that the statutory provisions are self-contained. Formally distinguishing between traditional movement cooperatives and NGCs in the statute (along the lines of the distinction between the LLC and the L3C) could administratively facilitate the investment of charitable capital in cooperatives. The one allowable variation from a traditional cooperative structure, however, would be to allow charitable organizations to provide non-member capital, to fill the gap otherwise left by the exclusion of venture capital funding.

D. Enhanced Definitions of Charitability and Accountability

As indicated by many commentators, social enterprise organizations suffer from two major flaws: a lack of a clearly defined quantum of public good, and a lack of accountability and enforcement. Professor Dana Brakman Reiser has noted, “What begins as philanthropic mission could, as a result of it being embedded within a business, become biased toward alignment with the goals of the for-profit company.”⁴²⁸

Nothing in most L3C or benefit corporation legislation requires some minimum standard of charitable benefit. A L3C must have low profit, but no one really knows how low.⁴²⁹ A benefit corporation must have a general public good as part of its purpose, but no one really knows how much.⁴³⁰ In each case, there is no stakeholder that has an interest in pursuing and defending the public good that is theo-

428. Dana Brakman Reiser, *For-Profit Philanthropy*, 77 *FORDHAM L. REV.* 2437, 2465 (2009); see also Dana Brakman Reiser, *Benefit Corporations—A Sustainable Form of Organization?*, 46 *WAKE FOREST L. REV.* 591, 609–10 (2011).

429. J. William Callison & Allan W. Vestral, *The L3C Illusion: Why Low-Profit Liability Companies Will Not Stimulate Socially Optimal Private Foundation Investment in Entrepreneurial Ventures*, 35 *Vt. L. REV.* 273, 292–93 (2010).

430. See Reiser, *Benefit Corporations*, *supra* note 428, at 610–11.

retically inherent in the structure of the organization. Very few jurisdictions give the Attorney General or other governmental authority standing to enforce the public purpose of these entities.⁴³¹

One of the differences between the L3C and the benefit corporation, on the one hand, and the cooperative on the other hand, is that the cooperative does have a constituency to defend any charitable purpose: its members. If by definition a social enterprise cooperative has, in part, a mission to provide services to its members that qualify as charitable—such as employment opportunities—then the members themselves have an interest in seeing those purposes furthered. Moreover, to the extent that the ULCAA allows for a non-member charitable investor class, such as a foundation making a PRI, that investor clearly has the standing and the ability to enforce those provisions.

VI. CONCLUSION

Inherent in the nature of the cooperative are a set of values: democracy, sustainability, economic opportunity, and self-determination. As a social matter, cooperatives bind communities of individuals who associate for their common good. As an economic matter, cooperatives allow their members to pursue these goals free from the constraints of the profit motivation of a separate capital class. From a legal perspective, cooperatives provide a structure where charitable values can be pursued simultaneously with economic benefit. As such, cooperatives truly can be considered the first social enterprise.

Randall Torgerson, the former Deputy Administrator for Cooperative Services for the USDA, once observed:

Cooperatives by virtue of their structure are embedded by ownership, use, benefit and governance in rural areas. The benefits of cooperatives in rural settings are decentralization of decision making and distribution of wealth generation locally. The very nature of the organization brings empowerment to rural people generally and specifically to rural communities. The impact of cooperative operations can therefore can be viewed as a public developmental good at the grass roots level.⁴³²

Although Mr. Torgerson's comments specifically address rural cooperatives, his thoughts are universally applicable to all cooperatives.

431. Illinois' L3C legislation explicitly subjects a L3C to the state's Charitable Trust Act. *See* 805 ILL. COMP. STAT. 180/1-26(d) (2014); Charitable Trust Act, 760 ILL. COMP. STAT. 55/1 (2014); *see also* Evelyn Brody & John Tyler, *Respecting Foundation and Charity Autonomy: How Public Is Private Philanthropy*, 85 CHI.-KENT L. REV. 571, 579–80 (2010); Mayer & Ganahl, *supra* note 368, at 399–400 (discussing the weaknesses of current oversight of social enterprise organizations).

432. Torgerson et al., *supra* note 51.

Cooperatives empower their members to determine the services necessary to bring economic development, employment opportunities, and education and sustainability to their communities. These charitable values are inherent in the nature of the cooperative, and as such, should cause the cooperative to be a part of the larger dialogue regarding the role of social enterprise in assisting individuals and communities in need.

