THE APPLICATION OF LABOR LAW TO WORKERS' COOPERATIVES

by

Neil A. Helfman
Attorney at Law
El Cerrito, California

December 1992
THE APPLICATION OF LABOR LAW TO WORKERS' COOPERATIVES

Neil A. Helfman

We have a gun aimed at our future economic and cultural well-being (1), warns Joseph Steger, president of the University of Cincinnati, in a recent article questioning the ability of the United States to maintain a competitive workforce in the twenty-first century. To remedy this, Steger advocates a new culture in the workplace (2) based upon some form of shared governance (3). The worker of the future will have to be far more involved in accessing information and making decisions than presently exists (4), according to Steger and others concerned with the issue.

One such structure for shared governance already exists in the form of a workers' cooperative. Workers' cooperatives not only provide a mechanism for worker participation in the management and the economic fortunes of a business, but also combine the role of employer and employee. As the U.S. Tax Court in Puget Sound Plywood v. Commissioner, 44 T.C. 305, 307-8 (1965) observed:

"Under the cooperative association form of organization...the worker members of the association supply their own capital at their own risk; select their own management and supply their own direction for the enterprise...and then themselves receive the fruits of their cooperative endeavors".

This paper examines the structure and role of these cooperatives and critical issues raised as new options evolve to keep us competitive in the workplace. In particular, it examines the impact, if any, that labor law (pertaining only to employees) should have on the economic regulation of such hybrids of workers with broad management responsibilities.

Distinguished from other business structures (5), and favored by the law, the unique operations and characteristics of cooperatives have been recognized in at least some areas of law. United States Supreme Court Justice Louis Brandies commented in Liggett v. Lee, 288 U.S. 517, 579, that cooperatives were entitled to different tax and regulatory treatment than other types of entities. (See also I.R.C. 1381 et. seq.: Puget Sound, supra).

One important area that has received little attention in this respect is the role economic labor laws should have on such entities. Premised on an antagonist relationship between capital, management and employment (7), present definitions and understandings of an employment relationship, reflected in existing labor (and corporate) law, not only fail to address other possible relationships in the work force, but may in fact be an impediment to the very creativity needed to achieve harmony between our legal structure and the changing labor relations climate (8). This publication suggests ways the law can, and should, be changed to allow the flexibility essential to meet the demands of doing business in a world market.

LABOR LAW

Though labor law covers a number of distinct legal matters relating to social, liability and financial issues, this paper focuses solely on the element of economic regulation. Accordingly, it examines the following laws as most directly impacting the area of workers' cooperatives:

Federal


State

1. Statutory wage, hour, and working conditions, Cal. Labor Code 1171-1204

By examining these laws, we are able to review the various factors courts have looked at under different circumstances to determine the existence of an em-
emploi relationship. This threshold question (whether an employment relation exists), ultimately determines the application of labor law to workers’ cooperatives.

The courts have provided little guidance as to how to determine the existence of an employment relationship; and there appears to be no statutory authority defining the employment status of cooperative members. Existing law is inconclusive, and could provide support to both the existence and non-existence of an employment relationship in the cooperative. Much depends upon the structure of a particular cooperative and the objective of a particular law. Determination of employment status of worker cooperative may be far-reaching, impacting such everyday matters as tax and record keeping, as well as such legal issues as the responsibilities of worker members towards each other, and mechanisms for internal dispute resolution.

**EMPLOYMENT STATUS OF MEMBER WORKERS**

**Legal Criteria**

There is no single criterion for determining the existence of an employment relationship. Through the years, courts have developed a common law definition based upon a number of recognized factors. First and foremost, they look to the right of the principal to control the manner and means of a desired result. (See 22 Cal Code Reg 4304-1; 26 CFR 31.3121(d)-1(c)). The right to discharge at will, without cause, is strong evidence of such control. (Id). Secondary factors, including the understandings of the parties, ownership of the instrumentalities for performing the work, and manner of payment have also been considered. (Id; Tieberg v. Unemployment Ins. App. Bd. (1970) 2 Cal 3d 943, 950-53).

Some statutes expressly rely upon such common law criteria. Most notably, the United States Congress by joint resolution in 1948 passed the “Gearhart Resolution”, which explicitly disapproved the proposed Federal Unemployment Tax Act (F.U.T.A) and Federal Insurance Contribution Act (F.I.C.A.) because their criteria diverged from common law rules. The Resolution reiterated that employee status should be determined by traditional — e.g. common law — legal tests (9). This sentiment is echoed in state law which also relies upon common law tests, (Cal. Unemp. Ins. Code 621).

Still other labor statutes, such as workman’s compensation, find the common law criteria deficient, and mandate that the “control test”, (the power of an employer to direct and control both the product and execution of an employee’s work) be applied in light of the purpose of applicable statutory law, (Yellow Cab Cooperative Inc. v. Workers’ Comp. Appeal Bd., (1991) 226 Cal. App. 3d 1288, 1297). The Fair Labor Standards Act (F.L.S.A.) uses the “economic reality” test (economic dependency on a business entity by persons providing services to the entity), which considers the “control test” equally with other factors — such as investment and participation in profit and loss — to examine the “entire economic reality”, (Dole v. Amerilink Corp., 729 F.Supp 73,76 (E.D. Mo. 1990)).

Regardless of the criteria, where doubt exists, the courts go beyond mere technical concepts to look at the “total situation”, examining all relevant facts and circumstances, (see Bonnette v. Calif. Health & Welfare Agency, 704 F.2d 1465, 1470 (9th Cir. 1983)). (See also, McGuire v. United States, 349 F.2d 644 (9th Cir 1965)), applying this to common law cases.

None of these tests, however, adequately serve to assess the unique business relationships of members of workers’ cooperatives. Common law rules in general, and the “control test” in particular, were developed to limit vicarious liability for the misconduct of a person rendering services for a principle, (See S.G. Borello & Sons v. Department of Industrial Relations, (1989) 48 Cal. 3d 341, 354). As indicated, some statutory provisions have noted this deficiency and look to the remedial intent of the law.

The “economic realities” test, which has been applied to workers’ cooperatives, is closer to the mark. But it has been used primarily to ascertain whether an entity has employed the cooperative structure as a “scheme” to avoid F.S.L.A. standards; it has yet to be applied in meaningful ways to look specifically at the status of business relationships for cooperative workers.

A further and more fundamental problem, is that these tests have been used primarily to distinguish independent contractors from employees. In these situations, the critical issue is whether the person providing services to the entity maintains a separate and distinct existence from that entity. This is not an issue in workers’ cooperatives, since there is no need to separate worker members from the entity. It is this author’s contention that in a properly structured cooperative, the worker members are the entity.

**The Effect of Incorporation**
In California, consumer, producer, and worker cooperatives may be incorporated pursuant to California Corporation Code 12200 et. seq., Cal. Corp Code 12200, 12201. These provisions are intended primarily for consumer cooperatives, but may include other forms as well. While some states have statutes specifically addressing incorporation of workers’ cooperatives, California does not at this time. Most worker cooperatives in this state are incorporated, but incorporation as a cooperative is less common (10).

As the law presently stands, it looks at form over function. The fact of incorporation may have more bearing upon the determination of an employment relationship, than the actual relationship between the parties. A worker in an incorporated cooperative who has managerial authority, for example, may be considered an employee just because the business is incorporated; while a junior partner of a thousand-partner accounting firm, who is under the control of others, is not. The rationale for this distinction is not entirely clear; one explanation is that in the former, worker-members are providing services to an entity (11). For example, in the Matter of Construction Survey Cooperative, (Case No. T-62-3) (1962) before the California Unemployment Insurance Appeals Board, members of a workers’ cooperative were held not to be employees. In that case, member workers received compensation on the basis of their contributed labor. By common consent, the activities of the cooperative were directed by a manager, although ultimate authority for managerial decisions rested with the membership. The appeals board found the workers to be principals of the cooperative, and held that under California law that it was incompatible for them to be employees of their own organization. When presented to the Employment Development Department, EDD representatives took the position that if the entity were incorporated, workers should be considered employees even if no other facts had changed (12).

In spite of this legal distinction, similarities between incorporated and unincorporated entities appear to be greater than their differences. The traditional legal concept of unincorporated entities, as an aggregate of individuals, is no longer valid. Just as corporate rights and liabilities have been determined to be distinct from the persons comprising the corporation, (Merco Constr. Engineers, Inc v. Municipal Court, (1978) 21 Cal 3d 724,729-30), so too unincorporated entities have been held to be entitled to general recognition as separate legal entities, (Cal-Metal Corp. v.

State Bd. of Equalization, (1984) 161 Cal. App. 3d 759, 765). Moreover, both corporations and unincorporated joint-stock companies have perpetual succession (where stock or other economic interest can be transferred to outside parties instead of limiting the life of the entity to its original participants), own property, and incur liabilities in the name of the entity. Both are directed by a board of directors and officers, and are treated the same by the United States Internal Revenue Service (See I.R.C. 7701(a)(3)).

The differences that do exist between incorporated and unincorporated businesses have little bearing on determining the existence of an employment relationship. The financial distinction between an incorporated and an unincorporated entity is that a corporation is required to maintain sufficient assets to meet its liabilities with third parties. As a result, a corporation provides protection to its shareholders by limiting liability to the extent of the corporate assets. If, however, a court finds that a corporation is too thinly capitalized, or otherwise unable to meet its liabilities, the corporate structure will be disregarded and individual stockholders held personally liable in the same manner as unincorporated entities. Thus, even if formal requirements of incorporation are otherwise met, the corporation will be deemed invalid if it cannot meet its liabilities.

Another difference between incorporated and unincorporated associations is that the former may be formed only by the authority of the state; while the latter are formed by mere agreement of the parties.

Important as these matters may be, they relate to an entity’s relationship with third parties, and not to the internal relationship within the entity. Neither the formal requirements for incorporation, nor the corporate capitalization requirement have anything to do with defining an employment relationship. Matters which impact the internal relationship, such as participation in the decision-making process, management, and economic fortunes, are not unique to incorporated entities. Nevertheless, as exemplified in the position of the California EDD, the fact of incorporation is often given overriding importance over all other factors.

Due to the unique character of workers’ cooperatives, the employment status of cooperative members is affected by this apparent incongruity between the factual criteria for determining an employment relationship, and the mechanical status which results from incorporation. Cooperative members who may not consider themselves to be employees because of the bylaws and operational structure of the cooperative,
may nonetheless be classified as employees simply because the entity is incorporated. There can be unexpected, even harmful, legal consequences as a result of the absence of clear guidelines on this. In order to discern how labor laws should be applied to worker cooperatives, and under what circumstances worker members may be employees, it is first necessary to examine existing law which may impact this determination.

EXISTING LABOR LAW

Federal law

The Fair Labor Standards Act (F.L.S.A.) was enacted in 1938 to regulate the hours and wages of employees. In particular, the Act governs minimum wage and overtime payment for businesses engaged in interstate commerce. The United States Supreme Court specifically noted that it was enacted in response to the unequal bargaining power between employer and employee, (Brooklyn Bank v. O’Neil, 324 U.S. 697, 706 (1944)), and further observed:

“The legislative debates indicate that the prime purpose of the legislation was to aid the unprotected, unorganized and lowest paid of the nation’s working population; that is, those employees who lacked sufficient bargaining power to secure for themselves a minimum substance wage”, Id at 707, fn. 18.

An employment relationship must exist in order for the F.S.L.A. to apply, (Walling v. Portland Terminal Co., 330 U.S. 148, 152 (1946)). Section 3(e)(1) of the Act defines an employee as “any individual employed by an employer”. The determination of an employment relationship is not mechanical; the fact-finder must look beyond mere labels to scrutinize the “economic realities” of the situation, according to the court in (Wirtz v. Construction Survey Cooperative, 250 F. Supp. 621, 624 (1965 D. Conn)). In order to make this determination, the courts have identified six factors known as the “economic realities” test:

1. The degree of the so-called “employer’s” right to control the manner in which the work is to be performed;
2. The “employee’s” opportunity for profit or loss depending upon his or her managerial skill;
3. the “employee’s” investment in equipment or materials required for his or her task, or his or her employment of helpers;
4. Whether the service rendered requires a special skill;
5. The degree of permanence of the working relationship; and
6. Whether the service rendered is an integral part of the “employer’s” business, (Real v. Driscoll Strawberry Associates, Inc., 603 F. 2d 748, 754 (9th Cir. 1979)).

No single factor is dispositive of an employment relationship. Nor are these factors exhaustive. Rather all of the circumstances of the work activity must be taken into consideration, (Dole v. Amerlink Corp., 729 F. Supp. supra at 76) Though the six factors mentioned were designed, and generally applied to distinguish employees from independent contractors (Id at 75), in Wirtz, supra, they were used by the court to “scrutinize the kernel of ‘economic realities’ “ in order to determine the employment status of surveyors organized into a cooperative structure, (Id at 624).

While there is significant F.S.L.A. case law in regard to cooperatives, most actions concerned cooperatives established as a subterfuge to avoid F.S.L.A. requirements. With the notable exception of Wirtz, the “cooperatives” had nothing in common with plywood cooperatives in the Pacific Northwest, or those adhering to Mondragon principles, including separation of economic interest from participatory rights. Unlike the latter cooperatives, those examined by the courts were set up by outsiders who were also the chief beneficiaries of the cooperatives’ business activities.

In Fleming v. Palmer, (123 F. 2d 749 (1941)), the Court of Appeals reversed a lower court decision which held that members of a needlework cooperative were not subject to the F.S.L.A. The appellate court noted that the cooperative had been formed shortly after the enactment of the F.S.L.A. for the explicit purpose of avoiding its requirements, that the workers were informed of this purpose, and that the cooperative would be dissolved when it was no longer necessary for the employers to meet the Act’s requirements, (Id at 752). The main issue before the court was whether the business was controlled by worker members or the incorporators. The court found that the worker members had no real power either in the economic or operational affairs of the business. Incorporators had named directors for multi-year terms, the board determined who had a right to vote, and in fact, all actions of the managers which required board approval received unanimous consent, (Id., at 758-60). Furthermore, the court found that the workers were economi-
cally subservient to the incorporators, who not only had the power to dictate the terms of employment, but also to dissolve the cooperative at any time, (Id at 759).

Fleming is significant not only for what was decided but also for what was not decided. In addition to determining the employment status of workers in this particular case, the government also wanted the court to rule on the application of the F.S.L.A. to cooperatives controlled by their members. The court said this was “unnecessary”, and declined to rule on this issue, (Id at 762).

In McComb v. Homeworkers’ Handicraft Cooperative, (176 F.2d 633 (1949)) the appellate court also faced a situation in which a cooperative was created as a subterfuge. The complaint, filed by the U.S. Dept of Labor, alleged that it was not a “true cooperative”, but merely an agent for workers whose sole task was to insert draw strings in tobacco and other kinds of bags for companies that manufactured the bags, (Id at 634). The bag companies responded that the homeworkers were independent contractors, (Id at 635). The cooperative had been organized by the bag manufacturers shortly after passage of the F.S.L.A. in an effort to avoid the Act’s application. When the incorporators became fearful that the corporation might be subject to the Act, they dissolved the corporation, forming a cooperative to take over its functions, (Id at 635).

The appellate court found that the workers were employees, not independent contractors, because they were unskilled and unorganized manual laborers who performed a single step in a manufacturing process for which they were paid a “ridiculously” low wage of 5 to 13 cents an hour, depending on piece-work, (Id at 636-37). The court further held that the existence of the cooperative did not affect the determination of an employment relationship since the workers’ efforts benefited the bag companies, not the cooperative. The cooperative had no other interest in the economic affairs than to distribute the bags and payment to the workers, (Id at 639).

The employment status of a worker’s cooperative was presented to the United States Supreme Court in Goldberg v. Whitaker House Cooperative, (366 U.S.28 (1961)). The cooperative was comprised of approximately 200 members who worked at their homes. Each member had one vote, was required to remain a member for at least one year, could be expelled at any time by the board of directors, and had to agree to the provisions of the by-laws. The members were not responsible for the cooperative’s debts, and patronage dividends were to be paid solely at the discretion of the board of directors from any income remaining after expenses and deposits into reserve accounts, (Id at 31-2). The board, in fact, had made no such payments to the members, (Id at 32). Although the case did not specifically find that the cooperative was organized to avoid the F.S.L.A., the Supreme Court held that the “devises of the cooperative” was “too transparent” to survive the statutory definition of an employee, (Id at 33). The court saw no reason why members of a cooperative could not also be employees if they work in the same way they would if they had an individual proprietor as an employer, (Id at 32).

The last case to determine whether cooperative members were employees subject to the F.S.L.A was decided 28 years ago in Wirtz v. Construction Survey Cooperative, (235 F. Supp 621 (D. Conn 1964)). The cooperative was an unincorporated business formed in 1933 to remedy the evils manifested by the Depression, and provide its members with an improved standard of living, (Id at 622). Membership in the cooperative fluctuated between 5 and 25 members, all with equal voice in management and freedom to come and go as they pleased. No initial investment was required. Members shared in the profits and losses in accordance with a “labor rating system”, which was a pro rata assessment based upon their contribution of labor. Unrecorded meetings were held several times a year, but there was no corporate structure or officers, (Id at 623-24). The District Court stated at the outset that the economic base which supported the cooperative “was antithetical to the wage and hour system of production which the Act was designed to control” (Id 622). The court held that under the facts presented, the cooperative lacked all “indicia” of an employment situation, (Id at 624).

The Wirtz case is important for several reasons. First, although it was decided after Goldberg, and acknowledged that cooperative members may also be employees, it held that these particular cooperative members were not employees. Secondly, it determined that the structure of the cooperative is similar to cooperative businesses known as collectives, and should provide strong authority that in those types of business the workers are not employees. However, this case provides no indication whether a cooperative governed by the workers through a management structure would also be exempt. New judicial review should be given this question in view of the major changes in both law and society since Wirtz was decided 28 years ago.
Third, and probably most significantly, this case shows that where a cooperative is genuinely bilateral—in that it imposes reciprocal obligations on its members—and is characterized by mutual rights and duties, an employment relationship may not exist, at least for purposes of the F.S.L.A.

It should be noted that in none of these cases was the fact of incorporation a factor in determining the existence of an employment relationship. Instead the courts focused on the reasons the cooperatives were formed, who managed and controlled their affairs, and who received the benefits, or suffered the consequences, of the cooperatives’ endeavors.

The sentiments of these cases, and factors comprising the economic reality test, are reflected in the U.S. Dept. of Labor, Wage and Hour Division, Field Operation Handbook, (6/8/90). In section 10c02, titled Cooperatives as Employers it states:

“The F.S.L.A. contains nothing to indicate that cooperative organizations, as such, are to be excluded from the category of employers subject to its terms. It is clear that the employment relationship may exist at least between such an organization and non-members whom it hires or suffers or permits to work. Nor can it be said that membership in a cooperative in the ordinary case establishes a mutual agency analogous to a partnership or otherwise identifies the member so closely with the cooperative that they cannot become, respectively, employer and employee. Among the circumstances which may be taken to indicate that a cooperative is an entity separate and distinct from its workers-members, are a corporate form or organization, the presence of the usual incidents of the employment relation (for example, control) by the governing body or a designated officer over the work performed, the member’s hours of labor, selection for and discharge from the job and the like) and the exercise of financial or managerial control or the furnishing of capital or management services by outsiders, especially if such outsiders are wholesalers, manufactures, or others who purchase or dispose of the products of the cooperatives.”

An official from the U.S. Department of Labor, Wage and Hour Division, responsible for enforcement of F.S.L.A. provisions, told the author that these guidelines would be affected by factors identified in Goldberg and the like. To wit: (1) Cooperative members had no real policy or decision making input (2) Cooperative members had no real power over the distribution of income and benefits (3) No internal agreement existed between cooperative members and/or (4) The cooperative structure was created for the purpose of avoiding governmental regulation (13). Members of a “true cooperative” — which adhered to cooperative principles such as subordination of capital (economic or participatory rights based on a members functional role in the cooperative, not on paid-in capital), democratic control by the members, and patronage distribution of cooperative income on a pro rata basis — would probably not be considered employees (14). This could include cooperatives which utilized a management system of delegated authority, if all cooperative members had a meaningful role in running the cooperative (15). As in other situations before the Wage and Hour Division, determination of an employment relationship in a workers’ cooperative would have to be made on a case by case basis. No single factor would control this determination, including the presence or absence of incorporation (16).

The National Labor Relations Board (N.L.R.B.) And Involvement Of Labor Unions With Workers’ Cooperatives


In addition to these functions, the Act identifies certain activities as unfair labor practices and provides the machinery to prevent them, (29 U.S.C. 158 et seq). The N.L.R.B., through its regional offices, has the task of investigating and prosecuting unfair labor practices.

Like other labor law, the provisions of the N.R.L.A. apply only to workers who are employees. An employment relationship exists when certain “incidents of employment” indicate the right of control, (Williams v. United States, 126 F.2d 129, 132-33 (7th Cir. 1942)). The “incidents of employment” test contains similar factors found in other tests (e.g. “economic realities test”) including the right to fire and hire workers, ability of workers to profit from the business, and the
responsibility for providing work material, (National Van Lines, Inc. v. NLRB, 273 F.2d 402, 404, 407 (7th Cir. 1960)). Also relevant to this determination is whether agreements or conditions were the products of negotiations or imposed by an alleged employer, (Mochican Trucking Co. 131 N.L.R.B. 1174, 1178 (1960)).

The employment status of members of workers' cooperatives has been specifically addressed by the N.L.R.B. where cooperative members are included within an "employee" group created to negotiate with management. The question before the N.L.R.B. was the degree to which the worker members were empowered to implement the policies and practices of the business. Worker-members found to have an "effective voice" generally were not considered to be employees, (See Brookings Plywood Corporation, 98 NLRB 794, 788-89 (1953)).

Originally the N.L.R.B. took the position that even in a workers' cooperative where the workers had equal shares of stock, and control of company policy, worker members were still employees, because their interests as stockholders did not "outweigh or overshadow their interest as workers", (Olympia Shingle Company, 26 NLRB 1398, 1414 (1940)).

But, in the landmark decision in United Furniture Co., (67 NLRB 1307 (1946)) the N.L.R.B. changed its policy towards workers with a proprietary interest. The Board identified two factors in determining whether such workers could be included within an employee bargaining unit. (1) Did the worker-stockholders have too much power as stockholders, and (2) was there a divergence of interest to the extent that it caused a conflict of interest between the proprietary and non-proprietary workers, (Id at 1309-10).

United Furniture had been incorporated in 1867 as a "producer cooperative", but with the passage of time, the original stockholders had either bequeathed or sold their stock. At the time of litigation, nine of the 90 production workers were stockholders. The N.L.R.B. decided that these nine had to be excluded from the bargaining unit because they held a substantial minority of voting stock and had a strong voice in the election of directors. There was further concern that inclusion of these workers could compromise the bargaining unit's ability to decide such policy matters as whether to have an open or close shop.

Thus United Furniture created a factual test, which the N.L.R.B. used to distinguish that case from one in which stock ownership is so dispersed that a stockholder has only a negligible interest in determining corporate policy.

The test established by United Furniture has endured and continues to provide the basis for determining employment status in worker-ownership cases decided under the N.L.R.A. In Everit Plywood, (105 NLRB 17 (1953)), the N.L.R.B. rejected a local labor union's contention that stockholder workers were not employees of a workers' cooperative. Only stockholders were employed, and it was not anticipated that non-stockholders would be hired in the future. But a management group hired, instructed, and directed the employees. There was no mention of any power, or even input, exercised by the workers. In Blue & White Cab Co., (126 NLRB 956 (1960)), the N.L.R.B. permitted worker-owners of a taxi cooperative to be part of the union, with the exception of one driver on the board of directors. The N.L.R.B. found that the workers did not have a voice in formulating corporate policy since they held only 6 of 96 shares. However, in Red & White Air Cab Company, (123 NLRB 83 (1959)), worker-stockholders of another cooperative were excluded from bargaining on the grounds that they elected the board of directors (who supervised the manager chosen from the worker-stockholders), and resolved any disputes between the manager and the board of directors. Also, only worker-shareholders had the power to force other worker-shareholders to leave. Under these circumstances, the N.L.R.B. determined that the worker-shareholders had an effective voice in implementing policy, and that they were in a position to receive preferential treatment over workers who were not shareholders.

More recently, the United States Supreme Court in NLRB v. Yeshiva University, (444 U.S. 672 (1980), established a two-part test for identifying "managerial employees" exempt from the N.L.R.A. The court held that this determination was dependent upon (1) the nature of the worker's input (i.e. what matters are within their decision making power) and (2) the weight assigned to the decisions (i.e. the extent which these decisions are carried out), (Id at 686). Although Yeshiva does not involve a cooperative, the case is important because it creates a precedent for identifying other arrangements in which workers participate in management as well. In Yeshiva, the court noted that the "employees" were in a higher managerial structure than those explicitly mentioned by Congress in formulating the N.L.R.A., (Id at 682-83). This is not only an admission of the inadequacy of the present law, but
leaves open the possibility that workers who have real decision-making power in areas traditionally exercised by management, will also be classified as "managerial employees".

Yeshiva has not been applied to worker owned and operated businesses, but appears to reflect the general sentiment of the "effective voice" criteria established by the N.L.R.B. Apparently under both prongs of the Yeshiva test, workers empowered to participate in decisions concerning work product, work environment, production, income distribution, and the power to include or exclude fellow workers, would not be considered employees. But neither Yeshiva, nor earlier cooperative cases, provide clear guidance as to whether workers having delegated authority from other workers, would also be exempt. A management system made up of workers in revolving committees (i.e. salary determination, work scheduling, marketing, discipline, etc.) is also beyond what Congress envisioned.

Worker owned firms controlled by union officials or agents present similar issues. Unions may, for example, play an important role during a worker buy-out of an existing business, where workers need a body to represent their interests. Unions may also purchase or create a business as a means of providing employment for their membership. Such union involvement with cooperatives requires careful structuring. An effective balance must be created between the union's leadership role in fostering worker owned businesses, and maintaining arm's length relationships while representing all workers within its jurisdiction.

As a preliminary matter, if the union has substantive control of a business, there is little likelihood it could be viewed as a "labor organization" of employees under section 2(5) of the N.L.R.A. since the group will not be "dealing with" management (17). On the other hand, if the union is too distant, then it is not fulfilling its mandate to its members.

Union control of worker-owned business may also create a conflict of interest with employees from other businesses subject to the union's collective bargaining agreement. In the leading case, Bausch and Lomb Optical Company, (100 NLRB 1555 (1954)), the N.L.R.B. disqualified an optical workers' union from representing employees because the union had created a cooperative to provide low cost eyeglasses to its membership. Although the Board made no allegations of improper conduct, it observed:

"In our opinion, the Union's position at the bargaining table as a representative of Respondent's employees while at the same time enjoying the status of a business competitor renders almost impossible the operation of the collective bargaining process. For the Union has acquired a special interest which may well be at odds with what should be its sole concern - that of representing the interest of Respondent's employees".

Possible solutions to this dilemma might include limiting union participation to minority voting interests, and/or limiting union voting power to plant closures, layoffs, working conditions and other traditional matters, while leaving financial matters and management decisions, such as distribution of income and approval of expenditures, to workers who are not union officials. While some observers believe union officials don't want total control (18), it may still be unrealistic to expect unions to relinquish control of their investments to someone else, even union workers.

The wisdom of union formation of worker cooperatives is beyond the scope of this paper. But the legal implications of such undertaking brings into focus the legitimate role of labor unions in workers' cooperatives once the workers have established control. If member-workers have "effective control", then it is questionable as to whether there is any need for union representation. If member-workers don't have "effective control", then it is questionable whether the entity is truly a workers' cooperative.

Federal Insurance Contributions Act (F.I.C.A.) and Federal Unemployment Tax Act (F.U.T.A.)

F.I.C.A. directs contributions from income to fund the Social Security system. F.U.T.A. is the federal unemployment tax. Both are in the U.S. Tax Code. Although they are intended to fund agencies which have distinct functions, the legal issues relevant to this discussion are virtually the same. Like other law previously discussed, application of these provisions depends upon the existence of an employment relationship.

Both F.I.C.A. and F.U.T.A. use the common law test to determine whether an individual is an employee. More specifically, United Tax Code Regulation, interpreting a F.I.C.A. statute defining employee, sets forth a factual criteria for determining "common law" employees:

"Generally such relationship exists when the person for whom services are performed has the right to control and direct the individual who performs the services not only as to the result to be accomplished by the work but also
as to the details and means by which that result is accomplished... The right to discharge is also an important factor indicating that the person possessing that right is an employer", (26 CFR 31.3121(d)-1(c)(2))

"Whether the relationship of employer and employee exists under the usual common law rules will in doubtful cases be determined upon an examination of the particular facts of each case", (26 CFR 31.3121(d)-1(c)(3)).

F.U.T.A. regulations use the same factual criteria to determine "common law" employees: expanding application to include "all classes or grades of employees" including paid (but not unpaid) corporate officers, as well as other supervisory personnel and managers, (CFR 31.3306(i)-1).

Most courts interpreting these regulations consider the "right to control" the most important factor in determining employment status. (See Lifetime Siding, Inc. v. United States, 359 F.2d 657,660 (2nd Cir. 1966)). Although the determination of employee status is to be made pursuant to common law concepts, realistic interpretations of employees should be adopted, (Breaux & Dangle, Inc. v. U.S, 900 F.2d 49, 51-52 (Cir. 5 1990)) The Ninth Circuit of Appeals reviewing a California decision, found an employment relationship to exist after applying the "economic reality" test, (Westover v. Stockholders Publishing Co., 237 F.2d 948, 951-53 (9th Cir. 1956)).

Though critical to the issue of both amount and manner of F.I.C.A. withholding, guidelines for determining employment status of members of workers' collectives are not discussed either in the regulations or in case law.

This issue is important because employment status determines the manner and amount of F.I.C.A. withholding that must be paid and by whom. In all of cooperatives interviewed for this article, members were treated as employees for F.I.C.A. purposes (19). This may or may not be advantageous, given the recently enacted personal income tax deduction for self-employment taxes (F.I.C.A. taxes paid by the self-employed). Other factors such as income distribution, overall tax rates, time of payment, and accounting procedures should also be considered.

The unique structure of workers' cooperatives also raises other issues relevant to F.I.C.A. Should income received by cooperative members as patronage dividends also be taxed as part of an "employee's" F.I.C.A. withholding? Should cooperatives pay the amount due F.I.C.A. for that portion of the member's income retained by the cooperative, in the name of the member, by means of a non-qualified written notice of allocation as specified in I.R.C. 1388(c)? Should the member be required to pay the F.I.C.A. tax when the non-qualified written notice of allocation is redeemed? And, should the cooperative be able to take a deduction from taxable income for amounts paid in redemption (as this author finds consistent with Subchapter T of I.R.C. 1381 et. seq.)? (See Helfman, Choosing a Workers' Cooperative - Another Way of Doing Business in California, 5 CEB Cal Bus L Prac 28, 35-35 (Winter 1990)). At minimum, these issues require greater thought and planning, both by the I.R.S. and those involved with workers' cooperatives.

State Law

Labor Standards (wage, hour and overtime)

The Division of Labor Standards Enforcement (hereinafter "Labor Standards"), under the direction of the California Labor Commissioner, is charged with enforcing all labor laws not enforced by any other agency (Cal. Lab. Code 79 et seq). Labor Standards' efforts are primarily directed towards violations of wage, hour, and overtime provisions (20). But the Labor Commissioner also has power to cite companies that do not maintain workers' compensation; to investigate actions for wages, penalties (Cal. Lab. Code 98) and other compensation, and to prosecute claims believed to be valid and enforceable, (Cal. Lab. Code 98.3). Labor Standards is also empowered to assist with enforcement of the F.S.L.A., (Cal. Lab. Code 50.6).

The intent of California law is to promote the welfare of wage earners, (Cal. Lab. Code 50.5). The law assumes that the interest of workers and management are inherently in conflict, that the relationship between the two is antagonistic, and that the bargaining power of workers is not equal to that of management (21). Consequently, the Labor Code guarantees certain rights to workers, including the right to strike and engage in collective bargaining, (Cal. Lab. Code 923).

The Labor Commissioner has no jurisdiction over independent contractors, working partners in a partnership, nor others not considered employees (22). But neither the Labor Code, regulations, nor case law, provide criteria for determining employee status; though the "economic realities" test may be applied to statutes which have a remedial purpose, such as minimum
wage and overtime regulations (23). The Commissioner also lacks jurisdiction over wage claims of union members working under collective bargaining agreements that have a grievance procedure with an arbitration clause (24).

Labor Standards sets no law or policy regarding the employment status of members of workers' cooperatives (25). Under existing law, a worker is either an employee or an independent contractor. Though neither of these categories adequately address the relationship in a workers' cooperative, in the absence of new legislation, the status of worker members can only be determined by one or the other of these categories (26).

Unemployment and Personal Withholding

The Employment Development Department for the State of California (EDD) collects what is commonly known as state “payroll” taxes. These withholdings from employee salary include unemployment insurance, state disability, and employment training tax. EDD also collects income tax withholdings for the Franchise Tax Board. Because unemployment insurance and income withholdings are the most significant payroll taxes, and the other taxes do not present additional legal issues relevant to workers' cooperatives, this section will only examine the law concerning to these two taxes.

The amount of these taxes withheld and manner of collection depends upon the employment status of the taxpayer. "Unemployment insurance taxes accrue only on amounts paid as remuneration for services rendered by employees", (Emphasis in original) (Pierce Specialized Equipment Company v. Cal. Unemp. Ins. Bd. Precedent Tax Decision No. P-T-2, p.8 (1968)). (See also Cal. Unempl Ins. Code 901 et seq). Individuals such as partners and sole proprietors, who are excluded from required participation in unemployment insurance, may elect coverage if they elect both unemployment and disability protection, Cal Unempl. Ins. Code 701 et seq.


Common law rules are used to determine whether an individual is an employee for unemployment insurance and/or income tax withholding purposes, (Cal. Unempl Ins. Code 621; Cal. Code of Reg, Title 22, Section 4304-1). The principal test used is manner and means of control, (Id; Tieberg v. Unemployment Ins Bd., (1970) 2 Cal. 3d 943, 946, 950). The right to fire at will, without cause, is considered conclusive evidence of the right to control, (Cal. Code of Reg, Title 22, Section 4304-1). And, internal agreements which have express provisions, followed in practice, concerning powers of direction and control, are similarly deemed significant, (Tieberg v. Unemployment Ins. Bd., 2 Cal. 3d supra at 951-52; Pierce Specialized Equipment company, P-T-2, supra at 8).

There is no EDD policy concerning the employment status of members of workers' cooperatives. Nor are guidelines set by statute, regulation or case law — with the exception of one non-precedent tax decision by the California Unemployment Insurance Appeals Board limited to the facts of that particular case. In Construction Survey Cooperative, (T-62-3 (1962)), the Appeals Board was presented with the question as to "whether those who are members of an organization of this type can also be employees of the organization when they render services to it". (Id at 6). Coincidentally, this case involved the same survey cooperative in Wirtz, (discussed in the F.S.L.A. section).

The Appeals Board found the following facts: Members shared the returns and losses in relation to their individual contributions of time and money (Id at 4,5). A member's labor rate was fixed by mutual agreement between the member and the cooperative when the member first joined. This rate could be adjusted subject to approval of the majority of the membership (Id at 4). And, the activities of the cooperative were directed by a manager by common consent with the ultimate right to make managerial decisions reserved to the membership, (Id at 4,5).

The Board noted that if the entity were a partnership instead of a cooperative, there would be no problem in establishing the employment status of members-workers. Since partners are co-owners of the business, service provided to the partnership would not be employment, (Id at 6). Under long-standing California law, a party cannot be principal and employee in regard to the same transaction; these relationships are legally incompatible, (Id at 8, citing Wiltree v. California Unemployment Commission, (1945) 69 Cal. App. 2d 120, 127).

Furthermore, remuneration received by partners
does not constitute wages within the meaning of the Unemployment Insurance Code, (Id at 6; Cal. Code of Reg., Title 22, Section 926-2). The Board held that the same reasoning which applies to a partnership should apply with equal force to a cooperative, and found the cooperative exempt, (Id at 8).]

An important factor in the Appeal Board’s consideration was that the cooperative was an unincorporated association. “Their status as members of an unincorporated association in and of itself may be sufficient to exclude them from an employment relationship with it”, according to the holding, (Id at 6).

As earlier stated, EDD took the position that if the cooperative had been incorporated, members should have been considered employees. When asked why the entity status of a cooperative should control the internal working relations between members, EDD representatives responded that since a corporation constituted a separate entity, apart from its participants, workers would be providing services to the entity (27). When asked why this should make a difference given the factual criteria set forth in common law, they could not provide an answer; they rejoined that this issue has not been decided and that they had not had the occasion to examine this question more closely (28).

The employment status of worker-members of an incorporated workers’ cooperative has been decided by the State of Oregon Court of Appeals (29). In Employment Division v. Surata Soy Food, Inc., (1983) (63 Or. App. 221, 662 P.2d 810), the court was asked to review a referee’s decision setting aside a notice of tax and deficiency assessments for unemployment contributions against a worker’s cooperative that was structured on principles consistent with the Mondragon and other “true cooperatives”. In an extensive finding of facts, the referee found that the cooperative did not issue stock; that it required instead a $300 membership fee; that members of the cooperative operated as the board of directors; that this Board elected corporate officers, designated distribution of patronage “fees” to members and wage scale for non-members, designated work and shift assignments, and distributed payments based upon an estimated net annual income; and finally, that members performed their production tasks without direction or supervision, (Id at 811).

On these facts, the referee held that the cooperative “did not include the requisite characteristics of an employee-employer status”, (Id at 812). The referee further noted that a member’s compensation was dependant upon the existence of profit (patronage dividend), and hence that there was a distinct possibility members would not be compensated for their services if the cooperative experienced adverse conditions.

The Court of Appeals reversed the referee’s decision solely in reliance upon an Oregon statute defining employees as persons employed for “remuneration”, (Id at 812). Relying upon another decision pertaining to a workers’ cooperative, Assoc. Reforestation v. State Workers’ Comp. Bd., (1982) (59 Or. App 348, P.2d 1068), the Oregon court held that patronage dividends were “remuneration” within the meaning of the statute, (Id). Incredibly, it appears that neither the referee’s finding of facts, nor factual criteria other than the existence of “remuneration”, had any bearing upon the court’s decision. Possibly this is because Oregon’s unemployment insurance definition of “employee” is statutory, based solely on “remuneration” instead of the common law criteria used in California.

It is noteworthy that the fact of incorporation was not discussed; nor did it appear to be a factor in this decision. Thus, the issue presented to the EDD is yet to be judicially determined in this or any state. The inference of the Oregon decision is that incorporation may not have the overriding importance given to it by the EDD.

Representatives of EDD explain that the policy of unemployment insurance is to protect workers, and that the entity structure is relevant to the extent it effects employment (30). The stated objective of the California Unemployment Insurance Code is to provide benefits to “persons unemployed through no fault of their own,” (Cal. Unempl. Ins Code 100). This policy, declared by the Legislature, is intended to guide interpretation and application of the California Unemployment Insurance Act, (Whitcomb Hotel, Inc v. Cal. Emp. Com., (1944) 24 Cal. 2d 753, 756-57). Given this stated objective, it is difficult to understand how entity status makes any difference. Presumably, if the bylaws provide a cooperative with the power to lay-off members at will, or to freely terminate worker-members due to decrease in business activity, then the stated policy should apply. But if the cooperative requires that all members share in good and bad times alike, similar to a partnership, then this policy would not be applicable.

The EDD acknowledged that there is an inconsistency between the policy underlying the California Unemployment Code and the corporate status of a cooperative (31).

EDD spokesmen stated that the employment status
of unincorporated entities should be determined on a case by case basis, depending upon the degree of equality between members (32). In this view, it would be important to show that members had a “reasonable share” in management, were in a position to assume the risks of employment, and had received remuneration consistent with their contribution of time and capital (33). There is no reason why incorporated cooperatives shouldn’t also be judged on the facts of each case. Such determination could be based on factors including those stated by the EDD, the policy objectives of the law, the effect of entity status upon employment, and internal agreements and relationships between the members.

Workers’ Compensation

Workers compensation is a statutory scheme designed to compensate employees for injuries incurred during the course and scope of employment, (Cal. Lab. Code 3600, 3700; Quong Ham Wah Co. v. Ind. Acc. Com., (1920) 184 Cal. 26, 36). It is primarily a no-fault doctrine for those risks that are typical or broadly incidental to the enterprise, (Westbrooks v. W.C.A.B., (1988) 203 Cal. App. 3d 249, 254). Under this approach, compensation for work-related injuries can be provided without the need for determining liability. This serves several purposes — including guaranteeing prompt compensation to the employee, and tort liability protection for the employer. (S.G. Borello & Sons, Inc. v. Department of Industrial Relations, (1989) 48 Cal. 3d 341, 354). Workers’ compensation is also intended to place the cost of workplace injuries on the cost of goods rather than on society, and to promote workplace safety (Id).

Although common law factors such as control are given important consideration, the test for employment relationship mandates their consideration within the larger context of the Workers’ Compensation Act, its policies and purposes, (Id at 353). Beyond the question of control, the law attempts to determine, for example, which party is in the best position to assume the cost and risks of work related-injuries, (See Id at 357).

Employers are required by statute to maintain workers’ compensation insurance for employees, with the amount of compensation for injuries set by statute. There are, however, some exceptions to mandatory workers’ compensation coverage. Certain categories are exempt by statute. Independent contractors are exempt in recognition that the goals of the Workers’ Compensation Act are best served by imposing the risk of “no-fault” work injuries on the provider instead of the recipient of compensated services, (Id at 354). Though working general partners are defined as employees, workers’ compensation is elective rather than mandatory for them, (Cal. Lab. Code 3359(f)). Officers and directors are covered employees unless they are sole shareholders, (Cal. Lab. Code 3359(c)), or the corporation is a general partner in a partnership, (Cal. Lab. Code 3359(f)).

There is no statutory definition of the employment status of member workers of cooperatives, nor is the coverage of the Workers’ Compensation Act to workers’ cooperatives otherwise stated in the code. Also, there is no California case law. In Yellow Cab Cooperative, Inc. v. W.C.A.B., (1991) (226 Cal. App. 3d 1288), the court held that workers’ compensation had to be paid to drivers of the cab company. In spite of its name, the company did not present itself as a cooperative. It argued, instead, that drivers were independent contractors who had entered into lease agreements with cab company. The court found that the company had “pervasive control over the enterprise”, (Id at 1299), and there was no evidence that it operated as a workers’ cooperative.

In Oregon, the Court of Appeals held that Hoedads, a tree planting cooperative, was subject to workers’ compensation law, Associated Reforestation Contractor, Inc v. State Workers Compensation Board, (1983) (59 Or. App. 348, 760 P.2d 1068). The court relied upon a workers’ comp statutory definition of employee as:

“any person...who engages to furnish services for a remuneration, subject to the direction and control of an employer.”

The cooperative argued that since the workers were paid a pro rata share of the profits in the form of patronage dividends representing the amount of work performed, such compensation should be seen as incidents of ownership, not remuneration. The court saw no reason why patronage dividends should not be considered remuneration “just because the amount varies with the profits of the organization”, (Id at 1071).

Would the court have reached the same conclusion for partnership draws? This was not addressed in the reported case. According to California law, working members of partnerships are employees for workers’ compensation purposes since they receive “wages irrespective of profits”, (Cal. Lab. Code 3359(f)). The inference of this law is that partners who receive compensation dependent upon profits are not employees.
The cooperative also argued that it was a partnership, exempt from the Oregon workers’ compensation law. Why the cooperative used this approach, instead of seeking exemption as a cooperative, is not clear. While noting that cooperatives are distinct in character from partnerships and corporations, (Id at 1072), neither the court nor cooperative addressed these unique characteristics as grounds for exemption. The court concluded that Hoedads was not a partnership because: Members could be terminated “at will”; there was a high turnover; and members had only limited control through elected representatives. The fact that members had a proprietary interest was not in itself deemed inconsistent with an employer-employee relationship. (Id). The case made no mention of incorporation as a factor in the court’s decision.

While the case is not binding upon the courts of California, it presents an interesting question. Would the court have ruled differently in interpreting the “direction and control” if there was no “at will” termination, and cooperative members had more control of operations? Under these circumstances, would cooperative members, like general partners, be deemed to be in a position to assume responsibility for workplace injuries? Although cooperatives are distinct from partnerships, they do share common characteristics relevant to the underlying application of workers’ compensation law. In both cooperatives and partnerships, the ultimate power to determine the entity’s operations rests with active participants who have made financial and contractual commitments to the entity — not third parties whose interests may be no more than a return on invested capital. In this sense, cooperative members are in no less a position than general partners to assume responsibility for the entity’s activities, including providing both health care and compensation for workplace injuries. Thus, there is no reason why a cooperative should be treated differently than a partnership where the members share the financial risks and rewards; have meaningful roles in its management; and from which they cannot be terminated at will. Under California law, workers’ compensation is elective rather than mandatory. The same rule should apply to appropriate workers’ cooperatives.

PROPOSED LABOR LAW GUIDELINES FOR WORKERS COOPERATIVES

This report does not advocate the demise of labor law. On the contrary, these laws are needed today more than ever as workers’ rights have been eroded by the political and economic climate of the last decade. The resulting encouragement of greed and deception on the part of employers, has given life to an eager generation of union-busting attorneys.

It is neither necessary nor right that such adversarial premise defines and/or directs the relationships of workers who have committed themselves to jointly operating their own business. Though labor law grew out of the Great Depression at a time of warfare between labor and management, (34) current law should be both flexible and artful enough to recognize that not all labor relations are hostile. (See Bowen v. U.S. Postal, 459 U.S. 212 (1983)).

Even where labor law distinguishes different types of working relationships, such distinctions do not relate to the circumstances found in workers’ cooperatives. As mentioned, the tests for defining an employment relationship were created to distinguish independent contractors from “employees”. There is no separate test for members of workers’ cooperatives. In the absence of more precise law, any employment determination has to be made on the existing criteria (35). This is like trying to determine whether a cow is a fish or a plant because there are no biological categories for land animals. Thus, not only is labor law undeveloped in regard to workers’ cooperatives, but the law that does exist, is inappropriate in whole or in part.

While existing law does not meaningfully address the issue of cooperatives, it does provide a useful starting point. Certain issues and characteristics, such as degree of worker control, are a common thread in both federal and California labor law. Both systems are also concerned that cooperatives will be created primarily to avoid labor laws, while giving only lip-service to cooperative principles. With this in mind, this author suggests the following to determine the employment status of members of workers’ cooperatives:

1. Shared governance of operation by worker members, with each having meaningful input in the affairs of the entity. This will depend, to some degree, on the number of members in a given cooperative. In a small cooperative, or collective, this could be a relatively simple process where decisions are made collectively by members, without the need for management. As the operation involves more people and the functions become more diverse, some management structure may be necessary to oversee day-to-day operations (36). The
management structure should be composed of members who either exercise direct control or participate in management committees (e.g. work scheduling, purchasing, discipline, etc.) (37). Outside managers can also be used, if subject to the ultimate control of members through the board of directors. Regardless of the management structure, ultimate authority should always rest with cooperative members, who should have the power to determine policy and elect the board of directors (38). Members should have equal voting rights, (though this author believes there should be some variance from the one-person-one-vote rule to take into consideration varying degrees of participation in the cooperative, though not to the extent that any one member would be disenfranchised). This option already exists for agricultural cooperatives organized under the California Food and Agriculture Code.

2. All members of the cooperative should share in the profits and losses of the business on a pro rata basis in accordance with their annual participation in the cooperative. Cooperatives that pay salaries to members, instead of draws against estimated annual income, should distribute all surplus, or patronage dividends on a pro rata basis (39). Only members should receive a share of the cooperative’s income other than salaries (and perhaps bonuses) distributed to non-member workers, and return on interest to creditors.

3. All members should make an initial capital contribution in the form of membership fees, and possibly subsequent capital contributions as well (40). To the extent possible, such contributions should represent a shared and equal capital risk, (See 5 CEB California Business Law Practitioner (Winter 1990) supra at 33-34). Instead of membership fees, capital contributions can also be made in exchange for “stock” whose value is not tied to the net worth of the cooperative, and which can be redeemed for no more than the amount contributed. With the exception of preferred shares, no stock may be issued to non-members.

4. A cooperative should have a stated internal grievance procedure, with an existing body of cooperative members to resolve internal disputes (41).

5. There should be no at-will termination (42). The acceptance of new members and the removal of existing members to be decided by the membership, preferably by a super-majority vote (i.e. a vote requiring more than a mere majority of members).

6. There should also be internal agreement between members in the form of bylaws or other written statement, binding upon the members, specifying the operation of the cooperative. In addition to including the above-stated terms, the document should further expressly declare that the entity is to operate as a workers’ cooperative.

This list is not meant to be exhaustive. Nor should the presence or absence of any factor in itself be determinative. Any proposed law should be flexible, evolving in conjunction with the development of workers’ cooperatives and other pertinent law. The legislative purpose of different labor laws should be taken into consideration — in one instance the issue of control may be of primary importance, while in another, greater emphasis will be placed on a members’ financial stake.

But as to all labor law examined herein, where these factors are followed, and a valid workers’ cooperative exists, its members should not be considered employees; nor should an employment relationship between the members and the entity be deemed to exist.

Hopefully, in the future, state and federal legislatures will enact laws, in areas including labor, corporate, and tax, to provide a legal structure of operation addressing the unique characteristics of workers’ cooperatives. Such legislation (statute and/or regulation) should delineate the factors that should be present for an entity to qualify as a workers’ cooperative. It is further hoped that a clear and thoughtful statement of the law will encourage cooperatives to develop to their fullest potential and discourage the existence of pseudo-cooperatives created primarily to subvert existing laws.

PERCEIVED BENEFITS OF DEVELOPING LABOR LAWS RESPONSIVE TO WORKERS’ COOPERATIVES

Cooperatives provide a combination of operating advantages not found in other structures. In large part, this is due to the unique capital equation found in a workers’ cooperative. Unlike business structures that premise economic and participatory entitlements upon contributed capital, in cooperatives, members’ benefits
are based upon what they do instead of what they own. Fundamental legal definitions such as "profit", "investment", and "employment", are inapplicable.

Consequently, workers' cooperatives are subject to single taxation that can be apportioned between the entity and member, liability protection (43), and exemption from bureaucratic entanglements such as those posed by state and federal securities law (see 5 CEB Cal. Bus. Law Prac. (Winter 1990), supra).

The perceived benefits of labor law relating to cooperatives provide yet another advantage to choosing this form of business entity.

But this unique structure carries with it extra responsibility as well. In order to receive the benefits of their endeavors, members must also shoulder additional burden for managing their own affairs. As a practical as well as legal matter, it is inaccurate to label member-workers "employees" where they validly share responsibility for operations through shared management and ultimate decision-making power. To consider them "employees", undermines this power. Moreover, if, as employees they can resort to federal and state enforcement agencies to resolve their disputes, instead of using

their own internal mechanisms, then the practice of economic democracy is distorted, and the commitment they have made among themselves is weakened (44). A member who engages a state or federal agency to resolve an internal dispute is no longer one member entitled to one vote. Rather his or her empowerment is the one vote, plus the power of the agency. Furthermore, reaching outside the cooperative for dispute resolution may well destroy the trust necessary for members to pursue common objectives.

In order for a cooperative to assume responsibility for its own affairs, any dispute resolution mechanism must have the practical ability as well as legal authority to settle disputes. As a threshold requirement, particular conduct which could result in disciplinary measures should be clearly spelled out and brought to the attention of all members. While this would most likely include many of the same strictures found in current employee policy manuals, it should also include violations of the members' joint proprietary interest, such as prohibitions against self-dealing at the expense of the cooperative.

Second, there should be an existing mechanism to resolve disputes. There could, for example, be a revolving committee, either chosen or appointed by the members, with power to address disputes among members, and between members and the cooperative. This committee could investigate and determine the facts in dispute. When possible, it should also act as mediator in an attempt help disputing parties find workable solutions. The committee should also have the power to order compliance with its recommendations when no other resolution can be found. A member who feels that the committee is in error should have the right to bring the matter to the general membership, and even to overturn the committee's decision if a super-majority of the members are in agreement. Finally, the committee should have the power to request expulsion by the general membership of a member who willfully fails to follow its decision, flagrantly violates stated policy on matters that could materially affect the cooperative, or engages in egregious conduct, such as assaulting another member. A super-majority vote should be required for expulsion.

Certainly other systems can and should be created. Like anything else, the best solutions will come through trial, error, and an honest attempt to meet existing conditions.

For all these reasons, workers' cooperatives that adhere to criteria stated in the preceding section should be exempt from most, if not all, labor laws regulating economic affairs between members — in the same manner as partnerships, joint ventures, and other aggregations acting for a common purpose. This is consistent with both the policy and practices of labor law. The lack of managerial power and the inherent conflict of interest present in employer-employee situations (45), which justify existing labor laws, are absent in workers' cooperatives. Cooperative members are different from employees because they do have the power to affect workplace conditions, and because only they may share in the profits and losses of their own businesses; accordingly, they should be treated differently under the law.

Other perceived benefits of the recommendations proposed herein for workers' cooperatives include the following:

**Clear Guidelines**

The absence of well-defined labor law applicable to worker's cooperatives, and perhaps other entities with both worker and management elements, puts workers' cooperatives in the position of not knowing what is required of them under the law. Existing laws should be amended, supplemented and/or otherwise developed to provide guidance to cooperatives in the
form of bright line tests that indicate under what circumstances an employment relationship exists, and what compliance with labor law is required. It is common for cooperatives to treat member-workers as employees, without really knowing why or challenging this assumption, even when they believe it is inappropriate (46). For example, one cooperative president expressed astonishment at overtime requirements mandated by state and federal law, even though labor law requirements for employees were otherwise followed. (See Wirtz, discussed in the F.S.L.A. section). The overtime pay requirement, in his view, was incongruous with the cooperative’s equalized pay structure, and with the stated and practiced objectives of that cooperative. Similar protests were made regarding other required procedures.

Reduction of Paper Work

If workers’ cooperatives meeting certain requirements are exempt from labor law, they should also be relieved from the recording requirements of the various labor regulating agencies. Both state and federal agencies monitoring wage and hour law require extensive records to be kept. The F.S.L.A. alone requires employers to keep nine different types of records (47). While some of these records normally would be kept by cooperatives, others are clearly an unnecessary burden - as for example, total daily and weekly straight time, overtime pay and total wages per pay period. California’s Division of Labor Standards has additional reporting requirements, including daily time records showing, among other things, meal periods and split shift intervals (48). Payroll tax recording requirements could also be reduced, if not eliminated, if members of workers’ cooperatives were not considered employees.

Possible Alternatives to Workers’ Comp and Unemployment Insurance

Some form of guaranteed payment for workplace injuries should be in place for all business. But, workers’ comp may not be the most suitable answer for workers’ cooperatives (49). Like, partnerships, cooperatives should have the option to elect workers’ comp coverage or create their own alternative — as for example, self-insurance by the cooperative or a collection of cooperatives (50).

Ideally, no cooperative should have the right to terminate at will. Presently however, some do. Such "cooperatives" which allow such "at will" termination or other lay-offs during weak business cycles, should be subject to unemployment insurance law. Those cooperatives which cannot terminate members “at will”, and whose members can be terminated only by a majority, or super-majority vote of the membership, should be allowed to elect coverage. In such situations, involuntary terminations would most likely result from matters unrelated to the economic fortunes of the cooperative, and the frequency of involuntary termination should be low, if not non-existent. Under these circumstances, unemployment insurance would not serve the purpose stated by statute, nor provide any foreseeable benefit to members of workers’ cooperatives. A member who is terminated “for cause”, or leaves the cooperative voluntarily, most likely would not be legally entitled to unemployment insurance benefits.

The proposed recommendations in this report hope-fully will not only encourage the development of worker’s cooperatives, but will also provide a dynamic and democratic business structure to meet the competitive needs of the emerging world economy.

ENDNOTES


2. Ibid. P. 273.

3. Ibid. P. 274

4. Ibid.

5. 18 Am. Jur. 2d, Cooperative Associations # 3.


8. Ibid. P. 21.

9. 37 ALR Fed 95, 106.


11. Interview at California Employment Development Department (E.D.D.), November 4, 1991, with David Johnson (Senior Tax Counsel), Terry Savage (Section Chief Auditor and attorney), and Noreen Vincent (tax auditor).

12. Ibid.

13. Interview at U.S. Department of Labor, March 16, 1992, with Mike Ginley (Assistant District Director), Leon Garoyan (Director of the Center for Cooperatives, University of California
at Davis), also present and participating.

14. Ibid.
15. Ibid.
16. Ibid.


19. Interview conducted at four workers’ cooperative: Mt. Xianu Computers (computer services and software), November 19, 1991; China Books (publisher and distributor of books and periodicals), November 20, 1991; Alvarado Street Bakery (bakery and distributor or bakery products), December 6, 1991; Missing Link (sales and service of bicycles and sales of accessories), May 6, 1992. All interviewees cooperatives treated workers as employees for payroll tax purposes, including payment of Social Security.


21. Ibid.

22. Ibid; Policies & Procedures For Wage Claim Processing, pamphlet published by Labor Standards and distributed to the general public.

23. Cadell interview.
24. Policies & Procedures For Wage Claims, supra.
25. Cadell interview.
26. Ibid.
27. E.D.D. interview.
28. Ibid.
29. No other cases found.
30. E.D.D. interview.
31. Ibid.
32. Ibid.
33. Ibid.
34. 3 The Labor Lawyer, supra at 18-19.
35. Cadell interview.

36. At Alvarado Street Bakery, a 50 member cooperative with 45 non-member employees, initially every member was on the board of directors but this became unworkable. Approximately 4 years ago it adopted a more hierarchical structure which separated management from policy. At Missing Link, a 24 member cooperative with no non-member employees, utilizes a loose hierarchical structure characterized as a “flat triangle”. At meetings any member can speak to any matter effecting the cooperative. China books, a 25 member cooperative, has a seven person board of directors elected by the membership. The board of directors appoints management which is composed of worker members. Mt. Xianu, consist of 7 co-owners who do not technically consider themselves to be a cooperative, manages by consensus.

37. In each of the interviewed cooperatives members participated in management committees.

38. In all of the interview cooperatives the members had ultimate decision power to decide policy issues, approve major expenditures, and appoint a the board of directors (only two cooperatives had a board of directors).

39. All of the interviewed cooperatives paid salaries to their members. In one cooperative salaries were the same for all members and distributed on a pro rata basis according to hours worked. The other three cooperatives paid additional bonuses if there was a year-end surplus.

40. Two of the cooperatives required new members to make an initial cash contribution of $1,000 or more. In another cooperative, the initial cash contribution was nominal. The fourth cooperative obtained its formation capital over twenty years ago, and due to expanding revenues and profits, even during the most recent recession, it did not appear that additional capital contributions were required.

41. All of the interviewed cooperatives have some in-place structure to deal with internal disputes.

42. In three of the four cooperatives interviewed members can be fired “at will”, although in two of them this has not yet occurred. In one of these cooperatives termination can be appealed to the general membership. In the fourth cooperative membership can only be terminated by a 2/3 vote of the membership.

43. Even where corporate status is disregarded for some purposes (e.g. unemployment insurance coverage) liability protection may be unattacked (see Cooperman v. Unemployment Ins. Appeals Bd. (1975) 49 Cal. App. 3d 1, 8).

44. All interviewed cooperatives expressed a desire to be exempt from labor law and were willing to accept in place of the traditional employment relationship, a fiduciary relationship of sorts where members related to each other as co-trustees.

45. The courts have observed little distinction between the terms “employee” and “servant”, and the former California Labor Code definition of servant has been cited and applied as definition of the employment relationship in general (29 Cal Jur (Rev). Employer and Employee # 1).

46. All interviewed cooperatives treated members for purposes of complying with labor law as employees, although none of them knew why. In discussions with these cooperatives, and other individuals who provide legal or financial counseling to cooperatives it appears workers cooperatives will do little, if any, to challenge labor law requirements even when they believe they should not apply.


48. California Industrial Welfare Commission Order 4-89

49. Three out of the four interviewed cooperatives were strongly opposed to workers comp as applied to their cooperative, and felt that this aspect of labor law was in the greatest need for change.

50. In one interviewed cooperative that has been in existance for approximately 20 years there had only been two workers comp claims. The cooperative representative believed that both the members and the cooperative would have been much better off if compensation for work place injuries would have been handled by
the cooperative instead of paying premiums to a profit seeking insurance company for all these years and then have the further need to hire attorneys to set the amount of compensation. Representatives from two of the interviewed cooperatives expressed the desire for some form of umbrella organization serving the needs of various cooperatives including some system of inter-cooperative insurance. One of the representatives stated that prior to the interview he had been contemplating this matter and intended to take some action to bring this about.

GLOSSARY OF LEGAL CITATIONS

STATUES:

Federal:

Federal citations refer to title, code, and section. As example, 29 U.S.C. 201 refers to title 29 of the United States Code, section 201. A citation 29 U.S.C. et seq. refers to several code sections that are part of a statutory scheme which begin with section 201.

State:

State citations refer to the code name and section. As an example Cal. Lab. Code 3200 refers to California Labor Code section 3200, or a statutory scheme beginning with that section if followed by “et seq.” California codes cited in this report:

<table>
<thead>
<tr>
<th>Citation</th>
<th>Code</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cal. Corp. Code</td>
<td>California Corporation Code</td>
</tr>
<tr>
<td>Cal. Unemploy. [Ins.] Code</td>
<td>California Unemployment Insurance Code</td>
</tr>
</tbody>
</table>

REGULATIONS:

Both Federal and State regulation citations refer to the title, regulation, and section. As example 22 Cal. Code Reg 4304-1 refers to title 22 of the California Code of Regulations section 4304-1. Regulations cited in this report:

<table>
<thead>
<tr>
<th>Citation</th>
<th>Regulation</th>
</tr>
</thead>
<tbody>
<tr>
<td>CFR</td>
<td>Code of Federal Regulations</td>
</tr>
</tbody>
</table>

CASE LAW CITATIONS:

Case law citations refer to the parties, volume, court, date, page of beginning of the case, and page(s) of relevant pages. As an example Duck v. Mouse (1990) 49 Cal. 3d 200, 205 refers to a court action brought by Duck against Mouse, that was reported in 1990, and the case appears in volume 49 of California Reports, third series, beginning on page 200, with page 205 being the relevant page. Federal cases cite to the district where the court is located. As an example U.S. v. California (9th Cir. 1990) 900 F.2d 100 refers to an action brought by the United States government against the State of California that was heard by the Ninth Circuit Court of Appeal in 1990, found in volume 900 of the Federal Reporter, second series, beginning on page 100. Decisions of Federal District Courts also cite to district. As an example Inslaw v. Meese (E.D. N.Y. 1990) 600 F. Supp. 300 refers to an action brought by Inslaw against Meese heard in the Federal District Court, Eastern District of New York, in 1990, found in volume 600 of the Federal Supplement beginning on page 300. Case citations in this report:

<table>
<thead>
<tr>
<th>Citation</th>
<th>Name of Case Law Reports</th>
</tr>
</thead>
<tbody>
<tr>
<td>Federal Cases Cited:</td>
<td></td>
</tr>
<tr>
<td>1. United States Supreme Court</td>
<td>U.S. United States Reports</td>
</tr>
<tr>
<td>2. Court of Appeals</td>
<td>F.2d Federal Reporter, second series</td>
</tr>
<tr>
<td>4. Tax Court (Actions brought by the I.R.S.)</td>
<td>T.C. Tax Court</td>
</tr>
<tr>
<td>5. Appeals to the National Labor Relations Board</td>
<td>NLRB National Labor Relations Board</td>
</tr>
<tr>
<td>State Cases Cited:</td>
<td></td>
</tr>
<tr>
<td>1. California Supreme Court</td>
<td>California Reports first, second, and third series</td>
</tr>
<tr>
<td>2. California Court of Appeal</td>
<td>California Appellate Reports, second, and third series</td>
</tr>
<tr>
<td>3. Appeals to the California Unemployment Insurance Appeals Board, tax decisions</td>
<td>Precedent Tax Decision</td>
</tr>
<tr>
<td>P- T - (case number)</td>
<td>Non-precedent Tax Decision</td>
</tr>
<tr>
<td>T- (yr.) - (case number)</td>
<td></td>
</tr>
<tr>
<td>4. Oregon Court of Appeals</td>
<td>Oregon Appellate Reports, also reported in Pacific Reporter, second series</td>
</tr>
<tr>
<td>Ore. App.</td>
<td>P.2d</td>
</tr>
</tbody>
</table>

18
SECONDARY SOURCE CITATIONS:

Citations to legal journal refer to the author, title of article, journal volume, journal name, date of article, and beginning page and relevant page of cited article. As an example,


<table>
<thead>
<tr>
<th>Citation</th>
<th>Name of Publication</th>
</tr>
</thead>
<tbody>
<tr>
<td>Am. Jur. 2d</td>
<td>American Jurisprudence, second series</td>
</tr>
<tr>
<td>Cal. Jur. 2d</td>
<td>California Jurisprudence,</td>
</tr>
<tr>
<td></td>
<td>second series</td>
</tr>
<tr>
<td>The Labor Lawyer</td>
<td>The Labor Lawyer</td>
</tr>
<tr>
<td>CEB Cal. Bus L. Prac</td>
<td>California Continuing</td>
</tr>
<tr>
<td></td>
<td>Education of the Bar,</td>
</tr>
<tr>
<td></td>
<td>California Business Law</td>
</tr>
<tr>
<td></td>
<td>Practitioner</td>
</tr>
</tbody>
</table>

6. “ “ 923
7. “ “ 1171-1204
8. “ “ 3200 et. seq.
9. “ “ 3359(c), (f)
10. California Unemployment Insurance Code 600 et. seq.

REGULATIONS

A. FEDERAL
1. 26 CFR 31.3121(d)-1(c)(2)
2. 26 “ 31.3121(d)-1(c)(3)
3. 26 “ 31.3306(i)-1

B. STATE
1. 22 Cal. Code of Reg. 926-2
2. 22 “ “ “ 4304-1

REPORTED CASE LAW

A. FEDERAL COURTS
1. Bonnette v. Calif. Health & Welfare Agency 704 F. 2d 1465 (9th Cir.)
7. Fleming v. Palmer 123 F.2d 749 (1st Cir. 1949)
8. Lifetime Siding, Inc v. United States 359 F.2d 657 (2nd Cir. 1966)
11. McComb v. Homeworkers Handicraft Cooperative 176 F.2d 633 (4th Cir. 1949)
12. McGuire v. United States 349 F.2d 644 (9th Cir. 1965)
15. NLRB v. Yeshiva University 444 U.S. 672 (1980)
17. Westover v. Stockholders Publishing Co. 237 F.2d 948 (9th Cir. 1956)
18. Williams v. United States 126 F.2d 129 (7th Cir. 1942)

B. U.S. TAX COURT CASES
1. Puget Sound Plywood v. Commissioner 44 T.C. 305 (1965)

C. NATIONAL LABOR RELATIONS BOARD APPEALS
1. Bausch and Lomb Optical Company 100 NLRB 1555 (1954)
2. Blue & White Cab Co. 126 NLRB 956 (1960)
4. Evertt Plywood 105 NLRB 17 (1953)
5. Olympia Shingle Company 26 NLRB 1398 (1940)
6. Red & White Cab Co 123 NLRB 83 (1959)
7. United Furniture 67 NLRB 1307 (1946)

D. CALIFORNIA CASE LAW
1. S.G. Borello & Sons v. Department of Industrial Relations (1989) 48 Cal. 3d 341
5. Quong Ham Wah Co v. Ind. Acc. Com. (1920) 184 Cal. 26

E. OREGON CASE LAW

F. CALIFORNIA UNEMPLOYMENT INSURANCE BOARD APPEALS
1. Construction Survey Cooperative T-62-3
2. Pierce Specialized Equipment Company P-T-2

SECONDARY LEGAL SOURCES
2. 18 American Jurisprudence 2d, Cooperative Associations sections 3, 6
3. 37 American Law Review Federal 95
4. 29 California Jurisprudence 3d (revised), Employer and Employee # 1

GOVERNMENT PUBLICATIONS AND PUBLICATIONS TO THE GENERAL PUBLIC
2. Division of Labor Standards (California), Policies & Procedures for Wage Claim Processing
4. Industrial Welfare Commission Order No. 4-89, Wage, Hours, and Working Conditions in Professional, Technical, Clerical, Mechanical
and Similar Occupations
7. U.S. Dept. of Labor, Wage and Hour Division, Field Operation Handbook (6/8/90), Section 10c02

INTERVIEWS CONDUCTED BY AUTHOR

A. WORKERS COOPERATIVES
1. Alvarado Street Bakery (bakery and distributor of bakery products) with Greg Cisneros (Personnel Specialist, Administrator of Benefits) and Debbi Edward (Controller) at Rohnert Park, Ca., Dec. 6, 1991
2. China Books (publisher and distributor of books and periodicals) with Bob Schidgen (Senior Editor) and Bill Bramblett (Controller) at San Francisco, Ca., Nov. 20, 1991
3. Missing Link (sales and service of bicycles and sales of accessories) with Walt Handlos (President) at Berkeley, Ca., May 6, 1992
4. Mt. Xinu Computers (computer services and software) with Lesta Nadel (Treasurer), Vance Vaughan (Vice President), and Deborah Schemer (President) at Berkeley, Ca., Nov. 19, 1991

B. GOVERNMENT OFFICIALS
1. Division of Labor Standards Enforcement with H. Thomas Cadell (Chief Counsel), and Leon Garoyan (Director of the Center for Cooperatives, University of California at Davis) also present at San Francisco, Ca., Jan. 24, 1992
2. Employment Development Department with David Johnson (Senior Tax Counsel), Terry Savage (Section Chief Auditor and Attorney), and Noreen Vincent (Tax Auditor) at Sacramento, Ca., Nov. 4, 1991
3. U.S. Department of Labor with Mike Ginley (Assistant District Director), Leon Garoyan also present, at Sacramento, Ca., March 16, 1992