Rural Broadband Cooperative Cookbook

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Cooperatives 101

What is Cooperative?

For our purposes, cooperatives are simply organizations owned and controlled by their members for the members' benefit and incorporated under one of Wisconsin's cooperative statutes, Wis. Stat. 185 or Wis. Stat. 193. They may be taxed under Subchapter T of the Internal Revenue Code (IRC) or under one of the various tax-exempt statutes available to certain types of cooperatives. We will focus on 501(c)(12) tax-exempt status because broadband cooperatives fall under this designation.

The Cooperative Principles

The cooperative model is used all over the world and can be found in almost every sector. While cooperatives come in many forms and provide innumerable types of goods and services, they share a common set of fundamental tenets known as the Cooperative Principles. These principles can be traced back to early iterations of the modern cooperative and provide a framework for cooperative operation and decision-making that extends beyond the self-interest of the cooperative's members. Together, they are the foundation of a cooperative culture meant to foster solidarity between cooperators, nurture the communities that support cooperatives, and strengthen the cooperative movement. See Appendix A for an explanation of each principle.

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
7. Concern for Community

Types of Cooperatives

Though cooperatives provide countless types of goods and services, cooperatives usually fall into one of the following categories. See Appendix B for an explanation of each category.

1. Worker Cooperatives
2. Producer / Marketing Cooperatives
3. Consumer Cooperatives
4. Housing Cooperatives
5. Purchasing Cooperatives
6. Multi-stakeholder / Solidarity Cooperatives

Cooperative Governance

Though cooperatives are owned and controlled by their members, most cooperatives have at least four types of stakeholders, each with its own set of rights and responsibilities: members, the board of directors, management, and employees. Generally, members buy an interest in the cooperative in exchange for their membership rights. Members are then eligible to vote in board elections, run for board seats, and vote on changes to the bylaws. The board sets the cooperative's policies and strategy, and hires management, which in turn hires employees to run the cooperative. See Appendix C for greater explanation of each stakeholder class.

Applying the Cooperative Model to Broadband

Basic Structure

A broadband cooperative will almost always be a consumer cooperative—in other words, the cooperative's members will be the cooperative's broadband customers. The cooperative will need to build, buy, lease, or otherwise gain access to the infrastructure necessary to provide broadband to its members and could very well need to hire employees to operate the broadband service. These employees will not be members of the cooperative via their role as employees—if they are members, it will be because they are also consumers of the cooperative's broadband services. Further, while the board of directors will be comprised of consumer members, running a broadband service requires significant technical and industry knowledge, and it may be prudent to add board seats for non-member industry experts. To create such a cooperative, a community will have to decide that the benefit of broadband is great enough to justify the time and expense of organizing, financing, and running a cooperative. Ultimately, the consumer-members will pay the cooperative for broadband internet, and the cooperative will use their contributions to finance the service.

Financing

Finding start-up capital is often the greatest barrier to creating a cooperative. This capital comes from a combination of member equity, loans, grants, charitable donations, and, occasionally, outside investors. Not all cooperative statutes allow cooperatives to raise capital through outside investors, however, and those that do generally place significant restrictions on such investments. For instance, under Wisconsin's cooperative statute, Wis. Stat. 185, dividends paid out to capital investors are limited to 8% and there are significant restrictions on any voting rights accompanying shares given to capital investors. These restrictions exist to ensure that investor interests remain subordinated to member interests so that the cooperative never charges its members more than it costs to provide quality service, pay off debt, and to expand and improve as necessary.

As a result of these restrictions, cooperatives are left with a smaller pool of available capital to draw on than investor-owned businesses, making start-up particularly difficult for cooperatives. Providing broadband requires significant upfront investment in infrastructure, so this phase of development will be tricky for broadband cooperatives. Any cooperative considering providing broadband should look for strategic partnerships with government, other cooperatives, telecommunications companies, and investor-owned utilities that may reduce the amount of capital needed to build broadband infrastructure. Additionally, such cooperatives should survey and apply for federal and state grants, as both the federal and Wisconsin state governments are interested in financing rural broadband projects and currently offer several sources of grant funding for rural broadband projects.

State Funding Sources

Wisconsin Public Service Commission Broadband Grants

The Public Service Commission of Wisconsin's Broadband Expansion Grant Program has been a major source of funding driving the expansion of advanced telecommunications capability in underserved areas of Wisconsin. The program provides funds to assist eligible entities in deploying broadband infrastructure in areas of the state that are costly to serve. Since 2014, the grant program has awarded 268 grants totaling over $72.5 million. In March 2021, the Public Service Commission of Wisconsin awarded $24.8 million for 58 projects to help expand broadband internet to unserved and underserved areas of Wisconsin. Several of these projects were rural cooperatives. The Broadband Expansion Grant Program will continue into 2022.

Additionally, Governor Evers has dedicated $100 Million of American Rescue Plan Act Funds to be given out by the PSC to similar projects. The deadline for the 2022 application was July 27th, 2021, but funding will likely be available in upcoming years. Under U.S. Treasury guidance for the ARPA funds, eligible broadband projects are expected to:

1. Serve unserved or underserved households and businesses.
2. Be designed to deliver upon project completion internet service that reliably meets or exceeds upload and download speeds of 100 Mbps or at least 100 Mbps download and at least 20 Mbps upload if it not practicable to deliver the higher upload speeds due to geography, topography, or excessive costs.
3. Prioritize projects that deliver a physical broadband connection that achieve the last mile connection.
4. Prioritize affordability options.
5. Prioritize investments in fiber optic infrastructure where feasible.
6. Avoid investments in locations that have existing agreements to build reliable service of at least 100 Mbps download and 20 Mbps upload by December 31, 2024.

These grants can be found at https://psc.wi.gov/Pages/Programs/BroadbandGrants.aspx.

Federal Funding Sources

The United States Department of Agriculture (USDA) furnishes funds for broadband expansion via several grant and loan programs.

ReConnect Loan and Grant Program

The ReConnect Program offers federal financing and funding options in the form of loans, grants, and loan/grant combinations to facilitate broadband deployment in areas of rural America that do not currently have sufficient access to broadband, as defined by the latest Funding Opportunity Announcement (FOA). The amount and types of funds available, as well as the maximum and minimum award amounts, will be determined by the latest FOA.

The program generates private sector investment to deploy broadband infrastructure that provides high-speed internet e-Connectivity to as many rural premises as possible, including homes, community facilities for healthcare and public safety, schools, libraries, farms, ranches, factories, and other production sites.

These grants can be found at https://www.usda.gov/reconnect.

Telecommunications Infrastructure Loans and Loan Guarantees Program

This program provides loan financing for the construction, maintenance, improvement and expansion of telephone service and broadband in rural areas. Chibardun, a Wisconsin telecoms cooperative, recently received a $10.2 million loan to install 328.5 miles of fiber to the premises to serve the rural areas of Prairie Farm and Sand Creek exchanges.

These grants can be found at https://www.rd.usda.gov/programs-services/telecommunications-infrastructure-loans-loan-guarantees.

Modern Utility Cooperative Landscape

Today most cooperatives that offer broadband services are either electric cooperatives or telecommunications cooperatives. Most of the electric cooperatives were created in the first half of the

20th century in the wake of the Rural Electrification Act of 1936, which pumped federal loans into rural communities that were willing to organize their own electric utility cooperatives. The telecommunications cooperatives were mostly formed after 1949, a year in which the Rural Electrification Administration established a similar loan program for rural telephone projects. Though these cooperatives were originally created to provide electric and telecom services for their members, many have expanded their services to offer broadband because they determined it was in the best interest of their members and their members were willing to take on the risks and costs associated with expansion and diversification. Few cooperatives exclusively offer broadband services, but this may not be true for long thanks to a new wave of federal and state grants and loans targeted specifically at rural broadband projects.

Additionally, in July 2020, Governor Tony Evers signed Executive Order #80 creating the Governor's Task Force on Broadband Access. The task force advises the Governor and Wisconsin State Legislature on broadband actions and policy, including strategies for successfully expanding high speed internet access to every residence, business, and institution in the state; initiatives for digital inclusion; and pathways to unlocking and optimizing the benefits of statewide, affordable access to broadband for all communities in Wisconsin.

Legal Issues

Starting a cooperative requires an understanding of cooperative governing documents, the legal issues facing cooperatives, and community organizing and business planning processes. This section covers governing documents and legal issues. See Appendix D for the University of Wisconsin Center for Cooperative's step-by-step guide to starting a cooperative, which addresses community organizing and business planning.

Incorporation and Necessary Documents

In Wisconsin cooperatives may be incorporated under Wis. Stat. 185 or Wis. Stat. 193. Our analysis focuses on 185 Cooperatives because they are more commonly used in Wisconsin and the statute has no restrictions against utility cooperatives, whereas under 193 cooperatives may not provide natural gas, heat, light, power, or water to their members. While broadband is not listed under the utility service restrictions listed in Wis. Stat. 193, under Wis. Stat. 193 a broadband cooperative would be precluded from ever offering these services. Additionally, though Wis. Stat. 193 was adopted in 2006, the statute's failure to become widely used means that 193 cooperatives remain largely untested in the Wisconsin courts.

To create a 185 cooperative, the founding members will first need to file articles of incorporation, adopt bylaws, and create a membership agreement. The cooperative will then need to host its first membership meeting so that the members can elect its first official board of directors and approve or amend the bylaws.

Articles of Incorporation

To file articles of incorporation you must submit a Form 202 to the Wisconsin Department of Financial Institutions (WDFI). Filing currently costs a minimum of $55 dollars, $30 for a registration fee and at least $25 for a filing fee. If the cooperative is organized with capital stock, the filing fee is $1.25 for each $1,000 of capital stock, unless that total is less than $25, in which case the filing fee is $25. Unlike articles for other entities, cooperative articles cannot be electronically filed, meaning you will have to mail notarized copies of the 202 to the WDFI along with checks for both fees. At the time of filing, you must also be prepared to list five incorporators, who will act as the initial board of directors. The 202 Form has more detailed instructions on filing. See Appendix E. for an example of a complete 202 Form and an accompanying explanation of each article.

Bylaws

Once you file your articles you will need to write and adopt bylaws. Bylaws are the rules that govern the internal affairs of the cooperative. Unlike your articles of incorporation, you do not need to file them with the Wisconsin Department of Financial Institutions. Among other things, they define the financial and fiduciary relationships between members, directors, and officers, define the cooperative's decision-making processes, and define how to amend the bylaws. Below is an outline of cooperative bylaws that addresses which questions each section should answer.

Purpose, Mission, and Values

1. What is your cooperative's purpose and mission?
2. What values drive the cooperative?
3. What does your cooperative have the authority to do? What does your cooperative not have authority to do?

Comment: The introductory section of the bylaws should tell the reader about why the cooperative exists, what it is intended to do, and what the spirit and culture of the cooperative is intended to be. These bylaws will act as a guide for future generations of the cooperative's members, so take the opportunity to give them a thorough introduction to the cooperative. If ambiguity arises as to whether some action is appropriate for the cooperative to take, members often look to the mission and purpose of the cooperative.

This section should not contradict your articles. If there is a contradiction between the two documents, the articles will always rule. Many cooperatives add language making this point expect into their bylaws. For example: "*The articles of incorporation are hereby made a part of these bylaws. In case of any inconsistency between the articles of incorporation and these bylaws, the provisions of the articles of incorporation are controlling.*"

Membership

1. How many membership classes are there and what are they?
2. Who is eligible for each class of membership?
3. What rights and responsibilities come with membership?
4. How does member voting work, and can voting rights be suspended?
5. If entities are eligible for membership, how do they vote? Do they vote with delegates?
6. What is the process for admitting new members?
7. What does voluntary termination of membership look like? What about involuntary termination of membership?

Comment: Though all cooperatives have members, each cooperative's membership structure is unique. This section is where the cooperative defines its own unique structure. The structure should flow from practical considerations made by the cooperative's founders, not from uncritical adoption of another cooperative's membership model.

Member Meetings

1. When and where is the annual meeting to be held?
2. Who can call special meetings and under what conditions?
3. What notice must be given of meetings and of the topics to be voted on at meetings?
4. What constitutes a quorum?
5. How does voting work?
6. Can meetings be held electronically or via telephone? Under what conditions?
7. Can members vote remotely? (Remote voting is allowed, though Wis. Stat. 185 prohibits cooperatives from using proxy voting)
8. Can members vote via written consent in lieu of a meeting? Under what conditions?

Comment: This section will be referenced whenever there is uncertainty about meeting procedure, making it one of the most frequently referred to section of the bylaws, so be clear and specific. Too much information is better than too little.

Board of Directors

1. What are the board's responsibilities?
    a. Relationship to management?
    b. Duty to members?
2. Who is eligible?
3. How many board seats? Choose an odd number to avoid gridlock.
4. What is the process for election?
5. What are the terms of office?
    a. How long?
    b. Staggered?
    c. Are members limited to a certain number of terms?
6. What is the process for removing a director?
7. What is the process for filling a vacancy?
8. What restrictions on the board's powers exist?
9. How are board meetings organized?
    a. Frequency, or authority to call a meeting?
    b. Notice of Meetings?
    c. Quorum?
    d. Voting Rules?
    e. Electronic and telephone meetings?
    f. Remote voting?
    g. Written consent?
10. Will board members be compensated for their work? If so, how much? How is pay adjusted?

Comment: This is another contender for the most frequently referred to section. Spell it all out in detail. It may be prudent to also address board of director conflict of interest head on in this section with a statement to the following effect: "*It shall be the duty of all board directors to make prompt and full disclosure to the board of any personal, professional, or financial conflict of interest in a matter under discussion. When a conflict of interest is disclosed, the board member must not participate in the discussion or vote on the relevant issue.*"

Board Officers

1. What roles exist? (Typically, there is a at least a president, treasurer, and secretary.)
2. What duties and powers does each role have?
3. Who is eligible for an officer position?
4. How are officers selected?
5. How long is each role's term of office?
6. How does the cooperative remove officers?

*Comment: T*he board officers are sitting members of the board of directors. Typically, they are either elected by the membership during board elections, or they are selected by the board once a new board has been elected.

Member Equity/Patronage

1. What shares exist and what are their properties?
2. How many of each share must members purchase? Are there any exceptions?
3. What is the process for equity pay-out? Be sure to cover equity redemption for terminating members, deceased members, and unclaimed equity.
4. How will equity records be kept?
5. General policies for patronage reserves.
6. Consent to patronage distributions. This phrase is critical for a subchapter T cooperative to remain in compliance with the IRS. *"'Consent to patronage distributions' means that all members will report their cooperative patronage refunds and retained capital equity to the IRS as earnings. Each year members will receive a 1099 form itemizing their patronage refunds earned in that year. Each member of this cooperative as of the effective date of this by-law who continues as a member after such date, and each person who shall after such date become a member shall, by such act alone, consent that the amount of any distribution with respect to patronage occurring in any fiscal year of the cooperative and which are made in written notices of allocation (as defined in 26 USCA 1388), and which are received by said member from the cooperative, will be taken into account by said member at their stated dollar amounts in the manner provided in 26 USCA 1384(a), less any amount which may be excluded under 26 USCA 1385(b) in the taxable year in which such written notices of allocation are received by said member."*

Comment: This section should give the reader an understanding of what types of shares exist, what rights and responsibilities they come with, how much they cost, how much of each member is expected to purchase from the cooperative, and how members may redeem their equity in the cooperative upon exit. It should capture the flow of member equity money into and out of the cooperative.

Finances

1. Statement on operating on a cooperative basis. For instance, *"The Cooperative operates on a cooperative basis and allocates earnings and losses to Members on the basis of the business done with or for such Members. Thus, in accordance with Subchapter T of the Internal Revenue Code, the Cooperative may declare a patronage dividend to be distributed among the Members in accordance with the total amount of patronage made by each such Member during the preceding fiscal year."*

2. Definition of patronage for each membership class. What does it mean for a worker member to "do business with" the cooperative? What does it mean for a consumer member to "do business with" the cooperative?
3. How are assets distributed upon dissolution? Distributed to members on basis of patronage? To another cooperative? To charity? (To maintain 501(c)(12) tax-exempt status, a broadband cooperative must distribute any gains from the sale of any appreciated asset to all who were members while the cooperative owned the asset in proportion to the amount of business done with each, as far as practical.)
4. What rules are there regarding:
    a. Purchasing real property
    b. Taking on debt
5. Apportionment of net proceeds, both net margins and losses.

Comment: Covers any financial questions not covered in the member equity section.

Administration and Miscellaneous

1. When does your fiscal year begin?
2. What rules, if any, govern meetings? (Roberts Rules of Order, for instance.)
3. What is your corporate seal, if you have one?
4. Will you have an annual audit?
5. Option for the cooperative to have advisory councils, committees, etc.
6. Indemnification and insurance statement (A statement that the cooperative will cover insurance and reimburse a director for expenses incurred due to a legal proceeding.)
7. Severability. For instance: *"If a court of competent jurisdiction judges any section, clause, provision, or portion of these by-laws void or invalid, the remainder of these by-laws will not be affected."*

Comment: This is a catch-all section for anything that does not fit neatly above.

Amending the Bylaws

1. Who can amend the bylaws? Just members? Members and the board?
2. What is the process for proposing and deciding on amendments?

Comment: The ability to amend the cooperative's bylaws is one of the greatest rights held by members. Some cooperatives also allow the board to make amendments, which the members can veto if they vote to do so.

Membership Agreements

Membership Agreements are contracts signed by members of the cooperative upon purchase of their member equity that spell out the terms of membership in greater detail than is covered by the bylaws. They describe member rights and responsibilities as well as the cooperative's obligations to the members. Violation of a membership agreement is often grounds for termination of membership.

The following is a non-exhaustive list of topics worth addressing in a broadband cooperative membership agreement:

Acknowledgement of Articles, Bylaws, and Membership Agreement

Here the member acknowledges that the Articles, Bylaws, and Membership Agreement collectively constitutes the terms of the contract between the member and the cooperative and acknowledges their responsibility to be familiar with the terms of each document

Acknowledgement of Changes to Agreement

Allows the cooperative to update and revise the terms of the agreement upon giving notice to members, who may choose to continue or terminate their membership upon receiving such notice.

Membership Eligibility

Covers the eligibility requirements for membership and asks the member to confirm compliance with said requirements.

General Terms of Membership

Covers the cooperative's services offered to members, the cooperative's right to suspend services, the prohibited uses of the service, the distribution of membership certificates, the restrictions on transfers of member equity, the cooperative's equity redemption policies, authorization for the cooperative to offset debts owed by the member to the cooperative against the member's equity in the cooperative, equity redemption policies, refund policies, and any exclusivity agreements between the cooperative and its members.

Member Rights

Covers the members rights such as voting in board elections, voting on amendments to bylaws and certain organizational decisions such as consolidation and mergers, and eligibility for board candidacy.

Terms of Terminating Membership

Covers the conditions under which membership may be terminated and the process for termination.

Equity Requirements and Capital Calls

Covers the initial and on-going equity purchases required of members, and the conditions under which equity requirements may be adjusted. If the cooperative plans to ask members to commit some amount of capital to the cooperative to be called in later, this section should address the committed capital requirements and the conditions under which the cooperative can call in capital.

Disclaimer of Warranties and Waivers of Liability

Covers any disclaimers or waivers the cooperative deems prudent, such as disclaimers of uninterrupted, timely, secure, or error-free broadband internet service.

Indemnification

Members agree to compensate the cooperative for legal fees arising from legal actions made by third parties against the cooperative due to the member's breach of the cooperative's articles, or bylaws or membership agreement.

Financial Structure

Start-up Capitalization

Cooperatives use both debt and equity to capitalize. Debt is money borrowed as a loan that must be paid back to the lender with additional interest payments. Banks and government agencies are common sources of cooperative business loans. Equity is money invested in a business with no guaranteed financial return. Equity entitles the investor to an ownership share in the entity, meaning a degree of control and a portion of business profits and losses. Usually, a cooperative's members will make equity contributions in exchange for ownership and control rights. The equity contribution is made via the purchase of a membership certificate or common stock, which cannot be traded and does not appreciate. Capitalization costs that exceed the membership's equity contributions will generally be covered with debt financing.

Wisconsin cooperatives may also raise equity capital by selling preferred stock to both members and non-members. Preferred stock comes with rights to dividend payments but not member voting rights. Dividends are paid out of the cooperative's net profits at the discretion of the board.

Capital intensive cooperatives such as broadband cooperatives will often need more capital than member equity can satisfy. Wisconsin has therefore adopted a hybrid cooperative law, Wis. Stat. 193, which allows cooperatives to have non-patron investor members. In other words, 193 cooperatives can categorize investors who do not use the cooperative's services as members. Under Wis. Stat. 193, these non-patron members may receive a portion of net profits based on their investment without a ceiling. Additionally, they may vote as if they were patron members, though they may never have a greater voting share than patron-members. Under this model a cooperative is more likely to adopt a profit incentive, as the primary cooperative goal of operating for the benefit of the members must compete with the secondary purpose of earning a return on member investment. Interestingly, Wis. Stat. 193 also allows pass-through taxation status as a default.

Wis. Stat. 193 may be of assistance to cooperatives who can entice investors with a promise of a decent return on their investment. Unfortunately for would-be rural broadband cooperatives, the pithy return on investment associated with providing rural broadband is the primary reason investor-owned broadband providers have not served rural America in the first place. Non-patron investors would therefore more likely be individuals interested in supporting rural broadband projects than investors looking for the most lucrative return on their investment, making it uncertain whether the flexibility of Wis. Stat. 193 provides a substantial advantage to the restricted preferred share options available under Wis. Stat. 185.

Retained earnings

When a cooperative's earnings exceed its expenses, the board may decide to retain earnings to reinvest in the cooperative. Excess earnings may also be allocated to members based on their patronage. Such allocations may be distributed to the member as a refund, retained as allocated equity in the member's name, or a combination of both. Additionally, the cooperative may retain a portion of these earnings as unallocated equity. Typically, this portion of earnings is the profit from business conducted with non-members.

Tax Treatment

For federal income tax purposes, most cooperatives are taxed under subchapter T of the Internal Revenue Code (IRC). Broadband cooperatives are not taxed under subchapter T, but familiarity with subchapter T is important for understanding the fundamentals of cooperative taxation.

Subchapter T

Under subchapter T, cooperatives pay taxes at the corporate rate on earnings retained as unallocated equity, whereas members pay taxes on the net profit that is allocated to them based on patronage. To qualify for subchapter T taxation, a cooperative must meet the three following requirements:

1. The subordination of capital, regarding both control over the cooperative and ownership of the pecuniary benefits arising from the cooperative.
2. Democratic control by the members.
3. The allocation among the members of revenues exceeding operating costs in proportion to the members' active participation in the cooperative endeavor.

Under subchapter T, cooperatives are authorized to deduct allocations to patrons from earnings attributable to the business conducted with members. These allocations may be paid out as distributions to the member or may be retained. Regardless of whether an allocation is distributed or retained, the member will report the allocation as income and pay individual income tax on it. For this reason, cooperatives are required to distributed at least 20% of any allocation made to a member, so that the member can pay the taxes on the retained portion of any allocation. Cooperatives generally retain excess earnings from business conducted with non-members as unallocated equity and pay corporate income tax on such earnings.

Under subchapter T, farmers' cooperatives are also allowed to deduct dividends paid on capital stock and distributions on a patronage basis to members from non-member earning sources. Thus, by making distributions to its members, an exempt farmers' cooperative can avoid all or nearly all taxes at the cooperative level. In contrast, other subchapter T cooperatives may deduct distributions from member-based income, but their non-member-based income is taxed once at the cooperative level and, if distributed to its members, again at the member level.

Taxation of Broadband Cooperatives

Broadband cooperatives are taxed under IRC 501(c)(12) rather than subchapter T. IRC 501(c)(12) provides federal income tax exemption for benevolent life insurance associations of a purely local character, mutual ditch or irrigation companies, mutual or cooperative telephone companies, electric companies, or “like organizations.” The IRS considers broadband cooperatives “like organizations.”

The purpose of an IRC 501(c)(12) organization is to provide certain services to its members at the lowest possible cost. An organization must satisfy three requirements to qualify under I.R.C (Internal Revenue Code). 501(c)(12). First, it must be organized and operated on a cooperative basis, under the same principles required under subchapter T. Second, it must receive 85 percent or more of its income each year from members, and the income must be collected solely to meet the cooperative’s losses and expenses. Income does not include funds provided by a government entity in connection with the construction, relocation, or restoration of electric, communication, broadband, internet, or other utility facilities or services. Finally, it must meet the requirements spelled out in the IRC 501(c)(12):

1. The organization must keep adequate records of each member’s rights and interest in the assets of the organization.
2. The organization must distribute any savings to members in proportion to the amount of business done with them.
3. The cooperative must not retain more funds than it needs to meet current losses and expenses.
4. The cooperative cannot forfeit a member’s right and interest in the organization upon termination of membership.

5. Upon dissolution, the cooperative must distribute any gains from the sale of any appreciated asset to all who were members while the cooperative owned the asset in proportion to the amount of business done with each, as far as practical.

Liability

Directors and Officers

Like corporations, cooperatives provide limited liability to their members and management. In short, limited liability protects individuals associated with the cooperative from being held personally liable for the debts or damages owed by the cooperative. There are important exceptions to this general rule, however.

Under Wis. Stat. 185, directors and officers are generally not personally liable to the cooperative, its members, stockholders, or creditors, to any person asserting rights on behalf of the cooperative, or to any other person, for damages, settlements fees, fines, penalties, or other monetary liabilities arising from a breach of, or failure to perform, any duty resulting solely from his or her status as a director or officer.

If, however, the person asserting liability proves a breach or failure to perform constitutes one of the following, directors and officers may be held personally liable:

1. A willful failure to deal fairly with the cooperative, its members or stockholders in connection with a matter in which the director or officer has a material conflict of interest.
2. A violation of criminal law, unless the director or officer had reasonable cause to believe his or her conduct was lawful or no reasonable cause to believe his or her conduct was unlawful.
3. A transaction from which the director or officer derived an improper personal profit.
4. Willful misconduct.

Directors and officers may also be held personally liable for either of the following:

1. A civil or criminal proceeding brought by or on behalf of any governmental unit, authority or agency so long as the governmental unit, authority or agency is not acting in its capacity as a private party or contractor.
2. A proceeding brought by any person for a violation of state or federal law where the proceeding is brought pursuant to an express private right of action created by state or federal statute, so long as the party claiming liability is not a governmental unit, authority or agency in acting its capacity as a private party or contractor.

Further, directors who negligently or in bad faith vote for any distribution of assets contrary to Wis. Stat. 185 or the cooperative's articles are jointly and severally liable to the cooperative for the value of assets distributed in excess of the amount which could have been distributed without violating the statute or articles.

Members, Stockholders and Patrons

Members, stockholders and patrons of a cooperative are neither obligated to pay, nor liable upon, any cooperative obligation, except that stockholders are liable to an amount equal to the value of their shares for debts due an employee for not more than 6 months of service to the cooperative.

Common Challenges

Capitalization

Cooperatives can be harder to capitalize than other enterprises for a few reasons. First, they must subordinate capital interests to the needs of their members. This means cooperatives cannot give investors high returns on their investments if it would impair the cooperative's ability to serve its members and cannot grant investors management control of the cooperative in exchange for their investments. Many state cooperative statutes put explicit limits on the return on investment and voting rights that non-member investors can hold. Under Wis. Stat. 185 preferred stock dividend payments are capped at 8% and are at the discretion of the board, and such stock are non-transferable, may be recalled at the discretion of the board, and come with voting rights only for limited situations directly affecting the value of the investment, such as mergers or dissolution, if any. These restrictions make it difficult to entice capital investments from non-members.

Second, financial institutions are generally less familiar with cooperatives than they are with other types of enterprise, making them more hesitant to lend to cooperatives. Many banks and credit unions will lend to cooperative enterprises but convincing these institutions that the cooperative enterprise is worthy of the loan often means educating the lender on the cooperative model. Other lenders, while familiar with cooperatives, impose requirements on borrowers that cooperatives are structurally unable to meet. This phenomenon is on full display within the Small Business Administration, which only recently allowed cooperatives to participate in its flagship small business loan program, and still requires personal guarantees from owners of 20% or more of the business applying for the loan. Because most cooperatives have more than five members and all members own the cooperative equally, most cooperatives have no 20% owners and are therefore not eligible for the Small Business Administration's loan program.

Thus, unless a cooperative can secure a grant or loan, most of a cooperative's capital comes from its membership. This gives cooperatives a small pool of capital to draw from compared to other enterprises. Cooperatives can draw from this pool either by requiring members to buy a certain amount of equity in the cooperative, or by setting up a member loan program. Member loan programs work by raising capital from membership in the form of loans that will be repaid at a fixed rate with interest. Member loan programs carry less risk for members than equity buy-ins, because they are paid off before equity in case of liquidation. However, member loans are unsecured, as opposed to secured debt from a bank or other lending institution, and thus still carry risk for the member.

One important consideration when capitalizing a cooperative is whether the sale of stock will remain in-state. If stock is sold in multiple states, the cooperative will be subject to federal securities laws that require registration and reporting to the Securities and Exchange Commission. If cooperative stock is sold exclusively within Wisconsin, no similar registration or reporting is required at the state level. Member loan program represents a sale of securities as well, so member loan programs need to be structured with the same in-state considerations.

Membership Classification and Requirements

Cooperatives need at least a single defined membership class. In the case of a broadband cooperative, this is the consumer. The question for Liberty Grove is: who will the consumers be?

With a high percentage of Liberty Grove's homeowners only living in Liberty Grove for a few weeks out of the year, it is possible that a broadband cooperative would find that many homeowners are not willing to meet member equity requirements just to use broadband internet for a few weeks a year. Broadband requires significant investment in infrastructure, and this cost is fixed regardless of how much each consumer uses the service. In other words, it costs the same amount to build fiber lines to a someone's house regardless of whether they want to use broadband 365 days a year or 5 days a year. Thus, part-time residents' equity contributions may need to cover last-mile infrastructure costs that are too high for their intended use.

The severity of this problem will depend on how much of the infrastructure costs must be covered with member equity. If the broadband cooperative must finance the fiber optic lines itself, the equity requirement will likely have to be much greater to cover the expense, and the cooperative may have extra difficulty attracting part-time resident members. If the cooperative can use fiber optic infrastructure built by the municipality or can pay for the majority of the infrastructure through government grants, the member equity requirements could be much smaller, and more part-time residents may be willing to buy into the cooperative. Similarly, if the cooperative finds a satisfying alternative to fiber using cheaper technologies, more part-time residents may be interested in membership.

It is also worth noting that many part-time residents may already have invested in their own satellite internet equipment, which may suit their needs adequately. Once the initial equipment has been purchased, they can pay for satellite services exclusively for the time that they are living in their Liberty Grove residence. While satellite is not as fast as fiber broadband, the costs associated with fiber may be too great to convince part-time residents to switch over.

Free-Rider and Horizon Problems

The collective nature of cooperatives can create two key problems: the free-rider problem and the horizon problem. The free-rider problem refers to the tendency for members to prefer to let others make the investments necessary for the cooperative to operate but to nevertheless benefit from the investments. Typically, free-rider problems emerge when a cooperative is raising funds at formation or for growth and expansion. This problem is present when eligible parties decline to become members until the period in which the cooperative has the greatest capitalization needs has ended, and then become members.

Regarding broadband services, free-rider problems could emerge for a cooperative that has to build both middle-mile and last-mile infrastructure. Any such cooperative could run into a situation where few members want to put in the equity to facilitate the necessary investment in middle-mile fiber infrastructure but would be willing to participate in the cooperative once the only expenses are those associated with last-mile infrastructure. Using state and federal grants to finance the middle-mile infrastructure or using municipally owned infrastructure would help a cooperative avoid the issue entirely.

Horizon problems refer to situations in which a group of members expecting to exit the cooperative soon pressures the cooperative to invest less money into the cooperative and assets with long-term benefits and instead pressures the cooperative to increase member distributions and investments that benefit members in the short-term. If the pressure is successful, it can result in underinvestment in assets with long-term benefits that are necessary to keep the cooperative efficient and viable. In some scenarios the group of members near-exit can harm, sometimes irreparably, how well the cooperative is able to serve its newer members, who have longer exit horizons.

The horizon problem is a larger problem in producer and worker cooperatives, in which a member's membership is premised on their ability to work. In such cooperatives, horizon problems emerge when a generation of members approaches retirement age. Consumer cooperatives do not have obvious retirement timelines in which whole swaths of members will exit the cooperative and are therefore less prone to horizon problems. Because consumers will likely use broadband services until the end of their lives, horizon problems are not a significant risk for a broadband cooperative.

Equity Redemption Challenges

A cooperative's members provide the equity necessary to launch the cooperative and to help the cooperative achieve and maintain stability. Equity is ownership of the cooperative, so what happens when an owner leaves the cooperative? It may be natural to expect owners to be paid-out upon exit. This is true of some cooperatives, but not all.

Most cooperatives create systems for redeeming or returning equity to departing members. Such systems attempt to balance the capital needs of the cooperative and the interests of exiting members and vary significantly, from immediate redemption of equity upon exit to redemption only upon the death of the prior member. Practices vary by sector and depend on member expectations and the culture of the individual cooperative.

Cooperatives with small individual equity account balances might occasionally pay annual patronage refunds but will rarely return allocated equity to members upon exit. This model works for consumer cooperatives, because most members have not put enough equity into the cooperative to desire it back, and members tend to think of the cooperative's existence as the main benefit they receive from the cooperative. Worker cooperatives and capital-intensive agricultural cooperatives often have much higher internal equity account balances per member, and as a result their members expect equity to be redeemed upon exit. It is often difficult for cooperatives to manage immediate equity pay-outs with their own capital needs, so many cooperatives adopt gradual payout models, where member equity is paid out over several years after members have exited or is redeemed all at once several years after exit.

Gradual or delayed payout is not always a concern— often members feel that the benefits they receive from the cooperative outweigh the equity they put in. But members who are used to a financial return on their investments may find it unsatisfying.

A broadband cooperative may be a capital-intensive cooperative, but a significant portion of the equity needed to fund the cooperative will be used to build out the cooperative's infrastructure. This fiber infrastructure will have to be built out to members individual homes, making the equity investment feel less like an investment in the cooperative and more like the cost of enabling the cooperative to provide services to the member's specific locale. Further, building fiber optic lines to a home increases the value of the home, which may be a significant enough side-benefit of the equity contribution to justify using a model that gives out annual refunds based on patronage when possible but does not fully redeem member equity upon member exit. Further, most members will likely use the broadband service until they leave Liberty Grove or until end-of-life, meaning the question of equity redemption upon member exit will likely not concern most members.

Slow Decision Making

Cooperatives are responsible for acting in the best interest of their members, and that often means educating members on certain issues and getting member input before making decisions. For this reason, cooperatives can be slower to make decisions and move on opportunities than traditionally structured companies that are not concerned with stakeholder input.

This presents a greater problem for cooperatives working in rapidly evolving and competitive industries such as tech and finance. A broadband cooperative does not need to act particularly quickly, as its market will be secure once it has made the investment in broadband infrastructure.

Increased Governance and Member Education Costs

The democratic nature of cooperatives means not simply that the cooperative is accountable to its members, but that the members are responsible for running the cooperative. This means members need to be educated on both the cooperative model and the industry their cooperative exists within so that they can be informed voters on issues brought to member votes. Further, some members must develop the knowledge to be able to effectively serve on the board of directors. The more members are taught about the cooperative and its industry, the greater the cooperative's capacity for effective democratic participation. This means cooperatives must invest time and energy into educating their members.

Regarding a broadband cooperative, most internet users are not used to participating in any democratic process relating to their internet service provider. Many users may want nothing to do with their internet service provider— most interactions with an internet service provider are negative after all, either paying bills or troubleshooting connectivity issues. It will likely take significant outreach and educational efforts to teach members that they have the power and responsibility to contribute to their cooperative's success.

Discussion of Options Available to Liberty Grove

The principal hurdle for any potential Liberty Grove broadband cooperative is paying for the infrastructure. The model selected will likely be the one that most satisfactorily distributes this cost across different stakeholders. Several methods of financing the project exist.

First and most straightforward, the residents of Liberty Grove could create a new broadband cooperative to finance and operate the fiber broadband infrastructure. For this to happen, residents of Liberty Grove would incorporate the cooperative, build a membership base through community outreach and education, apply for federal and state grants, combine these monies with a pool of initial member equity, and use the capital to secure loans from financial institutions. While being the most straightforward, this option puts the highest capital burden on the residents of Liberty Grove, who will have to shoulder whatever costs cannot be borne by grants and loans.

This capital burden could be diminished through strategic partnerships, however. Many existent energy and communications cooperatives that have successfully started providing broadband services to their members did so through partnerships with other telecommunications and energy companies.

Tennessee's Appalachian Electric Cooperative (AEC) serves as one such example. AEC sent requests for information regarding potential partnerships to bring broadband services into AEC's service area to several regional telecommunications companies and received four proposals. AEC eventually accepted a proposal from Foursight Communications, which is a conglomeration of local telecommunications cooperatives. Under the partnership, Foursight created a subsidiary named Trilight to provide front office service representatives, electronics, home and business installations, and to handle trouble shooting calls. AEC contributes to the partnership with its fiber backbone and fiber network system, which it leases to Trilight. This model allows AEC to leverage its existing infrastructure to provide broadband to its members without having to take on the risk and expense of administering a broadband cooperative.

Similarly, Virginia's Prince George Electric Cooperative (PGEC) has begun to lease a fiber-optic network from Dominion Virginia Power, the state's largest investor-owned utility. Dominion was installing fiber-optic cable to improve the resiliency of the grid when it asked PGEC if it would be interested in leasing access to Dominion's fiber to bring broadband to unserved communities in Surry County. PGEC is now able to provide broadband services well beyond its original service area because it was able to leverage existing fiber-optic lines.

Though a new cooperative would not have its own infrastructure to leverage, finding a strategic partnership that could provide the cooperative with either infrastructure or administrative expertise would significantly reduce the amount of work and capital required. For instance, a new cooperative could propose a partnership with Washington Island Electric Cooperative, a nearby cooperative that is already experienced in administering broadband services. Under such a partnership, the Liberty Grove cooperative could raise capital to build a fiber-optic network in Liberty Grove, and Washington Island Electric Cooperative could provide the administer the broadband service.

Alternatively, the city of Liberty Grove could build the fiber-optic network and allow Washington Island Electric Cooperative or a new broadband cooperative to use it to provide services to residents of Liberty Grove. Wisconsin law makes it unpractical for a Wisconsin municipality to operate a broadband service, but a Wisconsin municipality can build broadband infrastructure and let other providers use the infrastructure so long as there is no more than one broadband provider serving the intended service area. In such cases, the municipality would have to offer use of its infrastructure to any provider who wants to offer broadband services to the area. Thus, though the infrastructure would be available to a cooperative, it would also be available to national providers who would be able to take advantage of the municipality's investment in order to offer service at lower cost than the cooperative may be able to. Using municipal funds to create the infrastructure helps bypass a cooperative's capitalization difficulties but leaves the cooperative without exclusive use of critical infrastructure, threatening the cooperative's long-term viability. That said, were a national provider to move into the area to provide service via municipal infrastructure, Liberty Grove would have broadband service. Democratic control over that service would be lost, but the importance of democratic control is for the residents of Liberty Grove to decide.

Third, Washington Island Electric Cooperative could expand its broadband services into Liberty Grove via the construction of new fiber lines. Because Washington Island Electric Cooperative is a cooperative, this expansion must be shown to be in the best interest of the cooperative's current members. If Washington Island were to conduct a feasibility study examining expansion into Liberty Grove and found that the larger membership base would decrease the cost of service to their current members in the long run, they may have a reason to expand. Such an expansion would be more likely were Liberty Grove to build the infrastructure, because Washington Island Electric Cooperative and its members would not need to shoulder the burden of financing new infrastructure.

Fourth, an existing internet service provider could be purchased and turned into a cooperative. Most cooperative conversions convert non-cooperative businesses into worker cooperatives, and conversions from non-cooperative business to consumer cooperatives are rare. Such conversions come with a set of unique challenges. First, the seller must be patient with purchasing groups, as it usually takes years to organize a community and raise capital enough capital to purchase the business. Additionally, because cooperatives require significant community buy-in, the process of selling a business to a cooperative usually involves extra financial transparency on the part of the seller, who will be asked to share their financial records with many community stakeholders rather than a single buyer. This can be an uncomfortable process for the seller. Furthermore, changing an organization's governance, management structure, community engagement model, internal record keeping policies, and staff culture is an extensive undertaking. In some ways, the biggest benefit of a cooperative conversion—that a business already exists—turns out to be the biggest challenge of the conversion. When a cooperative takes over a non-cooperative business, it must simultaneously restructure the business, educate the community, and manage any of the former business's pre-existent problems.

Appendices

Appendix A. The Cooperative Principles Explained

The Cooperative Principles, as described in the International Cooperative Alliance's Statement on the Cooperative Identity.

1. Voluntary and Open Membership

Cooperatives are voluntary organizations, open to anyone able to use their services and willing to accept the responsibilities of membership, without gender, social, racial, political, or religious discrimination.

2. Democratic Member Control

Cooperatives are democratic organizations controlled by their members, who actively participate in setting their policies and making decisions. People serving as elected representatives are accountable to the membership. In primary cooperatives members have equal voting rights (one member, one vote) and cooperatives at other levels are also organized in a democratic manner.

3. Member Economic Participation

Members contribute equitably to, and democratically control, the capital of their cooperative. At least part of that capital is usually the common property of the cooperative. Members usually receive limited compensation, if any, on capital subscribed as a condition of membership. Members allocate surpluses for any or all of the following purposes: developing their cooperative, possibly by setting up reserves, part of which at least would be indivisible; benefiting members in proportion to their transactions with the cooperative; and supporting other activities approved by the membership.

4. Autonomy and Independence

Cooperatives are autonomous, self-help organizations controlled by their members. If they enter into agreements with other organizations, including governments, or raise capital from external sources, they do so on terms that ensure democratic control by their members and maintain their cooperative autonomy.

5. Education, Training, and Information

Cooperatives provide education and training for their members, elected representatives, managers, and employees so they can contribute effectively to the development of their co-operatives. They inform the public -- particularly young people and opinion leaders -- about the nature and benefits of co-operation.

6. Cooperation Among Cooperatives

Cooperatives serve their members most effectively and strengthen the cooperative movement by working together through local, national, regional and international structures.

7. Concern for Community

Cooperatives work for the sustainable development of their communities through policies approved by their members.

Appendix B. Types of Cooperative Enterprises Explained

Worker Cooperatives

Worker cooperatives are businesses owned and democratically managed by their employees. They exist to provide employment for their worker-members and are the least common type of cooperative in the United States. Typically, the worker-members are either elected to a board of directors or rotate onto the board at a regular interval, and the board manages the business in accordance with the interests of the employee-members. Other worker cooperatives use direct democratic voting to make organizational decisions, with each worker-member having a single vote. Profit sharing among worker-members is common.

Example: Equal Exchange, https://equalexchange.coop/

Producer / Marketing Cooperatives

Producer cooperatives, often called marketing cooperatives, are cooperatives made of members who produce the same or similar products. These cooperatives process, market, and sell their members' products more effectively than the members can as individual producers. Common practices include sales price negotiation, accessing larger markets, and lowering the cost of production inputs for members by using consolidated demand to obtain better pricing.

Example: Land O' Lakes, https://www.landolakesinc.com/

Consumer Cooperatives

Consumer cooperatives are organized by members who use the cooperative to purchase desired goods or services. Often these are goods and services that were previously unavailable to the members, or that were too expensive or low quality to be of use. By consolidating demand, the cooperative provides better availability and pricing to individual consumer-members. Because these cooperatives exist to deliver goods or services to their consumer-members rather than to make a profit, excess earnings are paid out to consumer-members as patronage dividends or re-invested in the cooperative. The model is used across many sectors, including credit unions, grocery stores, telephone and electrical distribution, housing, and childcare.

Example: Willy Street Co-op, https://www.willystreet.coop/

Housing Cooperatives

Housing cooperatives are residential housing projects co-managed and often co-owned by their residents. Housing cooperatives come in many different sizes, from single-family homes filled with college students to thirty story Manhattan apartment buildings. Though many housing cooperatives have a formalized cooperative legal structure that involves collective ownership, housing cooperatives that operate primarily through a cooperative culture and interpersonal arrangements are also common.

Example: Madison Community Cooperative, https://www.madisoncommunity.coop/

Purchasing Cooperatives

Purchasing cooperatives are comprised of businesses that wish to jointly purchase supplies and services. These cooperatives consolidate member demand to receive lower pricing and better availability and delivery of supplies and services for their members. By lowering their members' operating costs, they help their members keep their pricing competitive with that of big-box store competitors.

Example: Ace Hardware, https://www.acehardware.com

Multi-stakeholder / Solidarity Cooperatives

Multi-stakeholder cooperatives, sometimes referred to as solidarity or hybrid cooperatives, are cooperatives with multiple member classes. These different member classes have distinct interests and distinct roles in the cooperative, but all benefit from the cooperative enterprise. Often multi-stakeholder cooperatives combine the structure of a worker cooperative with another type of cooperative listed above. For instance, a cooperative grocery store with both worker and shopper members would be a worker-consumer cooperative hybrid. Having multiple membership classes increases the complexity of structuring a cooperative, because the financial and control rights need to be carefully balanced between the member classes to guarantee that the interests of all members will be met.

Example: Fifth Season Cooperative, http://www.fifthseasoncoop.com/

Appendix C. Descriptions of Cooperative Stakeholder Categories

Members

Members own the cooperative and provide financial support by investing in the cooperative and paying for the cooperative's services. Members control the cooperative by running for and electing the board of directors, which is responsible for setting the cooperative’s policies and long-term strategic goals. Members also vote on amendments to the cooperative’s articles of incorporation and bylaws, and on certain business decisions such as mergers and dissolutions. Because members are eligible to sit on the board of directors and vote in board elections and on certain business matters, cooperatives must educate their members on their respective industry so that the members can make informed decisions.

Board of Directors

The board of directors is responsible for ensuring the cooperative’s long-term success. Their work includes hiring management, understanding and addressing the cooperative’s capital needs, establishing cooperative policies, and setting the cooperative’s long-term strategic goals. Directors are usually elected from the membership but are sometimes brought in from outside the cooperative to provide extra experience and expertise.

Management

Cooperative management is hired by the board to enact the board’s agenda and to hire and manage employees. Cooperative boards often hire a single manager with the title general manager, executive director, or CEO, who is responsible for hiring the rest of the cooperative’s management. Management responsibilities include overseeing the cooperative’s daily operations, giving performance reports to the board, developing a budget, and making suggestions to the board.

Employees

Cooperative employees run the cooperative’s operation. They can be members, in the case of worker and multi-stakeholder cooperatives, but often are not. More often cooperative employees are standard W2 employees.

Appendix D. UWCC's Cooperative Start-up Steps

The following cooperative start-up steps were developed by the University of Wisconsin's Center for Cooperatives and are available at https://uwcc.wisc.edu/start-a-co-op/steps-to-startup/.

1. Explore

A. Identify the problem and gauge interest

A core group of individuals explores an opportunity or common need for a particular product or service. They identify the benefits that a cooperative approach might offer and reach out to a broader group or community to gauge interest in the idea. This group organizes informational meetings for potential members to further define a common need. It also recruits others who have the skills and expertise required to lead the cooperative development process.

B. Form a Steering Committee

If there is enough initial interest in the cooperative idea, it is time to establish a steering committee. The steering committee should be made up of trustworthy individuals who have good business sense, will champion the project, and are capable of putting the interests of the group before their own. Many potential cooperative members will base their support of the cooperative on the credibility of the steering committee members. The steering committee:

1. Gathers more information on the cooperative option and potential member support.
2. Refines the business idea and its initial mission, purpose, and goals.
3. Manages financial matters in a responsible and trustworthy manner.
4. Leads decision-making during the cooperative development process.

2. Assess

A. Conduct a Feasibility Study

The steering committee coordinates a feasibility study to assess the viability of the proposed cooperative venture. This study examines whether there is a market for the new cooperative's products or services, and whether the co-op can generate enough revenue to cover the risks and costs of operating the business. It should be completed by someone who is knowledgeable about the particular business sector and does not have a vested interest in the study's outcome. This study is a key step in the development of the cooperative. The group may need to pay for the study by conducting the first phase of a membership drive, or by applying for funding from federal, state, or non-profit agencies.

A feasibility study includes:

1. Market analysis.
2. Management, equipment, and facility needs.
3. Revenue projections.
4. Sources of financing.
5. Potential membership.

B. Evaluate Feasibility Study Results

The results of the feasibility study help the steering committee decide whether to continue the cooperative development process. This is a critical decision point during the development process.

3. Incorporate

A. File Articles of Incorporation and Adopt Bylaws

If the feasibility study indicates the concept is viable and the steering committee decides to move forward, the group may decide to legally incorporate as a cooperative. In Wisconsin, the group can choose to incorporate under Chapter 185 or Chapter 193 of the state statutes by filing Articles of Incorporation with the Wisconsin Department of Financial Institutions. (Note: any cooperative created to provide natural gas, heat, light, power, or water to its members must incorporate under Chapter 185.) The Articles provide the basic organizational information required by state statutes.

The steering committee often acts as the interim board of directors. It may draft the Articles and the initial set of bylaws, which describe how the cooperative is governed. Articles and bylaws should be reviewed by a lawyer familiar with cooperatives. Bylaws must be adopted or amended by the cooperative's members at the first membership meeting.

B. Open a Bank Account

Once the cooperative is established, the interim board of directors should open a bank account for cooperative financial transactions. In many cases, a group will incorporate earlier in the process so that the cooperative can receive funds and pay initial expenses.

4. Plan

A. Prepare a Business Plan

A business plan is an in-depth analysis of and plan for the cooperative business. It is also an important communication tool for answering questions that potential members will have about the proposed cooperative. Banks and other funding sources will want to assess the business plan as part of their financing decisions. The business plan includes:

1. Description of the goods or services offered.
2. Market analysis.
3. Marketing plan.
4. Operational plan.
5. Description of the management and ownership structures.
6. Sources and uses of start-up funds.
7. Projected financial data for the first five years of operations.

B. Elect a Board of Directors

A membership meeting is held within six months of incorporation to elect the first board of directors and to present and approve the bylaws. The board of directors begins coordinating the business plan implementation and works to secure start-up capital.

5. Capitalize

A. Begin Membership Drive

The membership drive will indicate whether there is sufficient member support for the new cooperative. Materials for prospective members should clearly explain the cooperative's mission, the financial requirements for membership, and the risks and benefits of membership. Some groups launch the membership drive earlier in the development process.

B. Secure Start-up Capital

A cooperative may use both debt and equity to meet its initial capital needs. Cooperatives may also use member loans or preferred stock to raise start-up capital. Lending institutions will evaluate the risks associated with making a loan to the start-up cooperative business by analyzing the financial projections in the business plan and ensuring the co-op has capable staff lined up. Lenders will also look at the amount of member equity invested in the cooperative, since this indicates the level of risk and commitment that members are willing to assume. Members will typically be expected to supply 30-50% of the start-up equity capital. The cooperative will need to borrow the balance from a financial institution. Banks, credit unions, and loan funds that are specifically oriented to cooperatives and understand their unique structure can be important resources.

6. Launch

A. Hire Staff

The board hires a general manager, who plays a key role in securing the operations site, developing vendor networks, and hiring additional staff. Some groups hire staff earlier to assist with the development process.

B. Address Regulatory, Licensing, and Insurance Requirements

There are often specific licensing or regulatory requirements that must be met before the business can begin operations. Legal, insurance, and risk management issues must also be addressed before launching.

C. Commit to Ongoing Training and Education

Ongoing member education and board training are vital to establishing a sustainable foundation for successful cooperative operations. Education topics might include the cooperative model, cooperative finance and governance, industry trends, and working together effectively.

Appendix E. Example Form 202 and Instructions for Filing

Example Form 202

State of Wisconsin
DEPARTMENT OF FINANCIAL INSTITUTIONS
Division of Corporate & Consumer Services

FILING FEE $25.00 +

Please check box to request Optional Expedited Service ☐ + $25.00

DO NOT STAPLE

FORM **202**

ARTICLES OF INCORPORATION
COOPERATIVE

Sec. 185.05 Wis. Stats.

Executed by the undersigned for the purpose of forming a Wisconsin cooperative under Ch. 185 of the Wisconsin Statutes:

Article 1. Name of the cooperative:

Liberty Grove Broadband Cooperative

(must include the term "cooperative" or an abbreviation thereof)

Article 2. Its term of existence shall be ☑ perpetual **OR** ☐ ______________(term in years).

Article 3. The cooperative is organized to engage in any lawful activity within the purposes for which a cooperative association may be organized under Chapter 185 of the Wisconsin Statutes.

Article 4. *(The cooperative must maintain either a principal office or a registered agent in Wisconsin. Select, mark (X) and complete the appropriate item)*

A. ☑ The address of the cooperative's principal office in Wisconsin is: *(Provide complete address, including street and number, city, **county**, state and ZIP code)* 123 Broadband Road Liberty Grove Door County WI 54202	**OR**	B. ☐ The name and address of the cooperative's registered agent in Wisconsin is: *(Provide complete address, including street and number, city, **county**, state and ZIP code)*

Article 5. The number of directors constituting the board of directors ☑ shall be fixed by bylaw **OR** ☐ shall be ____________ (number).

Article 6. The classes of members are ☑ all of a single class **OR** ☐ designated by the following classes:

Office Use Only

Article 7. The cooperative is organized ☑ without capital stock **OR** ☐ with capital stock.

Article 8. The cooperative is authorized to issue _________ (number) shares of capital stock of the following description:

Number of Shares	Class	Par Value	Rights & Preferences
1000	A	300	Class A shares convey the rights and responsibilities of Membership to the owner. All Members must purchase one Class A share from the cooperative upon entering a Membership Agreement. No individual or entity may own more than one Class A share. Class A shares do not pay dividends, do not appreciate, and are not transferrable. The cooperative retains the right to recall any outstanding Class A shares.
5000	B	100	Class B shares exist as a mechanism for the cooperative to set equity requirements for Members and for Members to meet these equity requirements. The cooperative's Board may at its discretion require Members to purchase Class B shares in order to help the cooperative finance special projects, expand, maintain financial stability, or avoid insolvency. Class B shares do not pay dividends, do not appreciate, and are not transferrable. The cooperative retains the right to recall any outstanding Class B shares.

Article 9. Upon liquidation, the cooperative's assets shall be distributed on the following basis:

Upon dissolution, after all debts and liabilities are paid and all Members are compensated for their outstanding Class B shares, followed by their Class A shares, the cooperative shall distribute any gains from the sale of any appreciated asset to all who were Members while the cooperative owned the asset in proportion to the amount of business done with each, so far as practical. Any remaining assets shall be distributed to current Members on the basis of each Member's sum patronage to the cooperative over the most recent 5 years of the cooperative's operation.

Article 10. *(Select, mark (X) and complete the appropriate item)*

A. ☑ These articles of incorporation may be amended to change the foregoing basis for distribution of assets upon liquidation of the cooperative.	**OR**	B. ☐ Pursuant to sec. 185.033 of the Wisconsin Statutes, no changes may be made to the foregoing basis for distribution of assets upon liquidation of the cooperative.

This document was drafted by West Foster
(Name the individual who drafted the document)

Instructions for Filing:

Article 1

Article 1 asks you to select a name for the cooperative. The name must have the word “cooperative” or an abbreviation of the word, such as “co-op”.

Article 2

Article 2 asks you to select either a "perpetual" existence or a set term of existence. Select “perpetual”. Doing so allows the cooperative to exist until it is purposefully dissolved. Incorporators should only select a set term if the cooperative is meant to be temporary—for instance, if the cooperative is only meant to provide a service to a community until or unless another service provider moves into the area.

Article 3

Article 3 provides a broad statement of purpose for the cooperative. This statement can be left as-is or can be crossed out and replaced with a different purpose. The incorporators might replace the default purpose if the cooperative plans to file for 501(c)(3) tax-exempt status, instead adopting a purpose in line with the requirements of IRC 501(c)(3). For the purposes of a broadband cooperative, there is no need to edit the default statement unless the incorporators want to narrow the scope of the cooperative’s activity to a certain region or service. For instance, a cooperative could narrow its purpose to “Engaging in any lawful activity that furthers the cooperative’s mission of supplying residents of Liberty Grove with high-speed broadband internet.” Such self-imposed restrictions can keep the cooperative true to its original purpose but will need to be undone via an amendment to the articles if the cooperative eventually wants to diversify its services or expand out of Liberty Grove.

Article 4

Article 4 asks you to choose a principal office or a registered agent. If you choose a principal office, the cooperative will be responsible for any legal documents that are sent to that address. If you choose a registered agent, legal documents will be sent to the agent's address and the agent will be responsible for bringing them to the cooperative. Select a registered agent if you do not have a permanent business address. A principal office or register agent may be changed by filing a Form 204-13 with the WDFI for a $10 filing fee.

Article 5

Article 5 asks you to choose the number of initial directors on your board of directors but gives you the option to name the number of directors in your bylaws instead. Amending a cooperative’s articles requires a 2/3 vote from membership and a filing with the Wisconsin Department of Financial Institutions, whereas amending a cooperative’s bylaws requires whatever majority is specified in the bylaws and no filings. Because it is usually easier to amend bylaws than articles it is best practice to select "shall be fixed by bylaw." This selection will make the number of directors easier to change later.

Article 6

Article 6 asks you to designate how many membership classes there will be. You will likely select “all of a single class” unless your cooperative is to be a multi-stakeholder cooperative with multiple types of members, such as a grocery store cooperative where the employees and shoppers constitute two different membership classes.

Article 7

Article 7 asks you to select whether the cooperative will be a stock or nonstock cooperative. Stock cooperatives have a more flexible equity raising structure than nonstock cooperatives. Generally, stock cooperatives start with a single class of membership stock that establishes membership and member voting rights. They can then issue new types of stock as necessary in order to raise capital for start-up and future expansions, as well as to help the cooperative in the face of undercapitalization. Such stocks may be offered to members and nonmembers alike and can include preferred stock, which pays dividends. Preferred stock will be covered in more detail under the capitalization constraints section.

Article 8

Article 8 asks you to determine the number of shares the cooperative is authorized to issue. In other words, what types of equity is the cooperative allowed to sell, and how many of each type? Stock cooperatives will have at least one type of share, the Class A membership share. Members buy one membership share in exchange for membership rights and responsibilities. Many stock cooperatives will have additional types of shares, which give the cooperative a mechanism for raising capital in the future. For instance, many cooperatives have a Class B share that members may be required to buy intermittently as part of their membership responsibilities in order to finance the cooperative. If authorizing stock, the filing fee is $1.25 for each $1,000 of capital stock, unless that total is less than $25, in which case the filing fee is $25. Authorizing additional shares later requires an amendment to the articles.

Article 9

Article 9 requires that you choose how assets are divided in the event of liquidation. In other words, after debts and liabilities are paid, how would the cooperative distribute remaining cash and assets if it were to stop being a business? To maintain 501(c)(12) tax-exempt status, a broadband cooperative must distribute any gains from the sale of any appreciated asset to all who were members while the cooperative owned the asset in proportion to the amount of business done with each, as far as practical. If a cooperative wants 501(c)(3) tax-exempt status, the cooperative's assets must go to another non-profit upon liquidation. In such a case, it is best to put specific language to that effect into the articles.

If the cooperative is not seeking a 501(c)(3) tax-exempt status, assets should be distributed to members based on patronage, meaning members receive distributions proportional to the services they paid the cooperative for.

Article 10

Article 10 asks you to determine whether the division of assets upon liquidation may be amended in the future. Unless the cooperative is seeking tax-exempt status or has another specific reason for doing otherwise, select "A" to give the cooperative more flexibility in the future. Having the ability to change the distribution of assets upon liquidation may help the cooperative attract members and capital.

Article 11

Article 11 will have you select your five required incorporators. It is important to remember that these five people will act as your initial board of directors until a board is elected at the cooperative's first membership meeting and will be responsible for adopting the cooperative's initial bylaws. The board of directors makes decisions for the cooperative, so find people committed to the cooperative who you are comfortable working with and are confident in.

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