Are DAO's and Cooperatives a Good Fit? Linda Phillips, Yev Muchnik and Jacqueline Radebaugh, Jason Wiener PC - E55

Eric: This week on The Encrypted Economy, we're fortunate to have Linda Phillips, Yev Muchnik, and Jacqueline Radebaugh of JR Weiner on the podcast. This firm has really been doing a lot of work with DAO 's looking to constitute as cooperatives. I was so looking forward to diving into this topic with them because there's so much to cover. A cooperative might not be the right structure for every single detail, but is definitely a structure that facilitates decentralization in a blockchain-based ecosystem or privacy-enhanced data-centric ecosystems. Now there's a lot more than this podcast has to unpack for that in future episodes. But in this episode, we talked about the origins of cooperatives' specific use cases of how they are used by DAOs some of their fundamental principles surrounding governance, contributions, and patronage securities law exemptions.

And of course, taxation JR Weiner was so patient with me as I prodded them quite a bit. Regarding how to reconcile the contribution of infrastructure and other critical services. Would they fully decentralized co-op maybe overplayed it, but if you're like me, the notion of patronage-based returns take some conceptual adjustments, they were fantastic.

And I hope their conversation and responses on this facilitate your own. At the time of this podcast, we weren't able to coordinate it with the publishing of their DAO co-op paper that was sponsored by the DAO research collective. But look for that in another week or so.

Welcome to The Encrypted Economy, a weekly podcast featuring discussions, exploring the business laws regulation, and technologies relating to digital assets and data. I am Eric Hess founder of Hess Legal Counsel. I've spent decades representing regulated exchanges, broker-dealers, investment advisors, and all matter of FinTech companies for all things touching electronic trading, with a focus on new and developing technologies.

This is Eric Hess with The Encrypted Economy and I'm so excited to have attorneys from Jason Weiner law firm in Colorado on the podcast. Now we have Linda Phillips, Jackie Radebaugh, and Yev Muchnik on the podcast. And we are here to talk today about cooperatives a hot topic of conversation.

Particularly as people are contemplating decentralized organizations and this group, we have the dream team here and I'm going to let them introduce themselves. We'll start with Linda, then Yev, then Jackie, and then we'll get into it. Uh, first of all, welcome all. Thank you so much for coming on the podcast.

Linda: Thank you, Eric. And this is Linda Phillips, and I am an attorney and based out of Denver, Colorado, I've been working with cooperatives for about twenty-five years, and I joined Jason Wiener, PC in 2011. Jason and I did some work together converting Namaste Solar from a standard limited liability company into a worker co-op and co-ops are, has been my go-to business model for years.

And I look forward to our discussion today.

Yev: Yeah. I'm Yev Muchnik. I went down the crypto legal rabbit hole back in 2016 and have advised a number of companies between then and now whether what their, with respect to their token issuances with their governance models with custody, structuring, regulatory compliance.

You name it. That's kind seeing that the industry mature and it's been really rewarding to stick around for this long. I joined Jason Weiner's firm about a year and a half ago as of counsel and we connected on structuring the first DAO co-op in Colorado called the employment comments, LCA and have, have worked on a number of these alternative.

Organizations, structures, and alternative financing structures have now pulled in Jackie as a very valuable resource as well to pioneer the DAO co-op.

Eric: And Jackie.

Jacqueline: Yeah. I'm Jackie Radebaugh. My background is a little from outside sound. It feels a little all over the place with having practice law in Brazil and Europe before practicing here.

But I focused quite a bit on corporate taxation for a few years before doing nonprofit. And getting into shared ownership off land and real estate assets in Texas with the University of Texas entrepreneurship clinic. And I'm based in Dayton, Ohio. I moved a little bit in between New York, Texas, and then Ohio, the past few weeks.

To help a community base enterprise community-based groups to start their business and run it in a collaborative way where they actually do get to share equity and the profits and the benefits of it as a community. And so I've been doing that for about over four years in Dayton and joined the Jason and farm earlier this year.

So we're getting closer to a year in now, and I have been this best summer collaborating in between the very traditional cooperative work or traditional as far as traditional can be within the conference of practice, but then overlapping some blockchain and that work with new developments.

So it's been really fun and I'm looking forward to talking.

More about.

Eric: Great. So to get into it, and I'm really so excited about this podcast, even though I think I butchered a couple of names, but that's really par for the course of me. So we're right on track. Um, first let's start off with what is a co-op entity.

Jacqueline: I think I'll take about a one. That's always have stuff to add. Relevance has to add, so cooperatives can be business entities. They can be a governance of set of values and principles await that you really do business and organize during price can be a basic set of principles. So we often talk about.

No rush. They are principles that came up in the 1700's in England. The monitor gone principles that kind of is the basis of the multi-tenant co-operatives in his pain. As far as statutory business entities go in Colorado, they can be article 55, we call them AGs and electric cooperatives typically choose that as a business type or form article 56.

Cooperatives many states have adopted a similar, a corporative corporation is tattooed that guides and most cooperatives have adopted them so far. And then article 58 in Colorado, the limited corporates association, that's a flex model in between the cooperative corporation and the LLC model. So we can be ways of doing business and a variety of things.

So it can be a way of really running the business in a collaborative way. So sometimes you're just cooperating and then you're running a cooperative in that sense. So it depends on who you're talking with and whether you're talking about it.

Eric: All right. And Jackie, when you were talking about article 56 in article 58, these are the, I guess, the key articles as it relates to Colorado's cooperative law.

Now, Linda, you know anything about those articles? Were you involved at all with them?

Linda: Yes, I was involved with both of them. Uh, I'll give you a little hint. I'll give you a little history of co-ops. In the United States. I have been, I was lucky enough to work for an attorney by the name of James B. Dean, D E A N, who was instrumental in helping Colorado revise and adopt new co-op statutes in the 1990s that went from the standard. Most states around the United States have agricultural co-op statutes and rural utility cooperative. So your rural electric associations, your rural telephone associations, but many states do not have any type of cooperative corporation, statute and Colorado didn't either for many, many years. And then in the 1990s, mid 1990s, Jim Dean, and a group of other attorneys here in Colorado revised the Colorado AG co-op statute. To allow it to apply to other forms of businesses. And that would be any form of business, whether you're an industrial business retail a commercial operation, real estate, all kinds any, anything that you can form a business.

Under corporate law, you could now form into a corporate cooperative then in the mid two thousands and 2010 from 2005 to 2010, Jim and a professor out of South Dakota, Thomas Gooey who's a law professor up there. We're the two co-authors of the Uniform Limited Cooperative Association Act passed by the Uniform Law Commissioners in 2010.

And then I got to help on a committee here in Colorado to get it passed here in Colorado as Colorado's uniform Limited Quadrant Association Act. And it's been passed in six or seven states, maybe eight states. Now there are a couple of states, Minnesota being one. I think Wyoming being another that had similar.

LCA statutes, limited cooperative association statutes. And I think there's 10 to 15 of them now around the country that are available. Some new ones, the state of Washington just passed a good LCA statute, but even Washington DC has a limited cooperative association stuff.

Eric: Great. And so when we talk about cooperatives, they have some, I think Jackie referenced it.

Some very fundamental principles that apply to them.

Yev: Seven principle cooperative principles are voluntary, open membership, democratic member control, cooperation among cooperatives member, economic participation, concern for community education, training and information in autonomy and independence.

Eric: Great. So hence for cooperatives, what makes them so appealing to the members?

Linda: Co-operatives were formed originally as a self-help organization. Where you have a group of people coming together to help themselves either with purchasing power, with selling power, with manufacturing, power, things that they could do as a group that was much more difficult to do as an individual and the agricultural cooperative community is a good example.

You have a single farmer out there. If he wants to buy fertilizer and seed all by himself, if he doesn't have a co-op to go to, he has to pay higher prices than he would if he went to the co-op when he wants to sell his crop at the end of the year rather than trying to sell it himself. He can sell it through the co-op and the co-op gets better pricing because it's bulk pricing.

So it's a, it's a self-help organization and that's what benefits the members the most.

Eric: Great. So when we think about how cooperatives have developed in the U. S. How would we, how should we think about it in terms of if we were to break them into buckets? Like I know we have, there's the agriculture supply chain.

There's the public utility. There's the worker base. Is that the way to think about the different classifications or are there more that we should be considering?

Jacqueline: Yeah, I'd say that you could, if you want to two big buckets, you can say that you can simply find them by membership type. So you're looking at a producer cooperative.

Those are members, right? The producers aren't members, marketing cooperatives. You have the co-op markets, the member products or services. The purchasing cooperatives, the corporative bulk coordinates, bulk vendors the maybe the housing cooperatives. You have the residents. So you're doing per membership who are the membership classes, and we're seeing a growth and multi-stakeholder membership because you're talking about.

Multiple members of classes, or you can typically find them by sectors, as well. So agricultural cooperatives, the construction corporatism manufacturing sector, we're seeing a growth in tech cooperatives, and those can within them have those classes of memberships that you have workers users, if we're talking platforms, but also focusing on a sector specific, format.

Yeah, for thinking tech, because they're using their platforms so that maybe they're using a website or an online platform for you or those they're adopting tokens. So you can, I think the two big pictures would be from my perspective, membership, and sector types of clots.

Eric: And so when we think about all the changes in technology, which sounds like a loaded statement, but when we think about all the emerging technologies, Where do we see w you know, when you think about it, where do you see natural fits for the DAO structure in, in, in these decentralized economies or even in, in the with some of the new emerging technology use cases?

Yev: Yeah.

So I think it's important to step back and just talk about how DAOs.

Are being formed, how they came to be and what they mean specifically. So I'm at a rudimentary level. Dallas are unincorporated associations. There are people who come together for a common purpose. They can be non-profit; they can be for profit. They can be for investment pulling in capital resources for investment purposes.

Linda: Because

Yev: DAOs are layered on typically the web three layer and utilize smart contracts and essentially code to, to operate and govern themselves. They've, they've emerged spontaneously without any kind of formal legal structure, formal legal wrapper. And a lot of that is really because there is no.

Kind of precise, formal, legal wrapper that it's DAO needs. Exactly. Um, so they have been spontaneously mushrooming as unincorporated associations and treated as general partnerships. And with general partnerships, there are a number of issues that come up that. And the last couple of months have come to the attention of a lot of doubts, which is this unlimited liability that can be imputed to across all of the members.

Some of the tax implications of not paying your taxes. If you are, making distributions out of your treasury or. Even for kind of investment purposes if you are making donations or grants. So these things are, I think that kind of the philosophical pursuit has been there too to create thousand.

These. Communities, internet communities that are that are run democratically, but then all of the lawyers started coming in and scaring, scaring people off about all of the things that can go wrong. Um, our, uh, solution and not even solution, but really what we found to be a real kind of organic fit is as the DAO co-op structure, which is fitting in taking these principles that we alluded to earlier and fitting it into an LCA just because of the values, alignment, that ethos alignment and the flexibility of the LCA structure.

Eric: Great. And you know, when we think about the DAO structures, which DAO structures do you think are actually better suited toward the co-ops like if you have, cause different dials have different purposes, which where do you think it, it naturally fits? One to me seems clearly these.

You pure builder communities where they can collectivize and they can be insulated from, protected from liability to a certain extent, and then they could pay to get paid out for the work they do into it, or artists and simulate contributing into and receiving something from, is that the right way to think about it or.

Is there another way to think, you which towels make, might make sense to, to go the co-op route versus not?

Jacqueline: the way I've been thinking about that. I might need lean this help on the patronage aspect, but it's really thinking about how what's the relationship in between the dowel member with the entity and how that, that the group has an entity generate profits.

So, um, and then. Parlance we call it just the patronage activity is a corporative, provide a service, the member purchases that's patron adaptivity. The co-operative is developing something. As I mentioned with the devas, the workers are part of how. Profit is generated to the entity. They're contributing their hours.

That's their patronage activity as members, as worker members, worker owners. So I think whenever we can define well that relationship and the activities of the members in the cooperative outside of just simply participating in decision-making and simply putting capsule money into it. If you can define their Vivity outside of those, it's probably in my work in my, the co-operative format might be a good one for an in group.

Eric: Great. I'll also share that the other week I was at the NFT NYC conference. And I came upon one of your clients or somebody that you had worked on, I guess I won't share, but the exact name, although I don't think they'd really care. But it was basically one for employment. Basically all the 401k, all the employment services before it, and, You know, what a brilliant use of it, because, particularly for DAO communities themselves or different structures, trying to like to manage, in a decentralized fashion, all these different structures they had built a dowel around it that seemed compelling.

Cause obviously it's something that a lot of communities need and by pooling, you by, by having it within a single co-op structure, they can all I guess con contributed some services or otherwise, and also benefit.

Yev: So this is all bliss and the employment commons. And so we collectively help them find the appropriate legal and technical framework and found that the LCA, which is the best suited.

But I think, I do think it's worth doing a little bit more of a deep dive into how that particular Delco is structured. And they have, They're sort aggregating, as a producer, services co-op and so they're aggregating and utilizing collective bargaining power to obtain better pricing for benefits and healthcare for their members.

But there, their membership structure is actually multi-stakeholders. So they've got an employee member of class. They have a coalition member of class. And each sort of interact with the co-op in different ways where the employee members used the services of the co-op and, and earn P in patronage through what they call payroll mining.

They've got a formula for their token omics, which is based on how much payroll is mined and how many eat walks are kind opened up based on the volume of payroll. Um, They are patronage is represented through the work token which is, can be staked or distributed to

Linda: the members.

Eric: Maybe we should just break out, you know as we start to talk about the interactions with and even otherwise some of these, some of these core underlying principles such as, one member one vote.

Linda: What the fundamental principle is democratic governance. Most co-ops, I would say 99 then maybe not that high 95% of them, it is one member, one vote, but the statutes, both the cooperative corporation statute, as well as the LCA statute here in Colorado, allow you to vote based on your patronage activity with the.

And that's why patronage and defining what is patronage is so important. And the co-op some of the statutes also allow you to vote based on your equity in the co-op and how much equity you have in the co-op. So there are different voting structures that you can do with the co-op, but the majority of them currently are one member, one.

Eric: In the context of patronage it doesn't raise decentralization concerns because that's sort you know, you would argue that's sort the essence of, of decentralization. But when we talk about the notion of equity, because I think it's article 58 has more flexibility to allow equity members to the extent that equity members are allowed You know that they have different voting rights.

Does that start to change the nature of the cooperative or potentially even at state securities exemption status,

Linda: the investors uh, investor members and LCA, um, are not exempt from securities registration in either the state of Colorado or on a federal level. It is only the membership stock that is exempt from registration.

And exempt from securities regulation. So if you have investors coming in and you can have investors in a cooperative corporation as well you issue preferred stock in a cooperative corporation, as well as an LCA, but in an LCA, the member investor members do have the right to vote on various matters that come before the membership, there are specific.

Steps in the statute and provisions that say that the investor members can never have majority. Control of the voting rights or in the financial rights of the entity. So it's always the patron members, the members that use the co-op on a daily basis that have the majority of governance rights in

an LCA.

Eric: And so shifting to patronage, cause I think patron did the definition and what is, and isn't patronage is obviously becomes very important when you're structuring a co-op. I guess just a couple of questions. Like when people contemplate, Hey, do, is this ma there's a model that we're contemplating one that actually has something that's patronage.

Like how I do, what is patronage providing the platform like as a licenser is patronizing. Doing other things and then having the members food on it. Like I obviously, there may be some interpretive questions surrounding patronage. Anybody want to take a crack at that one? Jackie?

Jacqueline: I was hoping you'd take the relieve me from that one.

Linda: I'll add on to you.

Jacqueline: Yeah. Um, so I mentioned it's the, essentially the action or the activity of providing, buying from the cooperative or providing services to the cooperative So the patronage itself would depend on what type of cooperatives are talking about. So think of a grocery store it's a consumer cooperative typically, or at its core, you could be maybe a worker as well, or multi-stakeholder if we're thinking about the worker owner is off that grocery store, their page on objectivity is providing hours would typically be providing them.

I've worked to the cooperative their consumer members, their patronage activity. We'll be purchasing from the cooperative, the goods, and services that the cooperative group buys. So grocery store then providing groceries, the members patrons will be buying and that's their patronage activity. So we'll really be relating to that class of membership activity.

That's engaging, but essentially providing or acquiring goods or services from it. Linda.

Linda: I like to look at it at as how a member uses the co-op. If it's, if you're talking for example about a platform co-op the members' use of that co-op is how much they get onto the platform, how much they use the services that the platform is providing that is, is the patronage that, that they are using.

If it's a, it's a marketing co-op it's a group of artists and they want to market. They want to own an art gallery and market their art through the co-op. Their patronage could be how much rent that they pay for the co-op to, to rent this gallery as well as perhaps a percentage of the sales of their art through the gallery.

So say they take two to 5% of their sales goes off of the sale of their piece of art. And it goes to the co-op. So patronage is very, very specific to each type of co-op. So you have. Not just the industry. But how the people that are going to be the owners of the business because they're not just members in terms of governance, they actually own the business.

So how as owners are they using that business?

Eric: Let's say that in the context of an art gallery one of the members of the cooperative bought out a space. In this case, it's aligning with a technology platform, but we'll stay with the we'll stay with the physical sense because that's where he went.

I bought out the space and then I lease it to the co-op and or maybe I lease it for a discount rate and the remainder of it. I want to be reflected as patronage. Does that work?

Linda: You as the art gallery landlord would have to be in a separate class of membership because all of the other members are paying you rent.

And or they would be paying the co-op rent and the co-op would rent from you. You would just be the landlord. So in that sense, generally, no, you would not even be a member of the co-op because the purpose of the co-op is. To rent space from the co-op and to sell their art through the co-op. And if the co-op owned the building, that would be one thing.

But you as an investor, no. Now you as an investor could come in and invest in this art project and be a silent investor. And yes, that would be your patronage would be how much money that you put into the.

Eric: Okay. So the, the value to the extent that I'm donating something to the co-op, that could be reflected in the patronage.

So in inequity, or let's just say that so I'm going to, I'm going to play with this one a little bit, cause because you gave it to me. So, so. The whole bunch of us got together. We all love to pink, and we say, let's get this space. And I'm like, listen, guys, you're doing a lot of painting. I'm going to get this gallery.

I'm going to just, I'm going, just going to contribute it to the co-op. Let's just say that. Very generous. I decided to give it to the globe. Everybody says, whoa, Eric, that's really super nice here. You, because you're doing that and you're painting, we're going to give you, we think your patronage values should be a little higher well, yeah, but I want to be an investor because I don't, all that security stuff, I just, I'm just a painter with an art gallery.

Does that fact pattern fly with I'm given? So I'm like, I'm a contributor. I'm part of the whole. Yeah, but you don't want to be an investor.

Linda: You don't want to return on your money.

Eric: I, in the form of patronage only, right? You know, because of this art gallery, people are going into her, they're laying out megabucks and the whole place is everybody can send a fitting because I got a great in a great spot of town.

Right? Let

Linda: let's, let's call it token say so you're given 500,000 tokens for your contribution of the gallery to the. What are those tokens, get you?

Eric: I actually frame it a little differently. Because another principle of co-ops, which we also get it, there's so much to do on this episode. This is great.

I love it. So, um, another principle co-ops are this notion of you don't have this retained equity interest, right? Like you, if you're an investor, you can say I own 30%, but let's just say that the way we want to construct it is really on an annual basis. So let's say next year that the co-op says.

Nice try on the gallery, it was a nice part of town and then they put up the supersonic railway near it and nobody went to it anymore and it's worth nothing and good luck with it. I don't think dang it. All right. Whatever. And so maybe it takes me a couple of years and I find another beautiful place.

And I convinced everybody like, Hey, this is the greatest place. And they're like, okay. But the notion being is that my return on this art gallery. Is limited to the patronage that it is contributing to the co-op on an annual basis. So if it does great one year and next year, the members say, no, that's not really worth anything.

Okay. That kind of stinks. But I don't, I can't say, Hey, I own 35% of the co-op come hell or high water. I'm based on a year to year patronage, and now I'm way up. We're way out of my depth here, a patronage assessment, I'm sure. Minnesota thinking. Did he just say patronage assessment? Yes, I did.

Yev: As with any other kind of corporate entity, you can contribute non-cash assets, right? In exchange for your membership interest. And potentially I would imagine for tracking kind of a larger portion of patronage as well. So Linda and Jackie, I'll let you jump in on that one. I do want to talk about.

The other securities issues in a little bit too, but all of the patronage assessment topics covered here.

Eric: You could change the word anytime you want.

Jacqueline: The only thing I want to say about that is that if you want to be an investor and make an investment and not have it being treated as a security, you might need to rethink what your, what is your relationship with the business?

Because not being a cooperative or another legal entity, if it is an investment, it is going to be treated as investment in being that cooperatives, not going to prevent it from happening per se.

Yev: I guess maybe it is worth introducing this concept of a number of the jurisdictions have securities exemptions built into the incorporation and securities kind of qualification of the, the law, the cooperative laws.

So if you're buying in as a member for example, the color Colorado statute, Specifically exempt that as a security. You know, the specific or the exact.

References any security issued or sold by a cooperative association as an investment in its shares or capital to the members is exempt from securities laws in Colorado.

And if you are, and that's at the state level, at the federal level that has also been confirmed in, you know, Housing Foundation vs. Foreman, which set a three-prong test on the restrictions on transferability and expectation of profit and that voting is based on one vote, one member, one vote.

So again, looping that into the conversation and trying to untangle that from being a pure investor with an expectation of profit that meets the Howey test and then being a member. That is contributing something to the co-op and is also utilizing the co-op on a patronage basis or different

Eric: I think what you're telling me is there's no simple answer. I got it. All right. But, uh, no good point. So obviously, maybe the answer is, it depends. And so. And, and so this kind of gets to what exactly is, what can be patronage, like what would be deemed to be patronage in that context, is it, you do it have to be some sort of more uniform understanding of patronage, that all the members can participate in or, you know, can it be different for a specific contributor?

They're unique contribution.

Linda: You can create classes of membership. And I think that's what you're trying to do is, is for you, as the contributor of the platform is create a plan, create you as a separate class of membership than other members and your contribution of the platform to the co-op would be your membership interest.

Is that, is that the question or did I misunderstand

Eric: Well, I think it, it goes to, you if the intent is to and I mean, if there is no concern about the securities exemption, then arguably it really shouldn't matter. Because if I'm an investor and I want to invest in an insurer it's, it's an investment.

I, I find that. Reg D exemption, and, and I'm done with it. I don't have, all that many, that much more concerns because of it. But if the notion is it's you know, we ultimately, we being the cooperatives don't want to raise any securities laws issues whatsoever. We really want to run this has a patronage based system and it.

And, in a way that sort of meets to checks the box so that we don't have to worry about being recharacterized as security for potentially issuing the way that we're awarding or recognizing patronage in the platform, which might be tokens. I guess that's, that's the fundamental question that I think I have in, and probably a lot of people who are looking at co-ops and trying to figure out how it fits for them also might have.

Jacqueline: And then, that addresses that directly, but it does answer it. Or maybe I want to give an example of Dell LC that I just recently formed that touches on w how you're describing yours. Uh, Sunga DAO well, has given us permission to talk about them. It's essentially a consumer co-operative with founder.

Put this together, worked with. So they don't have a really large team yet, but they have people interested in participating, has a couple of classes off consumers. They, the founder provides songs to the co-operative, the co-operative mint NFTs of those songs. And sell it to the members and the members, patronage activity is just purchasing those NFTs, purchasing some rights to those songs.

One the cooperative, the corporates will receive revenues from that sale from the membership participation, right? And then from all varieties as little song, the songs get heard here, it's essentially a consumer co-op because the founder himself did not want a specific class or with return. Given or due to the founder is status.

As somebody, somebody that provides songs provides the goods that would be then sold by the corporative. But they could, and in that case that founder's patronage activity per se, would be providing the songs. And the more songs they provide, the more patronage refunds or rewards or dividends they wouldn't be receiving for that.

Potential with the payment for the providing that and on the members side just kind purchasing those MSTs and to your point with patronage assessment, we actually started using a patronage token. We're calling it for that. That's just a unit of accounting that we're using that they have adopted to count or to trace the patronage activity of the members.

So that is not a money representation per se. They're using pull apps, I believe to count, know how the member is activity and then just used for, you have this one token doesn't have interesting value. And so here, there isn't there may be an opportunity for investors at some point where there isn't until the securities aspect, hasn't been a huge deal or a big problem at all.

But if the show you, I think from my perspective, No, the relationship with the founder or somebody that provides value to the cooperative or the valid entity, that it can be flexible too. So he could be considered maybe an investor if that was the wish at the beginning they could have been a member as a member of class that has no additional voting rise or retirement.

Or just patronage activity like another member, but just traced or assessed to different based on that interaction that, that is providing the goods to the competence. And I hope that helps in liquid.

I think

Linda: one of the, I think one of the issues, or one of the, I'm seeing a stumbling block that I think I can clear up is that an investor makes a one-time event.

And, or a one-time contribution or a onetime, they give the co-op something whereas a patron member, somebody who patronizes the co-op, it's an ongoing everyday relationship with the co-op. So for example, the founder or you with your art gallery example may come in and contribute the art gallery to the co-op, that would be considered an investment.

Patronizing the co-op so that, um, they might charge, if you want to try and make it into a patron situation, instead of an investment, there might be annual fees, not an assessment, but annual dues or administrative fees that are charged to you as the member. But that doesn't make sense in a.

On a co-op basis because generally the investors come in and say, okay, I'm going to contribute $50,000. And this is the return that I want. There is no patronage, they don't patronize the co-op in any other way, other than giving the co-op something, whether that's goods, whether that's money, whether that's their time and services.

There's no additional patronizing of the co-op that the investor has.

Eric: Great. Does that help? It does. And, and I don't want to stick on a too long because I think you've explained it very well. And I think you know, one question I have in terms of patronage where the, where the patronage value isn't clear, do the members get to vote in assigned.

Patronage

Linda: or does the IRS get to vote

Eric: for the IRS? Get the virus always gets a vote. The only thing that we're sure in this world is death and taxes. That's what Ben Franklin said, but you know, what is, um, where it isn't as a hundred percent clear, like if you can clearly identify the value that patronage that's arguably easy, but where it isn't You know, let's say that there's evaluation based on expertise.

That's different, than just simply a task performed. How, how is that determined? Does that sort of at odds with the notion of a co-op?

Linda: a good example of that is a worker co-op where their patronage is based and the, and their share of patronage refunds, w which I like to call them instead of dividends, because they are refunds of the work that has been done.

Is that instead of using just ours, that some worker co-ops have created formulas that include seniority that include job description, as well as hours worked to determine what the patronage was of that particular employee. So employee worker, owner. So yes, there are other ways that you can.

Define patronage. And it is something that you usually do at the beginning. And the creation of the co-op is figuring out how are we going to determine

Eric: patronage? So going back to my art gallery, but I'm not going down the same road this time, but going back to my archives, as you can, like he's obsessed with art galleries.

So I go back to my art gallery. I am. I donate my art, just like every other artist in this co-op for this art gallery, somebody walks in and says, this painting is amazing. Basically makes a year for the co-op huge amount of money. Everybody comes back and says, okay, this is how much you contributed. You painted X here's yours.

You painted X years. You're paying an expert. Hold on. Sorry. I'm the one who sold the people equivalent for, nine figures. Sure my patron has to be worth more.

Linda: And it would be worth more. Uh, you were paid by the co-op for the work that you contributed, but your work created a profit and it's the profit that is used to calculate the refund at the end of the year.

It's not. How many, if my salary, as the janitor versus my salary as the president, it's going to be totally different salary. But if the president only worked half time this year, and I worked overtime, I'm going to have a bigger share of the patronage. Cause I CRE I produced more hours. Does that make sense?

Eric: Sure. Let's say though that at the beginning, hi, I always make it more difficult on, I let's say at the beginning, we all sat down, and we said, you know what? This is, we love the idea of just like you work, what will lock, how much everybody takes the time to paint, and you know how quick itself, and we have all these little metrics, but it's not perfect.

Nobody ever figures this guy comes in for nine for nine figures and picks up this. And so we look back and we, we look back at the structure of it. It doesn't align, it's like, whoa, Did the members get to say, okay, we're going to have a phone.

Jacqueline: I'm just thinking about all those new alternative scenarios where they're really good.

You know, in real life are still going to have to trace all that. So, uh, some people. Yeah, come for us for weighted average. Let's count how many years you've given and then your seller. And then the, your description of all of that. Somebody is going to have to trace that in a spreadsheet or some more updated version of that is going to be hard.

So why make it harder when you can simplify and having a proportionate proportional might be a one simple way you receive proportional to what you've put in versus. The whole balance of things, you can attribute different weights and it's fine, but how in practice you have that work? I think it's important to at least consider.

Eric: Uh, a great answer and swaying into another question, which is what are some of the problems that a co-op might encounter? What are the challenges of a co-op that maybe don't exist? They're unique to co-ops or maybe more unique to ACOs that don't, that may not exist in other structures.

Linda: Yeah, one, one big one is member participation, and I don't mean participating on a day-to-day basis, but participating in the management and operation of the co-op think of a credit union credit unions are as a form of co-op it's a member owned organization and.

The majority of them, Mo most of the people that become members of credit unions don't understand that they are owners of the company that they own that credit union, and that they have a right to participate on the board of directors. They have a right to participate in guiding the direction of the entity and so larger co-ops with hundreds of members.

That's one of the things.

Eric: Great. And I guess also in my example, if you're trying to correct the patronage allocation, you may not be able to get all the members to agree. Which goes back to Jacqueline's point. You better think about it ahead of time because it may not be as simple as getting together and saying, Hey, we have to allocate.

Linda: It's much easier if you only have 10 or 15 members versus several hundred members

Yev: and you have to you actually have the same problem in large down networks as well. So if you've got DAOs of hundreds or thousands of members, you have this governance bottleneck I know that Uniswap had sent their corum at 4% and have yet to read.

That quorum percentage and pass any kind of votes and their doubts. So that's definitely tracks with kind of large member-based organizations across the board

Jacqueline: to your point with the patronage as well with the platform cooperatives. What we've been struggling a little bit, is finding how to even trace that.

How do you keep track of the activity that's done online as well? I think it's going to become a big deal.

Eric: Right. Definitely. Definitely a challenge. One of the things that we talked about it in the context of the DAO is membership fees. You know, if you pay a membership fee to join the down can that appreciate in value

Linda: generally no.

Eric: That was quick. That was a quick answer.

Yev: And that's why, and that's why sometimes it makes sense to bifurcate uh, the kind of digital token representation of membership versus patronage. So you would have, for example, membership representative and an Ft, whereas patron is either the native token of the doubt, or some kind of a

Linda: separate token.

That's why it's outside. Security's regular. Because it doesn't appreciate and value, and there is no expectation of return, a farmer that paid $25 for a co-op membership back in 1950, when he leaves the co-op, he's going to get $25 back. He doesn't get any more than that.

Eric: How about things like member alone?

Can another member earn a yield on money that are lent through the co-op?

Linda: And of course that's just a lender relationship. Even if the, there has to be disclosure to the other members that this member is lending money to the co-op and there has to be approval of that loan. But other than that, it's just a long,

where do you find misalignment in what people?

Eric: Think that co-op is going to mean for a DAO versus what it actually means for a DAO.

Yev: It's a good question. I think that typically, if people are coming to us they've decided that they want to be compliant, that they want to find a way to limit liability across the members that they want to find a way to pay their taxes that they want, because they're looking at.

Different kinds of structures that are out there that, that make sense for them, whether it is a co-op or not. We also do a lot of consulting on maybe soloing. Legal the proper legal entity structure from different functions of the DAO, whether it is, the treasury should rest in an LLC or an unincorporated non-profit association, whether the governance protocols should really rest in the doubt.

Co-op whether it's, it doesn't make sense for everything to be combined under one umbrella.

Eric: Great. And one of the things, one of the benefits, I think that the co-op structure gives for membership is fluidity of many. You know, oftentimes when we, one of the reasons why a lot of doubts, one of the reasons that they remain unincorporated is because it's a very fluid membership structure.

People, it's hard to know who's a member necessarily people come in, people come out co-op arguably, addresses that because it ultimately boils down to patronage and participation and that sort of axes by design as a vehicle to manage the fluidity. Is that what you find?

Jacqueline: I think if that's how you define it and the bylaws potentially, right? So you see, you usually sign up to be a member and you have activity. You're not necessarily going to not be a member because you don't have activity. You are not. A patron injures return or refund if you're not a member, but if you're not producing activity various to a member what some groups I've seen do isn't for lack of activity, could no longer be a member.

The cooperatives essentially decides that unilaterally, if you haven't engaged in an activity or participated for a year or two or more we're just going to clean up the files whenever we get to it. And that's fine.

Eric: Is pseudonymity consistent with a co-op structure, like where members are synonymous?

I'm not going to go to anonymity cause that might raise other issues, but as soon pseudonymity consistent or inconsistent or too hard of a question?

Linda: I was thinking of in terms of, I always go back to the

IRS.

Eric: Yeah. That's why I took off anonymity.

And cause

Linda: the IRS requires if there is a profit if the entity is a for-profit entity and there is a profit and there is a tax return.

Then part of that tax return is an allocation of the profits to the members, and you have to have a social security number or some kind of tax ID number to get to the IRS.

Eric: And so the D so on an annual basis, what would be the w what do co-op members. Get like LLP. You have a K one. If you're a corporation, you don't, you might have a 1099 for a specific contributions, but w what does that look like for a cooperative or does it just dependent on the election?

Linda: If it's a subchapter T taxed, co-op you get a 1099-PATR stands for patronage, just like a 1099-div or a 1099-IMT it's 1099-PaTR. And at least, and it shows your entire allocation of profits. At least 20% of which had to have been paid to you in cash

Eric: 20% has to be paid in cash?

That's interesting. So, uh, Tether doesn't count?

Linda: I don't even know what Tether is.

She's not

Eric: even going there. The answer is no. And so, so for the cooperatives themselves there's, it's, from my understanding, there are you know, you could be taxed under two different regimes

Linda: A co-op can be taxed as either a C Corp or a subchapter T Corp or as a partnership.

You can have partnership taxation in co-ops, at least in NLC co-op and how it's tracked is that, again, it goes back to which how the revenue is generated by the co-op. Is the revenue generated by the members or is the revenue generated by non-members? If it's revenue generated by non-members, then it's taxed to the co-op at corporate tax rates.

Revenue generated by the members is, uh, profits are allocated to the members, and they get their K their 10 99 PATRs and that is deducted at the co-op level.

So we are at time. I want to thank you all for coming on the podcast. This was great. Great to have the dream team setting me straight on some things and providing education to the listeners.

Eric: So thanks so much.

Linda: Have a great day.

Yev: Thank you Eric.

Jacqueline: Been a pleasure. Thank you.

Eric: Now, Jacqueline came back after the podcast to clarify a taxation point as noted cooperatives can be taxed as C corporations, pass through entities, or under subchapter T, which is a co-op specific tax treatment effectively, a combination between a C Corp and a pass through. See, under subchapter T the profit generated by non-members in the amounts retained by the cooperative, are taxed at the cooperative level like a C Corp, but the surplus generated by members in which is distributed is taxed only at the member level. This surplus could be tax distributed in cash, cash equivalent, notices of allocation, and unqualified notices of allocation. If the distribution is by notice of allocation, the co-op must pay at least 20% in cash or cash equivalent. Otherwise, it'll have to advance the taxes on behalf of the member. .