

**EMPLOYEE-OWNED COOPERATIVES—A NEW ALTERNATIVE**  
**AND DRAKE LAW SCHOOL ET CLINIC LEGAL SERVICES**

*An employee-owned cooperative (“EOC”) represents an innovative and viable form of worker-ownership based on principles of democratic governance and equitable income distribution. As a distinct legal enterprise, EOCs are uniquely structured as employee-owned, employee-run, and employee-serving businesses. With an estimated 79-81% of small business owners planning to exit their business in the next 10 years,<sup>1</sup> a transition to employee ownership is a proven strategy for business owners to preserve their legacy and receive market value for their investment. Sellers of businesses converting to the EOC form can avoid current recognition of gain on the sale if the transaction is structured properly.<sup>2</sup> Additionally, cooperative tax treatment benefits exist when such entities are properly organized and operated on a cooperative basis.<sup>3</sup>*

*An EOC as a succession option for locally owned businesses is relatively new in Iowa but gaining popularity in other states. Iowa has one identified EOC which is a specialty coffee business in Ames, Iowa, ZLM LLC a/k/a Morning Bell Coffee Roasters. In comparison, across the United States approximately 500 worker coops or democratic workplaces exist, variously organized as corporations or limited liability companies or pursuant to a specific state worker’s cooperative statute.<sup>4</sup>*

*An EOC is not currently expressly defined or governed by an independent authorizing act in the Code of Iowa. However, current Iowa law governing business organizations, including Iowa Code Chapters 489, 490, 499, 501, and 501A, is each adaptable to serve as a legal framework for the creation of a range of types and sizes of EOCs. Primarily premised on its flexibility, Iowa’s Uniform Limited Liability Company Act, Chapter 489, is the preferred legal framework for the Iowa EOC.*

*The key is structuring the LLC as a membership organization for the mutual benefit of its employee members and incorporating core cooperative principles focused on democratic governance and equitable income distribution. More specifically, three primary features incorporated into a typical operating agreement distinguish an EOC LLC from a conventional LLC. First, membership eligibility should be primarily limited to the entity’s pool of employees. Second, governance should be by the EOC’s employee members based on “one person, one vote.” Third, the EOC profits should be equitably distributed based on patronage, which in the case of an EOC, is determined by some measure of labor provided. These primary features may be adapted to the needs of a specific business, but as cooperative principles must serve as the building blocks for the foundation of the organizational and operating documents of an EOC LLC.*

*Drake University Law School, through its Entrepreneurial and Transactional Law Clinic (“ETC”), as part of a focused collaboration with the University of Northern Iowa through AdvanceIowa and the Iowa Center for Employee Ownership and supported by The Governor’s Empower Rural Iowa Initiative, is working to raise awareness and share standardized knowledge for employee ownership with Iowa legal and financial professionals serving retiring Iowa business owners and innovative Iowa employee groups. To that end, model EOC formation and organizational documents are available for distribution from the ETC. Additionally, the ETC is committed to providing free, direct legal service to any qualifying small to medium-sized businesses owners in rural Iowa communities considering employee ownership or simply seeking legal advice for the structuring or transitioning of their business. For more information, visit the ETC website at*

*<https://www.drake.edu/law/clinics-centers/clinic/transactional/forprospectiveclients-transactionalclinic/>*

*or*

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<sup>1</sup> See <https://my.exitplanning.com> (last visited April 3, 2024).

<sup>2</sup> See I.R.C. § 1042.

<sup>3</sup> I.R.C. Subchapter T, § 1381 *et seq.*

<sup>4</sup> See [Find a Worker Co-op – U.S. Federation of Worker Cooperatives \(usworker.coop\)](https://www.usworker.coop/) (last visited April 3, 2024).