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## Organizing Cooperative Associations in North Carolina

EDITOR'S NOTE: the following is based on a review of the North Caroling General Statutes in effect as of October 7, 2011. The recipient of this information should be careful to be aware of any legislative changes that may occur in the future.

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### Cooperative Associations Formed Under N.C.G.S. Chapter 54, Subchapter IV.

Scope: Numerous publications are available through various governmental, educational and private organizations and through their respective websites pertaining to the rationale for forming cooperatives and tips for effective pre-formation planning and the eventual organization or incorporation. This brief article is an attempt to summarize the specific statutory requirements for the formation and operation of cooperative associations under North Carolina law as contained in the North Carolina General Statutes, Chapter 54, Subchapter IV, Articles 16, 17, & 18.

#### Article 16: Organization of Cooperative Associations

The laws related to the organization of a cooperative association in North Carolina are found in Chapter 54, Subchapter IV, starting at Article 16 of the North Carolina General Statutes. Pursuant to these statutes, a minimum of five persons is required to form a mutual association, society, company, or exchange, for the purpose of conducting any agricultural, housing, horticultural, forestry, dairy, mercantile, mining, manufacturing, telephone, electric light, power, storage, refrigeration, flume, irrigation, water, sewerage, or mechanical business.<sup>1</sup> Five or more persons may also associate for the purpose of purchasing, maintaining and using fire-fighting equipment.<sup>2</sup> In addition to the preceding functions specifically enumerated by statute, N.C. Gen. Stat. § 54-111 also recognizes an association of five or more persons for “any other lawful purpose...”<sup>3</sup> Although a minimum of five persons are required to form a cooperative association under this subchapter, there is no upward limit once the five member threshold is met.<sup>4</sup> Furthermore, shareholders in any corporation formed under this subchapter are not

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<sup>1</sup> N.C. Gen. Stat. § 54-111 (2011).

<sup>2</sup> *Id.*

<sup>3</sup> *Id.*

<sup>4</sup> *Id.*

personally liable for the debts of the corporation.<sup>5</sup> Agricultural organizations formed under subchapter IV are required to have its members be producers of agricultural products, handled by such organizations, or by organizations owned and controlled by such producers.<sup>6</sup> If a corporation or association that has been formed under this Subchapter is organized for profit, it is prohibited from using the term “mutual” in its name unless it has complied with the provisions of this subchapter.<sup>7</sup> In addition, any corporation violating the provisions can be enjoined from doing business under such name by any shareholder of any association legally organized under this subchapter.<sup>8</sup>

An initial step in the process of forming a cooperative association is to have the individual organizers execute written articles containing the name of the association, a statement of the purpose of the organization, the names and residences of the persons forming the association, and a designation of the city, town or village where its principal place of business will be located.<sup>9</sup> The articles must also state the amount of authorized capital stock, the number of authorized shares, and the par value of each.<sup>10</sup> The original articles of incorporation filed under this subchapter are then filed with the Secretary of State.<sup>11</sup> An alternative to filing the original articles of incorporation with the Secretary of State is to submit a true copy, verified as such by affidavits of two of the signers of the articles.<sup>12</sup> The next step is to obtain a verified copy of the articles of incorporation and a certificate of the Secretary of State, within 30 days of such filing and acceptance, and file these documents with the register of deeds in the county of the cooperative associations’ principal place of business.<sup>13</sup> The legal existence of the corporation formed under this subchapter will not have legal existence until the time that the articles of incorporation are left with the Secretary of State for recordation.<sup>14</sup> It should be noted that the statute does not require the act of actual recording by the Secretary of State to commence the corporate existence and the mere leaving of articles with the Secretary of State will suffice for the purpose of starting the corporate existence.<sup>15</sup> The filing fees that must accompany the filing of the articles of incorporation are found in N.C. Gen. Stat. § 54-115 and should be checked at the time of filing to insure compliance with the correct amount.<sup>16</sup>

Subchapter IV as it relates to the formation of cooperative associations also requires that the corporation make bylaws at the time of making the articles of incorporation.<sup>17</sup> The statute provides specific items that must be a part of the bylaws and are as follows:

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<sup>5</sup> N.C. Gen. Stat. § 54-113.

<sup>6</sup> N.C. Gen. Stat. § 54-111.

<sup>7</sup> N.C. Gen. Stat. § 54-112.

<sup>8</sup> *Id.*

<sup>9</sup> N.C. Gen. Stat. § 54-113.

<sup>10</sup> *Id.*

<sup>11</sup> N.C. Gen. Stat. § 54-114.

<sup>12</sup> *Id.*

<sup>13</sup> *Id.*

<sup>14</sup> *Id.*

<sup>15</sup> *Id.*

<sup>16</sup> N.C. Gen. Stat. § 54-115.

<sup>17</sup> N.C. Gen. Stat. § 54-116.

1. The name of the corporation.
2. The purposes for which it is formed.
3. Qualifications for membership.
4. The date of the annual meeting; the manner in which members shall be notified of meetings; the manner of conducting the meetings; the number of members which shall constitute a quorum at the meetings, and regulations as to voting.
5. The number of members of the board of directors; powers and duties; the compensation and duties of officers elected by the board of directors.
6. In the case of selling agencies of productive societies, regulations for grading.
7. In the case of selling agencies or productive societies, regulations governing the sale of products by members through the organization.
8. The par value of the shares of capital stock.
9. The conditions upon which shares may be issued, paid in, transferred, and withdrawn.
10. The manner in which the reserve fund shall be accumulated.
11. The manner in which the dividends shall be determined and paid to members.
12. Associations, societies, companies or exchanges, organized hereunder to engage in telephone or electric light business upon a mutual basis, shall adopt a bylaw limiting the patrons and subscribers to members of the association.
13. In the case of apartment housing, regulations governing the rental of apartments.<sup>18</sup>

All cooperative associations formed under this Subchapter are subject to the general corporation law or the general non-profit corporation law of North Carolina, unless otherwise provided by Subchapter IV.<sup>19</sup> One such provision is that any corporation or association formed under this Subchapter that is doing business in North Carolina cannot deal in the products of nonmembers to an amount greater in value than the amount of product that it handles for its members.<sup>20</sup> Another restriction on organizations formed under this Subchapter is that no housing corporation or association is allowed to rent to nonmembers for a period of more than 90 days.<sup>21</sup>

Subchapter IV also allows for a pre-existing organization to avail itself of its provisions if the president and secretary execute and file with the Secretary of State, a written declaration to the effect that their mutual company or association has, by a majority vote of its shareholders, decided to accept the benefits of and be bound by the provisions of Subchapter IV.<sup>22</sup>

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<sup>18</sup> *Id.*

<sup>19</sup> N.C. Gen. Stat. § 54-117.

<sup>20</sup> *Id.*

<sup>21</sup> *Id.*

<sup>22</sup> N.C. Gen. Stat. § 54-118.

Cooperative associations formed under Subchapter IV are subject to the provisions related to license taxes as found in Article 2, Subchapter 1 of Chapter 105 of the North Carolina General Statutes and franchise taxes as found in Article 3, Subchapter 1 of Chapter 105 of the North Carolina General Statutes.<sup>23</sup>

#### Article 17: Stockholders and Officers

Certificates of stock for cooperative associations formed under Subchapter IV cannot be issued until fully paid but if the bylaws so provide, a subscriber can be allowed to vote as a shareholder if any portion of the stock subscribed for has been paid in cash.<sup>24</sup> An individual shareholder of a cooperative association is prohibited from owning shares in excess of twenty percent (20%) of the paid-in capital stock and each shareholder is limited to one vote.<sup>25</sup> A cooperative association is required by statute to reserve the right of purchasing the stock of any member whose stock is for sale and may restrict the transfer of stock to persons that are made eligible to membership in the bylaws.<sup>26</sup>

Cooperative associations created under Subchapter IV are allowed the flexibility of purchasing the business of another association or person by paying for the purchase, in whole or in part, by issuing to the seller shares of its capital stock in an amount that at par value would equal the fair market value of the business being purchased.<sup>27</sup>

Subchapter IV allows for an absent member to vote at any regularly called general meeting or special meeting of the shareholders with certain limitations and by complying with certain provisions.<sup>28</sup> The requirements to allow such absentee voting are that the absent member must have been previously notified in writing of the exact motion or resolution being voted upon and a copy of this notification is forwarded and attached to the vote that is mailed by the absentee voter.<sup>29</sup> In addition to this type of absentee voting, a member who is unable to attend due to sickness or other unavoidable reason is allowed to vote by proxy in writing, but no member shall vote more than one such proxy.<sup>30</sup> The statute is silent as to what constitutes an “unavoidable absence” and the one time only proxy vote due to sickness or unavoidable absence is to be distinguished from the absent member voting that requires the written notification of the exact motion or resolution that is being voted upon with a copy of same being returned with the mailed in vote.<sup>31</sup>

Management of a cooperative association under Subchapter IV shall be by a board of not less than five directors who are elected by and from the stockholders of the association pursuant to the provisions contained for such election in the bylaws.<sup>32</sup> A director’s term is for the time of the term as specified in the election and until their successors are elected.<sup>33</sup> A majority of the stockholders can, at any legally called regular

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<sup>23</sup> N.C. Gen. Stat. § 54-118.1; N.C. Gen. Stat. § 54-118.2.

<sup>24</sup> N.C. Gen. Stat. § 54-119.

<sup>25</sup> N.C. Gen. Stat. § 54-120.

<sup>26</sup> *Id.*

<sup>27</sup> N.C. Gen. Stat. § 54-121.

<sup>28</sup> N.C. Gen. Stat. § 54-122.

<sup>29</sup> *Id.*

<sup>30</sup> *Id.*

<sup>31</sup> *Id.*

<sup>32</sup> N.C. Gen. Stat. § 54-123.

<sup>33</sup> *Id.*

or special stockholder's meeting, remove a director or officer for cause and fill the vacancy at that time.<sup>34</sup>

The officers of the association are elected on an annual basis by the directors and each officer must be a director of the association.<sup>35</sup> An association under Subchapter IV is required to have a president, one or more vice-presidents, a secretary and treasurer or a combined secretary-treasurer position.<sup>36</sup>

#### Article 18: Power and Duties

A majority vote of shareholders at any regular shareholders' meeting may amend its articles of incorporation.<sup>37</sup> Likewise, a majority of shareholders at a special shareholders' meeting called for the purpose of amending the articles of incorporation have the ability to amend the articles of incorporation.<sup>38</sup> Ten days notice must be given to shareholders if the articles of incorporation are amended pursuant to a special shareholders' meeting.<sup>39</sup>

In amending its articles of incorporation, the shareholders can vote to increase or diminish the amount of capital stock and the number of shares with the limitation that the amount of the capital stock shall not be diminished below the amount of the paid-up capital at the time the amendment is adopted.<sup>40</sup> Following the adoption of any amendment to its articles of incorporation, a cooperative association under Subchapter IV shall cause a copy of the adopted amendment to be filed with the Secretary of State and with the Register of Deeds of the county where the principal place of business is located.<sup>41</sup>

The net earnings or losses of a cooperative association subject to Subchapter IV are apportioned among the members in accordance with the ratio of each member's patronage during the specified period to the total patronage by all members during the same specified period.<sup>42</sup> *Patronage* is statutorily defined as the "...amount of purchases, sales, business, labor wages or other similar criteria."<sup>43</sup> The profits or net earnings are allocated to qualified members as provided for in the bylaws and can be distributed as frequently as once every 12 months.<sup>44</sup>

All cooperative associations subject to Subchapter IV are required to file an annual report, on or before March 1<sup>st</sup> of each year, with the Secretary of State and file a copy with the Department of Agriculture and Consumer Services.<sup>45</sup> The annual report must contain the following information:

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<sup>34</sup> *Id.*

<sup>35</sup> *Id.*

<sup>36</sup> *Id.*

<sup>37</sup> N.C. Gen. Stat. § 54-125.

<sup>38</sup> *Id.*

<sup>39</sup> *Id.*

<sup>40</sup> *Id.*

<sup>41</sup> *Id.*

<sup>42</sup> N.C. Gen. Stat. § 54-126.

<sup>43</sup> *Id.*

<sup>44</sup> N.C. Gen. Stat. § 54-127.

<sup>45</sup> N.C. Gen. Stat. § 54-128.

- The name of the company.
- The principal place of business in North Carolina of the company.
- A general statement as to its business including: total amount of business transacted; amount of capital stock subscribed for and paid in; number of shareholders; total expenses of operation, amount of indebtedness or liabilities; and its profits and losses.<sup>46</sup>

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<sup>46</sup> *Id.*