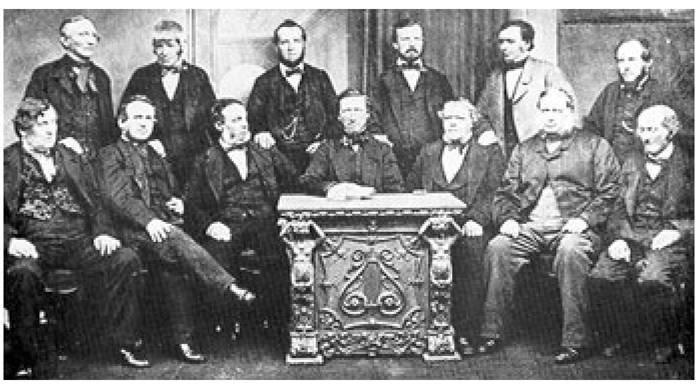
# Chapter II.
# The Rochdale Principles:

## The Pioneers:

The Rochdale Principles originated in 1844 in Rochdale, England, a short ride outside London. A group of weavers, now called the Rochdale Pioneers opened a co-op store at 31 Toad Lane, a place now considered to be the birthplace of modern cooperatives.

Although other groups had similar ideas at the time, none set out their principles of operation as effectively as did these Rochdale Pioneers. Their original Rochdale program identified seven fundamental principles that guided their cooperative business.

A century and a half later the principles that guided the Rochdale Pioneers still guide cooperative businesses today. Remarkably each of the original Rochdale Principles still applies today except perhaps the restriction to "trade on a cash basis only".



Thirteen of the original Rochdale Equitable Pioneers Society founders were (front from left) James Standring, John Bent, James Smithies, Charles Howarth, David Brooks, Benjamin Rudman, John Scowcroft and (back from left) James Manock, John Collier, Samuel Ashworth, William Cooper, James Tweedle and Joseph Smith.

As word of the success of the Rochdale adventure spread, the cooperative idea gradually built momentum in the United Kingdom. By 1880, national membership in what were then called *"consumer societies"* reached over a half million people. The remarkable growth of cooperative popularity resulted in the establishment in 1863 of the *Cooperative Wholesale Society*, in which the original Rochdale pioneers played an important role.

The Cooperative Wholesale Society began like the Rochdale effort, modestly in a few rented rooms in Manchester, England. But it grew quickly as a major food wholesaler and importer to serve the growing markets in England. Eventually the CWS owned warehouses on five continents to buy products directly from growers; it built its own fleet of ships; and it established factories to produce and sell a vast range of products to the cooperative societies they served.

Social conditions in Europe were ripe for the rapid growth of the cooperative model. Consumer cooperatives or societies, as they were often known, spread first in the United Kingdom, then quickly across Europe. From the barest of essentials at 31 toad lane, cooperatives grew quickly in other activities such as banking, insurance, retail stores, coal distribution and other ventures. Among them, housing cooperatives.

**International Cooperative Alliance.** This is not to say that the Rochdale Principles have not been interpreted to meet the needs of today's economies. The authority for making those interpretations has fallen to the International Cooperative Alliance. The Alliance, referred to as the ICA, was founded in London in 1895. Its members consist of national and international co-operative organizations in all sectors of activity including agriculture, banking, energy, industry, insurance, fisheries, housing, tourism, and consumer co-operatives. ICA has more than 230 member organizations from over 100 countries, representing more than 730 million individuals worldwide.

The International Cooperative Alliance published the first revision of the Rochdale Principles in 1938. The Principles were again revised in 1966 to reflect the changing times, omitting the reference to political and religious neutrality that had been on the 1938 list. In 1995 the Principles were revised once more, again reflecting the modern thinking of that time.

**The Statement on the Cooperative Identity.** The International Cooperative Alliance issued its most recent revision of the Rochdale Principles as the "Statement on the Cooperative Identity". In that statement the ICA defines a cooperative as:

> *"An autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise."*

We commonly know a housing cooperative to be a corporation that owns or leases residential property for the

**Real property** is property that is of the land or structures affixed to the land. Houses, office buildings, condominiums, farms are examples of real property.

**Personal property** is property that is not of the land or affixed thereto. Furniture, clothing, live-stock, mobile homes, auto-mobiles, stocks and bonds are examples of personal property.

purpose of passing ownership and tax benefits to its member shareholders. Based upon the ICA statement a housing cooperative can also be defined as an autonomous association of persons united voluntarily to meet their housing needs through a jointly owned and democratically controlled corporation. In this case the corporation refers to the cooperative that owns or controls the real property.

**Cooperative Values.** Public corporations and other organizations express *how the mission will be accomplished* in a *values statement*. The *values statement* defines the basic values that govern how the activities of an organization will be carried out.

Cooperatives, like other organizations also share common values that set cooperatives apart from other businesses and organizations. According to the International Cooperative Alliance identifies cooperative values are defined as:

> "S*elf-help, self-responsibility, democracy, equality, equity and solidarity. In the tradition of their founders, cooperative members believe in the ethical values of honesty, openness, social responsibility and caring for others.*"

## 1st Rochdale Principle: <u>Voluntary and Open Membership.</u>

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

***…Voluntary organizations open to all...*** Since their beginning, cooperative principles have held to the belief that membership be voluntary and open. Voluntary participation suggests that the decision to become a member of a cooperative must be an informed decision based upon accurate information about the cooperative's operations and financial condition. Although cooperatives are generally open to all who are able to use their services, housing cooperative also need to assure that each member will be able to continue to pay his or her fair share of carrying charges. Thus income and stability play a more important role in member selection for a housing cooperative than might be the case for other types of cooperatives.

***…Persons able to use their services…***Shelter, like food and water, is a basic need. Nonetheless, housing cooperatives are not for everyone. Ability to *use the services* of a cooperative and willingness to *accept the responsibilities of membership* are basic criteria for participation and membership in a cooperative. The desire to live in a housing cooperative does not by itself justify membership; it also requires the ability to keep the cooperative economically sound.

Most housing cooperatives in the United States offer two basic "services", shelter and equity growth. A person who seeks membership in a housing cooperative only for the shelter it offers may not be the most desirable candidate because he or she will not be motivated to take advantage of or participate in those aspects of ownership that apply to equity growth. In fact, such a person may serve as a drag on the cooperative, consuming its value without contributing toward maintaining it.

On the other hand, housing cooperatives generally discourage membership by persons whose interest is purely speculative, that is, seeking equity growth without shelter. Unlike condominium communities many housing cooperatives in the United States prohibit members from subletting their dwelling unit without the express consent of the Board of Directors.

***And willing to accept the responsibilities of membership…*** The Rochdale Principles imply yet another test for successful membership: that a person seeking membership in a cooperative should also be willing to accept the responsibilities of membership. This is especially applicable to membership in a housing cooperative. Membership in a housing cooperative implies three responsibilities; those associated with membership in the cooperative, those relating to homeownership and those relating to the creation community.

A person's *membership responsibilities* are governed by the relationship between a stockholder and the corporation and include participation in functions that assure the existence of the cooperative corporation. The corporation needs a Board of Directors to meet the obligations of its state charter. Certain among the membership must be willing to bear the responsibilities of the Board of Directors to make it function as required by law. At a minimum participation in the election of the cooperative's Board of Directors is a responsibility of membership.

A person's *homeowner responsibilities* relate to maintenance of the physical structure of the dwelling unit and maintaining a sense of community within the cooperative. Payment of carrying charges is essential to the cooperative's ability to maintain its own existence and certainly must be included as a responsibility of homeownership. A member's homeowner responsibilities include the proper care and maintenance of the dwelling unit and to preserve its value within the cooperative.

A person's *community responsibilities* are related to a responsibility each has to create a sense of community. A successful community has a broad vision of itself that is shared by the people living within it. Successful communities also share somewhat similar social behavior norms. A person living in a housing cooperative must be willing to live within the community's norms of acceptable behavior. Clearly criminal or other deviant behavior would not be acceptable in most housing cooperatives. However, a person does not have a community responsibility that grows from discriminatory practices, thus the inclusion of the following statement in the Rochdale Principles.

***…Without gender, social, racial, political or religious discrimination.*** Cooperatives have embraced voluntary and open membership since the time of the Rochdale pioneers. Clearly the Fair Housing Laws in the United States prohibit discrimination on the basis of protected categories that are more inclusive than those outlined in the most recent statement of the International Cooperative Alliance. In this case the more inclusive laws supercede, but include the Rochdale Principles.

## 2nd Rochdale Principle: Democratic Member Control.

*"Cooperatives are democratic organizations controlled by their members, who actively participate in setting their policies and making decisions.*
*Men and women serving as elected representatives are accountable to the membership."*

***…Democratic organizations controlled by their members...*** Corporate businesses, political organizations, and other voluntary associations can also be democratic. The definition of democratic control and how it is exercised is unique to cooperatives, especially in the business world. Although democratic, the voting strength of a public corporation is based upon the number of shares of stock controlled. This means that a single wealthy individual or a small group of wealthy individuals can effectively control a public corporation by virtue of the number of shares they own or by amassing proxies they can control.

The voting rights in a housing cooperative are often based on the one member, one vote theory. However, it is not uncommon for voting rights in a housing cooperative to be assigned on the basis of a member's pro-rata interest in the cooperative. In other words, a person living in a large unit may have more voting power than a person living in a smaller unit. Perhaps the most important distinction is that housing cooperatives often place restrictions on proxy voting to protect the democratic process,. Restrictions on proxy voting make it nearly impossible for a single individual or small group of individuals to seize economic control of the cooperative, provided that other members exercise their voting rights at business meetings.

***…Members who actively participate in setting their policies and making decisions…***
Again we see how the Rochdale Principles encourage the active participation of members. Although the corporate cousins of cooperatives may encourage stockholder participation for the election of directors, it is not with the same degree of intensity as cooperatives.

The Board of Directors is the legal representative of the cooperative and has a duty to provide governance and oversight for the operations of the cooperative. Although there may be outside appointed directors in some cases, housing cooperatives are generally governed by a Board of Directors elected by and from the membership.

The members of a housing cooperative participate when voting for a director or when voting on matters presented to the membership for resolution at an official meeting. In most cases this formal participation is limited to proceedings during the annual meeting or specially called meetings of the members.

***…Men and women serving as elected representatives are accountable to the membership.*** The Rochdale Principles clearly intend that the Board of Directors of a cooperative be accountable to the members. This principle applies equally to the Board of Directors of a housing cooperative. The most obvious show of accountability occurs during an election when an incumbent who is not perceived to represent the wishes of thee membership may not be reelected.

The bylaws of housing cooperatives often include stipulations that provide for the removal of directors who have compromised their ability to serve the best interests of the cooperative. Perhaps the most obvious of these is a stipulation that directors who themselves become delinquent in the payment of their carrying charges are automatically removed from their seat on the Board of Directors.

The bylaws of most housing cooperatives also provide for the removal of a director by vote of the membership. However, the provision realizes that the Board of Directors is often called upon to make difficult and sometimes controversial decisions. In most cases the bylaws offer some measure of protection by making it relatively difficult for the members to remove a director mid-term.

## 3rd Rochdale Principle:
## Member Economic Participation.

*"Members contribute equitably to, and democratically control, the capital of their 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."*

***…Members contribute equitably to, and democratically control the capital…*** The cooperative business model encourages capital participation on the basis of need. The primary motivation for investing capital in a cooperative is to benefit from the goods or services that are produced by the cooperative for its members. The non-cooperative business model fosters the accumulation of equity capital by outside investors who are motivated by corporate control and the financial return on investments.

The initial members of a housing cooperative contributed to capital when they purchase membership in the cooperative. Although in many limited equity housing cooperatives the amount of the initial contribution is similar to a security deposit there is a significant difference between a capital contribution and security deposit. A capital contribution becomes the property of the corporation and is subject to risk of loss. That is, the investor may lose his or her investment if it is not managed wisely. On the other hand a security deposit remains the property of the depositor (tenant) and may be withheld only if certain conditions are met.

An occupancy agreement is defined as a lease used by a cooperative that *requires a capital investment* and grants the right to occupy a specified dwelling unit. Unless bylaws provide otherwise, the first purchaser of the housing cooperative makes the initial capital contribution and becomes the owner of that membership or share of cooperative stock. Subsequent purchasers merely purchase the membership from the seller. In some cases the housing cooperative may want to place tighter control over sales and exercise an option to purchase the membership from the seller. The cooperative then becomes the owner of the membership or share of stock and has the right to resell it once again.

***…Limited compensation…on capital...*** In a 1994 article of the Cooperative Housing Journal, Joel David Welty writes "Capital Serves, Doesn't Dictate." These words express the cooperative philosophy as well as any. The members of a cooperative, not outside investors, provide the equity capital it needs to carry out its mission. Because cooperative members are themselves the owners and at the same time the producers or consumers of the cooperative's goods or services, they can place less emphasis on earning a return on their equity. *However, purist thinking that discourages the formation of new capital for cooperatives also limits the potential growth of cooperatives and their ability to serve their members.*

The members of a housing cooperative can and should expect to receive "compensation" on capital. Because housing is such a unique market in the United States the return can be substantial although it may not be the primary reason to own a cooperative membership.

A year-end cash surplus is often converted into a *patronage refund*. In some cases a direct pro-rata cash refund is made to the members of record on the last day of the year. In more cases the patronage refund is converted to reserves or budgeted as a cash carry forward and thus distributed in the form of lower monthly fees the subsequent year than would otherwise be possible.

The members of a housing cooperative also receive compensation on capital when they elect to sell their membership and withdraw from the cooperative. If the cooperative was well governed and well managed during the period the member owned the membership and if the cooperative is located in an area of rising housing prices, the selling member can expect to receive a return on his or her original investment. In most cases there are no limits on the amount of return one can receive. Some cooperatives, especially those that receive assistance or subsidy through a public program, may impose limits on the maximum values of membership over the term of the program.

Although few cooperative homeowners are motivated primarily by tax considerations, the owner of a housing cooperative, by virtue of having made a contribution of capital to purchase the membership, also receives a return on that investment in the form of tax deductions. Section 216 of the IRS code provides that owners of a housing cooperative can deduct from their income the pro-rata share of mortgage interest and real estate taxes paid during the year. Sellers of a housing cooperative whose gain upon sale exceeds the current threshold set by Congress and the IRS also receive more favorable capital gains treatment as opposed to ordinary income, on the increase in value of the membership.

***…In proportion to their transactions***. The cooperative business model does not eliminate compensation on capital; it only provides a different formula for its distribution. Public corporations distribute earnings (compensation) according to the number of shares owned. The shareholder of a public corporation need not to have produced or used a single product or service of the corporation yet is entitled to a per-share distribution of the earnings. The cooperative model distributes earnings in the form of patronage refunds, in proportion to each member's transactions with the cooperative.

In a producer cooperative such as an agricultural cooperative patronage refunds are made according to the volume of each grower's participation even though each may own exactly the same number of shares. A grower who brought a thousand tons of celery to the cooperative would receive twice the patronage refund of a grower who only brought in five hundred tons. In a consumer cooperative a consumer who purchased a thousand dollars worth of goods and services during the year would receive twice as much patronage refunds as a consumer who purchased only five hundred dollars worth.

In a housing cooperative the patronage refund is allocated according to the "unit value" of each dwelling unit. If all the homes in a cooperative are of the same size and value, every member would be entitled to the same patronage refund. However, if there are different styles and values of homes the refund is made according to the "unit values" assigned at the time the cooperative was developed. Since carrying charges are often based upon the same value formulas, patronage refunds at housing cooperatives are also then made according to each member's participation.

## 4th Rochdale Principle: <u>Autonomy and Independence.</u>

*"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."*

...***Autonomous, self-help organizations.*** Cooperatives in the United States are legal persons in the same way as private or public corporations. They are required by their charters to provide for their own governance and accountability. However, there is a significant difference suggested by the insertion of "self-help" in the statement. Whereas ordinary corporations seldom ask for "self help" contributions from their stockholders, the cooperative business model lends itself to self-help efforts and emphasizes service to members.

Self-help in a housing cooperative takes many forms. By virtue of serving as volunteer directors the Board of Directors of a housing cooperative contributes to self-help. Other volunteers and committee persons also make a self-help contribution to the cooperative whenever serving in that capacity. More informally the members make self-help contributions whenever they perform a task or service that would otherwise not be provided at all or provided as an expense to the cooperative.

***…Terms that ensure democratic control…and maintain autonomy...*** In many formerly communist countries of Eastern Europe and Asia housing cooperatives are viewed with suspicion, even after the collapse of the communist governments and system. Although housing cooperatives were possible under the communist system, they were tightly regulated and controlled by the party and government apparatus. In that sense these cooperatives did not fully met the test for democratic control and autonomy. As a consequence housing cooperatives are viewed with skepticism even after a decade of change.

Although there are many examples of informal cooperatives that operate without the legal status of a corporation, most are incorporated under state law and enjoy all the rights and privileges of incorporation. Incorporation gives the cooperative the status of a legal person under the law and provides the "corporate veil" of protection for stockholders and directors.

A housing cooperative is usually incorporated and therefore is an autonomous organization with all the rights of self-governance. Its Board of Directors has legal responsibility for the overall governance of the cooperative and the right to enter into contracts with other parties in the conduct of its business affairs.

Except that a cooperative is subject to the same laws as other corporations, the Board of Directors of a housing cooperative has full authority to act on behalf of the cooperative as provided for in its own bylaws. The distinction of autonomy often becomes blurred because many long-term decisions were made during the cooperative's formation. For example, if at the time of its creation the cooperative entered into a mortgage contract to borrow funds, later members and directors remain obligated to that contract for its term. Certain cooperatives, namely those who receive government assistance or subsidy are bound by a regulatory agreement that some would argue denies the cooperative the rights of true autonomy. The decision to accept government funds or subsidies and the accompanying regulatory restrictions was voluntary at that time it was made and for its duration the directors and members are bound by the terms of that commitment.

## 5th Rochdale Principle: 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 cooperatives. They inform the general public – particularly young people and opinion leaders – about the nature and benefits of cooperation."*

***…Provide education and training...*** The Rochdale Principles create an obligation for a cooperative to provide education and training to its members and to provide them information they need to be productive members of the cooperative. Public corporations and government agencies also provide management training to key management personnel and skills training for their line workers and technical employees. But few provide the same training to their stockholders. The Rochdale Principles suggest a commitment by cooperatives to provide training to their stockholder members as well as to their directors and key management personnel.

In today's world of high-speed Internet access to information worldwide it may seem that formal training is no longer needed. However, cooperatives reap the same benefits from an informed membership as other corporations do from educational product advertising. At the turn of the millennium many of the nation's rural electrical cooperatives joined together to create Touchstone Energy to raise awareness and educate their members and the public about the benefits of energy cooperatives.

Housing cooperatives provide education and training for their members through the use of good sales information documents, newsletters, open attendance at meetings of the Board of Directors, annual meetings and other functions. Education and training need not to be provided in a formal setting. Since the turn of the millennium housing cooperatives have looked more and more toward the use of email and the Internet to provide information about the cooperative.

***…Inform the general public – particularly young people and opinion leaders – about the nature and benefits of cooperation.*** The cooperative business model is widespread in the United States and cooperative corporations provide many services. Yet there are many who do not fully understand it. Cooperatives in the United States operate in a very competitive marketplace. In today's business climate it has become ever more difficult for smaller businesses like most cooperatives in the United States, to compete with large conglomerates for market share. Some, like the energy cooperatives, have pooled their resources to better advertise their products or services. Others have repositioned themselves in the marketplace to serve a niche market that the large conglomerates have overlooked.

Housing cooperatives compete in an aggressive real estate market. High-end cooperatives compete against luxury condominiums and single-family homes. Others compete against comparable rental properties in the area. Well-managed cooperatives often have lower operating costs and seem to be able to compete successfully. They may have waiting lists and may not feel the need to spend resources to inform the public about their existence in the short term.

However, there are definite benefits of taking a long-term view of their business. A long-term view will help them to foresee potential roadblocks for public advocacy, financing, insurability, taxation, obsolescence and their future impact on the overall value of the cooperative. Like their energy cousins housing cooperatives have learned that they are best able inform the public about the benefits of cooperative housing when acting in unison with one another. Many have joined local and national associations like that National Association of Housing Cooperatives that can provide public exposure and issue advocacy on their behalf.

## $6^{th}$ Rochdale Principle:
## Cooperation Among Cooperatives.

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

***…Serve their members…*** The Rochdale Principles repeatedly remind us that cooperatives exist to serve their members. The sixth principle contends that cooperatives can better serve their members when they work with one another.

***…Strengthen the cooperative movement...*** In a world of stock options, wealth creation and corporate takeovers, it is easy to overlook the fact that cooperatives provide cost effective and rewarding solutions to social challenges as well as business opportunities. The sixth Rochdale Principle challenges those who understand and benefit from the cooperative business model to bolster sister cooperatives and cooperative organizations when opportunities arise.

The International Cooperative Alliance was formed in London in 1895 to represent the cooperative movement worldwide. The Alliance now has its headquarters in Geneva Switzerland and provides a common umbrella that seeks to preserve and defend cooperative principles around the world.

There are many organizations that represent cooperative businesses in the United States. Among them is the National Cooperative Business Association that serves as a broad umbrella organization. The National Cooperative business Association (NCBA) is a national membership and trade association that represents cooperatives. Founded in 1916 and known for many years as the Cooperative League of the USA, its membership includes cooperative businesses in the fields of housing, health care, finance, insurance, childcare, agricultural marketing and supply, rural utilities, and consumer goods and services. The Association represents cooperatives before Congress and federal agencies and supports cooperatives through training and technical assistance publications and programs. The Association represents over 100 million Americans and 47,000 businesses.

Housing cooperatives and their members benefit from participation in local and national associations as well. These associations offer general advice and training that can bolster cooperative leadership and improve the cooperative's ability to serve its members. They can create a common marketing strategy that keeps the public, especially public officials, better informed about housing cooperatives and their contribution to the community. Through these associations an individual cooperative can support legislation that helps housing cooperatives to compete with other forms of home ownership. They can expose themselves to trainers and consultants whose expertise is nationally recognized. In some areas where adequate financing was not available housing cooperatives joined together to create their own financial institutions that now provide credit and financing for membership purchases and home improvements.

## 7th Rochdale Principle: Concern for Community.

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

***…Sustainable development of their communities.*** The seventh Rochdale Principle reminds us that cooperatives do not exist in a vacuum. Cooperatives are part of the American business and social culture. Like other business or social organizations, they become stronger themselves when they contribute to the development of the entire community.

Unlike other businesses a housing cooperative cannot move to another community, nor can it effectively isolate itself from the general community in which it is located. It is easy then, to conclude that the cooperative's economic, social and political future is closely tied to that of the larger community.

Because the value of membership is so closely tied to real estate values in the area, housing cooperatives are especially mindful of the impact of the general neighborhood on their own operations. In many locations a housing cooperative is the largest grouping of homeowners who can speak in a unified voice. Cooperative leaders who recognize the power of their influence are able to work with other community leaders to improve the entire community.

Concern for community is not limited to real estate values. Concern also reaches into social and environmental issues of the community. Because they represent a well-organized block of citizens and because they have expertise and knowledge of cooperative principles, the leaders of a housing cooperative can become a powerful force in the community.

***…Policies approved by their members.*** Finally the Rochdale Principles remind us once again that the cooperative mandate stems from its members. Boards of Directors are cautioned that concern for community does not give them license to use the influence or resources of the cooperative in ways that are not approved of by its members.