Legal Aspects of Cooperative Organizational Structure
Part II

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A leading proponent of agricultural cooperation has characterized the plight which engendered the need for agricultural marketing combinations as the inability of the individual farmer to extract from a buyers' market his "just economic due." The terminology employed alone renders the advocate's objectives suspect. But claims for preferential treatment of the cooperative corporation or association cannot be summarily rejected. They may be intelligently appraised only against the backdrop of economic conditions which stimulated the cooperative movement and which, to an unascertained extent, still prevail.

Due to seriously depressed conditions in the agricultural markets in the early decades of this century, it was perceived that encouragement of producer combination to augment the farmers' bargaining power was essential not only to their own well-being but also to that of the economy as a whole. To this end, solicitous judicial treatment and favorable legislative enactments have insulated agricultural organizations from the impact of state and federal statutes condemning combination. The agricultural marketing organizations which have evolved have assumed various forms. Legal relationships figuring prominently in this evolution include the corporation, unincorporated association, trust, agency, partnership, and bailment. The cooperative, chameleon-like, may staunchly invoke its status as an entity in one situation while emphasizing in another context, the agency aspect of its activity.

Judicial acceptance of such apparent inconsistencies finds adequate explanation only in an inarticulate conviction that cooperation should be facilitated even at the sacrifice of individual interests and doctrinal symmetry. In each instance, the fundamental problem is one of balancing the desirability of deferring to the aims of cooperation by characterizing a transaction in the light most favorable to the association against the disadvantage this course entails, such as defeat of an adverse party's reasonable expectation. Decision rests ultimately on social and economic

1. "By 1890, however, labor and agriculture generally realized that their bargaining ability to extract their just economic due from the total annual goods and services was feeble when compared with the bargaining power of capitalistic corporate groups inherent in the pricing power of big corporations and their subsidiaries and affiliated companies." Jensen, Integrating Economic and Legal Thought on Agricultural Cooperatives in Cooperative Corporate Association Law—1950, 37 (Jensen Ed. 1950).

2. See Part IV infra, passim.
policy considerations beyond the scope of this discussion. It is an ambitious objective merely to attempt to cast aside the judicial trappings frequently obscuring troublesome facets of the organizational structure of cooperatives and objectively present the controversies involved.

A major source of difficulty in fitting the farm cooperative, whether a corporation or an unincorporated association, into the same legal mold as its counterpart in businesses conducted solely for profit is the dual relationship of the patron-member to the enterprise. He is both a proprietor and one of the vendors with whom the cooperative transacts the bulk of its business. Hence the rights and obligations of the member and of the organization stem from two distinct sources. The vendor-vendee aspect of this relationship is usually governed by a comprehensive, standardized agreement, entered into by each grower, referred to as the marketing contract. While the numerous problems emanating from this relationship will be discussed in detail in a later section, recognition of the court's reluctance to release a producer from his contractual obligation in the event of a material breach by the association is important at this juncture.5

Problems to which the immediate discussion is addressed are primarily those created by the association agreement, which governs the member's relation to the cooperative in his capacity as an investor and proprietor. This includes matters commonly embraced in the articles and by-laws of an ordinary corporation, such as provisions relating to powers of the organization, election and duties of directors and officers, rights of creditors, qualifications of membership, and allocation and distribution of income. The unique position of the patron-member may compensate, in part, for seeming inequities in judicial construction of the marketing agreement. Improvident management detrimental to the interests of the grower may frequently be checked in his capacity as a

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3. "Profit" is used in the traditional sense, i.e. return on invested capital. Viewed from another perspective, the co-op is not a nonprofit enterprise. It lacks all of the distinguishing characteristics of an eleemosynary corporation. Its activities are calculated to enhance the financial position of its participants in proportion to their patronage.

4. This term is used loosely to characterize the marketing transaction. See Part III infra, passim.

5. Since the success of cooperation depends upon accumulation of substantial market control to enable farmers to present a unified front against the highly organized market for the produce, the courts have long accorded equitable remedies to the cooperative to enforce marketing contracts, while regarding with disfavor attempts of the individual grower to withdraw his crop from the pool. E.g., in Nebraska Wheat Growers' Ass'n v. Smith, 115 Neb. 177, 195, 212 N.W. 39, 44 (1927), in a suit for specific enforcement of a marketing agreement, the court rejected a defense of mismanagement by the association's officers. It was observed that the members had at their disposal ample means to insure the directors' compliance with the trust reposed in them without resort to repudiation of their marketing contracts. See Part III infra, passim.
shareholder or proprietor of the enterprise, not only through immediate control over directors and officers but also by means of remedies available to correct abuse of discretion.

The interaction of these two aspects of the member-patron's relationship to the cooperative is aptly illustrated in *Brame v. Dark Tobacco Growers Cooperative Ass'n*. The ostensible purpose of the cooperative was to market dark tobacco grown by its members. Several growers discontinued production of dark tobacco and entered the more lucrative business of raising burley. The Dark Association received this substitute crop, disposing of it through an agreement with a burley cooperative, and adopted the position that its contracts with its members entitled it to handle all tobacco grown by them. Patrons of the Dark Association had entered into separate marketing and association agreements. At the instance of a recalcitrant burley producer, the court determined that the growers had not obligated themselves to deliver to the organization any tobacco except the dark variety. In arriving at this conclusion, the court conceded that the liberal use of "tobacco" in the marketing agreement would support the broad construction urged by the association. However, the association agreement and subsequent articles of incorporation indicated clearly that the sole purpose of the organization was to merchandise dark tobacco.7

While sometimes realistically merged with the marketing contract, the association agreement constitutes a distinct relationship independently governing numerous aspects of the member's interest in and obligations

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6. 212 Ky. 185, 278 S.W. 597 (1925).
7. A persuasive factor militating against the contrary result may be found in the court's determination that the two products are not in competition since dark is mostly exported and used for different products. "An orderly marketing of burley is not essential to establish dark tobacco markets or minimize speculation or waste in production or marketing of dark tobacco." *Brame v. Dark Tobacco Growers' Coop. Ass'n*, 212 Ky. 185, 196, 278 S.W. 597, 602 (1925).

The technique here employed presumably achieved a result commensurate with the actual intent of the parties to the two agreements. Careful differentiation of the two relationships will facilitate clear analysis of the difficulties which arise between members and cooperative and promote certainty in their dealings. Following meticulous characterization of the problem, however, resort to a separate set of relations may well be justified in seeking indicia of the intended connotation of the particular agreement in question. The courts frequently have not observed this degree of care in their approach to the problems of cooperatives.

Another decision in which the court apparently relied heavily upon the membership arrangement to solve a conflict arising under the marketing contract is *Kansas Wheat Growers' Ass'n v. Rowan*, 125 Kan. 710, 266 Pac. 101 (1928). In a suit to recover damages for breach of the marketing contract and to enjoin the grower from disposing of wheat then in his possession, the defense was interposed that the agreement had been procured by fraudulent representations of the co-op's agent. Pointing out that defendant had signed the articles and by-laws and hence was affected with knowledge that the representations were ultra vires, the court rejected his contention that he had justifiably relied upon such representations.
to the cooperative which are entirely beyond the scope of the former instrument. For example, in *Burley Tobacco Growers' Cooperative Ass'n v. Tipton*, all marketing contracts with growers had expired. It was urged that the association having become inactive, continued retention of the so-called "1% fund", deducted from gross sales for operating costs, credits and commercial purposes, served no useful purpose. Hence, suit was initiated to compel the association to reduce the fund to cash and distribute it among the members. The court conceded that ultimately the fund was destined for such distribution. But it sustained the directors' exercise of discretion in retaining this asset, invested in warehousing corporations upon which possible future operation was dependent, on the ground that maintaining the association in readiness to resume business might well be in the best interest of the members. Under the association agreement, authority to make such decisions is conferred upon the board of directors; that the organization no longer possessed any marketing contracts did not vitiate this underlying agreement.

The validity of the marketing contract, on the other hand, may well depend upon the existence of a supporting membership agreement between the patron and the association. In *Tulsa Milk Producers' Cooperative Ass'n v. Hart*, the cooperative sued an alleged member for nondelivery of his crop. Since he only had signed a marketing agreement, prior to incorporation, and had never thereafter perfected his membership in the organization, the court sustained his defense based on the theory that under the by-laws the contract could not become operative until the contracting grower had become a member of the association.

An interesting decision concerning a suit upon a pre-incorporation marketing contract is *Hart Potato Growers' Ass'n v. Greiner*, 236 Mich. 638, 211 N.W. 45 (1926). A 50% acreage provision similar to that in the Edmore case was involved. After the co-op had been incorporated and defendant had received proper notice that the requisite acreage had been acquired, he defaulted on his commitment to deliver his crop. Sustaining the cooperative's cause of action, the court spurned defendant's insistence that plaintiff
This complex status of the grower-member, a significant point of differentiation between the cooperative and other corporations, explains an important peculiarity of cooperative law. The modern position with regard to ultra vires transactions and apparent authority—to the effect that a corporation is estopped to disclaim the detriment of a contract entered into in the regular course of business on the ground that the undertaking was beyond its power or its agent's authority—has limited impact upon the dealings of a cooperative. The farm cooperative transacts most of its business with members. And, since members are presumed to have cognizance of the exact scope of the cooperative's powers, they may not urge the doctrine of estoppel against the organization if it subsequently repudiates the arrangement as an unwarranted assumption of authority or an ultra vires act.

Potentially one of the most effective weapons available to the member to insure honest, prudent direction of his organization and prevent unwarranted inroads upon his proprietary interest is the suit to redress breach of a fiduciary duty. It seems plausible that the source of such a fiduciary relationship may be either the association agreement or the marketing contract. Indeed, this is an area in which the courts have failed to articulate precisely the origin of the obligations which they impose. It may be suspected that such a duty is frequently derived from the overall character of the two interconnected relationships. A possible explanation may well be a judicial desire to find a substitute remedy to fill the gap left by the extraordinary constructions which have been engrafted upon marketing contracts to enable cooperatives to preserve their market control. In view of the inadequacy of established contract remedies to protect the interests of patrons, the fiduciary theory of

had no legal existence when the contract was made and that it was initially wanting in mutuality. Defendant had made an offer in writing to enter a contract with the proposed corporation and had held the offer open until it had been accepted by the duly constituted entity. In another suit on a pre-incorporation marketing contract the same result was achieved on the basis of estoppel. Kansas Wheat Growers' Ass'n v. Windhorst, 131 Kan. 423, 292 Pac. 777 (1930).

11. To this effect see Cooperative Milk Service v. Hepner, 81 A.2d 219, 224 (Md. 1951). "Cooperative associations differ from ordinary business corporations principally in that they do most of their business with their own members. . . . It may be doubtful whether an ordinary business corporation, if and when it deals with its stockholders as such, is under any less duty of fairness and equality than a cooperative. Stockholders are not trustees or quasi trustees for each other. . . . But when majority stockholders use their voting power for their own benefit, for some ulterior purpose adverse to the interests of the corporation and its stockholders as such, they thereby become fiduciaries and violate their fiduciary obligations."

redress and other remedial devices assume increased significance in this area. Hence, more widespread acceptance of this theory is to be encouraged, as is the development of high standards of director responsibility.

Due to the principle of equality, which is deeply engrained in the philosophy underlying the cooperative movement, and the fact that directors are typically farmers who themselves conduct considerable business with the association and are therefore thoroughly familiar with its method of operation, a persuasive argument can be advanced for the imposition of a higher fiduciary standard upon such directors than that enjoined upon ordinary corporate officials. However, if encouragement of a vigorous and expanding cooperative program is the primary objective, the desire to subject cooperative officials to an exacting standard of conduct for the protection of individual participants must be tempered by the realization that such stringent requirements may unduly fetter managerial discretion or deter capable men from assuming the burdensome responsibilities.

Under the traditional view applied to ordinary corporations, a director is not responsible for the misdeeds of officers or agents, other than his co-directors, unless he was a direct participant, failed to exercise ordinary care in the selection or supervision of the offending officer, or knew or had reason to know of the dereliction. This rule has been applied to cooperative directors, although to absolve such officials from liability to this extent is perhaps unrealistic, in view of the directors' more intimate connection with the everyday affairs of the association. When the action of directors themselves proves highly detrimental to certain stockholders with a consequent advantage inuring to others, a fiduciary duty has been imposed. Where directors of a corporation, pursuant to a plan for reorganization, arranged the purchase of shares from stockholders ineligible for membership in the contemplated cooperative,

13. See notes 43-57 infra, and accompanying text.
14. "Experience demonstrated that if co-operative societies were to be really encouraged, a law was necessary which would offer the advantages of corporate form to exchanges, unions, and other associations, and at the same time allow great freedom of self-direction and self-control in the co-operative effort for mutual benefit." Loch v. Paola Farmers' Union Coop. Creamery & Store Ass'n, 130 Kan. 136, 138, 285 Pac. 523, 524 (1930).
15. In Lowell Hoit & Co. v. Detig, 320 Ill. 179, 50 N.E.2d 602 (1943), the court enunciated this general rule, absolving directors from liability for conversion by the manager of the cooperative, of which the directors had no knowledge and which they could not have discovered in the exercise of ordinary and reasonable supervision. For a decision imposing a patently lax standard of conduct upon erstwhile directors who perfect preferences in the insolvent co-op's assets immediately upon resignation, see Farmers Co-operative Ass'n of Bertha, Minn. v. Kotz, 222 Minn. 153, 23 N.W.2d 576 (1946).
the court perceived a fiduciary relation between the managing officers and the shareholders, with a concomitant duty to make full disclosure to such shareholders of all facts relevant to evaluation of the shares subject to purchase. In *Bogardus v. Santa Ana Walnut Growers Ass'n*, members of a marketing cooperative sought to prevent the association from distributing to withdrawn members money returned to the local from the central cooperative. There funds had originated in the central's operating reserve fund to which the ex-members had contributed. The court construed a by-law forfeiture provision as inapplicable to a withdrawn member's interest in the revolving fund to which he has contributed. Despite language of purchase and sale and references to passage of title in the marketing contract, the actual relation between the grower and the cooperative was one of a trust or fiduciary character. The funds in controversy constituted a trust res, distributable on a pro rata basis to each contributor. Implicit in *Cooperative Milk Service v. Hep*

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18. Another case which has recognized the "trust fund doctrine", at least to a limited extent, is Burley Tobacco Growers' Cooperative Ass'n v. Brown, 229 Ky. 696, 707, 17 S.W.2d 1002, 1006 (1929). The court there observed: "It may be that it would be improper to call the fund a general corporate asset, [1% reserve fund] and it may be that it would be improper to call it a trust fund, but it is a corporate asset which may be used for the specific purposes mentioned in the contract, and it partakes of the nature of a trust fund in that any balance unexpended for purposes mentioned in the contract will be distributed at some time, either when the association so directs, or when its existence is at an end."

In *Rhodes v. Little Falls Dairy Co.*, 230 App. Div. 571, 245 N.Y. Supp. 432 (Sup. Ct. 1930), a patron sued a milk handling cooperative for an accounting and for distribution of his proportionate share of withheld earnings. The court observed that plaintiff's complaint alleged facts constituting a fiduciary relationship similar to a joint venture, "in which case an action in equity is maintainable for an accounting, and is not unlike that of an agent who has been intrusted with his principal's money or property to be expended or dealt with for a specific purpose, in which case the agent is at all times amenable to the process of the court to show that his trust duties have been performed and the manner of his performance." Nor was it necessary that there be a technical trust. Where a relationship of agency and confidence exists and the agent has received property of the principal for which he refuses to account, a court of equity may take jurisdiction. *Id.* at 573, 245 N.Y. Supp. at 434.

19. It should be noted that the fiduciary duty extended to withdrawn, as well as existing members, and required distribution on a pro rata basis to each contributor to the fund in question. *Bogardus v. Santa Ana Walnut Growers' Ass'n*, 41 Cal. App. 2d 939, 956, 108 P.2d 52, 58 (1940).

A case in which the court arguably refused to limit the scope of a director's fiduciary duty to consequences of his own acts or omissions is *Kansas Wheat Growers' Ass'n v. Windhorst*, 131 Kan. 423, 292 Pac. 777 (1930). Defendant member sought to resist suit for breach of his marketing contract on the ground that the acreage control requisite to put the contracts into effect had never been achieved. He had been an inactive member of the committee responsible for certifying that the prescribed acreage had been secured. The court rejected his contention that only his own acts and omissions should be imputable to him. However, the case can be viewed as one in which he had no right
ner\textsuperscript{20} is a similar recognition that officers and directors of a cooperative occupy a position of trust with regard to their members and may not favor one faction at the expense of another.\textsuperscript{21} The court also suggested an interesting analogy which might be used as a basis for advocating recognition of a fiduciary duty in all instances in which officials deal with members, \textit{i.e.}, the most highly developed observance of the fiduciary concept in the corporate field is in the area of direct dealings between officers and shareholders. As previously pointed out, this phenomenon, unique in ordinary corporate dealings, is a typical attribute of cooperative transactions.\textsuperscript{22}

One pitfall which the injured patron must carefully avoid is the adeptness with which courts have discerned a waiver of rights against directors and officers based on some form of acquiescence in the challenged activity. Failure to object promptly upon discovery of fraudulent inducement to enter a marketing contract has been deemed a waiver of the right to rescind.\textsuperscript{23} Amendment of a charter to permit accumulation of reserves, although only prospective in effect, coupled with negotiation of a new marketing contract subsequent to the change, has been regarded as an affirmation of the association's previous improper accumulation of reserves.\textsuperscript{24} The absence of objection to a deviation from the prescribed allocation of profits and losses until such time as the non-observance of this provision proves detrimental to the challenger has been characterized as consent to modification of the contract.\textsuperscript{25} Failure to select competent officers may deprive members of the right to question performance of the trust reposed in such officials.\textsuperscript{26} While these decisions may appear harsh due to the absence of certain elements of estoppel, in each case acceptance of the plaintiff's theory of recovery might have proved injurious to the success of the organization. Under such circumstances the court may be tempted to subordinate the rights to rely upon the good faith and diligence of other members of the committee and hence was held for a negligent omission.

20. 81 A.2d 219 (Md. 1951).

21. In the Hepner case, \textit{supra} note 20 at page 224, the court suggested that when majority shareholders use their voting power for their own benefit, to the detriment of the interests of the co-op or its minority shareholders, they may become fiduciaries and violate their fiduciary obligations.

22. However, see notes 55-56 and accompanying text, to the effect that some members may be benefitted to a greater extent than others, if for reasons beyond the control of the co-op.


25. Matanuska Valley Farmers' Coop. Ass'n v. Monaghan, 188 F.2d 906 (9th Cir. 1951).

of the individual to the interest of the group and may indulge in hyper-
critical scrutiny of the plaintiff’s conduct to uncover some technical 
basis for denying recovery. Hence, the patron-member must exercise 
considerable diligence if he is to protect his interests against the neglect 
or depredations of those who conduct the cooperative enterprise.

Beyond the direct suit to redress breach of a fiduciary duty in the 
name of the association or in the plaintiff’s own behalf, there are several 
other devices which may prove successful in vindicating the rights of 
injured members in appropriate circumstances. Perhaps foremost among 
these is an action for an accounting. This is an appropriate remedy 
where the court can be induced to characterize the cooperative as an 
agent entrusted with the grower-principal’s property for a specific pur-
pose. Under these circumstances a court of equity will compel the agent 
to reveal the nature of the questioned transaction in order to demon-
strate that his duties have been properly performed.\(^27\) Even though 
title may have passed and no technical trust exists, the transactions may 
still be considered fiduciary in character. Regarded in this light, the 
cooperative, which assumed the duty of disposing of its patrons’ prop-
erty for the best price obtainable and returning the proceeds less speci-
fied deductions, possesses knowledge access to which plaintiff is entitled; 
and these facts may be ascertained in a proceeding for an accounting.\(^28\) 
The same result has been achieved despite by-laws expressly denying the 
remedy.\(^29\)

A more drastic remedy, appropriate only in cases of extreme mis-
management, would completely wrest control from the offending di-
rectors by means of appointment of a receiver.\(^30\) In \textit{McCauley v. 
Arkansas Rice Growers’ Co-op. Ass’n},\(^31\) this relief was sought in a 
complaint alleging numerous abuses from negligence to outright fraud. 
It was ascertained, however, that the facts failed to sustain these allega-

Supp. 432 (Sup. Ct. 1930), in note 18 \textit{supra}.

\(^28\) Reinert v. California Almond Growers’ Exchange, 63 P.2d 1114 (1937), subse-
guent opinion, 9 Cal.2d 181, 70 P.2d 190 (1937).

\(^29\) Reinert v. California Almond Growers’ Exchange, 9 Cal.2d 181, 187, 90 P.2d 
190, 193 (1937).

\(^30\) An even more extreme device, in view of the general tenor of judicial opinion 
with regard to specific enforcement of marketing contracts, was sustained in New 
Jersey Poultry Producers’ Ass’n v. Tradelius, 96 N.J. Eq. 683, 126 Atl. 538 (Ct. Err. 
& App. 1924). An association sued a recalcitrant member to compel delivery and the 
latter invoked the unclean hands doctrine on the theory that the association had failed 
to grade the produce according to the contract. While acknowledging that violation of 
a collateral covenant would not discharge the member from his duty to deliver, the court 
felt that this substantial deviation should preclude the corporation from seeking redress in 
equity.

\(^31\) 171 Ark. 1155, 287 S.W. 419 (1926).
tions and that the demonstrated breaches of discretion, including unauthorized purchases of rice in derogation of the association agreement, could be rectified by a restatement of accounts. Two interesting side- 
lights in the opinion are worthy of note: a dictum suggested that an attempt to withhold superfluous reserves for contingencies might be thwarted by injunction; and breach of the association agreement was urged by plaintiffs as justification for releasing them from their marketing contracts. The latter contention was summarily rejected with the observation that such a step would cripple the cooperative to the serious detriment of its remaining members. In Doss v. Farmers Union Cooperative Gin Co., the device suggested by the McCauley dictum was unsuccessfully invoked. A shareholder's suit to enjoin a cooperative from allocating net profits to patronage dividends without first paying dividends on the common stock was defeated by applying a permissive construction to the language of a typical by-law provision. This decision constitutes a formidable obstacle to efforts to compel payment of a share dividend where the articles and by-laws follow this pattern.

32. Id. at 1173, 287 S.W. at 424.
33. Id. at 1168, 287 S.W. at 423.
34. 173 Okla. 70, 46 P.2d 950 (1935).
35. The provisions of the by-laws dealing with dividends and profits provided for distribution in this order: (1) not less than 10% to be set aside in reserve fund until fund equals 50% of the capital stock; (2) dividends not over 8% may be declared at the discretion of directors, 5% may be set aside for educational purposes; (3) the remainder of the net profits shall be apportioned to members ratably on the amounts sold to co-ops by members. Id. at 70, 46 P.2d at 950.
36. Plaintiff further contended that under this decision, though having invested money in the business, a stockholder has no legal right to demand or expect a share in the division of profits. The court replied that a cooperative is "a special and peculiar form of business enterprise which is not within the class of corporations designed purely and solely for money profit." To strengthen this conclusion, the court quoted from Justice Brandeis' decision in Frost v. Corporation Commission, 278 U.S. 517 (1929): "The act further discourages entrance of mere capitalists into the co-operative by provisions which permit 5 percent of profits to be set aside for educational purposes; which require 10 percent of the profits to be set aside as a reserve fund, until such fund shall equal at least 50 percent of the capital stock; which limit annual dividends on stock to 8 percent, and which require that the rest of the year's profits be distributed as patronage dividends to members, except so far as the directors may apportion them to nonmembers." Id. at 71, 46 P.2d at 951.

In Callaway v. Farmers' Union Cooperative Ass'n of Fairbury, 119 Neb. 1, 226 N.W. 802 (1929), directors had declared a dividend and plaintiff sued to compel its declaration. The court avoided issuing a mandatory injunction requiring payment by relying on a by-law providing for submission of any proposed measure to the shareholders for approval or rejection. Finding the declaration subject to revision or veto by such a referendum or initiative, the court held that it was not binding upon the co-op until a reasonable time for referendum and review had expired. Since the directors had rescinded within such time, no rights were created by the prior declaration. While the attempt to control the conduct of directors through injunctive relief was ineffective, the case also suggests referendum and initiative as conceivable instrumentalities of control by the shareholders.
An anticipatory technique which may effectively be used to forestall contemplated managerial undertakings which threaten to undermine the interests of members or patrons is the declaratory judgment. Such a proceeding may prove particularly effective in unsnarling the complexities surrounding disposition of cooperative assets upon dissolution.38 A further measure which may be useful to the dissatisfied member who is unable to document his complaints against the association's management is the right to inspect the organization's books. This right has been sustained at common law, in the case of a nonstock cooperative corporation, although statutory provisions relating to inspection were expressly limited to stock corporations.39

While the remedy has not been frequently invoked, there is no reason to believe a member may not enforce a right inuring to the entity, either through a derivative or a representative action. In Olson v. Biola Cooperative Raisin Growers Ass'n,40 members of a cooperative demanded that directors enforce liquidated damages provisions of the marketing contract, on the theory that delivery of wet raisins by certain members violated this agreement. Their request having been rejected, the members initiated an action against offending producers, attributing the directors' nonaction to the fact that a majority of their number had been personally involved in the alleged breach. The court tacitly acknowledged their right to thus vindicate a right of the association under these circumstances.41 This remedy, if not rendered cumbersome by the appendage of judicial or legislative prerequisites, such as approval by a majority of the shareholders, can constitute an effective deterrent to official abuses as well as a convenient means to enforce rights of the association over the opposition of unwilling directors.

The basic attributes of cooperation—democratic control, limited return on capital, and sharing of benefits, savings and risks in pro-

41. Ibid. It found, however, that the liquidated damages clause was inapplicable to qualitative breaches since the damages consequent upon such default were subject to precise ascertainment.
42. An almost inevitable characteristic of the farm co-op is the one vote per member formula which emphasizes the mutual benefit of producers on a patronage basis, as contrasted with the more familiar corporate scheme of control geared to capital contribution. See Part I, p. 360 supra. However, deviations from this principle are not entirely wanting. See e.g., Alfalfa Growers of California v. Icardo, 82 Cal. App. 641, 645, 255 Pac. 287, 289 (1927), in which voting strength was based on units of interest in the
portion to patronage—have given rise to numerous organizational problems peculiar to farm cooperatives. Each of these attributes is but one aspect of the more fundamental principle of equality underlying the entire development of agricultural cooperation. This principle merits further discussion, first in the abstract and then in the context of the various concrete situations in which proprietary and creditor interests in cooperative assets are asserted.

The real significance of the doctrine of equality as a unique characteristic of cooperation is vividly illustrated in *Connecticut Milk Producers Ass'n v. Brock-Hall Dairy Co.* Although all members of this association marketed milk of the same quality, the fluid milk commanded a higher price than that sold for processing. Under a program worked out by a cooperative selling agent to dispose of "homeless" milk in the surplus season, certain members, who sold exclusively to fluid milk dealers, were in effect subsidizing others who sold, also through the cooperative, to large dairies equipped to process the excess over their fluid requirements. This was true because continued operation of the program ultimately depended upon an equalizing membership assessment, which certain of the members in the former category resisted. Sustaining the association's position, the court observed that it was: "...within the powers of the co-op to deal with members as a group and to call upon certain of them to surrender something of their own individual advantage in order to improve marketing conditions for those less fortunately situated." While this decision supports the right of the association to juggle, to a certain extent, the interests of its patrons in an attempt to equalize the advantage inuring to each from its operation, another court has imposed the exacting requirement that the cooperative account to members for proceeds of its operations strictly according to pools, since the association, an almond growers' marketing exchange, conducted its business on a pool basis. While adopting widely differing approaches to the equality principle, the two decisions are not necessarily inconsistent. In the former, the quality of the produce of

property of the association with one additional vote for each ton of alfalfa produced by each grower; and *Tapo Citrus Ass'n v. Casey*, 45 Cal. App. 796, 797, 115 P.2d 203 (1941), in which the articles expressly provided that voting power be unequal.

43. 122 Com. 482, 191 Atl. 326 (1937).
44. *Id.* at page 495, 191 Atl. at 332. In Tobriner, *Legal Aspect of the Provisions of Cooperative Marketing Contracts*, 12 A.B.A.J. 23 (1926), the author points out that the method of conducting co-op marketing transactions has an important bearing on this question. Use of the sale and re-sale contract permits the association greater latitude in adjustment of losses among its members than does the agency contract. For further analysis of the various marketing arrangements see Part III, *infra, passim.*

each member was identical, whereas in the latter, the almonds were classified according to size and quality.

The fundamental objective of cooperation under discussion prohibits a cooperative from deliberately favoring certain of its patrons by discontinuing its dealings with others because surplus supply threatens to deflate the market. This position has been upheld against the contention that the marketing contract of the dismissed members merely constituted the association a selling agent and that it had discharged its duty by exercising good faith in attempting to procure a buyer.46 In this case, the court reiterated the now familiar principle of cooperative law that a marketing organization is bound to exercise the same diligence and good faith to sell the produce of one member which it exercises in behalf of any other. Under this theory, each grower has an interest in the proceeds from the sale of every other grower’s crop. Hence, when a patron sells through another channel, the association is entitled to receive any benefit accruing to the recalcitrant member.47 A perspective which frequently recurs in the cases dealing with the equality problem and which strengthens the theoretical foundation of this doctrine is the idea that the marketing contract constitutes a covenant “running to and with every other member of the association.”48

46. 208 Wis. 40, 242 N.W. 486 (1932).
47. In California Peach Growers v. Harvey, 69 P.2d 915 (1937), subsequent opinion, 11 Cal.2d 188, 78 P.2d 1137 (1938), the court observed that “all members have an interest in the proceeds from the sale of defendant’s peaches and are entitled to share in the sum defendant received by reason of a sale made outside of his dealings with the association.” For a direct holding to the same effect see California Canning Peach Growers v. Downey, 76 Cal. App. 1, 243 Pac. 679 (1925).

A refinement of this position is to the effect that a general managing agent of a co-op, or even a director, has no apparent authority to release an individual grower from his contract. Patrons, by virtue of their contractual relation with the association, are affected with knowledge that any ostentatiously official act which violates the principle of equality is unauthorized. California Canning Peach Growers v. Harris, 91 Cal. App. 654, 267 Pac. 572 (1928).


The peculiar development of the law with regard to marketing contracts sometimes characterized as a lack of mutuality of remedies is perhaps best explained by this theory. If a breach on the co-op’s part entitled a grower to a release, the rule of equality would be undermined and remaining members would suffer from diminished market control. McCauley v. Arkansas Rice Growers’ Co-operative Ass’n, 171 Ark. 1155, 287 S.W. 419 (1926).

But see Staple Cotton Cooperative Ass’n v. Borodofsky, 143 Miss. 558, 108 So. 802 (1926), to the effect that an improper release of certain members from a marketing agreement, entitled remaining participants to release. This decision seems contra to the vast weight of authority in cases involving growers’ remedies for the co-op’s breach of the marketing agreement. However, when the improper releases have been so numerous as to cripple the effectiveness of the association, replacement of directors, recovery of money damages from them, and other remedies short of absolute discharge may be inadequate reparation.
An important implication of cooperative equality is the subordination of the traditional profit motive for investment to the objective of furthering the mutual interests of growers on a patronage basis. Hence, in *Doss v. Farmers’ Union Cooperative Gin Co.*, a shareholder objected to a construction of the association’s by-laws which he contended deprived him of any legal right to demand a share in the division of profits on the basis of his invested capital. Accepting the accuracy of the predicted consequences of their ruling, the court pointed out, "... that a co-op is a special and peculiar form of business enterprise which is not within the class of corporations designed purely and solely for money profits." This position was substantiated by reference to the epic *Frost Case* in which Justice Brandeis observed that cooperative by-laws are designed to discourage investment of capital with the primary objective of earning a return.

Cooperation is calculated to benefit participants personally only in so far as their interests as patrons are advanced through the operation of the enterprise. A member in affiliating himself with a cooperative is primarily interested in securing access to more efficient marketing and other facilities and only in a secondary sense in acquiring a property interest which will yield monetary returns. By the same token, all contributors to a reserve fund made available for distribution have been deemed entitled to share in the proceeds despite the fact that the membership of some has terminated and their sole claim is founded upon their prior contributions. A contrary result would prefer existing members as such and would defeat the objective of patronage-equality.

Basically, classification of members and disparity of treatment accorded them violates the equality theory. A California court frustrated efforts of a cooperative to market the crops of certain peach growers, classified as “renters” on a more favorable basis than peaches grown by

49. 173 Okla. 70, 46 P.2d 950 (1935).
51. See note 36 supra.
53. Consistent with the theory here enunciated, the court in *Avon Gin Co. v. Bond*, 198 Misc. 197, 22 So.2d 362 (1945), refused to grant an ineligible withdrawing shareholder more than par value for his stock. Since non-shareholders were entitled to participate in the assets on dissolution, granting the plaintiff the full book value of his shares upon his retirement would detract from the rights of such nonmember patrons. See also *Ozona Citrus Growers’ Ass’n v. McLean*, 122 Fla. 188, 189, 165 So. 625, 626 (1935), in which a withdrawing member was permitted to recover his pro rata part of the existing surplus arising from “retains” attributable to the handling of crops during his period of membership. This result was achieved in spite of a charter provision for forfeiture of “all rights and privileges in the association” upon cessation of membership.
the majority of its members. The principle of equality dictates that every one delivering produce to a cooperative, even in pursuance of an agreement purporting to accord preferential status, must have his rights determined by the same criteria which fix the rights of others. Reasonable classifications necessitated by the nature of the organization or the circumstances will be upheld if such devices are not inherently discriminatory. A recent decision sharply emphasizes the view that no violation of equality is inherent in special treatment accorded only to a select group of members where this is the result of factors entirely beyond the control of the cooperative. However, so deeply is the concept of equality rooted in the law of farm cooperatives that some courts have by indirection repudiated classification devices apparently not discriminatory as between members similarly situated.

Questions involving the rights of individual members in the assets of a cooperative arise primarily in situations in which the member has severed relations with the association. When such controversies have been litigated, it will be observed that a predominant consideration has been the desire to effect a disposition fair to the individual asserting the right while at the same time adhering to the principle of equality essential to the preservation of the cooperative effort. While few clear indicia of the proper resolution of disputes concerning dissolution or consolidation of farm cooperatives are to be found, the courts will presumably adhere to the established rules governing ordinary corporations in solving such problems. Deviations can be expected in situations where existing corporation rules cannot be reconciled with the philosophy of cooperation. In such instances the doctrine of patronage-equality is likely to emerge as the guiding consideration.

In the event that the cooperative movement undergoes a decline in popularity in the future, the question of dissolution is likely to become a

55. HULBERT, LEGAL PHASES OF COOPERATIVE ASSOCIATIONS 169 (F.C.A. BULL. No. 50, 1942).
57. In Matanuska Valley Farmers Cooperative Ass'n v. Monaghan, 188 F.2d 906 (9th Cir. 1951), a cooperative handled several different crops and agreed to pay each producer his share of the profits realized on resale of his particular crop. Actually, only a very crude allocation of profits and losses among the various crops was ever made. When this discrepancy was finally challenged, the court held that plaintiffs, by their long acquiescence in the cooperative's operations, had consented to a modification of the contract. Similarly, in Alfalfa Growers of California v. Icardo, 82 Cal. App. 641, 256 Pac. 287 (1927), the court rigorously condemned a scheme whereby control was geared to tonnage, membership fees were based on acreage planted to alfalfa, and assessments were founded upon tonnage. Refusal to enforce an assessment was attributed to the inequities which would ensue since non-owners and non-growers were entitled to membership in the association.
storm center of controversy. The problem will be magnified in intensity by one of the most startling phenomena of the agricultural cooperative development—the tremendous reserves accumulated by numerous associations through the device of deducting “retains” in excess of the association’s actual expenses. At common law, disposition of assets upon dissolution was a relatively simple matter. Only members of a nonstock cooperative or shareholders of a stock company at the time of the dissolution were entitled to participate in the distribution of assets remaining after payment of creditors. The method of disposition can be substantially modified by statute or by the articles or by-laws of the organization. For example, one model charter stipulates that upon dissolution, assets remaining after payment of debts and retirement of outstanding stock are to be distributed ratably to patrons “on an equitable basis.” Whether to define “patrons” to include former and existing growers or only those doing business with the association at the time of its demise is a latent source of controversy under this proposed article.

In a recent dissolution case, the court seemingly despaired of achieving any satisfactory disposition of assets among potential claimants and announced that, in the absence of any applicable provision in the article or by-laws, the members had no rights whatsoever. The task with which the court was confronted, of unscrambling the assets and devising an equitable plan for their distribution, was indeed a formidable one. Cooperation had been inaugurated in order to organize farmers and consumers into a cooperative enterprise the announced purposes of which included the marketing of milk and furtherance of economic and cultural welfare of the members and the public. While producer-members had claimed surplus earnings attributable to their phase of the cooperative's activities, a vast number of patronage dividend vouchers printed on milk containers remained unclaimed. Referring to the fact that the association carried on an extensive public education program relating to production and distribution of milk products, the court concluded that it was primarily a civic enterprise and, broadly speaking, constituted a “charitable corporation.” Hence, the court concluded that the assets were distributable, in the event of dissolution, according to

58. Clearwater Citrus Growers' Ass'n v. Andrews, 81 Fla. 299, 87 So. 903 (1921); HULBERT, op. cit. supra note 55, at 76. In the Clearwater case, the court rejected claims of withdrawn members of a cooperative, deciding, by analogy to the rule governing lodges and fraternal organizations, that a withdrawing member forfeits his interest in the association and cannot invoke the rule against enforceability of forfeitures in equity.

59. HULBERT, op. cit. supra note 55, at 403, 411.

the doctrine of *cy pres*. The case suggests the aura of confusion surrounding the problem and the difficulty of the task of delineating the rights of competing claimants which lies ahead.\(^{61}\)

Although consolidation likewise poses many problems as yet unsolved, proponents of cooperation may claim a major victory in *Pearson v. Clam Falls Co-op Dairy Ass'n*.\(^{62}\) Minority shareholders objecting to a proposed consolidation were required to accept shares in the newly created entity in exchange for their interests in the predecessors of the merged cooperative. In reaching this result, the court recognized that most consolidation statutes provide for optional appraisal and cash payments to dissenters, but held that the absence of such a provision in the Wisconsin statute did not render it unconstitutional. Significantly, the omission was attributed to legislative awareness of the difficulties encountered by small cooperatives in attracting new capital to finance proposed consolidations. The interests of remaining participants would be seriously jeopardized by a contrary holding. The decision is consistent with the oft-repeated view that the property interests acquired by a cooperative member are of secondary importance.\(^{63}\)

Most frequent assertions of an individual interest in cooperative assets have been pressed by the withdrawing member. *Clearwater Citrus Growers' Ass'n v. Andrews*\(^{64}\) has long been regarded as representative of the common law on the subject of voluntary withdrawal. It was there decided that forfeiture of all interest in the cooperative's assets was an incident of such withdrawal.\(^{65}\) Carefully drawn articles and by-laws today expressly provide for voluntary withdrawal.\(^{66}\) A by-law provision for payment, within twelve months, of the face value of shares of a member who dies or moves away has been upheld.\(^{67}\)

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61. In Burley Tobacco Growers' Ass'n v. Tipton, 227 Ky. 297, 11 S.W.2d 119 (1928), it was held that the fact that a cooperative association was temporarily inactive presented no ground for dissolution or distribution of assets.

62. 243 Wis. 369, 10 N.W.2d 132 (1943).

63. See note 36 supra.

A further issue in the *Pearson* case was whether dissenting minority shareholders must accept patronage dividends from the old corporation in the form of stock in the new. An affirmative decision was founded on the view that since patrons have no right to insist on being paid such a dividend, the form of payment is a matter within directors' discretion. *Pearson v. Clam Falls Co-op Dairy Ass'n*, 243 Wis. 369, 373, 10 N.W.2d 132, 134 (1943).

64. 81 Fla. 299, 87 So. 903 (1921).

65. Actually, this case did not directly involve an application of the common law since it was decided under a statute and by-law authorizing forfeiture. *Clearwater Citrus Growers' Ass'n v. Andrews*, 81 Fla. 299, 206, 87 So. 903, 905 (1921).

66. See contract of *CALIFORNIA WALNUT GROWERS' ASSOCIATION* (1940).

East West Dairymen's Ass'n, an erstwhile member demanded her pro rata share of the reserves deducted from proceeds of milk sold by the association during her term of membership. Conceding the validity of her claim to an interest in the fund, the cooperative was sustained in the contention that, pursuant to the applicable statute and by-laws, this claim could not be realized until such time as the association was liquidated. Such a result was deemed the only alternative consistent with the continued welfare of the enterprise. Enactments or by-laws providing for compensation of retiring shareholders will probably be construed to authorize payment of par value only. Since the non-shareholder commonly is entitled to participate in the assets upon distribution, payments to withdrawing shareholders in excess of par would undermine the interests of those patrons who possess no shares in the organization.

By-laws and statutes providing for forfeiture upon voluntary disassociation from a cooperative have no application to unpaid or undistributed proceeds received from the sale of crops contributed by the member prior to his withdrawal. Such amounts are ordinarily considered to be a debt owed to the patron and not "property or assets" of the cooperative to which forfeiture provisions apply. Here again careful distinction must be drawn between rights founded upon the association agreement and those stemming from the marketing contract. The former are vitiated by a separation from the association, if statute or by-laws so provide, but the latter are subsisting rights based upon a separate and enforceable relationship.

The revolving fund, an increasingly significant method of capitalization of agricultural cooperatives, presents a convenient solution to the withdrawal problem. Under the revolving fund system, reserves are accumulated through deduction of "retains" from the proceeds derived from marketing of members' crops. These retains are refunded periodically on a chronological basis. The members of longest standing are

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68. 52 Cal. App. 468, 126 P.2d 467 (1942).
69. Two further incidental aspects of voluntary withdrawal are worthy of note: In California Bean Growers' Ass'n v. Rindge Land & Navigation Co., 199 Cal. 168, 248 Pac. 658 (1926), it was held that a by-law providing that failure to deliver terminated membership could only be invoked at the instance of the co-op and did not relieve the defaulting member from compliance with his agreement in succeeding seasons; a Kentucky court, in Carpenter v. Dummit, 221 Ky. 67, 297 S.W. 695 (1927), sustained the validity of a restriction on alienation of stock. The provision had a legitimate purpose, to retain control of the cooperative in friendly hands, and since the membership of the association was large it was not an undue restraint.
70. According to Bogardus v. Santa Ana Walnut Growers' Ass'n, 41 Cal. App.2d 939, 108 P.2d 52 (1940), a withdrawing member's interest in the revolving fund is in this category.
71. Hood River Orchard Co. v. Stone, 97 Ore. 158, 168, 191 Pac. 662, 666 (1920).
72. HULBERT, op. cit. supra note 55, at 74, 75.
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repaid first with retains subtracted currently from proceeds belonging to members presently using the cooperative's facilities. The by-laws may appropriately provide that funds so withheld and credited to individual accounts will be repaid to disaffiliated members in the same manner they would have been refunded had such members continued to participate in the cooperative enterprise. Thus, the withdrawing member is entitled only to receive the balance of the proceeds of his crop less expenses, when such proceeds become available, and to be repaid his contributions to reserves when the cooperative sees fit to make like payments to nonwithdrawing members with similar tenure.\textsuperscript{73}

Withdrawal may also be involuntary, as in the case of expulsion or ineligibility to continue as a member of the association. In \textit{Adams v. Sanford Growers' Credit Corp.}\textsuperscript{74} the by-laws provided that marketing privileges could be denied to a shareholder for sufficient cause and, in such an event, his equity in the organization should be adjusted as in the case of voluntary withdrawal. The by-laws pertaining to voluntary separation authorized disposition of stock only with unanimous consent of the directors. Failing to procure an acceptable buyer, the departing member could require the directors to provide for the purchase of his stock. The court frustrated an attempt by directors to effect a forfeiture through their refusal to retire the offending member's stock. A member of an association who for varied reasons becomes ineligible to continue to participate in the enterprise is entitled to enforce rights still in existence under his marketing contract\textsuperscript{75} and also to receive the par value of his stock in the organization.\textsuperscript{76}

A cooperative, like any other business enterprise, must display some basis of financial responsibility to induce the extension of credit upon which successful conduct of any commercial venture is predicated. The problem differs with the character of the organization, \textit{i.e.}, whether it is an unincorporated or a stock or non-stock corporation. Moreover, the variety of approaches to the task of securing protection to creditors is limited only by the ingenuity of state legislatures and the drafters of

\textsuperscript{73} Reinert v. California Almond Growers' Exchange, 63 P.2d 1114 (1937), subsequent opinion, 9 Cal.2d 181, 70 P.2d 190 (1937).

\textsuperscript{74} 135 Fla. 513, 186 So. 239 (1938).

\textsuperscript{75} HULBERT, \textit{op. cit. supra} note 55, at 75 (1942).

\textsuperscript{76} Avon Gin Co. v. Bond, 198 Miss. 197, 22 So.2d 362 (1945). See also Snyder v. Colwell Cooperative Grain Exchange, 231 Iowa 1210, 3 N.W.2d 507 (1942), in which plaintiff, a shareholder in the old corporation, was ineligible for membership in a reorganized cooperative. It was held that a fiduciary duty existed between prior holders and the managing officers seeking to purchase such ineligible shareholders' stock. Thus the officers were obligated to make full disclosure to plaintiff of all facts bearing upon the value of the redeemed stock.
articles and by-laws for farm cooperatives. In keeping with the trend toward insulating the agricultural cooperative from the impact of many burdensome regulatory measures applicable to corporations generally, there may be a strong tendency to provide only a minimal margin of security to those extending credit to the cooperative. But the long run effect of such a policy may be to subvert the very goals sought to be advanced, by discouraging extension of credit.

Members of an unincorporated agricultural association assume full financial responsibility for the obligations incurred by it. Hence, members of an association organized to market a pickle crop were jointly liable not only for excess advances, but also for debts contracted by the managing trustees in connection with the marketing operation. In an incorporated cooperative having capital stock, shareholders whose subscriptions are paid in full ordinarily are subjected to no further liability for the debts of the corporation in the event of insolvency. However, there is no legal impediment to an agreement among all shareholders binding them to deliver to the cooperative their individual promissory notes whether for the purpose of strengthening its credit or of protecting directors from personal liability when they have found it necessary to pledge their own credit to obtain needed funds. Such agreements have been upheld against the contention that they were mere unenforceable unilateral promises wanting consideration. Consideration for the promise of each shareholder is found in the execution by the others of similar agreements for their mutual benefit.

The range of variety in approach to the problem of members' liability for debts of a nonstock cooperative corporation is broad; strained judicial constructions of exculpatory statutory and by-law provisions in order to protect creditors have not been infrequent. In Lockport Cooperative Dairy Ass'n, Inc. v. Buchner, plaintiff cooperative became

77. Ky. Rev. Stat. § 272.190(3) (1946). "No member shall be liable for the debts of the association to an amount exceeding the sum remaining unpaid on his membership fee or his subscription to the capital stock, including any unpaid balance on any promissory notes given in payment thereof."

78. Tomlin v. Petty, 244 Ky. 542, 51 S.W.2d 663 (1932).


82. For example, the court in Lewis v. Monmouth County Farmers' Co-op. Ass'n, 105 N.J. Eq. 257, 147 Atl. 550 (Ch. 1929), found that a by-law provision expressly negating personal liability for debts of the co-op in excess of a certain amount was an ineffectual attempt to limit such responsibility.

83. 129 Misc. 73, 221 N.Y. Supp. 433 (Sup. Ct. 1925).
unable to meet its maturing obligations and the directors, pursuant to statutory authorization, levied a per capita assessment to secure funds with which to accommodate creditors pressing for payment. Defendant resisted collection on the ground that the articles of incorporation limited individual liability to one dollar. Relying on a provision of the Membership Corporations Act under which plaintiff was incorporated, which imposed liability on members for the debts of the association, the court rejected this defense and condemned the charter provision as one in derogation of the legislative purpose. 84 In another jurisdiction the statutory device developed for the protection of creditors of a non-stock corporation limits the liability of individual members to the amounts due them under their marketing contracts. When the association has satisfied all claims of its members growing out of the marketing contract for a given year, the potential liability of such members to creditors is extinguished. Until such time as the proceeds are turned over to the growers, creditors have an equitable lien upon the funds in the hands of the cooperative. 85 Another scheme adopted in a few states renders each member initially liable for his proportionate share of the cooperative's debts and obligations. In addition, the shares of defaulting members are distributed per capita among remaining members, with the qualification that no member's ultimate liability shall exceed twice his initial share of the total debt. 86

Not infrequently cooperative charters authorize and articles or by-laws adopt a debt limitation. 87 In this event, members of a non-stock corporation are absolved from liability for obligations incurred in excess of this restriction. Legislation may impose personal responsibility on directors for such excesses, thus providing some modicum of protection to unwary creditors while limiting the risks assumed by the association's patrons. 88

84. While the applicable statute authorized establishment of a debt limitation beyond which the cooperative could not contract obligations, the provision in question purported to fix a limitation on individual liability, even for debts within an established debt limitation, in contravention of an express provision fixing liability on members individually.
85. Bank of Aurora v. Aurora Cooperative Fruit G. & M. Ass'n, 91 S.W.2d 177 (Mo. App. 1936).
86. Mandell v. Cole, 244 N.Y. 221, 155 N.E. 106 (1926); Lewis v. Monmouth County Farmers' Coop. Ass'n, 105 N.J. Eq. 257, 147 Atl. 550 (Ch. 1929).
88. Federal Chemical Co. v. Paddock, 264 Ky. 338, 94 S.W.2d 645 (1936). This decision also emphasizes the significance of protection of creditors by revealing that the co-op involved had no capital and conducted its business entirely on borrowed money.
A perennial difficulty not peculiar to cooperative concerns preferential treatment of certain favored creditors to the serious detriment of others, by a cooperative approaching insolvency. The dual status enjoyed by the patron-member makes this problem a perplexing one in the cooperative context. While "insiders" are commonly the recipients of the preference, such members also usually constitute the largest single group of creditors, since a large proportion of the association's business is conducted with its own proprietors.

One reason advanced for invalidating an attempted preference of shareholder-creditors is that they occupy a favorable vantage point from which to perceive the first symptoms of insolvency. Under this theory a Kansas court vitiated a preference granted to ten shareholders in the form of an assignment of promissory notes which were the obligations of eight of the favored group. The court buttressed its position that shareholder-creditors cannot be favored to the exclusion of outsiders who also have extended credit to the association with the arguments that: a) the notes had originally been contributed to make up an impairment of capital and hence constituted a trust fund to which all creditors were entitled to look for the satisfaction of their claims; b) the shareholders in question not only had the advantages of the usual incidents of stock ownership, such as the right of inspection, but also were active in the management of the affairs of the cooperative.

Directors of an insolvent cooperative corporation clearly cannot satisfy their claims against the corporation in preference to the demands of general creditors. This result can be substantiated on the trust fund theory or on the ground that the director occupies a fiduciary relationship to others interested in the assets of the organization and is forbidden to plunder its resources to satisfy personal claims when he foresees financial embarrassment. However, a recent Minnesota decision has adopted a singularly narrow construction of the rule, upholding

91. In Darling & Co. v. Petri, 138 Kan. 666, 27 P.2d 255 (1933), plaintiff supplied fertilizer to a cooperative on a consignment basis. Defendant, a director of the cooperative, had loaned it money and taken a note in return. He surrendered his note and claim in exchange for fertilizer immediately prior to the co-op's insolvency. Recovery against defendant was sustained on the theory that he was in effect a trustee, with notice of the terms of the contract and that as against creditors of the consignee, the consignor's rights are protected.
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a preference conferred upon a director and officer just one month after he had resigned. If his knowledge of impending financial difficulties is the basis for rendering a director ineligible to receive a preference, as the Minnesota case indicates, it is difficult to understand in what manner this factor becomes insignificant upon resignation of the director on the very eve of insolvency.

Numerous regulatory measures have potential application to agricultural cooperatives because of the nature of the activities they engage in and the corporate form under which they most frequently operate. Review of the courts' delineation of cooperatives' immunities from and obligations under these statutes reveals a crazy-quilt pattern indicative of an incessant conflict among major governmental policies. On the one hand, the courts are besieged with reminders of the depressed status of farming in this country before the advent of cooperation, while on the other the argument is urged that uniform achievement of a particular social objective outweighs the slight inconvenience incident upon its application to the farm cooperative. Judicial solicitude for agricultural cooperatives has resulted in their exclusion from the coverage of legislation regulating warehousemen, imposing a license tax on the privilege of conducting various commercial activities, prescribing standards and conditions precedent to the transportation of goods in interstate com-

94. This court recognized a split of authority on the question whether an insolvent corporation can confer a preference and took the position that it can when it has control of all its assets and such action will not prevent its continued operation. Farmers' Co-op. Ass'n of Bertha, Minn. v. Kotz, 222 Minn. 153, 23 N.W.2d 576 (1946).

95. A related problem concerns liability of a cooperative for negligent injuries arising out of its operations. It seems clear that the cooperative entity should assume the risks incident to its undertakings. This was the conclusion reached in Lichty v. Carbon County Agriculture Ass'n, 31 F. Supp. 809 (M.D. Pa. 1940). However, in Arkansas Valley Co-operative Rural Electric Co. v. Elkins, 200 Ark. 883, 141 S.W.2d 538 (1940), a cooperative electric power company successfully resisted liability on the two-fold theory that defendant was a public quasi corporation having no obligations not specifically provided by statute and that it was entitled to the immunity with which some states still clothe charitable corporations.

The liability of a central cooperative for torts of its inadequately capitalized local presents an interesting contrast with the rule ordinarily invoked in the parent-subsidiary context. Since, under the theory of cooperation, control moves upward from the base of the pyramid, members of the local organization presumably direct the activities of the central. Thus, the pattern of control which enables a court to disregard the corporate entity of a subsidiary corporation and impose tort liability on the parent cannot be found in the cooperative superstructure. An opinion emphasizing lack of control as a reason for its refusal to impose liability on a central for a tort of the local is Farmers' Educational and Cooperative Union of America v. Eakins, 188 Okla. 324, 108 P.2d 182 (1940).


merce,\textsuperscript{98} conferring upon creditors the right to institute involuntary bankruptcy proceedings,\textsuperscript{99} forbidding commission merchants from purchasing on their own account,\textsuperscript{100} imposing emergency price ceilings,\textsuperscript{101} and defining prohibited speculative future transactions,\textsuperscript{102} to name only a few. In addition, several courts have grafted unusually broad constructions upon the authorized powers provisions of cooperative charters. For example, in \textit{State v. Consumers Cooperative Ass'n},\textsuperscript{103} a charter provision entitling the association to furnish its members with machinery, equipment and supplies was deemed to justify its entrance into the oil refining business and ownership of oil wells and pipe lines, and, in addition, the operation of canning plants, lumber mills, printing plants, paint factories, and insurance and auditing enterprises.\textsuperscript{104} On the other hand, decisions inimical to the cooperative movement can be found which impose upon these organizations the restrictions embodied in state license taxes,\textsuperscript{105} legislation governing public markets,\textsuperscript{106} the federal bankruptcy act,\textsuperscript{107} and several others.\textsuperscript{108}

A context in which the problem of cooperative immunity from burdensome statutory requirements is brought into sharp focus is presented by the cases defining exemptive provisions employing the termi-
nology "agricultural labor." The lines of controversy have been sharply drawn by the appearance of diametrically opposed decisions in California and Arizona. In the former state, cooperative associations have been accorded the benefit of the "agricultural labor" exemption to the Unemployment Insurance Act on the theory that the association is merely an instrumentality of each individual participant. Since farm hands conducting identical activities on the farm would not be embraced within the scope of the act, the court reasoned that the performance of these functions "incidental to ordinary farming operations" by a cooperative marketing association at the central establishment was within the spirit of the exemption. To comply with the literal terms of the statute the court was forced to indulge the obvious fiction that the cooperative's activities were conducted "on the farm." The Arizona court, conversely, assumed the position that employees of a marketing association engaged in grading, sorting, cleaning, and wrapping fruits in the association's packing plant were not "agricultural laborers." The Arizona decision was founded upon recognition of the cooperative as a corporate entity and refusal to "pierce the veil" to impute to the member-cooperative relationship an agency or trust character.

Neither approach is to be advocated, nor is either result necessarily incorrect. Rather, doctrinaire application of meaningless legal formulae should be supplanted by a realistic evaluation of relevant policy considerations. When there are no real indicia of legislative intent, the court is at liberty to achieve a result most consistent with the welfare of all interest groups affected by their decision. Much, of course, depends upon the severity of the burden which the act would impose upon cooperation and the prevailing economic status of agriculture and of the marketing associations themselves. Such factors may indicate the necessity of shielding cooperatives from any additional financial burden. On


110. While the court in the California Employment Commission Case was entirely correct in rejecting the separate entity theory as a basis for application of the statute, the agency or instrumentality argument it adopted is equally questionable. California Employment Commission v. Butte County Rice Growers' Ass'n, 146 P.2d 908 (1944), subsequent opinion, 25 Cal.2d 624, 154 P.2d 892 (1944).


112. A similarly mechanical means of reaching a result was adopted in North Whittier Heights Citrus Ass'n v. N.L.R.B., 109 F.2d 76 (9th Cir. 1940). The court contrasted the means of accomplishing identical functions on the farm and in the co-op warehouse. On the basis of apparent differences, they concluded that the latter was not entitled to benefit from an exemption intended to cover agricultural labor.
the other hand, a policy strongly embedded in modern legal thinking, and embodied in the legislative enactments under discussion, is that a commercial entity should assume a portion of the risk of injury and unemployment incident to its business. Another circumstance which may be significant is the fact that administrative aspects of unemployment compensation render it particularly inadaptable to the small business such as the average farm unit. The agricultural labor exemption may stem from the latter consideration rather than from any legislative desire to exempt the farmer from the responsibilities growing out of the conduct of his business.

In the past, legislative and judicial attitudes have been extremely favorable to the farm cooperative, perhaps in response to the serious need to inject new vigor into our farm economy. With the advent of improved agricultural conditions and enhanced farm prosperity, some courts and legislatures have adopted a more critical approach to continuing cooperative demands for preferential treatment. Exact equilibrium among competing economic and social goals is, of course, unattainable. However, a continuing attitude of critical scrutiny of the claims of all organized groups is the only satisfactory means of adjusting governmental policy to the demands of changing economic conditions.