An Agricultural Law Research Article

Organization of Agricultural Marketing Cooperatives

by

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COMMENTS
Organization of Agricultural Marketing Cooperatives

The history of the economic system in the United States has been one of increasing combination and concentration of capital, and the indications are that the trend will continue in an ever-increasing spiral.[1] The result has been greater and greater domination of the market by a few large enterprises.[2] In the race for power in the commodity market the group which would be almost completely left behind, were it not for price supports, is the American farmer, particularly the kind of small-scale farmer typically found in Arkansas. In an attempt to secure equality of bargaining power, more and more farm groups are turning to the device of agricultural marketing cooperatives.[3] In view of the growing importance of cooperative enterprises, it behooves an attorney in an agricultural state to consider carefully the problems involved in setting up such organizations.

The typical farmers' cooperative marketing association is organized to take delivery of farm products immediately after they are harvested or otherwise produced; to store, process or ship them as necessary; to sell or contract to sell them as the products of a single business unit; and to distribute the proceeds on the basis of products contributed. Also provision is usually made for purchasing farm supplies and equipment at cost plus expense. For the most part cooperatives still adhere to the principles laid down by the Rochdale group in 1844: (1) paying or charging of locally prevailing prices; (2) limited interest on capital investment; (3) refunds in proportion to contributions or purchases; (4) dealing with members for cash and not for credit; (5) sex equality; (6) one vote for each member; and (7) regular and frequent meetings.[4] The members usually bind themselves to deliver their entire production for a limited period in return for their pro rata share of the receipts.

Courts and legislatures have often recognized the value of producers' cooperatives by granting them special privileges and immunities; that such grants are constitutional is no longer doubtful.[5] Thus Congress in the Clayton and Capper-Volstead Acts granted to such cooperatives in their normal operations immunity from the antitrust laws;[6] most states have done the same.[7] Similarly Congress

[1]Harris, *Growing Concentration of Economic Power in U.S.*, St. Louis Post-Dispatch, Nov. 24, 1946, § 6, p. 1, cols. 1-4.

[2]See Brandeis, dissenting in Louis K. Liggett Co. v. Lee, 288 U.S. 517, 565 (1933); BERLE AND MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 18 (1932).

[3]REP. FARM CREDIT ADM'N, COOPERATIVE RESEARCH AND SERVICE DIV. (Oct. 1945).

[4]PACKEL, COOPERATIVES § 4 (2d ed. 1947).

[5]Liberty Warehouse Co. v. Burley Tobacco Growers' Co-op. Marketing Ass'n, 276 U.S. 71 (1928).

[6]15 U.S.C. § 17 (1946); 7 U.S.C. § 291 (1946). Of course, this immunity does not protect cooperatives which enter into combinations or conspiracies with third persons, United States v. Borden Company, 308 U.S. 188 (1939), or engage in secondary boycotts. United States v. King, 250 Fed. 908 (D. Mass 1916).

[7]ARK. STAT. (1947) §§ 77-925, 77-1022.

has exempted producers' cooperatives from income taxation in certain cases,[8] although not extending the exemption to consumers' cooperatives, and has made special provision to assist their development through loans.[9] Arkansas, as have most other states, has sought to encourage cooperatives by granting some immunity from taxation and by providing special means of enforcing marketing contracts and preventing interference therewith by third parties.[10] In the same spirit the Arkansas court, on analogy to non-profit religious or charitable organizations, held that cooperatives were not liable for the tort of a member or employee.[11] However, this rule has now been abrogated by statute.[12]

The first problem for an attorney to consider is the type of organization best suited to the needs of the particular group with which he is concerned. Almost invariably it will be desirable to incorporate the organization; the reports contain many examples of the calamitous results of failure to achieve this end.[13] Therefore, care must be taken to comply exactly with the requirements of the particular statute under which it is decided to organize. Arkansas has made specific provision for incorporating various types of cooperatives;[14] but there are three separate statutes under which an agricultural marketing cooperative may be organized. In the first place, it is possible to incorporate under the general corporation laws.[15] Since, however, these make no express provision for many of the powers necessary to cooperative operation or for the special privileges granted cooperatives, they should be utilized only when it is impossible to bring the particular organization within the scope of the special statutes. Of the two special statutes, the Cooperative Marketing Act of 1921 and the Agricultural Cooperative Act of 1939,[16] the latter will be the better in most instances. Although the older act originally precluded handling products of any nonmember, it was amended in part to proscribe only the handling of products of nonmembers to an extent greater than those handled for members. However, it is not clear that the amendment is effec-

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[8]INT. REV. CODE §§ 101(12), 101(13).

[9]12 U.S.C. § 1134 (1946).

[10]*E.g.*, ARK. STAT. (1947) §§ 77-1023, 77-1017, 77-1021; McCain v. Farmers' Electric Cooperative Corp., 206 Ark. 15, 172 S.W.2d 933 (1943) (unemployment compensation taxes). Similarly, rural electrification cooperatives are exempted from the jurisdiction of the Public Service Commission. ARK. STAT. (1947) § 77-1131; Arkansas-Louisiana Electric Cooperative, Inc. v. Arkansas Public Service Comm'n, 210 Ark. 84, 194 S.W.2d 673 (1946); Department of Public Utilities v. McConnell, 198 Ark. 502, 130 S.W.2d 9 (1939).

[11]Arkansas Valley Cooperative Rural Electric Co. v. Elkins, 200 Ark. 883, 141 S.W.2d 538 (1940).

[12]ARK. STAT. (1947) § 64-1525.

[13]See, *e.g.*, Harris v. Ashdown Potato Curing Ass'n, 171 Ark. 399, 284 S.W. 755 (1926); Webster v. San Joaquin Fruit & Vegetable Growers' Protective Ass'n, 32 Cal. App. 264, 162 Pac. 654 (1916).

[14]ARK. STAT. (1947) §§ 66-801—66-1504 provide for incorporation of various kinds of mutual insurance companies; ARK. STAT. (1947) §§ 64-1501 *et seq.* provide for incorporation of consumer cooperatives; and ARK. STAT. (1947) §§ 77-1101 *et seq.* provide for incorporation of rural electrification cooperatives.

[15]Simon v. Sevier Ass'n, 54 Ark. 58, 14 S.W. 1101 (1890).

[16]ARK. STAT. (1947) §§ 77-901 *et seq.* and 77-1001 *et seq.*

tive as to the entire act.[17] The new act contains no limitation whatsoever in this respect. The old act limits membership to those engaged in the production of agricultural products to be handled through the association and prohibits transfer of membership to others; whereas the new act allows admittance of anyone engaged in the production of agricultural commodities and contains no restrictions on transfer.[18] The old act limits the term to fifty years, but the new act permits the cooperative to be perpetual.[19] Also the old act contains limitations as to amendments, a ten-year limit on marketing agreements, and an 8% limit on interest on stock, which are not included in the new.[20] Of possibly great value is the addition to the new act of a "conclusive presumption" that the products grown on a member's land are his and subject to the exclusive marketing agreement.[21] Although most of the limitations contained in the old act are likely to be inserted in the charter for various reasons, it would seem preferable to organize under the new act so that the charter may be amended if the necessity arises.

Under either special statute the cooperative may be organized with or without capital stock; in the latter case membership is denoted by a certificate. Formerly a great many cooperatives were organized without capital stock because of the greater ease of restricting transfer of memberships, but under modern statutes and decisions the transfer of capital stock can equally be restricted.[22] On the other hand, modern marketing cooperatives frequently require large amounts of capital, and that can usually be obtained only through the issuance of capital stock. Therefore, an organization with capital stock would seem preferable. As to whether provision should be made for both common and preferred stock, the factors to consider are similar to those involved in the organization of a regular business corporation. However, if the revolving fund plan[23] is to be used, it can be set up much more easily with preferred stock. The amount of stock to be authorized also depends upon the particular circumstances, but the revolving fund plan may require authorization of a great deal more stock than is initially to be issued. But the normal objections to a large authorization do not arise, because the tax exemption includes the corporate franchise tax.[24]

The articles of incorporation must include a statement of the purposes and powers of the cooperative. Although the statutory provisions on this point are quite broad,[25] it is desirable to adapt them to the particular organization involved and frequently to limit them in certain respects. To come within the immunity granted by

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[17]ARK. STAT. (1947) § 77-906(a). Although the statute limits dealings with nonmembers, there is no provision affirmatively empowering any dealings with nonmembers. *Cf.* Tulsa Milk Producers' Co-op. Ass'n v. Hart, 145 Okla. 263, 292 Pac. 558 (1930).

[18]Compare § 77-907 with § 77-1007, and § 77-914 with § 77-1014.

[19]Compare § 77-908(d) with § 77-1008(d).

[20]ARK. STAT. (1947) §§ 77-908(f), 77-909 (amendments), § 77-917 (marketing agreements and interest).

[21]ARK. STAT. (1947) § 77-1017. See text at note 78 *infra*.

[22]HULBERT, LEGAL PHASES OF COOPERATIVE ASSOCIATIONS 58 *et seq.* (1942). See text at note 37 *infra*.

[23]See text at notes 44-46 *infra*.

[24]ARK. STAT. (1947) § 77-1023.

[25]ARK. STAT. (1947) §§ 77-1004, 77-1006.

the Capper-Volstead Act a cooperative must follow the one vote per member principle and/or limit dividends on capital to 8% per annum, and in any event must not deal with nonmembers in an amount greater than its dealings with members.[26] The same requirement is made to qualify for a federal loan,[27] and as a matter of interpretation the word "cooperative" is usually defined to include these qualifications when it is used by Congress in other grants of special privileges and immunities.[28] Hence it is clearly desirable to include in the articles provisions which comply with these requirements. It is not so clear that an attempt should be made to comply with the requirements for complete exemption from the federal income tax. Such exemption is granted only if (1) the organization is organized and operated by farmers, (2) "substantially" all the common stock is owned by producers who do their marketing or purchasing through the association, (3) only reasonable and necessary reserves are accumulated, (4) members and nonmembers are treated alike, and (5) purchases by nonmember-nonproducers do not exceed 15% of all purchases.[29] Although these requirements sound easy to meet, they do not prove so in practice. They are strictly construed against the cooperative, and exact compliance is required.[30] Because of the difficulty and uncertainty of meeting these requirements, many cooperatives do not attempt to come within the exemption, but rely upon the deductibility of patronage refunds to reduce taxes below a burdensome amount.[31] This has proved satisfactory in most instances.

The articles of incorporation should also contain a detailed statement of the rights and duties of the member-shareholders, for herein lies one of the principal differences between the cooperative and the normal business corporation. The principle that each member should have only one vote regardless of his stock ownership is practically the *sine qua non* of cooperative organization; however, this does not preclude cumulative voting when more than one director is to be elected.[32] Whether or not to allow proxy voting or voting by mail frequently proves to be a problem; but, unless the membership is concentrated, the necessity of securing the consent of a large group would seem to outweigh the desirability of maintaining interest through personal participation by the members. Although the cooperative plan is designed to distribute income on the basis of products contributed rather than capital invested, it is generally found that some return on investments is necessary to attract the capital required to operate such an enterprise. Persons who are interested in cooperatives do not ordinarily have surplus capital, the use of which they can donate. That this return should be limited to 8% per annum has already been indicated; and if tax exemption is desired, the return must also be limited to the legal rate of inter-

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[26] 7 U.S.C. § 291 (1946).
[27] 12 U.S.C. § 1141(j)(a) (1946).
[28] Bowles v. Inland Empire Dairy Ass'n, 53 F. Supp. 210 (E.D. Wash. 1943).
[29] INT. REV. CODE § 101(12).
[30] U.S. Treas. Reg. 111, § 29.101(12)-1 (1945); Fertile Co-op. Dairy Ass'n v. Huston, 119 F.2d 274 (8th Cir. 1941); Farmers' Union Co-op. Co. v. Comm'r, 90 F.2d 488 (8th Cir. 1937).
[31] See note 50 *infra*.
[32] ARK. STAT. (1947) § 77-1014.

est.[33] Thus provision should be made for the rate on both common and preferred stock, and for whether either or both are to be cumulative. Since in the absence of contract the members' liability is limited to their investments, specific provision must be made for assessments if those are desired to finance various types of services.[34] The most equitable provision would be for assessment on the basis of products contributed or purchases made, which would result in a several liability for a proportionate part of the debts.[35]

Because of the importance of the personal relationship between the members of a cooperative and because of the fiduciary character of their mutual rights and obligations,[36] it is usually desirable to restrict not only the classes of persons eligible for membership, but also the transferability of shares. The easiest way to do so is to provide that shares can be transferred only with the consent of the board of directors; the same result can be reached by specifically enumerating the only classes to which shares may be transferred. The validity of such restrictions is now unquestionable.[37] There is not only specific statutory authorization therefor,[38] but they have also been upheld in the absence of such authorization.[39] Although these restrictions are properly placed in the articles of incorporation and by-laws, they must also be printed on the face of the certificate of stock if they are to be effective against third persons.[40] Also of importance is a provision for withdrawal of a member or termination of his status. Thus if a member becomes ineligible, the board of directors should be empowered to cancel his stock. The by-laws of most cooperatives provide for expulsion by vote of the membership of a member whose interests are opposed to those of the group.[41] In either of these situations or that of withdrawal by the consent of both parties, there should be a provision for equitable determination of the value of the interest and payment therefor. And similar powers may be used to penalize a member for failure to fulfill his obligations. Thus a provision for forfeiture if a member fails to deliver his products as agreed may be enforced as a contract between

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[33]INT. REV. CODE § 101(12). The legal rate in Arkansas is 6%. ARK. CONST. Art. XIX, § 13.

[34]Steelman v. Oregon Dairymen's League, 97 Ore. 535, 192 Pac. 790 (1920). ARK. STAT. (1947) § 77-1014. Although the statutes do not specifically authorize a provision for assessments, the latter would seem to be included within the general powers of § 77-1006(h) or the terms of § 77-1010(i): "The amount which each member or stockholder shall be required to pay annually or from time to time, if at all, to carry on the business of the association. . . ." The amount so assessed should be a "debt lawfully contracted" within the meaning of § 77-1014.

[35]Meikle v. Wenatchee North Central Fruit Distributors, 129 Wash. 619, 225 Pac. 819 (1924). *Cf.* Alfalfa Growers of Calif. v. Icardo, 82 Cal. App. 641, 256 Pac. 287 (1927), which held invalid a provision for assessment on the basis of acreage.

[36]See Bogardus v. Santa Ana Walnut Growers' Ass'n, 41 Cal. App.2d 939, 108 P.2d 53 (1940).

[37]Carpenter v. Dummit, 221 Ky. 67, 297 S.W. 695 (1927).

[38]ARK. STAT. (1947) § 77-1007.

[39]Stuttgart Cooperative Buyers' Ass'n v. Louisiana Oil Refining Corp., 194 Ark. 779, 109 S.W.2d 682 (1937).

[40]ARK. STAT. (1947) § 64-315.

[41]PACKEL, COOPERATIVES § 22.

the parties.[42] Again these terms must be printed on the face of the stock certificate.[43]

The third important restriction on stockholders' rights is a power in the cooperative to repurchase or redeem the stock at will. This power exists, however, only if there is a specific provision for it. The power to repurchase or redeem is an integral part of the revolving fund plan, which is generally considered to be the most successful method of financing the operations of marketing cooperatives.[44] While an investor in a business corporation understands that he can get his money back only through a sale or dissolution, the cooperative member usually invests to secure services and expects his capital to be returned as soon as possible. Since there is normally no market for cooperative stock, and since it is advantageous to the cooperative itself to keep the stock in the hands of active members, it is desirable to provide for repurchase or redemption of the oldest outstanding stock when funds are available for such purposes. Under the revolving fund plan a certain percentage is deducted from each member's share of the proceeds from sales and applied to the purchase of stock for him. When a sufficient amount of capital is accumulated to carry on operations, the balance is used to repurchase or redeem the oldest outstanding stock. Thus, after the stock has begun to revolve, the investment of the oldest members is continually being replaced by that of the presently active ones. Although this plan can be used by a non-stock cooperative to retire loans from members and by a stock cooperative to repurchase common stock, its most effective use is to repurchase preferred stock. This places the investment burden on those currently benefiting from the organization and allows contribution by customers not eligible for common stock ownership.[45] Since the revolving fund plan is in derogation of the ordinary rights of stockholders, particularly in its repurchasing phases, it should be clearly set forth in the by-laws, and provision should be made for determining the repurchase price.[46]

Since the accumulation of capital retains is necessary for the operation of the revolving fund plan, the by-laws must also carry express authorization for such accumulation.[47] Equally there must be provisions for taking care of expenses and setting up reserves. Therefore, the by-laws should outline in detail the deductions which may be made before distributing to members the proceeds of sales. Unless a clear distinction is drawn as to the purpose of each deduction and the board's authority with respect thereto, litigation is vir-

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[42]Bassette v. St. Albans Cooperative Creamery, 107 Vt. 103, 176 Atl. 307 (1935). *Cf.* Hood River Orchard Co. v. Stone, 97 Ore. 158, 191 Pac. 662 (1920), wherein a forfeiture of "all right and interest of every kind" was held not to include the member's interest in patronage refunds accumulated over several years, but was limited to "the interest which a member may have in and to the net assets . . . by reason of membership therein."

[43]ARK. STAT. (1947) § 77-1014.

[44]Nieman, *Revolving Capital in Stock Cooperative Corporations,* 13 LAW & CONTEMP. PROB. 393 (1948).

[45]Thus non-producers ineligible for membership under ARK. STAT. (1947) § 77-1007, but who make some purchases or sales through the cooperative, may make their fair contribution to capital.

[46]Bogardus v. Santa Ana Walnut Growers' Ass'n, *supra* note 36.

[47]McCauley v. Arkansas Rice Growers' Co-op. Ass'n, 171 Ark. 1155, 287 S.W. 419 (1926).

tually a certainty.[48] If there is any possibility of a future need of additional capital which will not be taken care of by the revolving fund, or if the revolving fund plan is not used, the board should be authorized to withhold part of the proceeds for reserves and retain them as necessary. These reserves remain the property of the contributing members and can always be distributed to them if not used; but unless an appropriate provision is made, the board is without power to withhold.[49] In connection with the accumulation of capital retains and reserves, it is important to note the possible income tax liability therefor. It is well settled that, whether or not the cooperative enjoys exempt status, its patronage refunds actually distributed on the basis of contributions may be deductible rebates or exclusions.[50] To achieve this result, however, the by-laws should specifically provide that it is the absolute duty of the cooperative to distribute all proceeds in excess of authorized expenses, reserves and capital retains.[51] By proper provision and actual operation consistent therewith, proceeds allocated to capital retains and reserves can also be non-taxable. Thus the by-laws should specifically state that sums accumulated are the property of the members, and should require that they be pro-rated to the members on the basis of business transacted. Then in practice the cooperative's books should show the allocations of reserves and capital retains to members, and some evidence of his rights should be issued to each member.[52] In the same connection the problem of dealings with nonmembers arises. Most marketing cooperatives have found it advisable to authorize dealings with nonmembers because the additional volume cuts pro rata expenses, but there is no agreement as to whether patronage refunds should be paid to nonmembers. This problem might be solved by giving patronage refunds to nonmembers only on condition that such refunds are applied to the purchase of stock.[53] Of course, if the cooperative is seeking tax exemption, it must deal with nonmembers on a non-profit basis.[54] But in any event it seems that any profits from sales for nonmembers, either distributed to or accumulated for members, is taxable gain to the cooperative, just as is the profit from which it pays dividends on stock.[55]

The third instrument defining the rights and duties of the cooperative and its patrons is the marketing agreement. These agreements are frequently signed before incorporation, subject to the condition precedent of signing up a certain percentage of producers in the area. Such a condition is necessarily ambiguous, and proof of compliance

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[48]Burley Tobacco Growers' Co-op. Ass'n v. Tipton, 227 Ky. 297, 11 S.W.2d 119 (1928); Burley Tobacco Growers' Co-op. Ass'n v. Brown, 229 Ky. 696, 17 S.W.2d 1002 (1929).

[49]Silveira v. Associated Milk Producers, 63 Cal. App. 572, 219 Pac. 461 (1923); Dryden Local Growers v. Dormaier, 163 Wash. 648, 2 P.2d 274 (1931).

[50]G.C.M. 17895, 1937-1 CUM. BULL. 56; Uniform Printing & Supply Co. v. Comm'r, 88 F.2d 75 (7th Cir. 1937).

[51]American Box Shook Export Ass'n v. Comm'r, 156 F.2d 629 (9th Cir. 1946).

[52]San Joaquin Valley Poultry Producers' Ass'n v. Comm'r, 136 F.2d 382 (9th Cir. 1943).

[53]*But cf.* ARK. STAT. (1947) § 77-1026, requiring for cotton cooperatives a membership contract in duplicate. Care must also be taken not to admit nonproducers. See note 18 *supra*.

[54]See note 29 *supra*.

[55]Farmers' Union Co-op. Co. v. Comm'r, 90 F.2d 488 (8th Cir. 1937).

therewith is difficult;[56] hence the question of compliance should be made determinable by the board of directors. Its determination will be upheld in the absence of fraud or bad faith.[57] Since the same agreement is customarily used for both members and nonmembers, there should be a provision incorporating the by-laws in the agreement and setting out in detail the revolving fund plan and the cooperative's right to make deductions and accumulations. The almost universal practice of marketing cooperatives is to advance to the producer upon delivery an amount approximately equal to the current market price for his products. Of course, any excess received by the cooperative, less the authorized deductions, is returned to the producer in the form of patronage dividends; but it may instead suffer a loss. To enable the cooperative to collect from the producer his pro rata share of the loss in such a case, the marketing agreement should make it clear that the amount given to him is an advancement, rather than payment for his products.[58] Although it has been held that the producer impliedly agrees to repay any excess advance, it is advisable to provide therefor expressly.[59]

A question similar to that of advance or payment is whether the relationship between the cooperative and the producer is that of vendor-purchaser, principal-agent or trustee-beneficiary. Although it is possible that the relationship is one new to the law,[60] the courts find it necessary to categorize it along traditional lines in determining questions of insurance or tort recovery, subjection to payment of debts, and rights in the proceeds.[61] To allow the cooperative the full freedom necessary to negotiate and sell, it must have title to the products free from any claim of the producer. Consequently, the marketing agreement should provide that title passes to the cooperative upon delivery, or sooner. However, the validity of many of the provisions concerning division of the proceeds may depend upon the establishment of the principal and agent relationship.[62] Thus it should be stated that the relationship between the parties is that of principal and agent, but that title passes to the cooperative with complete power to handle and sell the commodities. Although the great majority of jurisdictions hold that the cooperative is an agent with power of sale,[63] or a trustee,[64] the possibility that the contract will be construed as one simply of purchase and sale should be foreclosed.[65]

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[56]Erdmore Marketing Ass'n v. Skinner, 248 Mich. 695, 227 N.W. 681 (1929).

[57]Rowland v. Burley Tobacco Growers' Co-op. Ass'n, 208 Ky. 302, 270 S.W. 784 (1925); Wenatchee Dist. Co-op. Ass'n v. Mohler, 135 Wash. 169, 237 Pac. 300 (1925).

[58]Neith Cooperative Dairy Products Ass'n v. National Cheese Producers' Federation, 217 Wis. 202, 257 N.W. 624 (1934).

[59]Arkansas Cotton Growers' Co-op. Ass'n v. Brown, 179 Ark. 338, 16 S.W.2d 177 (1929).

[60]Jensen, *Cooperative Corporation Law on the Marketing Transaction,* 22 WASH. L. REV. 1 (1947).

[61]*But cf.* Louisville & N.R.R. v. Burley Tobacco Society, 147 Ky. 22, 143 S.W. 1040 (1912).

[62]Texas Certified Cottonseed Breeders' Ass'n v. Aldridge, 122 Tex. 464, 61 S.W.2d 79 (1933).

[63]Bowles v. Inland Empire Dairy Ass'n, 53 F. Supp. 210 (E.D. Wash. 1943).

[64]California & Hawaiian Sugar Refining Corp. v. Comm'r, 163 F.2d 531 (9th Cir. 1947).

[65]Colorado-New Mexico Wool Marketing Ass'n v. Manning, 96 Colo. 186, 40 P.2d 972 (1935).

The principal function of the marketing agreement is to define the mutual obligations of the cooperative and the producer. Since cooperatives frequently handle a large variety of products, provision is usually made to place each variety in a separate pool. Pools may also be set up on the basis of date of delivery when that factor largely determines the price. In such cases the pool becomes the unit of accounting; each producer is entitled to share in the proceeds of each pool according to his contributions thereto.[66] To take care of unforeseen difficulties in marketing, the pooling arrangements should be made discretionary with the cooperative, not mandatory.[67] And for the same reason other provisions as to the manner of marketing should be discretionary if the cooperative is to avoid future litigation.[68] Nor does this grant of discretion remove the element of mutuality of obligation.[69] The principal obligation which must be imposed upon the producer if the cooperative is to operate successfully is that he deliver the entire production by or for him for a stated length of time. It is this obligation which foments the largest part of the litigation in which cooperatives are involved. Clearly damages for breach of such an obligation are so difficult to ascertain that a liquidated damage provision is valid and enforceable.[70] There should also be a provision for equitable relief in the form of specific performance and payment of costs by the defaulting member in either type of suit.[71] All these provisions are specifically authorized by the Arkansas statute.[72] In cooperatives' actions to enforce such provisions, various types of defenses have been interposed, for the most part ineffectively. Although release of some producers from their obligations to deliver is usually considered justification for rescission by others,[73] the power of a cooperative effectively to release at all has been questioned.[74] The impropriety of any release raises the question of what should be done about a producer who finds it necessary to mortgage his crops. Apparently the best solution is to recognize in the marketing agreement the right of the producer to mortgage free of any claim by the

[66]Cole v. Southern Michigan Fruit Ass'n, 260 Mich. 617, 245 N.W. 534 (1932).

[67]Cunningham v. Long, 125 Me. 494, 135 Atl. 198 (1926).

[68]Arkansas Cotton Growers' Co-op. Ass'n v. Brown, 168 Ark. 50, 270 S.W. 946 (1925); California Bean Growers' Ass'n v. Rindge Land & Navigation Co., 199 Cal. 168, 248 Pac. 658, 47 A.L.R. 904 (1926).

[69]Thus it was held in Texas Farm Bureau Cotton Ass'n v. Stovall, 113 Tex. 273, 253 S.W. 1101 (1923) that consideration moved, not only from the cooperative, but also from its other members. The Arkansas court follows the same rule and has even held that the mandatory obligations of the cooperative are independent covenants, breach of which does not justify rescission by the producer. McCauley v. Arkansas Rice Growers' Co-op. Ass'n, 171 Ark. 1155, 287 S.W. 419 (1926). *Cf.* Dairymen's League Co-op. Ass'n v. Holmes, 207 App. Div. 429, 202 N.Y. Supp. 663 (4th Dep't 1924).

[70]Anaheim Citrus Fruit Ass'n v. Yeoman, 51 Cal. App. 759, 197 Pac. 959 (1921). See also *Ex parte* Baldwin County Producers' Corp., 203 Ala. 345, 83 So. 69 (1919), where such a provision was upheld as a charge for services rendered.

[71]Arkansas Cotton Growers' Co-op. Ass'n v. Brown, 168 Ark. 50, 270 S.W. 946 (1925); Pierce County Dairymen's Ass'n v. Templin, 124 Wash. 567, 215 Pac. 352 (1923).

[72]ARK. STAT. (1947) § 77-1017.

[73]Staple Cotton Co-op. Ass'n v. Borodofsky, 143 Miss. 558, 108 So. 802 (1926); Olympia Milk Producers' Ass'n v. Herman, 176 Wash. 338, 29 P.2d 676 (1934).

[74]California Canning Peach Growers v. Downey, 76 Cal. App. 1, 243 Pac. 679 (1925).

cooperative, but to provide that the cooperative may pay off the mortgage and deduct it from the proceeds due the particular producer.[75] Since it is always provided that a producer is released when he ceases production, a few have evaded their obligation by transferring all productive assets to their wives.[76] This could perhaps be prevented by a requirement of good faith cessation. Another loophole arises from the provision that the producer must deliver production "by or for" him. Although this clearly covers the share of a landlord-obligor produced by a tenant, it is held not to include the tenant's share.[77] This loophole has been closed in Arkansas, as in several other states, by a conclusive statutory "presumption" that the produce of an obligor's land is subject to his control.[78] There should be no doubt of the constitutionality of such a provision.[79] Also in an attempt to assist enforcement of marketing agreements Arkansas has provided civil and criminal sanctions against inducing a breach thereof.[80] Mere purchase with notice of the agreement does not constitute such an "inducement" in Arkansas,[81] but a statute drawn to penalize merely "permitting" breach would probably be constitutional.[82]

There is no question of the utility of the cooperative form of marketing organization; it has resulted in benefit both to its members and to consumers of agricultural products. However, the propriety of many of its privileges and immunities, particularly the limited tax exemption, has been closely questioned. Since these criticisms are steadily increasing both in volume and severity as cooperatives extend their scope, some modification of the present government policy will quite likely be the result.[83] On the other hand, there is also a possibility that the current policy of subsidizing agriculture will be modified, and this will necessitate increased efforts on the part of farmers themselves to better their market position. And on the whole, continued expansion of cooperative activity seems assured. An Arkansas attorney can be of distinct service both to himself and to his community by being able to cope with the problems involved in organizing or re-organizing agricultural marketing cooperatives.

W. DANE CLAY.

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[75]McCauley v. Arkansas Rice Growers' Co-op. Ass'n, 171 Ark. 1155, 287 S.W. 419 (1926).

[76]Layne v. Tobacco Growers' Cooperative Ass'n, 147 Va. 878, 133 S.E. 358 (1926); Inland Empire Dairy Producers' Ass'n v. Melander, 134 Wash. 145, 235 Pac. 12 (1925).

[77]Tobacco Growers' Co-op. Ass'n v. Bissett, 186 N.C. 180, 121 S.E. 446 (1924).

[78]ARK. STAT. (1947) § 77-1017(c).

[79]Feagain v. Dark Tobacco Growers' Co-op. Ass'n, 202 Ky. 801, 261 S.W. 607 (1924). *Contra:* Louisiana Farm Bureau Cotton Growers' Co-op. Ass'n v. Clark, 160 La. 294, 107 So. 115 (1926) (because of the peculiar nature of the tenant's interest in Louisiana). Wisconsin, apparently fearful of the constitutionality of the above provision, makes recordation of the marketing agreement notice to subsequent parties. Watertown Milk Producers' Co-op. Ass'n v. Van Camp Packing Co., 199 Wis. 379, 225 N.W. 209, 17 A.L.R. 391 (1929).

[80]ARK. STAT. (1947) § 77-1021.

[81]Loewer v. Arkansas Rice Growers' Co-op. Ass'n, 180 Ark. 484, 22 S.W.2d 17 (1929).

[82]Liberty Warehouse Co. v. Burley Tobacco Growers' Co-op. Marketing Ass'n, 276 U.S. 71 (1928). *Contra:* Minnesota Wheat Growers' Co-op. Marketing Ass'n v. Radke, 163 Minn. 403, 204 N.W. 314 (1925).

[83]JENSEN, COOPERATIVE CORPORATE ASSOCIATION LAW—1950 134.