Farmer Cooperatives and the Federal Securities Laws: The Case for Non-Application

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FARMER COOPERATIVES AND THE FEDERAL SECURITIES LAWS: THE CASE FOR NON-APPLICATION

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American public policy has encouraged the formation of farmer cooperatives since the early 20th century. While these efforts have been somewhat successful, certain legal questions persist which restrain the full potential of cooperatives. Lingering uncertainty about the applicability of the federal securities laws to farmer cooperatives is one such issue. This article reviews the public policies promoting cooperatives, examines judicial interpretations of securities issues, and advances the view that the federal securities laws should not apply to cooperatives. Such a conclusion, if embraced by judges, will clarify the legal status of farmer cooperatives and thereby aid farmers who are seeking to bolster their marketing institutions through cooperative ventures.

Given the extremely volatile nature of agricultural markets, farmers face immense economic uncertainty.[1] The unpredictability of markets and the absence of control over their economic futures compounds the pain of ultimate failure, farm bankruptcy. Cooperative efforts, while they may also fail, provide farmers an important sense of inclusion in their own fates by involving them in the marketing process.[2] Greater involvement in

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1. Clare Howard, *'Freedom to Farm' Exposes Family to a Brutal Market; End of Subsidies Makes it Hard for Small Farming Operations to Stay in Business*, PEORIA J. STAR, July 18, 1999, at A1 (reporting the "lowest soybean prices in 30 years and the lowest corn prices in 12 years" and "[i]ndications [which] seem to point to even lower prices to come"); Scott Kilman, *Weaning Farmers: Crop Deregulation Is Put to the Test in New Rural Crisis; Growers, Though Battered, Hang On, and Congress Passes Another Bailout; More Corn, Despite the Price*, WALL ST. J., Nov. 9, 1998, at A1 (noting that corn prices have dropped 60% since 1996 and soybean prices have dropped about 33%).

2. *See* W. Chan Kim & Renee Mauborgne, *Fair Process: Managing in the Knowledge Economy*, HARV. BUS. REV., July-Aug. 1997, at 65.

farmer cooperatives, which enhance farmer bargaining power with food processors or which enter the processing sector themselves, also allows farmers to avoid the dangers of vertical contracting on an individual basis with large processors[3] and to preserve their economic independence.[4] The strengthening of farmer cooperatives also serves social policy goals by aiding farmers' efforts to receive a just return for their products.[5] Strong farmer cooperatives preserve farmers' independent free-hold status as well, which can potentially slow the current trend of concentrating wealth in the hands of the richest and best-educated Americans.[6] Promoting self-organization and market participation,

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3. *See* Randi Ilyse Roth, *Redressing Unfairness in the New Agricultural Labor Arrangements: An Overview of Litigation Seeking Remedies for Contract Poultry Growers*, 25 U. MEM. L. REV. 1207, 1207-1209 (1995) (reviewing the problems of vertical contracting in poultry); Jedediah Purdy, *The New Culture of Rural America*, AMER. PROSPECT, Dec. 20, 1999, at 26, 28. According to Purdy:

> In the 1960s, meat-processing companies began contracting with farmers to raise chickens in large metal barns, becoming an integrated step in a single production chain. The chickens were delivered to the farmer as chicks and were retrieved as broilers; they never left the company's ownership. By 1980, except for a few specialty products, there was no place for independent chicken farmers to sell their birds. The poultry industry has become notorious for the low pay and dangerous work conditions of the employees who manhandle the birds, and for stream-killing pollution.

Id. A similar situation threatens to affect operation of the hog industry. *Id.* at 29.

4. *See* DREW R. MCCOY, THE ELUSIVE REPUBLIC: POLITICAL ECONOMY IN JEFFERSONIAN AMERICA 15, 66 (1980) (noting Jefferson's dread of "loathsome dependence, subservience, venality, and corruption," everything that he "associated with European political economy," and Franklin's hope for a "society of independent, moderately prosperous, relatively self-sufficient producers"); MICHAEL J. SANDEL, DEMOCRACY'S DISCONTENT: AMERICA IN SEARCH OF A PUBLIC PHILOSOPHY 169 (1996) (noting the "longstanding republican conviction that economic independence is essential to citizenship"). Describing Jefferson's thoughts, Sandel wrote that "[t]hose, like the propertyless European proletariat, who must subsist on wages paid by employers were likely to lack the moral and political independence to judge for themselves as free citizens." *Id.* Sandel further wrote that "Jefferson once thought that only yeoman farmers possessed the virtue and independence that made sturdy republican citizens." *Id.*

5. Burley Tobacco Soc'y v. Gillaspy, 100 N.E. 89, 94 (Ind. App. 1912) (concluding that "[p]ublic policy does not ask those who till the soil to take less than a fair return for their labor"). This controversy, which involved the efforts of tobacco farmers to pool their products for sale to "The Tobacco Trust," is emblematic of the market power problem cooperatives were designed to address. *See id.* at 93. The court noted an earlier case that explained the farmers' organizational problem in the face of powerful buyers:

> The farmers, scattered all over the state, each acting independently and separately for himself, were unable to dispose of their crops at a fair and reasonable price. There was practically no competition among the purchasers of the crops. A combination and trust had been formed by the buyers to depreciate the value of the crops below the real value, and, single-handed, the producers were unable to compete or deal in terms of equality with these trusts and combinations that controlled the markets in which the farmer was obliged to dispose of his produce.

Id. (citing Owen County Burley Tobacco Soc'y v. Brumback, 107 S.W. 710, 715 (Ky. 1908)).

6. David Cay Johnston, *Gap Between Rich and Poor Found Substantially Wider*, N.Y. TIMES, Sept. 5, 1999, at 16 (noting the inequality problem). Johnston noted in particular that:

> The gap between rich and poor has grown into an economic chasm so wide that this year the richest 2.7 million Americans, the top 1 percent, will have as many after-tax dollars to

policies that complement the American political tradition,[7] can achieve the goal of slowing wealth concentration without adopting unpopular redistributionist policies.

I. HISTORICAL BACKGROUND

The consolidation of economic power in the hands of a few large corporations in the late nineteenth century prompted fears among farmers.[8] Specifically, farmers feared that the diffuse and diverse nature of agricultural production fostered a level of economic disorganization that undermined their economic position relative to other sectors.[9] To improve their market position, farmers sought to build marketing cooperatives that could counter the economic power of these other sectors.[10] Efforts to promote cooperative marketing in recent decades

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spend as the bottom 100 million. That ratio has more than doubled since 1977, when the top 1 percent had as much as the bottom 49 million, according to new data from the Congressional Budget Office.

Id.

7. *See* RICHARD HOFSTADTER, THE AMERICAN POLITICAL TRADITION AND THE MEN WHO MADE IT viii (1948) (noting the influence of the market in American political culture). Hofstadter wrote that despite differences on specific issues, "the major political traditions have shared a belief in the rights of property, the philosophy of economic individualism, the value of competition; they have accepted the economic virtues of capitalist culture as necessary qualities of man." *Id.* Furthermore, Hofstadter believed that "[t]he sanctity of private property, the right of the individual to dispose of and invest it, the value of opportunity, and the natural evolution of self-interest and self-assertion, within broad legal limits, into a beneficent social order have been staple tenets of the central faith in American political ideologies." *Id.*; *see generally* LOUIS HARTZ, THE LIBERAL TRADITION IN AMERICA: AN INTERPRETATION OF AMERICAN POLITICAL THOUGHT SINCE THE REVOLUTION (1955) (emphasizing the power of self-reliance and liberty in American political culture).

8. *See* GILBERT C. FITE, GEORGE N. PEEK AND THE FIGHT FOR FARM PARITY 6-7 (1954) ("Through their organizations the farmers struck at the problems of the 'money trust,' business monopolies, railroads, marketing abuses, and others. Feeling their individual helplessness, they called on the government for aid—not for themselves, but aid in governing and restricting those they feared would plunder agriculture."); Jon Lauck, *Toward an Agrarian Antitrust: A New Direction for Agricultural Law*, 75 N.D. L. REV. 449, 450-453 (1999) (noting the agrarian foundation of antitrust law).

9. *See* ELLIS W. HAWLEY, THE NEW DEAL AND THE PROBLEM OF MONOPOLY: A STUDY IN ECONOMIC AMBIVALENCE 187-88 (1966) (describing the idea of helping economically disorganized groups such as farmers through "counterorganization," or the "idea of using the government to promote the organization of economically weak groups, thus restoring economic balance, pitting one power concentrate against another, and developing an economy of 'countervailing powers' capable of achieving the full utilization of resources that a free market was supposed to achieve").

10. *See* HAL S. BARRON, MIXED HARVEST: THE SECOND GREAT TRANSFORMATION IN THE RURAL NORTH, 1870-1930 107 (1997) (explaining that "[a]s the economy of the United States became dominated by large-scale monopolistic and oligopolistic business interests during the late nineteenth and early twentieth centuries, American farmers formed local cooperatives in order to redress their disadvantages in the marketplace"); LAWRENCE GOODWYN, THE POPULIST MOMENT: A SHORT HISTORY OF THE AGRARIAN REVOLT IN AMERICA 66 (1978) (discussing the "cooperative crusade" that was the source of the late

builds on these previous experiences and on government-encouraged cooperative building during the 1920's and 1930's.[11] As a result of these promotional efforts, previously localized cooperative enterprises have expanded, federated, centralized, merged, and started to compete with private merchants, elevators, processors, and exporters in a significant way—by the 1970's seven cooperatives entered the Fortune 500.[12] In recent years, the dismantling of the federal farm programs has placed a renewed emphasis on the development of cooperatives, especially processing cooperatives which can compete directly with food manufacturers for consumer dollars.[13] The building of successful farmer cooperatives is supported by a long history of public policies adopted by Congress.

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nineteenth century "agrarian revolt"); Thomas Broden, *Co-operatives—A Privileged Restraint of Trade*, 23 NOTRE DAME LAWYER 110, 118-19 (1947) (explaining cooperative development). According to Broden:

> A corrupt middleman could and did absorb the rightful remuneration that the producer should have received. When it became apparent that an injustice to the producer, as well as injustice to the public, resulted from these unfair practices of the middleman, legislatures and the courts aided the producer in overcoming the tyranny of the monopolistic middleman. Co-operatives were developed to combat the parasitic intermediary.

Id.

11. David Hamilton noted in particular:

> One response to the farmers' search for order was to build economic institutions for agriculture. The most hopeful of these efforts after 1900, and particularly after 1915, was the growth of independent cooperative marketing associations. Proponents of cooperative marketing argued that cooperation would give farmers greater control over marketing, provide them a share of the middlemen's profits, and create a more efficient marketing system.

DAVID E. HAMILTON, FROM NEW DAY TO NEW DEAL: AMERICAN FARM POLICY FROM HOOVER TO ROOSEVELT, 1928-1933 13 (1991).

12. Michael D. Love, *Antitrust Law—Fairdale Farms, Inc. v. Yankee Milk, Inc.:—The Right of Agricultural Cooperatives to Possess Monopoly Power*, 7 J. CORP. L. 339, 339 (1982).

13. *See* S. 19, 106th Cong. § 12 (1999) ("It is the sense of Congress that the Secretary of Agriculture should identify and provide opportunities, resources, and economic incentives for agricultural producers to expand participation in value-added processing (including renewable, biobased products), cooperative enterprises, and improved marketing and financial management techniques."); *see generally* LEE EGERSTROM, MAKE NO SMALL PLANS: A COOPERATIVE REVIVAL FOR RURAL AMERICA 228-30 (1994); Randall Torgerson, *Co-op Fever: Cooperative Renaissance Blooming on Northern Plains*, FARMER COOPERATIVES, Sept. 1994, at 12 (noting that the success of the Dakota Pasta Growers Company spurred the formation of processing cooperatives in the Northern Plains); Scott Kilman & Steven Lipin, *Cargill in Talks to Buy Rival's Grain Assets; Continental Grain Co. Deal Could Raise Concerns of Antitrust Regulators*, WALL ST. J., Nov. 10, 1998, at A3 (noting the importance of farmer entry into food processing given that "[m]any farm groups are already worried that the shrinking number of companies buying everything from cattle to corn is diminishing competition"); *see* Ron Knutson, *Cooperatives' Role with Declining Government Price and Income Supports*, presentation to Farmer Cooperatives 2000, Twin Cities, MN (Nov. 3, 1998).

A. THE ORIGINS OF FEDERAL COOPERATIVE POLICY

Formal government efforts to aid farmer cooperatives came with the passage of the Clayton Act in 1914.[14] In order to foster the growth of market power among farmers without creating legal problems, the legislation specifically exempted non-stock agricultural cooperatives from the antitrust laws.[15] Doubts about the effectiveness of the exemption triggered legislative efforts to draft a stronger statute.[16] This led to the Capper-Volstead Act of 1922, which broadened the exemption from the antitrust laws beyond non-stock cooperatives.[17] For protection from the antitrust laws, the Capper-Volstead Act required that cooperatives allow members only one vote, that annual dividends be limited, and that non-member products not exceed member products.[18]

Additional pro-cooperative legislation was passed later in the 1920's. In 1926, the Cooperative Marketing Act established institutional support for cooperative development within the USDA.[19] The support included informational reports on marketing conditions and cooperative growth and generally promoted education and research.[20] The year 1929 brought passage of the Agricultural Marketing Act, which established the Federal Farm Board as a mechanism for financing cooperatives.[21] From 1929 to 1932, the Farm Board emphasized the importance of cooperative

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14. Clayton Act of 1914 § 6, 15 U.S.C. § 17 (1994). Smaller scale efforts were made prior to 1914:

> The state . . . encouraged the more general development of agricultural cooperatives, which was one of the recommendations of the 1908 Country Life Commission, and provided a more favorable and supportive climate for them. The U.S. Department of Agriculture created the Office of Markets in 1913 (later the Office of Markets and Rural Organization), which assigned staff members to survey and study cooperatives and to work with them. That work dovetailed and was increasingly coordinated with the extension and research efforts of the land grant universities and with the newly formed marketing departments in the different states.

BARRON, *supra* note 10, at 122.

15. 15 U.S.C. § 17.

16. *See* Wendy Moser, *Selective Issues Facing Cooperatives: Can the Customer Continue to Be the Company?* 31 S.D. L. REV. 394, 395 (1986) (explaining that the Capper-Volstead Act was passed to "clarify the Clayton Act exemption provided to farmers").

17. Capper-Volstead Act of 1922 §§ 1-2, 7 U.S.C. §§ 291-292 (1994).

18. *Id.* § 291.

19. Cooperative Marketing Act of 1926 §§ 1-7, 7 U.S.C. §§ 451-457 (1994).

20. *See* MURRAY R. BENEDICT, CAN WE SOLVE THE FARM PROBLEM? 89 (1955) (explaining that along with the Capper-Volstead Act, the Cooperative Marketing Act "implied *full-scale governmental approval* of the cooperative form of organization and a policy of giving active support in creating and strengthening agricultural cooperatives" (emphasis added)).

21. Agricultural Marketing Act of 1929 § 1, 12 U.S.C. § 1141 (1994); BENEDICT, *supra* note 20, at 89-90 ("Farmers still did not feel that they were able to bargain on equal terms with the large-scale buyers of their products. This, they believed, could be accomplished only through the creation of larger and stronger cooperative associations.").

marketing and loaned $360 million to aid cooperative development.[22] The amount of commodities marketed through cooperatives increased fifteen percent from the 1930-1931 period to the 1931-1932 period[23] and many local cooperatives joined regional and national marketing associations.[24] Much of this progress must be attributed to the cheap credit of the Farm Board, yet many problems inhibiting cooperative organization persisted.[25] Rivalries among cooperatives remained intense.[26] Local cooperatives affiliated with the larger cooperatives continued to market through private channels which were more profitable, and too few farmers understood the workings of the organization or considered the national associations "farmer-controlled."[27]

B. AIDING COOPERATIVE GROWTH

With the onset of the Great Depression, the building of marketing cooperatives as a remedy to the farm problem competed with several other legislative proposals. In particular, the policy of promoting cooperative growth was overshadowed by the production control agenda of the Agriculture Adjustment Act.[28] Despite the great emphasis on production control policies, a little-noticed cooperative promotion policy persisted. As a result of the Farm Credit Act passed in 1933, the funds remaining in the Farm Board's cooperative loan fund were transferred to the newly-created Central Bank for Cooperatives and twelve district banks for cooperatives, including banks in Minneapolis, Omaha, and Wichita.[29] As 1934 ended, the system had loaned sixty-eight million dollars to cooperatives.[30] In 1941, the annual credit extended equaled $221 million, and this increased to $407 million by the end of World War

22. HAMILTON, *supra* note 11, at 132.

23. *Id.* The 15% growth contradicted the contemporaneous economic failures in banking and business. *Id.*

24. *Id.* at 133, 237-38 (explaining how "[t]he Farm Board sought a fundamental restructuring of agriculture and the agricultural marketing system around a handful of centralized cooperatives").

25. *See id.* at 133.

26. *Id.* at 134; *see* BENEDICT, *supra* note 20, at 165 (noting that the Farm Board lost $320 million of its $500 million appropriation).

27. HAMILTON, *supra* note 11, at 135-36.

28. Agricultural Adjustment Act of 1933 §§ 1-4502, 7 U.S.C. §§ 601-626 (1994); *see* BENEDICT, *supra* note 20, at 224-58.

29. *See* BENEDICT, *supra* note 20, at 108 (explaining that a review of the Federal Farm Board's loans took place and "[s]uch parts of their loans as were considered suitable for transfer were taken over by the banks for cooperatives, if the cooperatives chose to make the transfer"); HAMILTON, *supra* note 11, at 232; Christopher R. Kelley & Barbara J. Hoekstra, A *Guide to Borrower Litigation Against the Farm Credit System and the Rights of Farm Credit System Borrowers*, 66 N.D. L. REV. 127, 134-35 (1990).

30. JOSEPH G. KNAPP, THE ADVANCE OF AMERICAN COOPERATIVE ENTERPRISE: 1920-1945 263 (1961).

II.[31] In 1970, one third of the capital used by cooperatives stemmed from debt, and the banks for cooperatives provided nearly all of the remaining two thirds (sixty-five percent) of the capital.[32] The banks also bolstered the financial position of cooperatives by improving management techniques, requiring financial statements, and conducting audits.[33] The financial aid of the cooperative banks indicated a strong congressional policy for the continued growth of farmer cooperatives.[34]

After passage of the Farm Credit Act of 1953, the Cooperative Research and Service Division, an agency formerly located in the Farm Credit Administration, became directly controlled by the Secretary of Agriculture within the USDA.[35] Newly named the Farmer Cooperative Service, it carried out the Cooperative Marketing Act of 1926 and contained its own administrative structures, making the Service "a self contained and complete organization."[36] Farm cooperatives could request information, market research, and technical assistance from the Farmer Cooperative Service to aid in the growth and efficiency of their institutions.[37]

In subsequent years, various political actors indicated a continuing policy for supporting cooperative growth. In 1959, Senators Russell Long (D, LA) and Eugene McCarthy (D, MN) introduced a bill to exempt cooperatives from section seven of the Clayton Act and its severe limitation on mergers.[38] Another proposal would have granted the Secretary of Agriculture the authority to approve cooperative mergers.[39] In 1964, echoing promises made by Senator Kennedy in 1960,[40] President Johnson's farm message declared that "[n]ew legislation is needed to

31. *Id.* at 501.

32. In 1954, borrowed funds were 25% of "cooperative liabilities and member equity." MARTIN A. ABRAHAMSEN, COOPERATIVE BUSINESS ENTERPRISE 294 (1976).

33. *See* KNAPP, *supra* note 30, at 403-407, 494-495; JERRY VOORHIS, AMERICAN COOPERATIVES: WHERE THEY COME FROM, WHAT THEY DO, WHERE THEY ARE GOING 86 (1961).

34. In 1989, eleven cooperative banks were merged into CoBank, an $18 billion banking cooperative. Paula Aven, *CoBank Thinks Big; Banking Giant Grows in Englewood*, DENV. BUS. J., Nov. 29, 1996, at 1A.

35. BENEDICT, *supra* note 20, at 146 n.36.

36. Joseph G. Knapp, *Farmer Cooperative Service Gets Under Way*, NEWS FOR FARMER COOPERATIVES, May 1954, at 3.

37. *See id.* at 12; *see also* D.H. McVey & William Summitt, *Cooperatives Extend Reach of Grain Producers*, NEWS FOR FARMER COOPERATIVES, Jan. 1965, at 16-17 (discussing the important assistance grain cooperatives received from the Farmer Cooperative Service which contributed to the success of the grain cooperatives).

38. *See* Letter from P.J. Nash, Sec'y-Mgr., Farmers Union Jobbing Assoc., to Senator Frank Carlson 1 (Aug. 11, 1959) (located in Legislative Correspondence 1959-1960 file, document box 172, Carlson Papers, Kansas State Historical Society).

39. Stephen D. Hawke, *Antitrust Implications of Agricultural Cooperatives*, 73 KY. L. J. 1033, 1050 (1984).

40. Farmers for Kennedy-Johnson press release 1 (located in file 2, document box 5, Iowa Institute of Cooperation Papers, Iowa State University Library).

clarify the right of cooperatives to expand their operations by merger and acquisition."[41] Additional legislation did not pass, but the proposals indicated the continuing congressional support of cooperatives.[42]

Government efforts to promote cooperative growth produced results. By 1969-1970, 2,539 cooperatives handled three billion dollars worth of grain, or about thirty-two percent of the market, compared to forty percent handled by the four largest grain companies.[43] By 1993, the gross value of farm products marketed by all farmer cooperatives increased to $63.8 billion; net income totaled $1.36 billion.[44] The successes of new cooperatives in recent years, especially value-added cooperatives which process the farmers' products, has triggered talk of "co-op fever."[45]

II. THE WORKINGS OF A COOPERATIVE

Similar to a corporation, a cooperative can build capital through borrowing or through equity. Since the purchase of equity is often limited by statute to the cooperative's member-patrons, however, this financing option can be limited.[46] This option is especially limited in times of economic distress when farmers have very little working capital.[47] Non-

41. White House press release 1 (Jan. 31, 1964) (located in file 17, document box 10, James Patton Papers, University of Colorado-Boulder).

42. Hawke, *supra* note 39, at 1054 (arguing that "the debates demonstrated general congressional approval of the cooperative movement").

43. MARTIN A. ABRAHAMSEN, UNITED STATES DEP'T OF AGRIC., COOPERATIVE GROWTH: TRENDS, COMPARISONS, STRATEGY 52-54 (1973) (FCS Information 87, Farmer Cooperative Service, USDA, March 1973).

44. RALPH M. RICHARDSON ET AL., UNITED STATES DEP'T OF AGRIC., FARMER COOPERATIVE STATISTICS, 1993 viii, 36 (1994) (Rural Development Administration, Cooperative Services, CS Service Report 43, Nov. 1994) (noting that by 1993, the Banks for Cooperatives made over $13 billion in net loans).

45. Torgerson, *supra* note 13, at 12. As Torgerson noted:

> The "cooperative fever" sweeping the region gained impetus from the success of Dakota Growers Pasta Co., which was organized in 1992-93 and began operating this year. The cooperative was formed by North Dakota durum wheat growers who were determined to organize their own mill and pasta manufacturing operation in the Northern Plains, rather than in a distant city closer to population centers. Grower members have each invested an average of $14,000 in risk capital, demonstrating their commitment to the cooperative.

Id.

46. Kathryn J. Sedo, *The Application of Securities Laws to Cooperatives: A Call for Equal Treatment for Nonagricultural Cooperatives*, 46 DRAKE L. REV. 259, 262 (1997). According to Sedo:

> Because of the limited return on investment and the one member-one vote requirements, it is extremely difficult for cooperatives to obtain equity capital from anyone other than its members. The resulting lack of investment capital can have a negative impact on the cooperative's ability to initially form (or once formed, to expand) and compete competitively.

Id.

47. *See* RALPH W. DUTROW ET AL., UNITED STATES DEP'T OF AGRIC., FINANCIAL PROFILE OF 15 NEW AGRICULTURAL MARKETING COOPERATIVES 7 (1981) (Agricultural Cooperative Service, ACS Service Report No. 27, May 1981) (noting that this is especially difficult for value-added operations since "[a] tremendous amount of capital is required for

members are often uninterested in purchasing cooperative equity since its transferability and dividend potential is limited.[48] Cooperatives commonly turn net income into patronage refunds. These patronage refunds are returned to a patron in proportion to the business the patron does with the cooperative. The patronage refunds can be distributed to patrons as cash or can be held by the cooperative as retained patronage refunds. When refunds are retained, the member receives stock, an equity certificate, capital account credit, or some other indication of his interest in the cooperative.[49] Equity redemption is the process by which patrons are actually paid cash for the patronage refunds retained by the cooperative.[50] Typically, the board of directors has the discretion to decide how much will be refunded in cash each year and how much cash will be retained.[51] In order to benefit from favorable tax treatment, however, a minimum of twenty percent of a patron refund must be distributed in cash.[52]

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modern agricultural processing and marketing facilities, so even maximum effort by the farmer-members of new cooperatives is unlikely to generate sufficient equity funds to construct and operate these facilities initially").

48. Sedo, *supra* note 46, at 264.

49. *Id.* at 263.

50. When and how redemption should occur is a contentious area of cooperative law. *See* Sharlene F. Roberts-Caudle, *Agricultural Cooperative Member Equity: You Don't Have to Die for It!* 7 SAN JOAQUIN AGRIC. L. REV. 1 (1997) (noting the difficulties involved with deferred patronage refunds); James R. Baarda, *Farmer Cooperative Equity Conflicts: Judicial Decisions in the 1980s*, 12 HAMLINE L. REV. 699 (1989) (discussing the inherent problems of farmer cooperatives' use of patron financing).

51. Brief of Amicus Curiae, National Council of Farmer Cooperatives at 6, Great Rivers Coop. of Southeastern Iowa v. Farmland Indus., Inc., Nos. 98-2527, 98-2528 (8th Cir. Dec. 16, 1999) ("Various systems are used by farmer cooperatives to determine when patronage equities are redeemed for cash. The common denominator of virtually all systems, however, is that the cooperative board ultimately determines at any given time when such redemptions are consistent with providing service to the members of a cooperative."); Neil D. Hamilton, *Cooperative Member Relations and Members' Rights in Retained Equity—Setoffs and Other Approaches*, 6 J. AGRIC. TAX'N & L. 603, 611 (1984) ("When addressing equity redemption questions under such state statutes, the basic rule of law is that questions of equity redemption are committed to the discretion of the board of directors."); *see also* Terence J. Centner, *Cooperatives: A Search for Equitable Relief From the Equity Redemption Problem*, 7 J. AGRIC. TAX'N & L. 120, 125 (1985) (noting the judicial deference to cooperative decision-making in equity redemption matters). According to Centner:

> The few cooperative members and former members who have challenged the status quo have encountered a judiciary steeped in the theoretical underpinnings of the cooperative movement and loathe to interfere with the property rights of these benevolent and voluntary associations. The courts have tenaciously adhered to the concepts of obligation of contracts, noninterference with business decisions, and preservation or encouragement of the business enterprise to routinely deny relief to former cooperative members who sought the return of retained funds.

Id.

52. ABRAHAMSEN, *supra* note 32, at 309-10. The 20% requirement stems from changes made in the Internal Revenue Code in 1966. *Id.* at 231. The Revenue Act of 1962 also required that allocation be made within eight and one-half months after the close of the taxable year. *Id.* The Act further permitted the farmer to consent to the inclusion of his

Unlike stock in a corporation, cooperative stock does not appreciate in value.[53] According to cooperative ideology, patrons only seek services at cost and do not seek profits. Capital is to be "a means to an end" for cooperative patrons, not the opportunity to turn a profit.[54] Since equity capital is provided by the member patrons, and since during liquidation all other credit obligations must be met by the cooperative before equity is redeemed, it serves as a barometer of patron support and patron willingness to take risks for the cooperative.[55]

The initial infusion of capital into cooperatives can come in the form of common stock, preferred stock, or membership fees.[56] After the cooperative is established, the needed capital is typically generated through the profitable operations of the cooperative.[57] Additional stock in the cooperative can also be sold, but the dividends which can be paid are often limited by statute.[58] Coupled with requirements that limit the voting rights and the transferability of the stock, such characteristics reduce the appeal of cooperative stock.[59] Maintaining an adaptable

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patronage refund in his tax return by cashing a check equaling at least 20% within 90 days "after the close of the payment period of the cooperatives taxable year." *Id.*

53. *Id.* at 289.

54. *Id.* at 290.

55. *Id.* at 291.

56. *Id.* at 291-92 (explaining that the initial capital is a very small percentage of a cooperative's equity capital and that if common stock results in a dividend, it is not to exceed eight percent unless it is set lower by state law); *see also* David C. Crago, *Cooperative Dissent: Dissenting Shareholder Rights in Agricultural Cooperatives*, 27 IND. L. REV. 495, 499-500 (1994). Crago explained preferred stock as follows:

> Many cooperatives issue preferred stock. Preferred stock is usually non-voting and may be held by anyone, whether a member or non-member. Although some observers have asserted that a cooperative must be wholly owned by its members, the ability to issue non-voting common or preferred stock permits the cooperative to acquire capital from investors outside the cooperative's membership. The issuance of non-membership stock permits cooperatives to raise capital based on investment motives instead of patronage.

Id.

57. ABRAHAMSEN, *supra* note 32, at 291 (noting that "[a]bout 85 percent [sic] of the equity capital of farmers' marketing and purchasing cooperatives is obtained from operations").

58. Sedo, *supra* note 46, at 263. Minnesota limits dividend payments to eight percent annually. *Id.* at 263 n.47.

59. Crago, *supra* note 56, at 504. Cooperatives generally "limit shareholder eligibility, frequently limit voting rights, and restrict the transfer of shares. Not only is there little or no market for the stock of agricultural cooperatives, but the member/patron stockholders generally allow a particular entity to use their capital because of the stockholder's relationship with the cooperative." *Id.* Cooperative stockholders, however, do maintain the same rights as corporate stockholders. *Id.* at 499. For example, farming cooperative stockholders:

> [C]an bring derivative actions on behalf of the corporation, subject only to the statutory requirements for such actions. Officers and directors of cooperatives are subject to the same fiduciary standards imposed on other corporate officers. In other words, despite the distinctive operating principles of cooperatives, the rules, rights, and duties of shareholders, officers, and directors have been understood to be governed by the same principles applicable to all corporations.

Id.

equity redemption policy and limiting the power of stockholders enhances the discretion of a cooperative's board of directors.[60] This provides flexibility in times of economic distress and, when performance is better, provides additional funds to finance expansion.[61]

Once established, cooperatives often face pressure to redeem the equity of those farmers who have been patrons of the cooperative.[62] Studies of cooperatives divide equity redemption programs into systematic equity redemption programs and special equity redemption programs.[63] The three most common systematic equity redemption programs are the revolving fund, base capital, and percent-of-all-equities.[64] The revolving fund redeems equities on a first-in, first-out basis.[65] The base capital plan redeems equities as a component of a base capital project.[66] The percent-of-all-equities plan redeems equities as a proportion of the total outstanding equities in the cooperative.[67] Out of the cooperatives which use these methods, almost ninety-two percent use the revolving fund.[68] Typically, the bylaws of the cooperative govern the allocation and redemption of equities.[69] The board of directors maintain the discretion to modify these programs.[70]

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60. *See* ROBERT C. RATHBONE & ROGER A. WISSMAN, UNITED STATES DEP'T OF AGRIC., EQUITY REDEMPTION AND MEMBER EQUITY ALLOCATION PRACTICES OF AGRICULTURAL COOPERATIVES 2 (1993) (Agricultural Cooperative Service, ACS Research Report No. 124, October 1993) ("An overriding consideration may be the need to retain sufficient capital to maintain the cooperative's viability or finance growth through capital improvements or acquisition."); Crago, *supra* note 56, at 508-09. Crago noted that:

> The charters of most cooperatives provide that the redemption of outstanding equity held by patrons is within the discretion of the board of directors. Although several systems for retiring these equities have been proposed, these systems generally reserve the ultimate timing of redemption to the board in the bylaws or articles. Relying on a contractual understanding of their charter, then, cooperatives have successfully resisted most efforts to compel redemption.

Id.

61. *See* RATHBONE & WISSMAN, *supra* note 60, at 1-2.

62. *See id.* at 2 ("At times, the capital needs of the cooperative and the allocation and redemption expectations of the membership may conflict.").

63. *See id.* at iii (noting that in 1991 89% of cooperatives with equity subject to redemption had some type of active systematic or special redemption program).

64. *Id.* at 9.

65. *Id.*

66. *Id.*

67. *Id.*

68. *Id.*

69. *Id.* at 1.

70. *Id.* at 10 ("A target revolving fund length may be established as a matter of policy, but the board of directors must retain the discretion to alter it depending on the cooperative's financial ability to redeem.").

III. SHOULD COOPERATIVE EQUITY BE CONSIDERED SECURITIES?

A. THE CASE FOR SECURITIES REGULATION

Given the similarity between cooperative and corporate structures and the similarity between cooperative equity and corporate stock, the question arises whether cooperative equity should be governed by the same laws which govern corporate stock. In particular, the applicability of federal securities laws to cooperative equity becomes an issue. Cooperatives naturally seek to avoid additional statutory responsibilities and costs which accompany the registration of securities.[71]

Proponents of extending the coverage of the securities law invoke the language of the 1933 Securities Act to advance their arguments. The definition of "security" in the 1933 Securities Act, for example, includes "*any* note, stock, treasury stock, bond, debenture, evidence of indebtedness, *certificate of interest or participation in any profit-sharing agreement* . . . ."[72] The broad language of the statute would seem to include cooperative equity because cooperative equity represents a future interest in the cooperative and an expectation of cash redemption in the future. The United States Supreme Court endorsed the use of the statute's broad language stating that "Congress did not intend to adopt a narrow or restrictive concept of security in defining that term."[73]

For items that are not specifically listed in the statute, the Supreme Court has developed a method for determining what constitutes a security. The *Howey* test, for example, attempts to define an "investment contract," which is specifically listed in the statute.[74] In order to qualify as an "investment contract" under *Howey*, a person must: 1) invest money 2) in a common enterprise and 3) expect profits 4) from the efforts of others.[75] Since farmers permit a large percentage of their equity to be retained by the cooperative for operating costs and expansion with the hope of generating more profits for the cooperative, it could be argued that the *Howey* test extends the securities act coverage to cooperative equity. Patronage refunds have been described as "investments" and the idea of a cooperative necessarily involves the work and effort of others all

71. National Council of Farmer Cooperatives Brief, *supra* note 51, at 12 (noting that the application of the securities laws "would unnecessarily burden farmer cooperatives and increase substantially the cost of formation of new farmer cooperatives, the merger or consolidation of existing cooperatives and the ongoing operations of existing cooperatives through periodic reporting").

72. Securities Act of 1933 § 2, 15 U.S.C. § 77b(1) (1994) (emphasis added).

73. Tcherepnin v. Knight, 389 U.S. 332, 338 (1967).

74. 15 U.S.C. § 77b(1).

75. Securities & Exch. Comm'n v. W.J. Howey Co., 328 U.S. 293, 298-99 (1946).

in the hopes of boosting farm income.[76]

B. *GREAT RIVERS COOPERATIVE OF SOUTHEASTERN IOWA V. FARMLAND INDUSTRIES, INC.*

The Eighth Circuit recently decided the question of whether equities issued by cooperatives should be considered securities.[77] The case involved Farmland Industries, the nation's largest cooperative, which generated over six billion dollars in revenue in 1994,[78] and Great Rivers Cooperative of Southeastern Iowa, formerly a Farmland affiliate. The dispute originated with Farmland's 1980 decision to amend its bylaws to authorize the transformation of common stock in the cooperative into capital credits (a form of non-voting equity).[79] The two cooperatives involved in this class action, Great Rivers Cooperative of Southeastern Iowa and Sawyer Cooperative Equity Exchange, held the common stock in Farmland as part of the patronage refund process.[80] When these plaintiffs ceased conducting business with Farmland, they were disqualified from holding common stock in the cooperative because Farmland changed their common stock into capital credits without voting rights.[81]

The Iowa District Court granted summary judgement to Farmland, declaring that the securities laws did not extend to capital credits.[82] The plaintiffs argued that the determination was "not a pure question of law and therefore, must be given to a jury."[83] The court applied the *Howey* test and decided that capital credits were not securities "as a matter of law."[84] The court concluded that *Howey* provided "a structure for courts to use when analyzing the economic specifics of a transaction" and determined that capital credits did not fit within the *Howey* "framework."[85]

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76. ABRAHAMSEN, *supra* note 32, at 309.

77. Great Rivers Coop. of Southeastern Iowa v. Farmland Indus., Inc., Nos. 98-2527, 98-2528, slip op. at 22-30 (8th Cir. Dec. 16, 1999) [hereinafter *Great Rivers II*].

78. *Business Volume Approaches $100 Billion for 100 Largest Co-ops*, FARMER COOPERATIVES, Dec. 1995, at 10.

79. Great Rivers Coop. of Southeastern Iowa v. Farmland Indus., Inc., No. 4-95-70529, at 5 (S.D. Iowa, May 5, 1997) (memorandum opinion and order granting summary judgment) [hereinafter *Great Rivers I*].

80. *Id.* at 3. *See* discussion of patronage refunds *supra* Part II.

81. *Id.*

82. *Id.* at 21.

83. *Id.* at 16.

84. *Id.* at 21. The facts of *Howey*, it should be noted, involved an agricultural setting. Securities & Exch. Comm'n v. W.J. Howey Co., 328 U.S. 293, 295-97 (1946). The defendants sold interests in a Florida citrus grove development. *Id.*

85. *Great Rivers I*, *supra* note 79, at 21.

The court held that capital credits did not satisfy the investment prong of the *Howey* test.[86] The court stated that the primary purpose of participating in a cooperative is not to generate income by relying solely on a monetary investment.[87] Drawing on Eighth Circuit case law, the district court determined that farmer cooperatives are "'organized primarily for the purpose of helping individual farmers to better their bargaining position in the sale of their products and the purchase of their supplies.'"[88] The court also noted that unlike corporate stock, capital credits do not pay dividends or interest nor do they grow in value.[89] The basis of the capital credits is not an initial monetary investment in a cooperative, but "derived from the refunds credited to each member based solely on that member's patronage . . . ."[90]

Capital credits also failed the expectation of profits prong of the *Howey* test.[91] The court decided that the "inducement to become a member of Farmland is to acquire improved bargaining position based on economies of scale, not to invest for profit."[92] In analyzing this prong, the court reiterated that capital credits do not increase in value, do not pay interest or dividends, do not offer an opportunity to participate in earnings, and do not depend on the amount of money invested.[93]

Finally, capital credits failed to satisfy the fourth prong of the *Howey* test, which requires that an investment rely on the labor of others.[94] The court distinguished a cooperative system of patronage refunds from an investment in corporate stock because corporate stock performance depends largely on the decision-making of management and the board of directors.[95] Total earnings from investing in a corporation will be determined by the number of shares of stock held. The patronage refund system, by contrast, is based on the level of participation of members of the cooperative.[96] As the district court noted, a "patronage refund is not a function of how much equity a particular member holds, but is a refund based on the amount of business a member does with Farmland during the year."[97]

In reaching its decision, the court drew on the United States Supreme

86. *Id.* at 22-23.
87. *Id.* at 26.
88. *Id.* at 22 (citing Co-operative Grain & Supply Co. v. Commissioner, 407 F.2d 1158, 1162-63 (8th Cir. 1969)).
89. *Id.* at 23.
90. *Id.*
91. *Id.*
92. *Id.*
93. *Id.*
94. *Id.*
95. *Id.*
96. *Id.* Patronage refund does not depend on the amount of equity a member holds. *Id.*
97. *Id.*

Court's decision in *United Housing Foundation, Inc. v. Forman*,[98] which involved shares of stock in a New York City housing cooperative.[99] Tenants brought suit, arguing that their shares in the cooperative were regulated by the securities laws.[100] In deciding the cooperative shares were not securities, the Supreme Court conceded that the securities statutes were written to include a broad range of instruments within the meaning of "security."[101] The court rejected, however, the view that an instrument termed a "stock" was automatically covered by the law and invoked case law instructing that "form should be disregarded for substance and the emphasis should be on economic reality."[102] In response to the broad and explicit language of the securities laws, the court invoked the "Hail Mary pass" of statutory construction,[103] concluding that a "thing may be within the letter of the statute and yet not within the statute, because not within its spirit, nor within the intention of its makers."[104] The court considered the absence of dividends, the absence of voting rights, the non-negotiability, and the lack of potential increase in value when it decided that the form of the cooperative stocks did not constitute a security.[105] Similar to the reasoning of the Iowa District Court with regard to farmer cooperatives and bargaining power, the United States Supreme Court concluded that "the inducement to purchase [the cooperative stock] was solely to acquire subsidized low-cost living space; it was not to invest for profit."[106]

In addition to applying the *Howey* test to capital credits and drawing on the *United Housing Foundation* decision, the Iowa District Court also applied the test set forth in *Reves v. Ernst & Young*.[107] In

98. *Id.* at 18-20 (citing United Housing Found., Inc. v. Forman, 421 U.S. 837 (1975)).

99. *United Housing Found.*, 421 U.S. at 840.

100. *Id.* at 845.

101. *Id.* at 847-48.

102. *Id.* at 848 (citing Tcherepnin v. Knight, 389 U.S. 332, 336 (1967)).

103. *See* Philip P. Frickey, *From the Big Sleep to the Big Heat: The Revival of Theory in Statutory Interpretation*, 77 MINN. L. REV. 241, 247 (1992). According to Frickey:

> In my legislation course, I tell my students that *Holy Trinity Church* is the case you always cite when the statutory text is hopelessly against you, and the case title lends some additional mirth to this observation. The tactic of relying upon the case does sometimes resemble the "hail Mary" pass in football. As a matter of attorney advocacy, that may be all well and good, but as a matter of judicial resolution of a critical social issue, it may seem like something altogether different.

Id.

104. *United Housing Found.*, 421 U.S. at 849 (describing the quoted language from Church of the Holy Trinity v. United States, 143 U.S. 457, 459 (1892) as "a traditional canon of statutory construction").

105. *Id.* at 851.

106. *Id.* A lower court subsequently applied the *United Housing Foundation* analysis to farmer cooperatives. B. Rosenberg & Sons, Inc. v. St. James Sugar Coop., 447 F. Supp. 1, 3 (E.D. La. 1976), *aff'd*, 565 F.2d 1213 (5th Cir. 1977).

107. *Great Rivers I*, *supra* note 79, at 24 (applying Reves v. Ernst & Young, 494 U.S. 56 (1990)); *see also* Sedo, *supra* note 46, at 276 (noting that "[t]he *Reves* case was the first time

Reves, the United States Supreme Court held that "demand notes" issued by a farmer cooperative qualified as securities.[108] The *Reves* Court created a presumption in favor of finding a note to be a security unless it bore a strong resemblance to instruments excepted from the definition of security.[109] The *Reves* resemblance test factors include the following: 1) the motivations for a reasonable buyer and seller to enter into a transaction, 2) the plan of distribution, i.e., whether there is common trading, 3) the "reasonable expectations of the investing public," and 4) whether some other factor, such as a regulatory scheme, reduces the risk of investment, making extension of the securities laws unnecessary.[110] The district court in *Great Rivers* noted that the *Reves* factors were designed to determine the existence of a note but were the "same factors" used to determine the existence of a security.[111]

The conclusions of the Iowa District Court under the *Reves* test were similar to its conclusions under the *Howey* test.[112] The court held "*Reves* does not alter the economic reality of the circumstances at issue and does not change the conclusion that capital credits are not 'securities.'"[113] Under *Reves* motivation prong, the court found the primary motivation to be bargaining power, not profits.[114] Under the second prong, the court found distribution to be limited since equity was only available to Farmland members and noted that the articles of incorporation limited the transferability of capital credits.[115] Although Farmland did discuss developing a "secondary market" for capital credits, there was "no evidence that any trading of capital credits for speculation or investment ever actually occurred . . . ."[116] Analysis under the third prong led the court to conclude that the expectations of the general public could not have played a role in a decision to acquire capital credits since the creation of capital credits was triggered by Farmland's conclusion that

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the Supreme Court enunciated its approach to deciding which notes are securities").

108. *Reves*, 494 U.S. at 73.

109. *Id.* at 66-67; *see also* Securities Act of 1934 § 3, 15 U.S.C. § 78c(a)(10) (1994) (providing that "[t]he term 'security' . . . shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited").

110. *Reves*, 494 U.S. at 66-67.

111. *Great River I*, *supra* note 79, at 24. The Iowa District Court noted:

> While it is undisputed that the court in *Reves* explicitly set out to develop a principle to define the term "note" as used in the Securities Acts, in doing so it noted that the factors that are used in the so-called "family resemblance" test are the same factors that it has held apply in deciding whether a transaction involves a "security."

Id. (citations omitted).

112. *Id.* at 25.

113. *Id.* at 24.

114. *Id.* at 26.

115. *Id.* at 26-27.

116. *Id.* at 27.

an affiliated cooperative was out of business.[117] Finally, under the last prong, the court decided that the existence of any other regulatory schemes would have no effect on the level of risk associated with capital credits.[118]

In December 1999, the Eighth Circuit Court of Appeals affirmed the district court's grant of summary judgement, refusing to apply the federal securities laws to farmer cooperatives.[119] The Eighth Circuit found the *Reves* test inapplicable,[120] held that capital credits "lack the essential characteristics of securities,"[121] and specifically applied the investment and expectation of profits prongs of the *Howey* test.[122] The court seemed to focus on three primary factors in its "essential characteristics" analysis: 1) the purpose and origins of the equity and its linkage to participation in the cooperative; 2) money-generating capacity of the equity; and 3) the presence of characteristics associated with securities in the equity.[123]

The Eighth Circuit echoed the district court's holding emphasizing that the purpose of cooperative membership was not profit, but to "reap the benefits of [one's] relationship" with the cooperative.[124] The court dismissed the fact that some plaintiffs had obtained the equity in exchange for other equity and highlighted the importance of considering the equity's origins and purpose.[125] The equity interests were not available to the general public and were therefore "incidents of the cooperative

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117. *Id.* at 27-28.

118. *Id.* at 28.

119. *Great Rivers II*, *supra* note 77, at 30.

120. *Id.* at 26 (holding that the "*Reves* approach is not applicable here because 'capital credits' are not specifically included in the statutory definition of 'security'"). The court refused to invoke the *Reves* analysis since it applied only to notes, which is actually listed in the securities acts as a kind of security, and instead applied the *United Housing Foundation* summary of the *Howey* test. *Id.* In *Reves*, the Supreme Court rejected the Eighth Circuit's practice of applying the *Howey* test to notes:

> [T]he Eighth and District of Columbia Circuits apply the test we created in [*Howey*] to determine whether an instrument is an "investment contract" to the determination whether an instrument is a "note." . . . We reject the approaches of those courts that have applied the *Howey* test to notes; *Howey* provides a mechanism for determining whether an instrument is an "investment contract." The demand notes here may well not be "investment contracts," but that does not mean they are not "notes."

Reves v. Ernst & Young , 494 U.S. 56, 64 (1990).

121. *Great Rivers II*, *supra* note 77, at 25.

122. *Id.* at 29.

123. *Id.* at 26-27. The Eighth Circuit did not follow the tidy analysis of the district court and, instead, reviewed the prongs of the *Howey* test. *Id.* at 22-30. After rejecting the *Reves* analysis, the court focused on three general but interrelated factors. *Id.* at 26-27.

124. *Id.* at 26.

125. *Id.* at 27 (noting that "[r]egardless of how the Farmland credits were ultimately obtained, all represent equity interests that were *initially* obtained as an incident of *membership in a cooperative*." (emphasis added)).

relationship."[126] In addition to the purpose and origins of the equity, the court considered factors related to the money-raising capacity of the equity. The court noted that capital credits did not "finance substantial investments," were not commonly traded, and were not offered for sale.[127] Finally, the court cited several "characteristics" to support its decision that capital credits were not an investment: 1) the credits did not earn interest; 2) the credits did not pay dividends; 3) the credits did not appreciate in value; and 4) the credits had no liquidity.[128] Again, the court repeated the purpose factor concluding that "patrons of a cooperative ordinarily base their decisions to join a cooperative on the effectiveness of the services provided rather than on the risk inherent in an investment."[129]

In a final review of the issues the court applied the investment and expectation of profits prongs of the *Howey* test. The capital credits failed to pass the investment prong of the *Howey* test because there was no traditional monetary investment, only the receipt of capital credits as "part of the commercial relationship that exists between an agricultural cooperative and its members, patrons, and former members."[130] The equity failed the expectation of profits prong of *Howey* because "profits" were based on member patronage and were "not based on Farmland's activities or its utilization of the members' funds."[131]

C. SECURITIES LAW SHOULD NOT EXTEND TO COOPERATIVE EQUITY

By holding that the securities laws do not apply to farmer cooperatives the Iowa District Court and the Eighth Circuit made the correct decision. The analysis of the issues, however, needs strengthening. By relying solely on the text of the securities statutes and the judicial tests for determining what constitutes a security, the decision is vulnerable to reversal. This is particularly dangerous given the unpredictability of judicial decision-making in the area of securities law.[132]

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126. *Id.*

127. *Id.*

128. Id. at 28 ("[C]redits earn no interest, pay no dividends, do not appreciate in value, and have no liquidity, i.e. the credits were not freely transferable, were not traded on any securities exchange, and, in fact, had no secondary market.").

129. *Id.*

130. *Id.* at 29.

131. *Id.*

132. *See* Van Huss v. Associated Milk Producers, Inc., 415 F. Supp. 356, 361 n.8 (N.D. Tex. 1976). The *Van Huss* Court described securities designation as "an area of the law subject to wide variations, serious anomalies, and judicial disagreement, if not confusion. In short, the wealth of judicial writings on the subject has produced few discernible principles of decision." *Id. See* Kyle M. Globerman, *The Elusive and Changing Definition of a Security: One Test Fits All*, 51 FLA. L. REV. 271, 274 (1999) (noting that the "lack of uniformity that results from this ad hoc method of [judicial] review is problematic because investors cannot, with predictability, determine if the transactions they engage in are within the scope of the

The inconsistent analyses invoked in the two cases also creates the potential for judicial clarification in the future which could produce a holding adverse to the interests of farmer cooperatives. After clarifying the proper analysis for such cases, the courts should have considered the broader statutory scheme governing the operation of farmer cooperatives and the purposes undergirding this statutory scheme. In addition, the courts should have weighed important policy considerations embedded in cooperative promotion.

1. The Analytical Limits of Great Rivers

The district court's decision to invoke the *Howey* test and base its ruling on the meaning of "investment," while ultimately producing the correct result, leaves the decision open to criticism. Patronage refunds retained by the cooperative for expansion and development, which farmers hope will ultimately enhance their bargaining power and their annual income, could be construed by a reasonable person to be an "investment." The *Howey* decision defines an investment as "the placing of capital or laying out of money in a way intended to secure income or profit from its employment."[133] This is certainly the intention of many farmers who join a cooperative.[134] It is also the intent of the policy-makers who promote pro-cooperative measures.[135]

Furthermore, the Iowa District Court's use of "purpose" to determine whether a cooperative equity is an investment is also risky. Separating profits as a purpose from bargaining power as a purpose is an artificial distinction. The justification for promoting bargaining power is to generate greater profits for farmers so there is a greater chance farmers can remain independent producers on their own land.[136] A higher court reviewing such an interpretation could overlook the bargaining power stage of the sequence and simply infer profits as the ultimate motive. Bargaining power could be deemed a pretense, and the "economic realities" of the arrangement, the criteria which the *United Housing Foundation* Court concluded such a determination should "turn on," viewed as profiting the farmers who were members of the cooperative.[137]

Security and Exchange Acts").

133. Securities & Exch. Comm'n v. W.J. Howey Co., 328 U.S. 293, 298 (1946).

134. Crago, *supra* note 56, at 510 ("Even if designated as non-profit, cooperatives are economic institutions operated to generate a profit. Cooperative corporations are not eleemosynary; rather they are designed to make money for their patrons.").

135. *See* Dennis Johnson, *Surfing the New-Wave Cooperatives*, FARMER COOPERATIVES, Oct. 1995, at 10 (arguing that "[l]arge amounts of due diligence, time and hard work precede the startup . . ." of successful cooperatives).

136. *Great Rivers I*, *supra* note 79, at 26 (torturing the distinction by explaining that "farmers do not become members of a cooperative because they are interested in a *profit* they expect to be generated; rather, they do so to take advantage of the increased *bargaining power* a cooperative organization offers" (emphasis added)).

137. United Housing Found., Inc. v. Forman, 421 U.S. 837, 849 (1975) (noting that "[b]ecause

Bargaining power could also be viewed as a means of achieving a more fundamental purpose, greater profits.[138] The Iowa District Court recognized, for example, that farmers sought "'to better their bargaining position'" with relation to their desire to make a "sale," which is transacted for the purpose of turning a profit.[139] The court's reference to Farmland's bylaws, which lists under "purposes," acts of "marketing or selling," is unpersuasive.[140] The "marketing or selling" is not an end in itself; it carries the purpose of turning a profit.

The Second Circuit found cooperative equity in a subsidized housing complex to be securities.[141] In focusing on the purpose of the transaction, the court found the cooperative shares to be securities since they led to rent reductions for residents.[142] Such a finding is easily foreseeable for farmers who participate in farmer cooperatives to enjoy lower costs through the collective buying of the cooperative and higher prices for their products collectively sold through the cooperative.

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securities transactions are economic in character Congress intended the application of these statutes to turn on the economic realities underlying a transaction, and not on the name appended thereto").

138. Dale H. Oliver & Stephen J. Snyder, Note, *Antitrust, Bargaining, and Cooperatives: ABCs of the National Agricultural Marketing and Bargaining Act of 1971*, 9 HARV. J. ON LEGIS. 498, 536 (1971-72) (declaring that "[f]or agricultural collective bargaining to be successful in raising farm income, at least one of the following economic results must occur: (a) associations of farmers increase the efficiency of marketing or processing, (b) farmers acquire 'excess' profits from the handlers and processors, or (c) consumers pay higher prices for agricultural products" (emphasis added)); L. Gene Lemon, *Antitrust and Agricultural Cooperatives Collective Bargaining in the Sale of Agricultural Products*, 44 N.D. L. REV. 505, 513 (1968) ("The very *raison d'être* of agricultural marketing associations is price fixing.").

139. *Great Rivers I*, *supra* note 79, at 22 ("Farm cooperatives, like Farmland, are 'organized primarily for the purpose of helping individual farmers *to better their bargaining position* in the *sale* of their products and the purchase of their supplies.'" (emphasis added) (quoting Co-operative Grain & Supply Co. v. Commissioner, 407 F.2d 1158, 1162-63 (8th Cir. 1969))).

140. *Id.*

141. Forman v. Community Services, Inc., 500 F.2d 1246, 1250 (2d Cir. 1974), *rev'd sub nom.* United Housing Found. v. Forman, 421 U.S. 837 (1975).

142. *Id.* at 1254. The Second Circuit stated the following:

> Profit, however, need not be realized only in capital appreciation; equally important is the possibility of income from the investment. Here the shareholders have an expectation of "income" in at least three ways. First, and most directly, the tenant shareholders are able to share in the income from the leasing of retail establishments, office space, parking, and other commercial enterprises on the premises. The retail stores allegedly pay some $1,106,000 in rent to Riverbay. Income from renting office space and from coin-operated washing machines is stated to be $667,000 annually. Finally, some $2.5 million per year in parking fees is apparently collected from both tenants and others. In short, the shareholders may share— through the corporation— in substantial income. Admittedly, this income is not likely to come in the form of a dividend check (although according to the law dividends may be paid after all costs and expenses have been paid, *see* Private Housing Finance Law § 28) but rather in the form of reduced carrying charges to shareholder/tenants. The form that this income takes, however, is not determinative; in either case the shareholders are receiving a direct monetary benefit and as such, "profit" within the *Howey* concept.

Id.

If a higher court decides that the primary purpose of participating in a farmer cooperative is profit and not bargaining power, cooperative equity could satisfy the investment prong of the *Howey* test. Similarly, cooperative equities could qualify as securities under the motivation prong of the *Reves* resemblance test (if it was not limited to determining the existence of a note), which focuses on the motivations for involvement in an economic activity. In short, a judicial finding of a profit motive would significantly increase the chances of cooperative equity being deemed securities.

The Iowa District Court's reliance on the participation level of cooperative members as a method of determining the level of patronage refunds, as opposed to the dividend levels of corporate investors being determined by stock ownership, also poses potential problems. Ownership of enough stock, after all, allows investors to participate in shaping the direction of the corporation through votes relating to by-law changes and the selection of board members. While the court notes other distinctions between participating in a cooperative and investing in stock in a corporation, the distinctions could have been more forcefully drawn if broader policy issues had been considered.

Furthermore, the United States Supreme Court's decision in *United Housing Foundation* may not provide the precedential weight attributed to it by the Iowa District Court. First, the decision involves a controversy over a housing cooperative, not a farmer cooperative.[143] If purpose remains an important part of the analysis in farmer cooperative equity cases, *United Housing Foundation* could be distinguished away given its distinct motive. Seeking a place to live, especially a low-rent, subsidized accommodation for the economically distressed, is a purpose distinguishable from seeking bargaining power in order to reap higher profits.[144] Second, the three dissenters in *United Housing Foundation* recognized the weak basis of the purpose argument. Addressing the question of profits, they concluded that money saved was the equivalent of money earned.[145] Both would be economically beneficial.[146] The same equivalency could be found in the bargaining power/profits dichotomy

143. *United Housing Found.*, 421 U.S. at 841.

144. *Id.* at 841 (quoting the Second Circuit's self-described purpose in *United Housing Foundation* as the creation of "adequate, safe and sanitary housing accommodations for wage earners and other persons of low or moderate income").

145. *Id.* at 863-64 (Brennan, J., dissenting). According to the dissenters:

> All of the varieties of profit involved here accrue to the resident-stockholders in the form of money saved rather than money earned. Not only would simple common sense teach that the two are the same, but a more sophisticated economic analysis also compels the conclusion that in a practical world there is no difference between the two forms of income.

Id.

146. *Id.* at 864 (Brennan, J., dissenting) (explaining that the "Court errs in distinguishing among types of economic inducements which have no bearing on the motives of investors").

advanced in the *Great Rivers* decision. Third, in a matter involving very fine parsing of statutory meaning, it is not reassuring that the court is "guided" by the *Church of the Holy Trinity* decision, which blatantly ignored the statutory text involved in the controversy.[147] The use of such controversial precedent in *Great Rivers* unnecessarily jeopardizes the long-term prospect of maintaining the cooperative exemption from the securities laws.[148] The Iowa District Court ultimately makes the correct decision by focusing on the characteristics of the cooperative shares,[149] but its rationale could be greatly strengthened if other factors were also considered.

Parts of the Iowa District Court's decision are sound. The emphasis on objective distinguishing factors between cooperative equity and corporate stock, such as value appreciation and the payment of patronage dividends, offers higher courts a strong contrast with easily ascertainable criteria for decision-making.[150] Unfortunately, such analysis is secondary to the ambiguity-prone analysis of farmers' purposes for participating in cooperatives. Heavy reliance on the United States Supreme Court's *United Housing Foundation* decision is risky. The Iowa District Court's reasoning would be stronger if the more objective rationale was given greater weight. The decision would also be strengthened if additional rationales were considered.

The Eighth Circuit opinion in *Great Rivers* suffers from similar problems. In its "essential characteristics" analysis, the court denied that profit was the purpose of member involvement in a cooperative.[151] Similar to the district court decision, such a distinction could collapse and participation in a cooperative deemed a profit-making endeavor. Without citing *Reves*, the Eighth Circuit discussed *Reves* regulatory scheme prong and noted "patrons of a cooperative ordinarily base their decisions to join a cooperative on the effectiveness of the services provided . . . ," or, stated more directly, the potential for a cooperative to to be a profit-making

147. *Id.* at 849.

148. *See* WILLIAM N. ESKRIDGE, JR. & PHILIP P. FRICKEY, CASES AND MATERIALS ON LEGISLATION: STATUTES AND THE CREATION OF PUBLIC POLICY 627 (2d ed. 1995) (describing the *Church of the Holy Trinity* decision as an "eclectic interpretation").

149. *United Housing Found.*, 421 U.S. at 851 (considering whether the shares: 1) paid dividends, 2) could appreciate in value and 3) were the basis for the number of votes available to cooperative members).

150. *See* RICHARD W. JENNINGS ET AL., SECURITIES REGULATION: CASES AND MATERIALS 341 (8th ed. 1998) ("Stock or a membership in a business cooperative may or may not be a security. Where a nominal amount is paid for a non-transferable interest with no appreciation potential, and where earnings are distributed in accordance with patronage volume rather than shareholdings, no security would be involved. But some cooperative stock has sufficient profit/loss potential to be a security. Most of the authorities in this area are no-action letters." (quoting Carl W. Schneider, *The Elusive Definition of a 'Security'—1990 Update*, 24 REV. SEC. & COMMODITIES REG. 13-24 (1991))).

151. *Great Rivers II*, *supra* note 77, at 26.

venture.[152] Maintaining such a weak distinction will be increasingly difficult, especially given the tendency of new generation cooperatives to promote themselves as vehicles for boosting farm profits.

In addition, the Eighth Circuit did not clarify the proper analysis to be utilized in cases involving farmer cooperatives and alleged securities. The district court in *Great Rivers* endorsed the *Howey* "structure" for determining the existence of a security, but only applied the investment, expectation of profits, and efforts of others prongs of the test. The district court then proceeded to apply all prongs of the *Reves* test, even though the *Reves* test only applies to notes. Subsequently, the Eighth Circuit refused to apply the *Reves* test. Instead of specifically applying the *Howey* test, the court first reviewed the "essential characteristics" of capital credits. And before specifically reviewing the investment prong and expectation of profits prong of *Howey*, the court inexplicably considered the fourth prong of *Reves*, which it had earlier concluded did not apply. The absence of analytical clarity in this area increases the odds of United States Supreme Court scrutiny and a Supreme Court holding potentially detrimental to farmer cooperatives. In *Reves*, it should be remembered, the Supreme Court reversed the Eighth Circuit's holding that a note offered by a farmer cooperative was not a security.

2. *Courts Should Consider Complementary Legislation*

When determining whether the federal securities laws should govern the activities of farmer cooperatives, courts should consider the other federal statutes governing cooperatives.[153] Legislative efforts to aid the growth of cooperatives indicate that Congress would not want to subject them to the securities laws because doing so would impose large-scale costs on cooperatives and slow their development. Efforts to exempt cooperatives from the antitrust laws indicate congressional intent to confer on cooperatives a comparative advantage over corporations.[154] In

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152. *Id.* at 28.

153. *See* United Sav. Ass'n of Texas v. Timbers of Inwood Forest Assocs., 484 U.S. 365, 371 (1988) ("Statutory construction is a holistic endeavor. A provision that may seem ambiguous in isolation is often clarified by the remainder of the statutory scheme . . . ."); *see* Lauck, *supra* note 8, at 484-95 (arguing that the antitrust laws and complementary agricultural laws should be interpreted in pari materia).

154. David Millon, *The Sherman Act and the Balance of Power*, 61 S. CAL. L. REV. 1219, 1281 (1988). According to Millon:

> The exemption of labor and agricultural combinations from the Sherman Act's proscriptions further demonstrates that a deep concern about social balance lay beneath statements of solicitude for those harmed by the trusts. Several senators advocated exemption on the ground that such combinations were necessary to counterbalance the economic power of massed capital.

Id.; Love, *supra* note 12, at 341 (explaining congressional hopes of helping "cooperatives to finance business operations of sufficient magnitude to compete with corporations").

so doing, Congress demonstrated its intention to treat cooperatives differently from the typical corporation and to develop the capacity of cooperatives to provide farmers with economic bargaining power.[155] A Congress concerned about the growing concentration and power of industrial corporations passed the antitrust laws.[156] The greatest pressure placed on Congress during passage of the Sherman Act stemmed from the farm sector, which believed the statute would create more room for farmers to market their goods in an economy increasingly dominated by large corporations.[157] Congress even passed legislation authorizing the Secretary of Agriculture to monitor antitrust problems in industries such as meatpacking,[158] an industry many accused of exploiting farmers.[159] Courts have long recognized the unique advantages that Congress sought to extend to farmers in order to alleviate their economic disorganization.[160]

The clearest manifestation of Congressional intent came with the

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155. *Id.*; Sedo, *supra* note 46, at 272 (noting that cooperative exemption from the securities laws indicated the Congressional view that cooperatives were "an *alternative* to regular business corporations" (emphasis added)).

156. National Broiler Mktg. Ass'n v. United States, 436 U.S. 816, 829 (1978) (Brennan, J., concurring) (stating that "[t]he Sherman Act was the first legislation to deal with the problems of participation of small economic units in an economy increasingly dominated by economic titans"). Senator Jones lamented during the Sherman Act debate as follows:

> Now, however, having been allowed to grow and fatten upon the public, [the monopolies'] success is an example of evil that has excited the greed and conscienceless rapacity of commercial sharks until in schools they are to be found now in every branch of trade, preying upon every industry, and by their unholy combinations robbing their victims, the general public, in defiance of every principle of law or morals.

Millon, *supra* note 154, at 1278.

157. *See* Lauck, *supra* note 8, at 451-52.

158. Packers & Stockyards Act of 1921 § 1-415, 7 U.S.C. §§ 181-229 (1994).

159. *See* Douglas J. O'Brien, *The Packers & Stockyards Act of 1921 Applied to the Hog Industry of 1995*, 20 J. CORP. L. 651, 659 (1995). According to O'Brien:

> In enacting the Packers & Stockyards Act, Congress intended the prohibitions to be as rigorous as, if not more than, the Federal Trade Commission Act, the Clayton Act, and the Sherman Antitrust Act. The Act is remedial. It should be liberally construed to fully effectuate its public purpose, which is to protect farmers against receiving less than the true market value for their livestock and to protect consumers from the unfair marketing of meats.

Id.

160. Tigner v. Texas, 310 U.S. 141, 145 (1940). As the United States Supreme Court recognized:

> These large sections of the population – those who labored with their hands and those who worked the soil – were as a matter of economic fact in a different relation to the community from that occupied by industrial combinations. Farmers were widely scattered and inured to habits of individualism; their economic fate was in large measure dependent upon contingencies beyond their control. In these circumstances, legislators may well have thought combinations of farmers . . . presented no threat to the community, or, at least, the threat was of a different order from that arising through combinations of industrialists and middlemen.

Id.

passage of the Capper-Volstead Act.[161] Subject to certain limitations designed to maintain the democratic and agrarian character of the cooperative, the law granted farmers the right to act collectively to market and process their products without fear of antitrust prosecution.[162] The cooperative, however, is prohibited from restraining trade if the prices it receives for its products are "unduly enhanced."[163] By exempting farmer cooperatives from the antitrust laws Congress sought to help "farmers to compete with large corporations."[164] The Supreme Court held that "individual farmers should be given, through agricultural cooperatives acting as entities, the same unified competitive advantage—and responsibility—available to businessmen acting through corporations as entities."[165] Without fear of antitrust prosecution, farmers were to unify into farmer cooperatives to employ their combined bargaining power to negotiate with large food manufacturers for better prices for their products.[166]

Congress continued the policy of promoting farmer bargaining power in more recent decades with passage of the Agricultural Fair Practices Act of 1967.[167] The statute was designed to prevent corporations from interfering in the formation of collective marketing organizations among farmers.[168] Congressional action stemmed from episodes in which food

161. David L. Baumer et al., *Curdling the Competition: An Economic and Legal Analysis of the Antitrust Exemptions for Agriculture*, 31 VILL. L. REV. 183, 185 (1986) (recognizing that "Congressional passage of the agricultural antitrust exemption encouraged the formation of agricultural cooperatives intended to counterveil the monopsony power then held by the corporate purchasers").

162. Capper-Volstead Act of 1922 § 1, 7 U.S.C. § 291 (1994). Each member is allowed only one vote, dividends cannot exceed eight percent per annum and handling of nonmember products cannot exceed member products. *Id.*

163. *Id.* § 292.

164. Sunkist Growers, Inc. v. Winckler & Smith Citrus Prod. Co., 284 F.2d 1, 8 (9th Cir. 1960).

165. Maryland & Virginia Milk Producers Ass'n v. United States, 362 U.S. 458, 466 (1960).

166. C. Gordon Brown, Note, *Trust Busting Down on the Farm: Narrowing the Scope of Antitrust Exemptions for Agricultural Cooperatives*, 61 VA. L. REV. 341, 364 (1975) ("Capper-Volstead's authorization of collective processing and marketing was an attempt to counter the bargaining power of oligopsonist buyers, but the bargaining power gap is as wide today as it was fifty years ago"); James L. Guth, *Farmer Monopolies, Cooperatives, and the Intent of Congress: Origins of the Capper-Volstead Act*, 56 AGRIC. HIST. 67, 79 (1982) (noting the unsurprising hostility of processors to the Capper-Volstead Act). The discontent spurred the National Wholesale Grocers Association to take action to mobilize "grain dealers, millers, and the food trade to inundate legislators with protests against this 'class legislation.'" *Id.*

167. Agricultural Fair Prices Act of 1967 §§ 2-7, 7 U.S.C. §§ 2301-2306 (1994); Donald A. Frederick, *Agricultural Bargaining Law: Policy in Flux*, 43 ARK. L. REV. 679, 689 (1990) (noting that the legislation was "viewed as an important sanction of agricultural bargaining" and was a "congressional reaffirmation of the value of cooperative bargaining and marketing by agricultural producers").

168. 7 U.S.C. § 2303 (forbidding corporations from coercing, discriminating, or intimidating members of farmer bargaining groups).

processing corporations discriminated against cooperative bargaining associations by refusing to conduct business with them.[169] Courts have interpreted the "overriding purpose" of the resulting legislation to be the protection of farmers' rights to cooperatively organize.[170] Throughout the 1970's, Congress considered additional legislation to improve the bargaining power of farmers relative to that of the corporate food processing sector.[171]

Congress has also wielded its greatest power, taxation, in a manner favorable to farmer cooperatives. Since the establishment of the income tax, cooperatives have received some form of tax advantage over corporations.[172] Qualifying for tax exempt status includes the maintenance of a cooperative run by farmers, the marketing of products or the purchasing of supplies, and operating as a farmer cooperative by paying patronage refunds in accordance with the amount of business conducted through the cooperative.[173] Farmland used its tax advantage and rapidly expanded operations during World War II when corporate income tax rates were extremely high.[174] Despite intense lobbying from business groups to end the tax advantage, Congress maintained a pro-cooperative tax policy.[175]

Tax policy, combined with the other statutory protections afforded

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169. RANDALL E. TORGERSON, PRODUCER POWER AT THE BARGAINING TABLE: A CASE STUDY OF THE LEGISLATIVE LIFE OF S. 109 3-17 (1970).

170. Butz v. Lawson Milk Co., Div. of Consol. Foods Corp., 386 F. Supp. 227, 235 (N.D. Ohio 1974) (recognizing that "the overriding purpose of Congress in enacting the Agricultural and Fair Practices Act of 1967 was to protect the individual producer of milk in his right to band together with other producers or, in effect, to unionize"). *But see* Michigan Canners & Freezers Ass'n, Inc. v. Agricultural Mktg. and Bargaining Bd., 467 U.S. 461 (1984) (using the Agricultural Fair Prices Act to preempt stronger state bargaining law which required producers to sell their products on association terms).

171. National Broiler Mktg. Ass'n v. United States, 436 U.S. 816, 837 (1978) (Brennan, J., concurring) (noting the "persuasive evidence that Congress' concern for protecting contract growers vis-à-vis processors and handlers has not abated"); Frederick, *supra* note 167, at 691-692; Oliver & Snyder, *supra* note 138, at 498.

172. *See* Garry A. Pearson, *The Farm Cooperative and the Federal Income Tax*, 44 N.D. L. REV. 490, 490 (1968); *see also* Daniel S. Welytok, *Doing Business as a Cooperative in the Face of Increased Challenges*, 84 J. TAX'N 37, 37 (1996) (explaining the current treatment of cooperatives). Accoridng to Welytok:

> Certain farmer's cooperatives that satisfy the requirements of Section 521(b) ("exempt cooperatives") are permitted to allocate and deduct earnings from both patronage and nonpatronage sources. Most other cooperatives are classified as "nonexempt" and may allocate and deduct only earnings arising from business with patrons, and then only if certain conditions specified in Section 1388(a) are complied with.

Id.

173. Pearson, *supra* note 172, at 491-93.

174. *See* GILBERT C. FITE, FARM TO FACTORY: A HISTORY OF THE CONSUMERS COOPERATIVE ASSOCIATION 200-14 (1965).

175. John Earle Haynes, *Farm Coops and the Election of Hubert Humphrey to the Senate*, 57 AGRIC. HIST. 201, 202-05, 211 (1983) (noting the establishment of the National Tax Equality Association, which lobbied to end the cooperative tax advantage).

farmer cooperatives, clearly indicate a congressional policy to promote cooperative enterprise. As one circuit court squarely recognized, agricultural cooperatives are "a favorite child of Congressional policy."[176] The Supreme Court of Kansas agreed noting that "cooperative marketing associations are fostered and encouraged by legislative enactment and judicial construction."[177] Such opinions echo the United States Supreme Court, which has recognized that the Clayton Act, Capper-Volstead Act, and Cooperative Marketing Act "reveal widespread legislative approval . . . [of cooperative marketing as a method of] protecting scattered producers and advancing the public interest."[178]

3. *The Legislative History and Purpose of the Securities Acts Supports the Exclusion of Farmer Cooperatives from Coverage.*

Congress decided not to include farmer cooperatives within the scope of securities regulation. The House version of the Securities Act of 1933 did not contain an explicit exemption for farmer cooperatives, but such an exemption was added by the Senate before final passage.[179] The

176. Fairdale Farms, Inc. v. Yankee Milk, Inc., 635 F.2d 1037, 1043 (2d Cir. 1980) (quoting 5 TOULMIN, ANTITRUST LAWS § 6.1, at 334 (1950)). Farmer cooperatives were even afforded an exemption from compliance with the Interstate Commerce Act. *See* Northwest Agric. Coop. Ass'n, Inc. v. Interstate Commerce Comm'n, 350 F.2d 252, 254 (9th Cir. 1965) (noting the Congressional intention to "exempt from economic regulation under the Interstate Commerce Act trucking operations conducted by organizations which satisfy the definition of a 'cooperative association' in the Agricultural Marketing Act").

177. Claassen v. Farmers Grain Coop., 490 P.2d 376, 381 (Kan. 1971).

178. Liberty Warehouse Co. v. Burley Tobacco Growers' Coop. Mktg. Ass'n, 276 U.S. 71, 92-93 (1928).

179. Sedo, *supra* note 46, at 271. According to Sedo:

> While the idea of an exemption was favorably commented upon by Representative Rayburn, the House passed the bill without specific mention of an exemption for farmers' cooperatives. This exemption was very similar to that contained in the final version of the bill that was adopted by both houses of Congress. The United States Senate substituted its version for the House bill, and its version of the Securities Act contained a provision that provided an exemption for farmers' cooperatives. This exemption was very similar to that contained in the final version of the bill that was adopted by both houses of Congress.

Id. The exemption only applies to "a farmer's cooperative exempt from tax under Section 521 of the Internal Revenue Code." *Id.* at 280. This provision may only offer limited protection. *See* Jerome P. Weiss & Edward B. Crosland, *Fact vs. Fiction in Regulation of Agricultural Cooperative Securities*, COOPERATIVE ACCOUNTANT, Spring 1978, at 12, 19 (noting that "[i]t is extremely doubtful that more than half of all agricultural cooperatives in the United States qualify for the tax exemption provided under Section 521 . . . and thus are exempt from registration under Section 3(a)(5) of the 1933 Act").

Section 521 is restrictive, requiring: 1) "substantially all" cooperative stock be owned by farmers who market through or purchase from the cooperative; 2) the "dividend rate of such stock is fixed at not to exceed the legal rate of interest in the State of incorporation or 8 percent per annum;" 3) the value of goods marketed for or goods purchased by nonmembers does not exceed that of members; and 4) the"value of the purchases made for persons who are neither members nor producers does not exceed 15 percent of the value of all its purchases." I.R.C. § 521 (b)(2), (b)(4) (1994). In 1975, the Eighth Circuit decided that "[s]tatutory language exempting farmers' cooperatives from the full burdens of taxation is to

Securities and Exchange Act of 1934 did not mention cooperatives, but the statute was not applied to cooperatives.[180] In the Securities Acts Amendments of 1964, Congress specifically exempted cooperatives from the registration requirements.[181]

Since the securities laws were designed to reduce the potential for fraud and abuse when investing in corporations, they do not seem applicable to cooperative equity.[182] The securities laws were to "eliminate serious abuses in a largely unregulated securities market."[183] In the case of cooperative equity, unlike publicly traded stocks, transferability is severely limited. Also, unlike corporations, the return on cooperative stock is limited by statute and cannot appreciate in value.[184]

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be strictly construed." Land O'Lakes, Inc. v. United States, 514 F.2d 134, 139 (8th Cir. 1975) (strictly construing the tax exemption and stripping a farmer cooperative of its exemption for not meeting all of the exemption's qualifications). In order to fully promote the growth of farmer cooperatives, Congress should eliminate the qualifications which limit the applicability of Section 521.

180. Sedo, *supra* note 46, at 272.

181. Securities Acts Amendments of 1964 § 3, 15 U.S.C. § 78*l*(g)(2)(E)-(F). The statute states that the registration requirements do not apply to:

> (E) any security of an issuer which is a 'cooperative association' as defined in the Agricultural Marketing Act, approved June 15, 1929, as amended, . . . or a federation of such cooperative associations, if such federation possesses no greater powers or purposes than cooperative associations so defined.
>
> (F) any security issued by a mutual or cooperative organization which supplies a commodity or service primarily for the benefit of its members and operates not for pecuniary profit, but only if the security is part of a class issuable only to persons who purchase commodities or services from the issuer, the security is transferable only to a successor in interest or occupancy of premises serviced or to be served by the issuer, and no dividends are payable to the holder of the security.

Id.; Sedo, *supra* note 46, at 272.

The Agricultural Marketing Act defines a "cooperative association" as farmers working together to market their product or buy supplies provided that voting be based on one membership-one vote, dividends be limited to eight percent and transactions with non-members not exceed transactions with members. 12 U.S.C. § 1141j(a) (1994). In order to promote the continued development of farmer cooperatives, Congress should adopt legislation which would make the definition of cooperative in the Securities Act and the Exchange Act the same. The definition should not be burdened with the complicating qualifications of present definitions which make the securities laws exemption unnecessarily complex. A simple, concise definition could read "entities organized as farmer cooperatives under state statutes." State legislatures could then decide the necessary characteristics of a farmer cooperative. Farmers could then work with state legislators familiar with their problems and not worry about the unpredictability of the federal courts.

182. *See* JENNINGS ET AL., *supra* note 150, at 2 (noting that an important purpose of the securities laws is the manipulation of stocks traded on Wall Street, an impossibility for cooperative equity).

183. United Housing Found. v. Forman, 421 U.S. 837, 849 (1975).

184. Sedo, *supra* note 46, at 264, 272 (noting that "the abuses and speculation that the Acts were intended to curb were not present in cooperative investments, nor were the motives of the members that provided capital for a cooperative the same as investors in other businesses").

4. *Non-application of Securities Laws Advances Social Policy*

By not burdening farmer cooperatives with the demands of the federal securities laws, their chance for economic success improves. Non-application thus advances the long-standing public policy of promoting farmer cooperatives as a method of enhancing the economic bargaining power of farmers.[185] In so doing, farmers are better equipped to negotiate with the economically powerful processing sector and potentially receive a greater portion of consumer shopping dollars.[186] If farmer cooperatives begin to process the products of their members, they may be able to capture a greater share of the processing sector and receive the profits formerly captured by corporate processors.

Promoting the strength of cooperatives also more evenly divides power in the republic, an issue of great concern to the American founders.[187] It advances the economic decentralization goal famously articulated by Judge Learned Hand in the *Alcoa* case and restated by Chief Justice Earl Warren a few decades later.[188] The goal has been embraced by many groups in American history.[189] Strengthening farmer

185. National Broiler Mktg. Ass'n v. United States, 436 U.S. 816, 830-31 (1978) (Brennan, J., concurring) (noting, with specific reference to the Capper-Volstead Act, "the disparity of power between units at the respective levels of production that spurred this congressional action").

186. *See* GEORGE W. LADD, AGRICULTURAL BARGAINING POWER (1964) (examining ways agricultural associations can improve farmer bargaining power).

187. THE FEDERALIST NO. 10 (James Madison) (Henry Cabot Lodge ed., 1888). When Publius tried to explain how our experiment in self-government might work, welfare maximization and efficiency gains took a back seat to spreading, diluting, and dividing interests, parties, and factions. *See id.* Publius believed factions were incubators of "instability, injustice, and confusion," the "mortal diseases under which popular governments have everywhere perished." *Id.* at 51-52.

188. United States v. Aluminum Co. of America, 148 F.2d 416, 427-29 (2d Cir. 1945). Judge Learned Hand wrote:

> It is possible, because of its indirect social or moral effect, to prefer a system of small producers, each dependent for his success upon his own skill and character, to one in which the great mass of these engaged must accept the direction of a few.... Throughout the history of these [antitrust and related] statutes it has been constantly assumed that one of their purposes was to perpetuate and preserve, for its own sake and in spite of possible cost, an organization of industry in small units which can effectively compete with each other.

Id.; Brown Shoe Co. v. United States, 370 U.S. 294, 344 (1962) (Warren, C.J.) ("[W]e cannot fail to recognize Congress' desire to promote competition through the protection of viable, small, locally owned businesses. Congress appreciated that occasional higher costs and prices might result from the maintenance of fragmented industries and markets. It resolved these competing considerations in favor of decentralization."); *see* Richard P. Adelstein, *'Islands of Conscious Power': Louis D. Brandeis and the Modern Corporation*, 63 BUS. HIST. REV. 614-656 (1989).

189. DAVID A. HOROWITZ, BEYOND LEFT & RIGHT: INSURGENCY AND THE ESTABLISHMENT xi (1997) ("'Two souls dwell in the bosom... of the American people,' wrote the newspaper columnist Dorothy Thompson in 1938. One sought the abundant life of the corporate market. The other yearned for 'former simplicities, for decentralization, for the interests of the 'little man.'"); *see* MICHAEL KAZIN, THE POPULIST PERSUASION: AN

cooperatives advances this goal and also addresses the concerns of many contemporary critics who are fearful of a growing social and economic imbalance in American life.[190] Cooperative promotion is particularly appropriate given that the historical concerns of farmers prompted much of the subsequent social commentary about inequality.[191]

Strengthening farmer cooperatives as a method of addressing social concerns about economic concentration and inequality complements the work of scholars who have been re-examining the interpretation of the antitrust laws in recent decades.[192] Some fear that concerns about economic efficiency have crowded out the social concerns that originally prompted the passage of the antitrust laws.[193] In particular, such laws addressed the late-nineteenth century concerns about the coming of large-scale industrial capitalism and its impact on a democratic society.[194] Failure to consider the factor of economic power in society when interpreting the antitrust laws distorts the original meaning and intent of the statute.[195] Considering the economic power factor, some scholars now argue that the antitrust laws have not necessarily undermined economic efficiency.[196]

AMERICAN HISTORY (1995).

190. *See* WILLIAM GREIDER, WHO WILL TELL THE PEOPLE: THE BETRAYAL OF AMERICAN DEMOCRACY 12 (1992) (arguing that "the government now responds more often to narrow webs of power—the interests of major economic organizations and concentrated wealth and the influential elites surrounding them"); CHRISTOPHER LASCH, THE REVOLT OF THE ELITES AND THE BETRAYAL OF DEMOCRACY 77-78 (1995) (noting that since the Civil War "the concentration of corporate power, the decline of small-scale production, the separation of production from consumption, the growth of the welfare state, the professionalization of knowledge, and the erosion of competence, responsibility, and citizenship have made the United States into a society in which class divisions run far more deeply than they did in the past"); KEVIN PHILLIPS, BOILING POINT: REPUBLICANS, DEMOCRATS, AND THE DECLINE OF MIDDLE CLASS PROSPERITY (1993) (examining why the middle class economy stagnated, why the wealthy did so well and why the combination was a political disaster for the GOP).

191. LASCH, *supra* note 190, at 81-82.

192. *See* DONALD DEWEY, THE ANTITRUST EXPERIMENT IN AMERICA 21, 40 (1990). Dewey noted that the view that "Congress intended the primacy of [economic efficiency] when it passed the Sherman Act in 1890 is historically suspect and can only be supported, if at all, by a highly selective use of evidence." *Id.* at 21. Dewey also urged consideration of "honorable values" such as the "[d]ecentralization of decision-making, the dispersion of power, and a higher standard of business ethics." *Id.* at 40. Dewey believed that "[t]here is no reason why the Law's reasonable man should not conclude that antitrust, with all its presumptive inefficiencies, is not worth the cost." *Id.*

193. RICHARD HOFSTADTER, THE AGE OF REFORM: FROM BRYAN TO FDR 243 (1955) (explaining the Sherman Act as a "gesture, a ceremonial concession to an overwhelming public demand for some kind of reassuring action against the trusts"); Herbert Hovenkamp, *Antitrust Policy After Chicago*, 84 MICH. L. REV. 213, 249 (1985); Rudolph J. Peritz, *A Counter-History of Antitrust Law*, 1990 DUKE L.J. 263, 266 (1990) (explaining that "[t]he steady din of competition rhetoric has numbed our faculties and kept us from remembering that competition policy has never been the sole normative ground for antitrust laws").

194. *See* HOROWITZ, *supra* note 189, at 6.

195. Millon, *supra* note 154, at 1275-82.

196. *See* Peter C. Carstensen, *How to Assess the Impact of Antitrust on the American*

Addressing the issue of economic concentration is not merely a concern of the American left. Prominent business publications have begun to doubt the wisdom of the concentration trend in certain economic sectors.[197] Some business commentators urge greater attention to the problem of monopoly,[198] as do some political conservatives.[199] To avoid a public backlash against corporate concentration, the use of the antitrust laws has been urged as a policy that avoids more technical and intrusive kinds of government planning and preserves citizen faith in market capitalism.[200] By promoting citizen involvement in the marketing process, farmer cooperatives serve such an end.

IV. CONCLUSION

Public policy has strongly supported the growth of farmer cooperatives in the United States since the nineteenth century. The current legal controversy concerning the extension of the securities laws to cooperatives could undermine this historic support by placing additional burdens on cooperatives. To avoid this result, courts need to clarify the analysis to be used when determining the existence of a security in the farmer cooperative context and broaden their considerations beyond the text of the securities laws. Courts should consider the wider policy rationale advanced in support of cooperatives and the federal statutory regime designed to aid cooperative growth. By so doing, a ruling favorable to continued cooperative growth is more

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Economy: Examining History or Theorizing?, 74 IOWA L. REV. 1175 (1989) (contending that a historical appraisal does not show antitrust laws have forfeited economic efficiency).

197. Gretchen Morgenson, *A Cautionary Note on Mergers: Bigger Does Not Mean Better*, N. Y. TIMES, Dec. 8, 1998, at C1; Peter Passell, *When Mega-Mergers Are Mega-Busts*, N.Y. TIMES, May 17, 1998, at 18; Phillip L. Zweig et al., *The Case Against Mergers; Even in the '90s, Most Still Fail to Deliver*, BUS. WK., Oct. 30, 1995, at 122 (noting that the "historic surge of consolidations and combinations is occurring in the face of strong evidence that mergers and acquisitions, at least over the past 35 years or so, have hurt more than helped companies and shareholders").

198. *Monopolies: Time to Debunk the Myths*, BUS. WK., June 16, 1997, at 158 ("It is time to start worrying about monopolies again. A decade and a half into a great wave of deregulation that has unleashed competition in trucking, banking, natural gas, railroads, airlines, and telecom, an unsettling pattern of market concentration is creeping back.").

199. William Safire, *The Curse of Bigness*, N.Y. TIMES, Dec. 13, 1999, at A33 (arguing that the Federal Trade Commission and the Department of Justice are "overwhelmed by the rising momentum toward concentration throughout American big business").

200. Irwin M. Stelzer, *A Conservative Case for Regulation*, PUBLIC INTEREST, Summer 1997, at 86-87 (urging conservatives to accept stronger antitrust measures as a method of respecting "society's abiding concern for the diffusion of private power and maximum opportunity for individual enterprise"); Steven Lipin, *Amalgamated America; Concentration: Corporations' Dreams Converged in One Idea: It's Time to Do a Deal; Merger Wave Gathers Force as Strategies Demand Buying or Being Bought; 'You Need to Be a Gorilla,'* WALL ST. J., Feb. 26, 1997, at A1. Since the Sherman Act "the fears of industry concentration and market power reflected in that law have remained part of Americans' shared concerns. Thus it is possible that, if it goes too far, today's merger wave could produce a comparable backlash." *Id.*

likely. Such considerations will strengthen the legal standing of farmer cooperatives and thereby bolster agricultural marketing institutions and help preserve the economic independence of the American farmer. If courts do not consider such factors and clarify the appropriate analysis in cooperative security controversies, Congress should act to specifically exempt all farmer cooperatives from the onerous registration requirements of the securities laws and thereby bolster the long-standing public policy of promoting cooperative formation.