Are Financial Instruments Issued by Agricultural Cooperatives Securities?: A Framework of Analysis

by

Frank A. Taylor, Esq. and Patrick A. Reinken, Esq.

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ARE FINANCIAL INSTRUMENTS ISSUED BY AGRICULTURAL COOPERATIVES SECURITIES?: A FRAMEWORK OF ANALYSIS

Frank A. Taylor, Esq. & Patrick A. Reinken, Esq.[*]

The Securities Act of 1933[1] ("Securities Act") and the Securities Exchange Act of 1934[2] ("Exchange Act") provide the basic framework for regulation of issuance, distribution, and trading of securities in the United States.[3] Both of these Acts were enacted as a result of the Great Depression of 1929, a period of horrible economic dislocation.[4] In response to this economic crisis, Congress effectively

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* Mr. Taylor is a capital partner in the Minneapolis office of Hinshaw & Culbertson, and Mr. Reinken is associated with Hinshaw & Culbertson in its Minneapolis office. The authors also wish to thank Scott Paxton, Esq., and Kay Kelley for their extensive assistance in preparation of this article.

1. *See* 15 U.S.C. §§ 77a-bbbb (1994 & Supp. 1998).

2. *See id.* §§ 78a-11. In this manuscript, the Securities Act of 1933 will be referred to as the "Securities Act," and the Securities Exchange Act of 1934 will be referred to as the "Exchange Act."

3. *See* LOUIS LOSS & JOEL SELIGMAN, FUNDAMENTALS OF SECURITIES REGULATION 34 (3d ed. 1995).

4. *See id.* at 24. In their seminal treatise, Professors Loss and Seligman write:

> [T]he great stock market crash beginning in October 1929 . . . abruptly ended the postwar era of seemingly indefinite prosperity and was followed by the long depression. The losses that investors suffered in the few years following the crash would almost finance a few weeks or months of a modern war. From 1920 to 1933, some $50 billion of securities were sold in the United States. By 1933, half were worthless. In 1934, the American public also held over $8 billion of foreign

adopted the philosophy from the 1914 Louis D. Brandeis book, *Other's People's Money*, in which Justice Brandeis rather strongly suggested that "[s]unlight is said to be the best of disinfectants; electric light the most efficient policeman."[5] The basic function of both securities acts is to shine direct light upon financial instruments through full and complete disclosure, so that the investing public can make informed decisions about the purchase and sale of securities.[6]

Today, many commentators suggest that the agricultural community is again ravaged by an economic climate reminiscent of the Great Depression.[7] For example, it is estimated that some eight percent of the farmers in Minnesota will quit farming in the next year.[8] Presumably, many of these farmers and ranchers are members of agricultural cooperatives. These farmers and ranchers also presumably have, over the years, purchased goods and services from cooperatives in which they are members. In doing so, these people have built up equity in their respective cooperatives.[9] As producers retire from agriculture and leave their cooperatives, questions will be raised as to whether and when the cooperative will redeem the producers' equity. Some of these questions may very well be raised under either or both of the securities acts.[10]

This manuscript is not intended to provide a comprehensive history of the treatment of cooperative equity. Nor will it provide definitive commentary on (i) federal securities or other laws deemed or determined to govern activities or

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> securities, of which $6 billion had been sold in the years 1923 to 1930. By March 1934, $3 billion were in default. The aggregate value of all stocks listed on the New York Stock Exchange on September 1, 1929, was $89 billion. In 1932 the aggregate figure was down to $15 billion—a loss of $74 billion in two and one-half years. The bond losses increased the total drop in value to $93 billion.

Id. at 24-25.

5. LOUIS D. BRANDEIS, OTHER PEOPLE'S MONEY 62 (National Home Library Foundation ed., 1933) (reprinted by special arrangement with Frederick A. Stokes Company).

6. *See* LOSS & SELIGMAN, *supra* note 3, at 7-8.

7. *See* Robert Franklin, *Shifting Demographics Challenge Regional Towns*, STAR TRIB. (Minneapolis), Oct. 4, 1999, at B1; *Freedom to Fail? Safety Net Is Not Serving Farmers*, STAR TRIB. (Minneapolis), May 23, 1999, at A24.

8. *See* Bob von Sternberg, *Who's Tending the Farm?*, STAR TRIB. (Minneapolis), Sept. 26, 1999, at A30.

9. In a paper filed with the United States Court of Appeals for the Eighth Circuit, the National Council of Farmer Cooperatives represented:

> The total agricultural production in this country attributed to farmer cooperatives is significant. Farmer cooperatives market 86% of the nation's milk, 40% of all grains and oil seeds, 41% of cotton, 20% of fruits and vegetables, and 13% of the livestock produced in the United States. With total sales of more than $128 billion, farmer cooperatives generate significant activity across many rural areas and communities. Nearly 3,000,000 jobs are directly dependent on farmer cooperatives, with most located in rural areas and communities. These, in turn, support another 20,000,000 jobs throughout the U.S. economy.

Amicus Curiae Brief for National Council of Farmer Cooperatives at 2, Great Rivers Coop. v. Farmland Indus., 198 F.3d 685 (8th Cir. 1999) (Nos. 98-2527, 98-2528). The authors of this paper have not independently verified the accuracy of the statements made by the NCFC.

10. *See* discussion *infra* Parts II.B-C.

instruments of agricultural cooperatives; or (ii) any particular case, administrative opinion, or other such determination. Rather, the Article provides a brief recitation of the historical framework of cooperatives and their financing instruments, an overview of federal securities laws in the context of the potential liabilities they create for modern agricultural cooperatives using such instruments, and possible actions that might be taken by those cooperatives to mitigate such liabilities.[11] It concludes by strongly suggesting that many issues about the nature of cooperative equity and redemption practices may be avoided through timely, full and complete disclosure – the sunlight envisioned by Justice Brandeis![12]

I. THE HISTORY AND PURPOSE OF COOPERATIVES AND THEIR FINANCING INSTRUMENTS

The agricultural cooperative is a unique business entity and a product of history that predates the securities acts. By typical lay definition, agricultural cooperatives may be comprised of agricultural producers who combine together in organized associations to achieve better product distribution and marketing, in that way securing better services and prices for their members through economies of scale.[13]

Cooperatives enjoy tax favored status under the Internal Revenue Code.[14] To maintain that status at the end of each fiscal year, cooperatives must distribute the profits earned from the cooperative's business to their customers.[15] This distribution of profits is called the "patronage dividend" or "patronage refund."[16]

Historically, cooperatives have financed their operations through retention of a portion of the patronage dividend or refund.[17] For many years, cooperatives would distribute their profits in cash, and in a form of equity that represented the profit portion that the cooperative retained to finance ongoing business operations.[18]

This distribution of profits is consistent with the notion that "[a] cooperative is a user-owned and controlled business from which benefits are derived and

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11. *See* discussion *infra* Part II.

12. *See* discussion *infra* Part III.

13. *See, e.g.*, Atchison County Farmers Union Coop. Ass'n v. Turnbull, 736 P.2d 917, 919-20 (Kan. 1987); Mary Beth Matthews, *Recent Developments in the Law Regarding Agricultural Cooperatives*, 68 N.D.L. REV. 273, 273 (1992); ISRAEL PACKEL, THE ORGANIZATION & OPERATION OF COOPERATIVES 15 (4th ed. 1970).

14. *See* I.R.C. § 1383 (1998).

15. *See* 14 NEIL E. HARL, AGRICULTURAL LAW § 136.01[1], at 136-5 (1999).

16. *See id.* Dr. Neil Harl describes the patronage refund in the following way: "[A] distribution by a cooperative to all patrons of the cooperative of the excess of the amounts received by the cooperative for furnishing services to patrons over the operating costs and expenses chargeable to the services furnished." *Id.*

17. *See id.* As with any business, cooperatives must raise capital, usually through the issuance of equity or debt. *See id.* § 136.01[1], at 136-4 to 136-6.

18. *See* Matthews, *infra* note 13, at 274.

distributed on the basis of use."[19] In turn, this view is founded upon a basic user-owner cooperative principle that provides that those people who use the cooperative should also finance the cooperative. [20]

This makes sense when the agricultural producer is active. But what happens when the producer retires? One commentator suggests that the equity should be redeemed within a reasonable time:

> [T]he cooperative's equity structure should reflect current patterns of use. Farmers currently benefiting from the cooperative should be those financing it. Relatively heavy users of the cooperative should provide a relatively larger share of its equity capital. Farmers no longer using the cooperative should not be expected to have a continued equity stake. Thus programs for revolving equity within a reasonable time frame are an absolute necessity.[21]

An obvious tension exists between (i) those retired members of the cooperative who financed its operations when they used it and now want their equity redeemed, and (ii) the cooperative's active members and the board of directors who are still using the cooperative and enjoying the benefits of, in effect, an extension of interest free funds from the equity held by the retired farmers. This tension heightens when farmers are told different things, at different times during their membership in the cooperative. For example, Farmland Industries, Inc. ("Farmland"), once described the equity held by its patrons as "savings," a term that usually connotes a sum of money available on retirement:

> The board of directors recommended and the shareholders approved the distribution of [Farmland's] ***savings*** in accordance with the by-laws which provide that after dividends on stock, all of the remaining savings (computed on an income tax basis) on cooperatives' business shall be returned to the patron cooperatives as patronage refunds.
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> In accordance with the distribution of savings plan adopted by the shareholders in 1952, 80% of the patronage refund was paid in 2% dividend-bearing preferred shares and 20% in cash. Some associations not owning their quotas of common stock received 10% of their patronage refund in common shares and 70% in preferred shares.
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> Since 1952, the distribution of savings has involved the disbursement in cash of an amount equal to about 55% of the current year's patronage refund. Of these payments, approximately two-fifths have been

19. John R. Dunn, *Basic Cooperative Principles and Their Relationship to Selected Practices*, J. AGRIC. COOP., 1988, at 85.

20. *See id.*

21. *Id.* at 87.

> made to current patrons and three-fifths have gone to patrons of previous years as payments on the revolving fund.[22]

Farmland's Bylaws as late as 1993 supported a conclusion that the "savings" equity would be redeemed on retirement:

> All revolving capital certificates or credits, by whatever name or names known, shall be issued or credited in annual series . . . and shall be retired in the order of their issuance or entry, by years, as and when the financial condition of the Association will permit, as conclusively determined by the members.[23]

Farmland's present disclosure about its redemption policies suggests a far different story, however.

> The Equity Redemption Plans described below, namely the base capital plan, the estate settlement plan and the special equity redemption plans (collectively, the "Plans") may be changed at any time or from time to time at the sole and absolute discretion of the Board of Directors. The Plans are also not binding upon the Board of Directors or the Company, and the Board of Directors reserves the right to redeem, or not redeem, any equities of the company without regard to whether such action or inaction is in accordance with the Plans. . . . By retaining discretion to determine the amount, timing and ordering of any equity redemptions, the Board of Directors believes that it can continue to assure that the best interests of the Company and thus of its owners will be protected.[24]

Clearly, if a farmer earned his equity with an expectation that it was his "savings" to be redeemed when the cooperative was financially able, he would be quite disappointed to learn that the cooperative believes it has an unfettered right to redeem the equity whenever it pleases.

Today, equity redemption practices deserve even closer scrutiny because of the consolidations, mergers, and acquisitions within the agricultural community. For

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22. CONSUMERS COOPERATIVE ASSOCIATION, 32ND ANNUAL REPORT 11 (1960) [CCA is Farmland's predecessor]. In that report, President Cowdens' comments are eerily similar to statements made about today's agriculture economy:

> The beginning of our 1959-60 fiscal year came at a time when farmers were acutely conscious of sagging income. The calendar year of 1959 was one of the worst of the past decade from the standpoint of net return on farm operations in the United States. The income situation has leveled out in 1960, but the final figures will show very little improvement over 1959.

Id. at 2.

23. FARMLAND INDUSTRIES INC., ARTICLES OF INCORPORATION AND BYLAWS OF FARMLAND INDUSTRIES, INC. KANSAS CITY, MISSOURI 9 (effective Dec. 3, 1992) (on file with author).

24. FARMLAND INDUSTRIES, INC., S-1A REGISTRATION STATEMENT 119 (Dec. 9, 1997).

example, on September 15, 1999, Farmland and Cenex Harvest States advised their voting members about a "proposed unification between Farmland and Cenex Harvest States."[25] Farmland and Cenex Harvest States did not describe the policies that will govern redemption of equities held by non-members in the two cooperatives in the merger letter.[26] The only reference to non-members (those not active) was the provision that "[m]embers not conducting any business for two years will be converted to non-voting status."[27] There was no statement in this Merger Letter that non-members holding equity in the cooperatives were advised as to the terms of the resultant combined corporation.[28] As these two previously separate cooperatives sought to combine, it should have been essential that all parties to the transaction—including the non-member equity holders—understood clearly the equity redemption policies that would be followed upon completion of the transaction.[29]

Given the growth in the number and scope of complex transactions, the question of the applicability of the securities laws in this context is becoming more complicated rather than simpler. Indeed, the legal treatment of instruments offered in the course of such financial arrangements is open to debate in many circumstances. As Dr. Harl observed:

> The applicability of the federal securities laws to the different interests between an agricultural cooperative and its members (such as the membership interest itself as evidenced by a certificate of membership in a non-stock agricultural cooperative or the distribution of patronage refunds to all patrons of the cooperative) arising because of the nature of the cooperative itself is not entirely clear. Whether the federal securities laws apply to the activities of agricultural cooperatives begins with the question: do agricultural cooperatives issue "securities" under the federal securities laws? An answer requires an analysis of the definition and characteristics of a "security" under the federal securities laws.[30]

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25. Letter from Cenex Harvest States to Farmland Industries, Inc. 1 (Sept. 15, 1999) (on file with author). On November 29, 1999, the proposed merger between Farmland and Cenex Harvest States was rejected by the members of Cenex Harvest States. *See* Cenex Harvest States, Press Release (Nov. 23, 1999) <http://www.cenexharveststates.com/news/112399.html>.

26. *See* Letter from Cenex Harvest States to Farmland Industries, Inc., *supra* note 25.

27. *Id.* at 3.

28. *See id.*

29. For example, in *Great Rivers Coop. v. Farmland Industries ("Great Rivers Coop.")*, which was recently decided by the United States Court of Appeals for the Eighth Circuit, a portion of the Plaintiff's Class had held instruments that the defendant had distributed in exchange for *other* instruments that Class Members held, with the exchange occurring in the course of the defendant's acquisition of controlling interests in other business entities. *See* Great Rivers Coop. v. Farmland Indus., 934 F. Supp. 302 (S.D. Iowa 1996), *aff'd*, 198 F.3d 685, 701 (8th Cir. 1999). The authors of this article acted as counsel for the Plaintiffs in *Great Rivers* which is discussed in more detail below.

30. HARL, *supra* note 15, § 136.01[3], at 136-6. *See also id.* § 136.01[1], at 136-5 to 136-6 n.22 (identifying agricultural cooperative instruments or transactions whose status as a security has not been fully determined).

A very real danger consistently underlies cooperative financing instruments—even in common usages, the instruments may have characteristics of securities under federal law and they therefore can carry the risks attendant to such securities.[31] In the more unique situations arising in modern financing, the use of financing instruments creates a much greater risk as the characteristics of the instruments at issue change, bringing them more closely in line with traditional areas of "securities."[32]

That danger is exacerbated where instrument holders are non-members or members leaving the organization. The status of inactiveness or potential inactiveness results in the holding of cooperative instruments by persons or entities other than the cooperative's active members, making cooperatives appear more like federally regulated securities. Where the cooperative refuses immediately to redeem or repurchase certain forms of instruments in the hands of new non-members, it opens itself up to litigation that (i) is brought by persons having no meaningful business interest in the cooperative itself, and (ii) arises not under simple contract or fiduciary duty law, but potentially under applicable securities laws.

II. FEDERAL SECURITIES LAWS AND THEIR IMPACT ON THE COOPERATIVE SYSTEM

Analyzing the potential impact of securities laws in the use of financing instruments for cooperatives requires that one first have an understanding of the fundamental workings of such laws, the restrictions inherent in them, and the arguable scope of their coverage. Federal securities laws are discussed below in this regard, as the pre-eminent example of securities anti-fraud laws having potential application in the context of cooperative financing instruments.[33] The *Great Rivers* case, recently decided by the Eighth Circuit Court of Appeals, is also discussed.[34]

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31. *See id.*

32. *See id.* § 136.01[1], at 136-6.

33. *See infra* Part II.A-C. The number of state jurisdictions and the breadth of the variance among them precludes a definitive discussion of the state securities "blue sky" laws and their possible impact on cooperative financing instruments. Nevertheless, those bodies of laws frequently impose their own requirements on issuers of securities, parallel to the federal requirements discussed below. Thus, while focus here is on federal laws and cooperatives, legal practitioners must also consider the implications of any governing securities law arising from individual states.

34. *See Great Rivers Coop.*, 198 F.3d 685.

A. *An Overview of the Requirements of the Federal Securities Laws*[35]

Business enterprises—including agricultural cooperatives—that offer or sell securities to the public through interstate commerce are subject to the provisions of both the securities acts and the rules and regulations promulgated by the Securities Exchange Commission (SEC), absent specific statutory exemption from those regulations.[36] The primary import of such regulation is the requirement, under Section 5 of the Securities Act, that issuers of non-exempt securities file an appropriate registration statement with the SEC before public trading of the securities at issue may occur. [37]

Both the Securities Act and the Exchange Act impose civil and criminal liabilities on persons responsible for the preparation and filing of the Registration Statements when these preparatory instruments include untrue statements or omissions of facts material to investors.[38] While the Securities Act and Exchange Act both contain exemptions for certain agricultural cooperatives,[39] those exemptions apply only where the cooperative qualifies for specific tax benefits. [40] As commentators have recognized:

> It is extremely doubtful that more than half of all agricultural cooperatives in the United States qualify for the tax exemption . . . and thus are exempt from registration. . . . It is equally unlikely that the majority of agricultural cooperatives qualify for and have utilized other 1933 [Securities] Act exemptions, particularly the exemptions for intrastate and private offerings[,] which are quite technical, have limited usefulness, and are narrowly construed and closely regulated by federal and state

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35. *See Great Rivers Coop.* 198 F.3d 685, 701 (8th Cir. 1999). The federal securities laws do not provide the only statutory framework for an analysis of the issuance of securities by cooperatives. Each state has its own securities law or "blue sky" law which governs the purchase and sale of securities in that particular state. *See* LOSS & SELIGMAN, *supra* note 3, at 46-47. A discussion of the framework of regulation provided by those laws is outside the scope of this paper.

36. *See* Jerome P. Weiss & Edward B. Crosland, Jr., *Fact vs. Fiction in Regulation of Agricultural Cooperative Securities*, *in* THE COOP. ACCOUNTANT 12, 15 (1978). *See also* 15 U.S.C. § 77c(a) (exempted securities) (1994 & Supp. 1998); 15 U.S.C. §§ 77d (exempted transactions), 77e (prohibitions on sale or delivery of unregistered securities) (1994).

37. *See* 15 U.S.C. § 77e(c) (1994); Weiss & Crosland, Jr., *supra* note 36, at 15. A registration statement for issuance of securities typically must include the prospectus for the issuance and specified disclosures to prospective investors, including financial and issuer information relating to the offer. *See* 15 U.S.C. § 77f, *amended by* 15 U.S.C. §§ 77f(b), 77aa(28) (Supp. 1998); 15 U.S.C. § 77g (1994); 17 C.F.R. §§ 210, 229 (1999). The Exchange Act of 1934 imposes additional requirements based on, *inter alia*, inclusion of the security on national exchanges, and the extent of the issuance. *See* 15 U.S.C. § 78*l* (1994), *amended by* 15 U.S.C. § 78*l*(g) (Supp. 1998).

38. *See id.* §§ 77*l*, 78j (1994); Employment of Manipulative and Deceptive Devices, 17 C.F.R. § 240.10b-5 (1999).

39. *See* 15 U.S.C. §§ 77c(a)(5)(B), 78l(g)(2)(E) (1994).

40. *See* Weiss & Crosland, *supra* note 36, at 17.

> authorities. Therefore, it would appear reasonable to conclude that most agricultural cooperatives either are not aware of the securities laws or do not believe that the various financing instruments offered to their members and patrons constitute "securities."[41]

It is that lack of awareness, or a belief that cooperative instruments are not "securities," that may give rise to unanticipated liabilities in the modern world of cooperatives. To better understand the potential applicability of federal securities laws, and to avoid such liabilities, it is necessary to have an understanding for the manner in which an instrument is determined to be a "security."

B. *"Securities" Under the Securities Act and the Exchange Act*[42]

Potential doubts or confusion regarding the status of equity in cooperatives—and the implications arising from use of such equity, given the requirements discussed above—come early in any analysis of equities as "securities" under federal law. Under the definitions of the 1933 Securities Act and the 1934 Exchange Act, the term "security" encompasses a broad range of instruments, including any "stock . . . evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement . . . transferable share, investment contract . . . or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing."[43]

The United States Supreme Court has recognized the breadth of the definitions, expanding the scope of the securities laws and, in the process, expanding the confusion surrounding their applicability: "Congress did not intend to adopt a narrow or restrictive concept of security in defining that term. . . . [T]he reach of the Act does not stop with the obvious and commonplace." [44] The Court has also stated

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41. *Id.* at 19.

42. Whether a particular instrument is a security is open to question. For example, in *Consumers Gas & Oil v. Farmland Industries*, the United States District Court of Colorado held, in an order denying in part a Fed. R. Civ. P. 12(b)(6) Motion, that certain equity called "Capital Credits, Series of Ten" issued by Farmland were securities. Consumers Gas & Oil, Inc. v. Farmland Indus., 815 F. Supp. 1403, 1410 (D. Colo. 1992). By contrast, in *Great Rivers*, the United States District Court, Southern District of Iowa held in ruling upon a Fed. R. Civ. P. 56 Motion that similar Capital Credits issued by Farmland were not securities. *See* Great Rivers Coop. v. Farmland Indus., 934 F. Supp. 302, 303 (S.D. Iowa 1996), *aff'd*, 198 F.3d 685, 701 (8th Cir. 1999).

As noted earlier, state blue sky laws also may be instructive in determining whether an instrument is a security. *See supra* text accompanying note 30. For example, in *State ex rel. Arn v. Consumers Coop. Ass'n*, the Kansas Supreme Court held that equity instruments issued by Consumers Cooperative Association are securities under Kansas blue sky law. *See* State *ex rel.* Arn v. Consumers Coop. Ass'n, 183 P.2d 423, 448-49 (Kan. 1947). Again, an analysis of state blue sky laws is outside the scope of this paper.

43. 15 U.S.C. §§ 77b(1), 78c(a)(10) (1994). The Supreme Court treats the two definitional sections as being "virtually identical." *See* Tcherepnin v. Knight, 389 U.S. 332, 335 (1967).

44. *Tcherepnin*, 389 U.S. at 338 (quotation omitted).

that "form should be disregarded for substance and the emphasis should be on economic reality."[45] Accordingly, the Court has held that some instruments are obviously within the defined class that Congress intended to regulate and are "securities," and beyond that, the particular instrument must be examined to determine if it is a security based on its "economic reality."[46]

Under the guidelines established in *Reves*, a court addressing the issue of instruments as security is obligated first to determine if the instrument is within the Congressionally established classes of "securities." If it is not, the court must examine the instrument's characteristics under securities tests that have been developed by the federal appellate courts and that have taken two principle forms—a "Family Resemblance" test and a *Howey* test.[47]

1. *The Scope of the Definitions*

The breadth of "securities" definitions creates the potential for instruments to be found as securities based on those definitions alone. In *Great Rivers*, for example, a portion of the Plaintiffs' Class had held the Common Stock of cooperative Farmland.[48] The Class Members received the stock as the retained portion of patronage refunds made while they were active Farmland members.[49] After the cooperatives ceased business, Farmland determined they did not qualify for membership and converted their Common Stock into Farmland "Capital Credits."[50] Thus, the Capital Credits at issue in *Great Rivers* were instruments that Farmland issued to holders who (i) previously held Farmland Common Stock but no longer

45. *Id.* at 336 (citing SEC v. W.J. Howey Co., 328 U.S. 293, 298 (1946)).

46. *See* Reves v. Ernst & Young, 494 U.S. 56, 62 (1990). *See also* Landreth Timber Co. v. Landreth, 471 U.S. 681, 690 (1985) (explaining the need to examine the economic substance of the transaction existing only when the instruments are not plainly securities by their nature).

47. *See Reves*, 494 U.S. at 67 (applying the family resemblance approach); S.E.C. v. Howey Co., 328 U.S. 293, 298-99 (1946).

The reference to tests articulated in *Howey* and *Reves* is not intended to be dispositive of all possible issues surrounding cooperative instruments as securities. *See generally* United Housing Foundation, Inc. v. Forman, 421 U.S. 837 (1975) (examining the instruments for the "usual characteristics" of stock, including the right to receive dividends, negotiability, ability to be pledged or hypothecated, the conferring of voting rights, and the capacity to appreciate in value). Indeed, other tests have been articulated in specific circumstances, including examination of stock issued by a particular cooperative having attributes of "common stock" sufficient to make it a security. *See id.* at 851. *Howey* and *Reves* are offered because they—and, for that matter, *Forman*—demonstrate that the analysis fundamentally looks to whether the instrument in question has sufficient characteristics of a "security." *See id.* at 848-51; *Howey*, 328 U.S. at 298-99; *Reves*, 494 U.S. at 67. Within that broad scope, the particularities overlap along the broad outlines suggested in *Howey* and *Reves*. *See id.* at 852 (citing Howey Co., 328 U.S. at 301 as the "basic test for distinguishing the [security] transaction from other commercial dealings").

48. *See* Great Rivers Coop. v. Farmland Indus., 934 F. Supp. 302, 303 (S.D. Iowa 1996), *aff'd*, 120 F.3d 893 (8th Cir. 1997).

49. *See id.* at 303-04.

50. *See id.* at 304.

qualified for membership in Farmland, or (ii) participated in transactions in which Farmland distributed the Credits in exchange for other equities.[51]

The characteristics of such instruments arguably brought them within the "securities" definition found both in the Securities Act and the Exchange Act. In the litigation against Farmland, certain former members argued that the Capital Credits could be found to be securities on the following definitional bases:

1. As certificates of participation in a profit-sharing agreement. Based on Farmland's own descriptions, the Class argued that Farmland's equity system involved distribution of cooperative earnings to the members whose business created those earnings, as well as the return of cooperative profits as price refunds on business done by the members. That, the Class maintained, made the Credits "certificates of participation in a profit-sharing agreement."[52]
2. As "Rights to Purchase" Common Stock. The Class further maintained that, based on the stated opinions of Farmland's general counsel, the Credits were a "right to purchase" Farmland Common Stock.
3. As Transferable Shares. Under the Class' argument, the free transferability of the Credits, and more specifically Farmland's encouragement of that transferability through its attempt to establish markets expressly to facilitate such transfers, made the Credits "securities."[53]
4. As Evidence of Indebtedness. The Class finally argued that cooperative instruments such as Farmland Capital Credits are

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51. *See id.*

52. *See* HARL, *supra* note 15, § 136.01[3](3), at 136-14 to 136-15. "A cooperative that distributes to members earnings made from handling non-members' business is making *a distribution of profits* rather than of patronage dividends. *If such distributions occur on a regular basis, a member's interest would meet the requirements for a security.*" *Id.* (emphasis added).

53. To the extent an agricultural cooperative promotes and encourages an active trading market for its patronage instruments, such a cooperative is engaged in activity outside the normal commercial relationship between an agricultural cooperative and its members and patrons. Such instruments, when actively traded, no longer reflect solely a price or cost adjustment but acquire characteristics of an investment interest. To that extent, the underlying objectives of securities regulation become relevant and the registration and reporting process may be meaningful.

HARL, *supra* note 15, § 136.01[3], at 136-14 n. 78 (quoting Weiss & Crosland, *supra* note 36, at 35). In *Great Rivers*, Farmland earlier had created an equity system expressly intended to further transfers of Farmland instruments among those who wished to "increase their investment in Farmland." *Great Rivers Coop.*, 198 F.3d at 694.

> securities by definition because they evidence the indebtedness of the cooperative to its members. [54]

On appeal, the Eighth Circuit in *Great Rivers* focused its analysis on *Forman*, affirming the district court's determination that the instruments at issue lacked sufficient characteristics of "securities," principally because they were deemed to be representative of membership interests in the cooperative.[55] In so doing, however, the Eighth Circuit also recognized the great breadth of the statutory definitions of "security:"

> Congress broadly defined the term security so as to include within that definition the many types of instruments that in our commercial world fall within the ordinary concept of a security. [Citation omitted] Congress therefore did not attempt precisely to cabin the scope of the securities acts. Rather, it enacted a definition of 'security' sufficiently broad to encompass virtually any instrument that might be sold as an investment. [Citation omitted][56]

As is clear from the Court's statement, the applicability of the definitions remains an open question to be determined on a case-by-case basis.

2. *Common Law Tests*

It is not, however, simply the broad definitional categories that threaten to bring cooperative instruments within reach of the federal securities laws. To the contrary, the tests developed by courts addressing what constitutes a "security" under federal law are more malleable and potentially serve to extend federal securities laws beyond comfortably predictable grounds.

a. *The Howey Test*

One prominent test for determination of whether an instrument is a "security" under federal law is derived from the Supreme Court's opinion addressing the securities nature of "investment contracts" in *SEC v. W.J. Howey Co.*[57] Under

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54. In *Atchison County Farmers Union Coop. v. Turnbull*, the Kansas Supreme Court stated: "Equity-credits are not an indebtedness of a cooperative association which is presently due and payable to the members, but represent an interest *which will be paid to them* at some unspecified later date to be determined by the board of directors." Atchison County Farmers Union Coop. Ass'n v. Turnbull, 736 P.2d 917, 920 (Kan. 1987) (emphasis added). The class in *Great Rivers* argued such descriptions plainly show that "equity credits" indeed *are* evidence of indebtedness, with the "pay-off" of that debt coming at some future point. See *Great Rivers Coop.*, 934 F. Supp. 302, 303 (S.D. Iowa 1996).

55. *Great Rivers Coop.*, 198 F.3d at 698-99. *Forman* and its implications are discussed below.

56 *Id.* at 698 (citations omitted).

57. *See* S.E.C. v. W.J. Howey Co., 328 U.S. 293, 297-99 (1946).

Howey and its progeny, an investment contract—a category of "security" specified in the applicable definitions[58]—is a contract, transaction, or scheme in which a person (1) invests money, (2) in a common enterprise, and (3) is led to expect profits (4) substantially from the efforts of the promoter or a third party.[59] If an instrument meets these requirements, it is an investment contract, and it therefore is a security.[60]

In *Great Rivers*, the parties' analysis of this test focused largely on the first and third factors, the "investment" question and the holders' expectation of profits.[61] In that regard, a cooperative's particular structuring of its equity system and its profit distribution scheme stand to play a substantial role in shaping whether that cooperative's instruments can be considered "securities" under federal law.

In his treatise, Dr. Harl describes categories of cooperative instruments in an effort to identify them as "securities" or "non-securities."[62] Dr. Harl's first category, which he concludes are not securities, broadly includes cooperative financing instruments such as "per unit retains and evidences of membership in the cooperative."[63] His second category, however, is "financial instruments issued to members and nonmembers of the cooperative to raise capital."[64] According to Dr. Harl, these instruments *are securities* and should be regulated as such. [65]

Several characteristics of cooperative instruments can support a determination that those instruments fall within Harl's second category and therefore are investments, bringing them one step closer to the definition of securities. Some of those characteristics might include, for example:

- the use of equity instruments to raise necessary equity capital;[66]
- free transferability;[67]
- provision of the instruments to holders in exchange for value;[68]

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58. *See id.*
59. *See id.* at 298-99.
60. *See id.* at 299; 15 U.S.C. §§ 77b(a)(1), 78c(a)(10) (1994 & Supp. 1998).
61. *See Great Rivers Coop.*, 198 F.3d at 700-01.
62. *See* HARL, *supra* note 15, § 136.01[3], at 136-12 to 136-15.
63. *Id.* § 136.01[3], at 136-12.
64. *Id.* § 136.01[3], at 136-14.
65. *See id.* § 136.01[3], at 136-14 to 136-15 (emphasis added).
66. *See* Terence J. Centner, *Retained Equities of Agricultural Cooperatives and the Federal securities acts*, 31 U. KAN. L. REV. 245, 254 (1982). According to Centner, "the primary objective of all [cooperative equity plans] is to provide a source of capital for cooperative operations." *Id.*
67. *See* HARL *supra* note 15, § 136.01[3], at 136-14. Again, where a cooperative "promotes and encourages an active trading market for its patronage instruments," it acts outside the normal commercial relationship, and the instruments "no longer reflect solely a price or cost adjustment but acquire characteristics of *an investment interest*." *Id.* (quoting Weiss & Crosland, *supra* note 36, at 37 (emphasis added)). The Class in *Great Rivers* stressed that the Credits were securities based on, *inter alia*, Farmland's attempt to create an equity system where instruments could be purchased by those wishing to "increase their investment in Farmland." Great Rivers Coop. v. Farmland Indus., 198 F.3d 685, 694 (8th Cir. 1999).

- creation of a profit-distribution system that includes distribution of profits from the cooperative's *non-member*, as well as member, businesses. [69]

b. *The "Family Resemblance" Test*

The "Family Resemblance" test, established by the United States Supreme Court in *Reves v. Ernst & Young*,[70] similarly suggests a multi-factor analysis in the determination of whether a particular form of instrument—in that case a note issued by an agricultural cooperative—was a "security" under federal law.[71] Given common descriptions of cooperative instruments as certificates evidencing monies retained by the cooperative but ultimately owed back to the instrument holders, the Supreme Court's analysis of cooperative notes as securities is illustrative.[72]

Under *Reves*, a note is presumed to be a security unless that presumption is rebutted by a showing that the instrument bears a strong resemblance to a group excepted from the Exchange Act.[73] To determine whether an instrument resembles such an excepted group, the Court established a four-part test looking to:

1. The motivation for the transaction. "If the reason for the transaction is to finance the operation of the business, the instrument created is a security."[74]
2. The plan of distribution. "The instrument created is a security if it is commonly traded for speculation or investment."[75]
3. The reasonable expectations of the public. "The Court will consider instruments to be 'securities' on the basis of such *public* expectations, *even where an economic analysis of the circumstances*

68. *See* HARL *supra* note 15, § 136.01[3] at 136-15. As suggested above, exchanges of cooperative equity instruments in the course of mergers, acquisitions, or consolidations should create particular concerns in regard to the question of whether a holder is giving "value" for the instrument received, since cash is "not the only form of contribution or investment that will create an investment contract" under *Howey*. Uselton v. Commercial Lovelace Motor Freight, Inc., 940 F.2d 564, 574 (10th Cir. 1991). Where a holder of a cooperative instrument obtained that instrument for securities or other things of value given up in exchange, the "value" question supports a finding that the instrument received is an investment and, in certain circumstances, may also be a security. *Id.*

69. *See* HARL, *supra* note 15 § 136.01[3] at 136-14 to 136-15 (emphasis added).

70. *See* Reves v. Ernst & Young, 494 U.S. 56 (1990).

71. *See id.* at 66-67.

72. *See* HARL, *supra* note 15, § 136.01[1] at 136-21 (discussing *Reves* as test for determining whether Agricultural cooperative instruments are securities). *See also Reves*, 494 U.S. at 65 (holding the "family resemblance" test is a "promising framework" for analysis).

73. *Id.* at 67. *See also* Great Rivers Coop. v. Farmland Indus., 198 F.3d 685, 697-99 (8th Cir. 1999) (applying *Howey* and *Forman* and declining to apply *Reves* where "Capital Credits" were not included in the statutory list of "securities").

74. HARL, *supra* note 15, § 136.01[3] at 136-21.

75. *Id.*

> *of the particular transaction might suggest that the instruments are not 'securities' as used in that transaction.*"[76]
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> 4. Any reduction of the risk of investment through, for example, another regulatory scheme.[77]

As with the discussion of the *Howey* test, arguments of the *Reves* family resemblance test in *Great Rivers* concentrated primarily on certain of the factors, in this instance the motivation for the transaction and the reasonable expectations of the public.[78] The first of these—the motivation for the transaction—looks, under Harl's analysis, to the *cooperative's* motivation for the transaction.

Under the suggestion of Dr. Harl, quoted above, instruments created in transactions that are intended to finance the operation of the business are securities, an analysis of the *issuer's* motivations.[79] In support of that position, the *Great Rivers* Class stressed evidence that Farmland used its equity system as a means of obtaining equity capital. [80]

By contrast to that focus on the insurer, the third factor from *Reves* looks to the public's—the holder's—reasonable expectations. It is the status of the holder—particularly the non-member who continues to hold cooperative equities—that presents perhaps the greatest issue as to whether equities are treated as securities under federal law. In that regard, *Reves'* third factor—the public's reasonable expectations—can come into play. [81]

In *Reves*, the Supreme Court itself stated that instruments would be considered "securities" on the basis of public expectations, "even where an economic analysis of the circumstances of the particular transaction might suggest that the instruments are not 'securities' as used in that transaction."[82] The implication is that a cooperative's actions with respect to its instruments can result in a finding that they are securities for purposes of federal law, *based solely on the expectation of holders that they are "securities."*[83]

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76. *Reves*, 494 U.S. at 66 (emphasis added).

77. *See generally id.*; HARL *supra* note 15, § 136.01[3], at 136-21.

78. *Compare* HARL, *supra* note 15, § 136.01[3] at 136-14 to 136-16 *and* HARL, *supra* note 15, § 136.01[3], at 136-20 to 136-22 (emphasis added).

79. HARL, *supra* note 12 § 136.01[3], at 136-21.

80. *See also* Centner, *supra* note 66, at 254 (discussing how "the primary objective of all [cooperative equity plans] is to provide a source of capital for cooperative operations").

81. *See Reves*, 494 U.S. at 66.

82. *Id.*

83. *See id.* at 66-67. In *Great Rivers*, the Eighth Circuit expressly recognized the import of this factor even while it declined to rely on *Reves* or to find that the instruments in *Great Rivers* were securities:

> Farmland's registration of the credits as securities and its reference in various communications to the credits as securities and investments weighs in favor of a finding that the public perception was [that] the credits were securities. However, the characteristics of the credits themselves provide countervailing factor that would

Once again, the factors at issue in a "securities" analysis implicate several characteristics of cooperative instruments that can support a determination that those instruments are securities.[84] As with the analysis under the *Howey* test, those characteristics appear to include, for example:

- the use of equity instruments to raise necessary equity capital;[85]
- free transferability or other characteristics suggesting an "investment," particularly where the instruments are held out to the public as freely-transferable instruments that can be purchased or sold to "increase an investment;"[86] and
- provision of the instruments to holders in exchange for value.[87]

C. *The Price of Miscalculation— Remedies Under the Federal Securities Laws*

The recovery of monetary damages is expressly provided for in numerous provisions of the federal securities laws.[88] A claimant commonly may be awarded the calculated "out-of-pocket" loss,[89] a determination based on comparison of the amount paid for the instrument and the value received in obtaining that instrument.[90]

Recovery by an injured party is not necessarily limited to actual damages. The Securities Act and Exchange Act both provide for a court, in its discretion, to assess costs and reasonable attorneys' fees against a party.[91] In such circumstances, the party found liable for violations of certain applicable securities law may receive

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lead a reasonable person to question the characterization of the credits as investments or securities.

Great Rivers Coop. v. Farmland Indus., 198 F. 3d 685, 700 (8th Cir. 1999) (discussing *Reves*).

84. *See Reves*, 494 U.S. at 56-57.

85. *See* Centner, *supra* note 66, at 254.

86. *See* HARL, *supra* note 15, § 136.01[3], at 136-6 to 136-16 (defining characteristics of securities subject to registration and regulation).

87. Uselton v. Commercial Lovelace Motor Freight, Inc., 940 F.2d 564, 574 (10th Cir. 1991).

88. The Exchange Act broadly provides for recovery of actual damages upon demonstration of a valid claim arising under that Act. *See* 15 U.S.C. § 78bb(a) (1999). Thus, for example, actual damages are recoverable *inter alia* for claims brought under the most common securities law provisions—Exchange Act Section 10(b) and SEC Rule 10b-5—for injury arising from manipulative or deceptive devices, and under Exchange Act Section 14 for market manipulation. *See id.* §§ 78n, 78j(b), 78n (1994). The Securities Act similarly provides for recovery of damages in an action based on liability arising from, *inter alia*, a false registration statement, or the sale of unregistered securities or securities accompanied by a misleading prospectus. *See id.* §§ 77, 77*l* (1994).

89. *See* 69A AM. JUR. 2D *Securities Regulation-Federal* § 1078 (1993 & Supp. 1999).

90. *See id.* at § 1079 (1993 & Supp. 1999).

91. *See* 15 U.S.C. §§ 77k(e) (civil liabilities on account of false registration statement), 78i(e) (manipulation of security prices), 78r(a) (liability for misleading statements in applications, reports, or documents filed purchase to the Exchange Act or rules and regulations promulgated thereunder) (1994).

the additional burden of paying the expenses and attorneys' fees *that were incurred in proving that very violation.*[92]

III. LEARNING LESSONS AND AVOIDING DANGERS: TOWARD A MORE PREDICTABLE COOPERATIVE INSTRUMENT SYSTEM

Consideration of the points above suggests potential courses of actions that can mitigate against undesirable and costly brushes with federal securities laws and the liabilities they create. The "investment" nature of an equity instrument is a constant factor in determination of whether instruments rise to the level of a security.[93] Cooperatives are well-served where they strongly control any transfers of their instruments, both among members and among non-members.[94]

At its most basic level, free transferability of an instrument carrying a monetary value supports an argument that transfers may be effectuated, at some compensatory level, in order to achieve a return on amounts paid.[95] Where the cooperative actively *encourages* transfers as investments, it effectively is seeking to create an active trading market for those instruments that is outside the normal relationship between an agricultural cooperative and its members.[96]

The dangers become particularly great when the active trading market involves transfers to *non*-members.[97] In such circumstances, the cooperative creates concerns for the reasonable expectations of those acquiring the instruments; where non-members are doing so, the argument is that much greater that the motivation is for investment in securities rather than accession to any perceived benefits of cooperative membership.[98]

In a similar vein, cooperatives must be attentive to use of their instruments as investment vehicles in general and as bases for exchanges made in the course of consolidations, mergers, and acquisitions in particular. As noted above, an issue and exchange of cooperative instruments for cash or other instruments having determinable value supports an argument that the instruments issued are given for value.[99] They therefore would constitute investments within the meaning of federal law.[100]

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92. *See id.* (emphasis added).
93. *See, e.g.*, 15 U.S.C. § 78r(a) (1994).
94. *See, e.g.*, 15 U.S.C. § 78r(a) (1994).
95. *See, e.g.*, 15 U.S.C. § 78r(a) (1994).
96. *See* HARL, *supra* note 15, § 136.01[3] at 136-14 & n.78 (quoting Weiss & Crosland, *supra* note 36, at 35). *See, e.g.*, United Housing Foundation, Inc. v. Forman, 421 U.S. 837, 851 (1975) (cooperative equities were not securities where, *inter alia*, the equities were not freely transferable).
97. *See* HARL, *supra* note 15, § 136.01[3], at 136-15.
98. *See id.* § 136.01[3], at 136-14 to 136-15.
99. *See id.*
100. *See id.*

Cooperatives must take care with labeling and applying descriptions when discussing and structuring their equity systems. While not necessarily definitive, the characterizations that a cooperative applies to its own instruments arguably, *inter alia*, serve as a valuable indicator of the cooperative's own understandings of the nature of its equities as investments, whether the instruments are given for value, and what the public expectations surrounding issuance of a particular instrument are.[101]

For example, cooperatives traditionally and appropriately do not (and therefore *should* not) simply "return profits" to equity holders. Instead, they should use a portion of those profits to return to members those amounts of money originally retained in member purchases by the cooperative.[102] In that way, any argued "profit-sharing" characteristic is downplayed by a more accurate description of a cooperative appropriately returning to its members, on a dollar-for-dollar basis and without appreciation, those amounts previously held back from them.[103]

Where the cooperative actually is distributing profits from *non*-member business, the difficulties become greater. Under these circumstances, the cooperative has stepped outside the characteristic cooperative-member relationship.[104] By doing so, it definitively makes a profit distribution, not a return of patronage. This distribution suggests that the instrument holders to whom it distributes profits are holding securities. [105]

This strong member/non-member dichotomy most pointedly and importantly gives rise to the admonition that a cooperative seeking to avoid liability under federal securities laws could enact and enforce a strict "members-only" policy for instrument ownership. In *Forman*, the United States Supreme Court made clear that non-transferable cooperative instruments that reflect an interest required for membership rather than for investment are not securities:

> Common sense suggests that people who intend to acquire only a residential apartment in a state-subsidized cooperative, for their personal use, are not likely to believe that in reality they are purchasing investment securities simply because the transaction is evidenced by something called a share of stock. These shares have none of the characteristics 'that in our commercial world fall within the ordinary concept of a security.'
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> * * *
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> We decide only that the type of transaction before us, in which the purchasers were interested in acquiring housing rather than making an investment for profit, is not within the scope of the federal securities laws.[106]

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101. *See id.* § 136.01[3], at 136-12. *See also* Centner, *supra* note 66, at 275-76.

102. *See* Centner, *supra* note 66, at 254.

103. *See* ROGER A. MCEOWEN & NEIL E. HARL, PRINCIPLES OF AGRICULTURAL LAW § 10.08, at 10-23 (1997).

104. *See* HARL, *supra* note 15 § 136.01[3], at 136-14.

105. *See id.*

106. United Housing Foundation, Inc. v. Forman, 421 U.S. 837, 851, 859-60 (1975). *See also* Seger v. Federal Intermediate Credit Bank, 850 F.2d 468, 469 (8th Cir. 1988).

Indeed, the Eighth Circuit in *Great Rivers* placed great weight on *Forman* in holding that the cooperative instruments at issue were *not* securities.[107]

Given the guidelines of *Forman*, imposition of a clear and mandatory "buy-in" requirement for cooperative membership supports an exception from federal securities for any instruments issued to reflect that membership interest.[108] Similarly, cooperatives should utilize a "buy-back" concept whenever members leave the cooperative. This approach enforces the demonstration of the membership requirement and ensures fairness by requiring support of the cooperative only by those actually using the cooperative.[109] In that way, such a principle serves to avoid disputes at both a legal and a practical level.

Centner recognizes the importance of such a "buy-in, buy-back" guideline in terms of adherence to the guiding principles behind a cooperative system based on associations intended to benefit those actually participating in the associations:

> If the cooperative does not redeem the retained equities of an inactive member within a reasonable time, this interest-free investment helps finance the cooperative for the current active members. The failure of a cooperative to relieve a former member of this obligation to finance is unfair and contrary to cooperative principles.[110]

The value of the foregoing suggestions is demonstrated by reference to another source of information: SEC "no-action" letters. In response to narrow inquiries presenting a specific set of definable facts, the SEC staff may issue letters indicating that the SEC will take "no action" against the party making the request.[111] These letters provide the requesting party with an assurance that the party will not be charged criminally or civilly for securities law infractions regarding the content of the letter.[112]

Reliance on SEC no-action letters for more general guidance is problematic.[113] SEC no-action letters are fact specific and extend no further than the party requesting

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107. *See* Great Rivers Coop. v. Farmland Indus., 198 F.3d 685, 698-99 (8th Cir. 1999). *See also* Reves v. Ernst & Young, 494 U.S. 56, 60-70 (1989) (discussing *Howey* and *Forman*).

108. *See* Centner, *supra* note 66, at 268.

109. *See* Centner, *supra* note 66, at 254-56.

110. Centner, *supra* note 66, at 255.

111. *See, e.g.*, Independent Stationers, Inc., SEC No-Action Letter, Apr. 15, 1994, *available in* 1994 WL 133456, at *9 (enclosure); Kentucky Pharmacy Serv. Corp., SEC No-Action Letter, June 6, 1991, *available in* 1991 WL 176913, at *12; Producers Feed Co., SEC No-Action Letter, July 30, 1990, *available in* 1990 WL 286768, at *10-11.

112. *See, e.g.*, Independent Stationers, SEC No-Action Letter, Apr. 15, 1994, at *9; Kentucky Pharmacy Serv. Corp., SEC No-Action Letter, June 6, 1991, at *12; Producers Feed Co., SEC No-Action Letter, July 30, 1990, at *10-11.

113. As the letters commonly note, a "no-action" position is based on the facts presented in that request, and different facts may require different conclusions. *See, e.g.*, Independent Stationers,

assurances.[114] The letters are not precedent for the judiciary.[115] These agency communications "do not represent the opinion of the entire [SEC]."[116] They are written by the staff[117] and commonly state by their very terms the absence of any conclusive legal analysis.[118] Nevertheless, examination of prior letters suggests that the considerations proposed can provide practitioners with valuable information to avoid undesired coverage under the federal securities laws.[119]

For example, the SEC has previously stated it would take "no action" in letters to cooperatives to address instruments that were not (1) issued to raise capital, (2) freely transferable, and/or (3) in regard to cooperative members required for membership purchase.[120] By contrast, the SEC has refused a "no-action" request to a cooperative when the cooperative instrument had "security" characteristics such as transferability, and where the applicant had not shown exemption from registration.[121]

Through their articles, bylaws, and other statements of governing guidelines and principles, cooperatives set their own requirements and policies, which can be clearly defined.[122] With that ability, and with an overall goal of avoiding issues that otherwise might arise under federal securities laws, cooperatives occupy an ideal position for defining and shaping the characteristics of the instruments that they use.

SEC No-Action Letter, Apr. 15, 1994, at *9; Kentucky Pharmacy Serv. Corp., SEC No-Action Letter, June 6, 1991, at *12; Producers Feed Co., SEC No-Action Letter, July 30, 1990, at *10-11.

114. *See* HARL, *supra* note 15, § 136.01[3] at 136-15.

115. Pargas, Inc. v. Empire Gas Corp., 423 F. Supp. 199, 239 (D. Md. 1976), *aff'd*, 546 F.2d 25 (4th Cir. 1976).

116. *See* HARL, *supra* note 15, § 136.01[3], at 136-15.

117. *See id.*

118. *See, e.g.*, Independent Stationers, SEC No-Action Letter, Apr. 15, 1994, at *9; Kentucky Pharmacy Serv. Corp., SEC No-Action Letter, June 6, 1991, at *12; Producers Feed Co., SEC No-Action Letter, July 30, 1990, at *10-11 (all three No-Action Letters state "[T]his Letter merely expresses the Division's position on enforcement action, and does not purport to express any legal conclusion.").

119. *See* HARL, *supra* note 15, § 136.01[3], at 136-16.

120. *See, e.g.*, Independent Stationers, SEC No-Action Letter, Apr. 15, 1994, at *9; Kentucky Pharmacy Serv. Corp., SEC No-Action Letter, June 6, 1991, at *12; Producers Feed Co., SEC No-Action Letter, July 30, 1990, at *10-11; Associated Grocers of New England, Inc., SEC No-Action Letter, [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,415, at 77,181 (Oct. 5, 1989); NDS/Basic, Inc., SEC No-Action Letter, June 30, 1988, *available in* 1988 WL 234433, at *7; Affiliated of Florida, Inc., SEC No-Action Letter, Sep. 25, 1987, *available in* 1987 WL 108467, at *11; Speer Hardware Co., SEC No-Action Letter, Jan. 5, 1987, *available in* 1987 WL 107433, at *6; Certified Grocers of Illinois, Inc., SEC No-Action Letter, June 22, 1984, *available in* 1984 WL 45381, at *10-11; American Crystal Sugar Co., SEC No-Action Letter, Feb. 19, 1984, *available in* 1984 WL 45677, at *5; American Hardware Supply Co., SEC No-Action Letter, Jan. 9, 1984, *available in* 1983 WL 44919, at *7. *See also* End-Users, Inc., SEC No-Action Letter, [1984-1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,845, at 79,242 (Nov. 12, 1984) (entity was not a cooperative; instrument was a membership cash deposit requirement).

121. *See* Associated Grocers of Florida, Inc., SEC No-Action Letter, Jan. 23, 1984, *available in* 1984 WL 47171, at *2.

122. *See* HARL, *supra* note 15, § 133.01[1], at 133-4 to 133-5.

IV. CONCLUSION

Much time, energy, and money undoubtedly will be spent in the future arguing about the redemption policies of cooperatives and whether financial instruments issued by those cooperatives are securities. Ultimately, the amount of effort spent on such discussions will detract from the business of the cooperatives, as the money expended could be better utilized in redeeming equity or expanding the cooperative's business for the benefit of its members.

The time, energy, and money expended on such efforts could be reduced materially if the persons responsible for the operation of the cooperative would only subscribe to the view of Justice Brandeis that "[s]unlight is said to be the best of disinfectants; electric light the most efficient policeman."[123] Full, complete, and fair disclosure to all interested parties about redemption practices is truly the only solution to a difficult problem.

123. *See* BRANDEIS, *supra* note 5, at 62.