An Agricultural Law Research Article

Agricultural Cooperatives: Part 2 The Development and Significance of Agricultural Cooperatives in the American Economy

Part II

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Part III

The Cooperative Marketing Contract

In the preceding discussions concerning the organizational structure of the cooperative enterprise, emphasis centered primarily upon the producer as a member and owner of the association. Of equal importance is the complementary relationship of the producer as a contractual party to the marketing agreement. Executed by each producer concurrently with acquisition of membership, this agreement prescribes the terms and conditions for marketing through the cooperative facilities.[1]

Suspicious of any contractual attempt to combine economic power, some courts were reluctant initially to sanction the legality of exclusive contracts between the association and its members. Invalidation was predicated upon a lack of mutuality and consideration, illegal restraint of trade, and contravention of public policy.[2] However, federal and state legislatures, traditionally sensitive to agricultural interests, repudiated the rationale of these earlier decisions by expressly exempting member contracts from the interdictions of the antitrust laws[3] and declaring, as a matter of legislative policy, that agricultural associations and their objectives were to be considered in the public interest.[4] Cooperative marketing statutes enacted in every state further established a statutory

1. For general discussions of member cooperative marketing contracts, see HULBERT, LEGAL PHASES OF COOPERATIVE ASSOCIATIONS 115 *et seq.* (F.C.A. BULL. No. 50, 1942); PACKEL, THE LAW OF THE ORGANIZATION AND OPERATION OF COOPERATIVES 39 *et seq.* (2d ed. 1947); NOURSE, THE LEGAL STATUS OF AGRICULTURAL COOPERATION 171 *et seq.* (1927); HANNA, THE LAW OF COOPERATIVE MARKETING ASSOCIATIONS 509 *et seq.* (1931).

2. Georgia Fruit Exchange v. Turnipseed, 9 Ala. App. 123, 62 So. 542 (1913); Burns v. Wray Farmers Grain Co., 65 Colo. 425, 176 Pac. 487 (1918); Ford v. Chicago Milk Shippers' Ass'n, 155 Ill. 166, 39 N.E. 651 (1895); Reeves v. Decorah Farmers' Co-op. Society, 160 Iowa 194, 140 N.W. 844 (1913).

3. For consideration of the applicability of federal and state antitrust statutes see PART IV, *infra*. See PART V, *infra*, for a discussion of federal income tax exemptions available to cooperative associations.

4. Mr. Justice Frankfurter in Tigner v. Texas, 310 U.S. 141 (1939), in referring to the transformation in legislative and judicial attitude towards agricultural cooperatives concluded: "Since Connolly's case was decided, nearly forty years ago, an impressive legislative movement bears witness to general acceptance of the view that differences between agriculture and industry call for differentiation in the formulation of public policy. The states as well as the United States have sanctioned cooperative action by farmers; have restricted their amenability to the antitrust laws; have relieved their organizations from taxation. . . ." Such expressions of legislative policy have withstood challenge in the courts. *Id.* at 145-146. Extensive citations and excerpts from state court opinions expressing the same view are found in Liberty Warehouse Co. v. Burley Tobacco Growers' Coop. Marketing Ass'n, 276 U.S. 71 (1928).

basis for the inclusion in member contracts of terms and provisions commonly employed in association-member agreements.[5]

Drafted within the framework of this enabling legislation, the typical cooperative marketing agreement is essentially an entire output contract for the term of five to fifteen years.[6] The producer agrees to deliver to the association all crops grown or acquired during the term of the contract[7] in exchange for the association's promise to receive, process and market such produce for the best price obtainable.[8] The

5. The state cooperative marketing statutes are collected in Jensen, *The Bill of Rights of U.S. Cooperative Agriculture,* 20 ROCKY MT. L. REV. 181, 191 n.29 (1948). The Uniform Cooperative Corporation Act, drafted and approved by the American Bar Association and the National Conference of Commissioners on Uniform State Laws has been adopted in Utah and Maine with some modifications. *Id.* at 192. However, the Bingham Cooperative Act of Kentucky, first enacted in 1922, is the prototype of a majority of the state statutes. KY. REV. STAT. § 272.100 *et seq.* (1946). See, ABSTRACT OF THE LAWS PERTAINING TO COOPERATION IN THE UNITED STATES Pt. II (W.P.A. for City of New York, 1940).

With respect to the cooperative members' contract the Bingham Act provides: "The association and its members may make marketing contracts, requiring the members to sell . . . all or any specified part of their agricultural products . . . exclusively to or through the association. . . . If they contract a sale to the association, it shall be conclusively held that title to the products passes absolutely, except for recorded liens, to the association upon delivery, or at any other time expressly and definitely agreed in the contract. The contract may provide that the association may sell or resell the products delivered by its members, with or without taking title to them; and pay its members the resale price, after deducting all necessary expenses. . . ." KY. REV. STAT. § 272.220 (1946). The constitutionality of this statute was sustained in Liberty Warehouse Co. v. Burley Tobacco Growers' Co-op. Marketing Ass'n, 276 U.S. 71 (1928).

6. The Bingham Act limits the term of the agreement to ten years. KY. REV. STAT. § 272.220 (1946). Attempts to extend the effectiveness of the agreement do not necessarily invalidate the entire contract. Olympia Milk Producers' Ass'n v. Herman, 176 Wash. 338, 29 P.2d 676 (1934). However, the contract or by-laws may provide for withdrawal privileges. By the withdrawal provisions in the marketing contract of California Walnut Growers Association for 1940, the member is privileged to withdraw as of February first of each year, upon written notice to the association between Jan. 1 and Feb. 1 of the year in question.

7. The agreement quoted in Beaulaurier v. Washington State Hop Producers, 8 Wash.2d 79, 111 P.2d 559 (1941) at page 90, 111 P.2d at 563, is representative. "The grower agrees to deliver to, and market and sell through the Association . . . all hops produced, owned, controlled or possessed by him, commencing with all hops produced during the year 1938 and every year thereafter to and including the crop produced in 1947."

8. See the contract set forth in Kansas Wheat Growers' Ass'n v. Oden, 124 Kan. 179, 184, 257 Pac. 975, 978 (1927). "The association shall classify wheat by quality, grade, variety or any other commercial standard: and this classification shall be conclusive. . . . The association agrees to resell such wheat . . . at the best prices obtainable by it under marketing conditions." The court in the instant case, held the contract provision as to the conclusiveness of the association's grading and classification was controlling in the absence of a showing of fraud, mistake or injury to the grower. *But cf.* Myrold v. Northern Wisconsin Co-op. Tobacco Pool, 206 Wis. 244, 239 N.W. 422 (1931).

As to the association's duty to secure the "best price obtainable," see Arkansas Cotton Growers' Co-op. Ass'n v. Brown, 179 Ark. 338, 16 S.W.2d 177 (1929); California Prune and Apricot Growers v. Baker, 77 Cal. App. 393, 246 Pac. 1081 (1926).

contract may contemplate a purchase and sale of the producer's crops, in which case title is said to vest absolutely in the association. In the alternative, the cooperative may receive the crop merely in the capacity of marketing agent for purposes of sale. Although the agreement may require that each producer's crop be marketed individually, seasonal or periodic pooling of members' crops is a common practice.[9] The association accounts to the producer for the net proceeds realized on the final sale of his crops, after deducting the prorated operational expenses and other authorized deductions. To insure complete patronage by every producer—the primary economic objective of the contract—the association reserves the remedies of injunction, specific performance, and liquidated damages in event of the producer's failure to deliver all or a part of his crop.[10]

Liberal construction by the courts, in conformity with the legislative policy, has established the basic validity of the cooperative member contract.[11] Moreover, express statutory sanction of equitable remedies and liquidated damages forecloses most litigable questions with respect to remedies against the defaulting producer.[12] There remain, however,

9. BLANKERTZ, MARKETING COOPERATIVES c.10 (1940). For an excellent description of the operation of the various commodity associations in pooling, see FETROW & ELSWORTH, AGRICULTURAL COOPERATION IN THE UNITED STATES (F.C.A. BULL. No. 54, 1947). See Reinert v. California Almond Growers Exchange, 63 P.2d 1114 (1937); *subsequent opinion*, 9 Cal.2d 181, 70 P.2d 190 (1937); Texas Certified Cottonseed Breeders' Ass'n, 122 Tex. 464, 61 S.W.2d 79 (1933).

10. The cooperative marketing statutes specifically authorize these remedies. *"Remedies for breach of contract.—(a)* The by-laws or the marketing contract may fix, as liquidated damages, specific sums to be paid by the member to the association if he breaches any provision of the marketing contract regarding sale or delivery or withholding of products. . . . The clauses providing for liquidated damages shall be enforceable as such and shall not be regarded as penalties. *(b)* If any member breaches or threatens to breach such marketing contract, the association may have an injunction to prevent the further breach of the contract and a decree of specific performance." KY. REV. STAT. § 272.230. For decisions granting these remedies, see note 12 *infra*.

11. Anaheim Citrus Fruit Ass'n v. Yeoman, 51 Cal. App. 759, 197 Pac. 959 (1921); Rifle Potato Growers' Coop. Ass'n v. Smith, 78 Colo. 171, 240 Pac. 937 (1925); Burley Tobacco Growers' Coop. Ass'n v. Rogers, 88 Ind. App. 469, 150 N.E. 384 (1926); Clear Lake Coop. Live Stock Shippers' Ass'n v. Weir, 200 Iowa 1293, 206 N.W. 297 (1925); Kansas Wheat Growers' Ass'n v. Schulte, 113 Kan. 672, 216 Pac. 311 (1923); Potter v. Dark Tobacco Growers' Coop. Ass'n, 201 Ky. 441, 257 S.W. 33 (1923); Louisiana Farm Bureau Cotton Growers' Coop. Ass'n v. Clark, 160 La. 294, 107 So. 115 (1926); Minnesota Wheat Growers' Coop. Marketing Ass'n v. Huggins, 162 Minn. 471, 203 N.W. 420 (1925); Tobacco Growers' Coop. Ass'n v. Jones, 185 N.C. 265, 117 S.E. 174 (1923); Oregon Growers' Coop. Ass'n v. Lentz, 107 Ore. 561, 212 Pac. 811 (1923); Washington Cranberry Growers' Ass'n v. Moore, 117 Wash. 430, 201 Pac. 773 (1921); Northern Wisconsin Coop. Tobacco Pool v. Bekkedal, 182 Wis. 571, 197 N.W. 936 (1923).

12. The courts uniformly grant the association the remedies of specific performance, injunction and liquidated damages. *Specific Performance:* Colma Vegetable Ass'n v. Bonetti, 91 Cal. App. 103, 267 Pac. 172 (1928); Tobacco Growers' Coop. Ass'n v. Jones, 185 N.C. 265, 117 S.E. 174 (1923); Texas Farm Bureau Cotton Ass'n v.

several significant areas for judicial delineation in the construction and interpretation of marketing agreements. Meriting particular consideration are the defenses and recourse available to the producer resulting from irregularities in the formation of the contract; the sale of the producer's land or the mortgage of his crops; and the association's violation of the terms of the agreement. Finally, the present judicial reliance upon the concept of passage of title under the terms of the contract as determinative of risk of loss and other ownership consequences warrants specific examination.

Irregularities in the formation of the contract stemming from misleading representations at the time of execution or failure of the association to comply with conditions precedent to the producer's obligations under the agreement have been particularly productive of litigation.[13] Overzealous cooperative organizers are prone to exaggerate the benefits of cooperative marketing in an effort to increase membership. Should such statements relate to present or past material facts and the producer reasonably relies to his detriment, it is well established that he may assert such misrepresentation as a defense to a contract action or as a basis for rescission or cancellation.[14] For instance, where a cooperative

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Stovall, 113 Tex. 273, 253 S.W. 1101 (1923). *Injunction:* Burley Tobacco Growers' Coop. Ass'n v. Devine, 217 Ky. 320, 289 S.W. 253 (1926); Kansas Wheat Growers' Ass'n v. Schulte, 113 Kan. 672, 216 Pac. 311 (1923); Minnesota Wheat Growers' Coop. Marketing Ass'n v. Huggins, 162 Minn. 471, 203 N.W. 420 (1925); Nebraska Wheat Growers' Ass'n v. Norquest, 113 Neb. 731, 204 N.W. 798 (1925); Beaulaurier v. Washington State Hop Producers, 8 Wash.2d 79, 11 P.2d 559 (1941). *Liquidated Damages:* Dark Tobacco Growers' Coop. Ass'n v. Daniels, 215 Ky. 67, 284 S.W. 399 (1926); Dark Tobacco Growers' Coop. Ass'n v. Mason, 150 Tenn. 228, 263 S.W. 60 (1924). For further citations and discussion of these remedies, see HULBERT, *op. cit. supra* note 1, at 179-194. The necessity for additional protection to the association and the development of these remedies in the courts are set forth in NOURSE, *op. cit. supra* note 1, at 195-215, 267-331.

The cooperative marketing statutes further provide that it shall be a misdemeanor for a third party to knowingly induce a breach of or interfere with the members' contract and that the association may recover a penalty of $500. See Liberty Warehouse Co. v. Burley Tobacco Growers' Coop. Marketing Ass'n, 276 U.S. 71 (1928). See also Watertown Milk Producers' Coop. Ass'n v. Van Camp Packing Co., 199 Wis. 379, 225 N.W. 209, 226 N.W. 378 (1929); Monte Vista Potato Growers' Coop. Ass'n v. Bond, 80 Colo. 516, 252 Pac. 813 (1927); HULBERT, *op. cit. supra* note 1, at 194.

13. Frequently, the contract or the by-laws condition the effectiveness of the contract upon the association's securing the specified number of producers or requisite acreage or bushelage. The association has the burden of proving compliance with such conditions in an action to recover on the contract. Kansas Wheat Growers' Ass'n v. Bridges, 133 Kan. 397, 1 P.2d 265 (1931); Washington Wheat Growers' Ass'n v. Leifer, 132 Wash. 602, 232 Pac. 339 (1925).

14. Kansas Wheat Growers' Ass'n v. Massey, 123 Kan. 183, 253 Pac. 1093 (1927); Wenatchee Dist. Coop. Ass'n v. Mohler, 135 Wash. 169, 237 Pac. 300 (1925).

Similarly, if the contract is signed under duress it is subject to rescission at the instance of the producer. Sun-Maid Raisin Growers of California v. Papazian, 74 Cal.

agent induced a producer to enter into a cooperative agreement by assurances that the association had secured an elevator in the locality[15] or would extend credit during the growing season,[16] the producer's assertion of these misrepresentations as a defense in an equitable action to compel delivery was sustained. The statements, however, must not be mere opinions or predictions and the producer must reasonably believe that the agent had authority so to represent.[17] A general prediction as to the increased price obtainable by marketing through the association will not entitle the grower to cancellation of the contract.[18]

Chief among the anti-misrepresentation weapons in the association's arsenal are the classic rules of estoppel and waiver which are doubly lethal because of the dual role of the grower as a member of the association and a contracting party. Incorporation by reference of the by-laws into the contract lends credence to the argument that the two roles are interdependent.[19] Hence, if subsequent to signing the contract and with knowledge of the fraud, the producer either performs under the contract or participates as a member of the association, he is held to

App. 231, 240 Pac. 47 (1925); Commonwealth v. Reffit, 149 Ky. 300, 148 S.W. 48 (1912).

15. Kansas Wheat Growers' Ass'n v. Vague, 118 Kan. 246, 234 Pac. 964 (1925). There were also representations as to the number of producers in the locality who had signed marketing contracts with the association.

16. Dunbar v. Tobacco Growers' Coop. Ass'n, 190 N.C. 603, 130 S.E. 505 (1925). The illiteracy of the producer as compared to the expert knowledge of the cooperative agent was stressed by the court. *But see,* Kansas Wheat Growers' Ass'n v. Rowan, 125 Kan. 710, 266 Pac. 101 (1928).

17. Kansas Wheat Growers' Ass'n v. Rowan, 125 Kan. 710, 266 Pac. 101 (1928); Natchez Pecan Marketing Ass'n v. Bramlett, 163 Miss. 596, 143 So. 429 (1932) (holding disclaimer clause in contract precluded rescission upon grounds of oral misrepresentations); Simpson v. Tobacco Growers' Coop. Ass'n, 190 N.C. 603, 130 S.E. 507 (1925). *But cf.* Placentia Coop. Orange Growers' Ass'n v. Henning, 118 Cal. App. 487, 5 P.2d 444 (1931).

18. Burley Tobacco Growers' Coop. Ass'n v. Rogers, 88 Ind. App. 469, 480, 150 N.E. 384, 388 (1926); Kansas Wheat Growers' Ass'n v. Floyd, 116 Kan. 522, 524, 227 Pac. 336, 337 (1924); South Carolina Cotton Growers' Coop. Ass'n v. English, 135 S.C. 19, 133 S.E. 542 (1926).

19. Kansas Wheat Growers' Ass'n v. Massey, 123 Kan. 183, 253 Pac. 1093 (1927). Watertown Milk Producers' Coop. Ass'n v. Van Camp Packing Co., 199 Wis. 379, 225 N.W. 209, 226 N.W. 378 (1929). In the *Massey* case *supra,* the court concluded at page 185, 253 Pac. at 1094: "The result is, membership and marketing are fused elements of the cooperative scheme. Because the bond of membership binds each member to others to sell only through the association, to affirm membership is to affirm obligation to fulfill requirements of the marketing agreement, and obligation to fulfill requirements of the marketing agreement may not be denied by one who asserts membership and exercises privileges of membership by participating in the corporate activities of the organization."

As to the incorporation of by-laws into the marketing contract, the provisions of the California Fruit Exchange Marketing Contract are illustrative: "The By-Laws of Exchange shall constitute a part of this contract, and any amendment to said by-laws, made as herein provided, shall automatically modify this contract." THE BLUE ANCHOR, HISTORY OF THE CALIFORNIA FRUIT EXCHANGE 49 (1947).

waive any previously existing grounds for avoidance.[20] No finding of specific intent to waive is necessary nor is a showing of reliance by the association required. Under similar circumstances the producer may be estopped to assert the non-compliance by the association with conditions precedent to producer's duty to perform.[21]

Reliance by the association, if required, may be implied from its assumption of contractual obligations for the future sale and delivery to commercial buyers. While the finding of waiver by further participation under the contract is in accord with settled contract principles, the alternative basis for implying such waiver, the exercise of membership privileges, may be subject to question. That the relationship of member and contracting party can be separate is demonstrated by the contracts between nonmembers and the association.[22] Further, the casting of a proxy vote, or any other exercise of membership right, may seem totally unrelated to the marketing contract. It remains true, however, that the membership rights, in a broad sense, are exercised to further the identical objectives as those of the marketing contract, an increased financial return on the marketing of the member's produce. Thus, the courts are reasonably justified in concluding that a participation in the affairs of the association is sufficiently inconsistent with an intention to deny the validity of the contract as to warrant a finding of waiver.

The producer's inability to perform under the agreement due to the acquisition by a third party of an interest in the land upon which the

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20. Kansas Wheat Growers' Ass'n v. Rowan, 125 Kan. 654, 266 Pac. 104 (1928) (by exercise of proxy vote in association's general meetings); Kansas Wheat Growers' Ass'n v. Oden, 124 Kan. 179, 254 Pac. 975 (1927) (same); Dairy Cooperative Ass'n v. Brandes Creamery, 147 Ore. 488, 495, 30 P.2d 338, 340 (1934) (partial performance under the contract); Beaulaurier v. Washington State Hop Producers, 8 Wash.2d 79, 111 P.2d 559 (1941) (participation in meetings). The applicable principle was stated in Kansas Wheat Growers' Ass'n v. Massey, 123 Kan. 183, 253 Pac. 1093 (1927), "If defendant [producer] considered he was fraudulently induced to become a member, he was privileged to renounce membership, and renunciation would relieve him from obligation to comply with the marketing agreement. . . . He could rescind and stay out, or he could stay in. But he could not consider himself out at marketing time, and in when corporation business was to be transacted, or keep membership and withdraw from the marketing agreement. . . ." *Id.* at 186, 253 Pac. 1094.

21. Kansas Wheat Growers' Ass'n v. Windhorst, 131 Kan. 423, 292 Pac. 777 (1930) (producer's membership on preorganization committee, which had certified as to number of bushels of wheat under contract, estopped him from asserting falseness of the certification, despite his lack of actual knowledge): Wenatchee District Coop. Ass'n v. Thompson, 143 Wash. 655, 255 Pac. 918 (1927). However, usually the producer must have actual notice of the fraud or of the association's non-compliance with conditions precedent before waiver will be implied. See Wenatchee Dist. Coop. Ass'n v. Mohler, 135 Wash. 169, 237 Pac. 300 (1925).

22. Other distinctions between the producer's relationship as a member and as a contracting party have been discussed in PART II, notes 6-12 *supra*, and accompanying text.

produce is grown, or on the crops by way of a security lien is frequently asserted as a defense in an action for failure to deliver. Typically, the contract obligates the producer to deliver "all products produced by or for him or acquired by him as landlord or lessor. . . ." As to the producer's liability subsequent to a good faith sale of the land, upon which the crops subject to the contract were grown, the decisions have quite properly construed such a provision as imposing no duty on the producer to continue growing the particular crop nor to assume responsibility for the delivery of his grantee's produce.[23] Since there is no promise to produce or deliver any particular quantity, by a reasonable interpretation of the contract, the member impliedly agrees to market through the association only upon the condition that he grows or acquires the crop to which the contract has reference. Any other interpretation would effectuate a restriction on alienation and hinder the progressive utilization of land. However, the mere pretense of a sale, in an effort to evade the obligation to deliver to the association, will be considered ineffectual and the producer remains subject to the terms of the agreement.[24] Determination of whether a particular sale was bona fide or a mere subterfuge is primarily one of fact, dependent upon such factors as whether the grantee is a member of the grantor's immediate family, the presence or absence of consideration, and continuation of control over the farming operation by the grantor subsequent to the transaction.[25]

A further complication occurs in the event of a member-landowner's lease to a tenant on a sharecrop arrangement. The issue upon which

23. Phez v. Salem Fruit Union, 113 Ore. 398, 233 Pac. 547 (1925). The court concluded: ". . . it does not appear that it was the intent of any of the parties that if a grower died, or sold or conveyed his land in good faith and not for the purpose of avoiding his obligation, that such grower, or his representatives, should go into the market and purchase berries to deliver under the contract, or would be required to deliver under the contract, or would he be required to deliver berries which he did not raise, or else suffer damages." *Id.* at 437, 233 Pac. at 560. See also Layne v. Tobacco Growers' Coop. Ass'n, 147 Va. 878, 133 S.E. 358 (1926).

24. Burley Tobacco Growers' Coop. Ass'n v. Devine, 217 Ky. 320, 289 S.W. 253 (1926) (member-lessee of land had lease for year in question made out to his daughter who was absent from home and defendant continued to conduct the farming operations); Dark Tobacco Growers' Coop. Ass'n v. Alexander, 208 Ky. 572, 271 S.W. 677 (1925) (member transferred land to his wife); South Carolina Cotton Growers' Coop. Ass'n v. English, 135 S.C. 19, 133 S.E. 542 (1926) (same); Hollingsworth v. Texas Hay Ass'n, 246 S.W. 1068 (Tex. Civ. App. 1923) (same). See also Proodian v. Plymouth Citrus Growers' Ass'n, 152 Fla. 684, 13 So.2d 15 (1943).

25. Kansas Wheat Growers' Ass'n v. Lucas, 128 Kan. 350, 278 Pac. 7 (1929); Kansas Wheat Growers' Ass'n v. Garnett, 128 Kan. 337, 278 Pac. (1929). Usually, the issue of good faith would be a question for the jury. However, in Burley Tobacco Growers' Coop. Ass'n v. Devine, 217 Ky. 320, 289 S.W. 253 (1926), where the association sought to enjoin the breach of the producer's contract, the jury's finding of good faith or fraud was held to be advisory only and not binding upon the chancellor. See also Kansas Wheat Growers' Ass'n v. Leslie, 126 Kan. 694, 271 Pac. 284 (1928).

the decisions are not in accord is the responsibility of the sharecropper and landlord respectively under the latter's contract with the association. The conflict among jurisdictions is largely attributable to the enactment in some states of a conclusive presumption provision which places it beyond the power of the tenant or landlord to plead or prove the lack of control by the landlord over the disposition of the tenant's share of the crop.[26] Thus, not only must the landlord deliver his share but he must insure delivery of his tenant's share or suffer substantial liquidated damages.[27] The clause also has been construed to subject the tenant to the remedies of specific performance and injunctions at the instance of the association if he entered into the tenancy with knowledge of the landlord's contract.[28]

The Supreme Court of Louisiana, however, found this legislative presumption arbitrary and unreasonable and thus subject to federal due process constitutional objections.[29] Moreover, the court was unwilling to interpret the contract as implying such a presumption. Since existing Louisiana statutes vested the tenant with absolute title to his share and

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26. CAL. AGRIC. CODE §1211 (1943); COLO. STAT. ANN. c. 106, 332 (1949 Repl. Vol.); KY. REV. STAT. § 270.230(3) (1946); MISS. CODE ANN. § 4510 (1942); The section provides: "*(c)* In any action upon such marketing agreements, it shall be conclusively presumed that a landowner or lessor is able to control the delivery of products produced on his land by tenants or others, whose tenancy . . . thereon were created or changed after execution by the landowner or landlord or lessor of such marketing agreement. . . ."

27. Feagain v. Dark Tobacco Growers' Coop. Ass'n, 202 Ky. 801, 261 S.W. 607 (1924), is cited as the leading case in sustaining the legislature's authority to enact such a presumption. See Dark Tobacco Growers' Coop. Ass'n v. Daniels, 215 Ky. 67, 284 S.W. 399 (1926) (landlord liable for tenant's share not delivered to the association). Where the conclusive presumption is not in effect a tenancy on a flat rental is treated as a sale by the landlord, Kansas Wheat Growers' Ass'n v. Garnett 128 Kan. 337, 278 Pac. 5 (1929); or if the tenancy is by share, the landlord is not responsible for the tenant's share, Tobacco Growers' Coop. Ass'n v. Bissett, 187 N.C. 180, 121 S.E. 446 (1924); *But cf.* Oregon Growers' Coop. Ass'n v. Lentz, 107 Ore. 561, 212 Pac. 811 (1923).

28. Wilson v. Monte Vista Potato Growers' Coop. Ass'n, 82 Colo. 428, 260 Pac. 1080 (1927); Monte Vista Potato Growers' Coop. Ass'n v. Bond, 80 Colo. 516, 252 Pac. 813 (1927). However no cases in the jurisdictions wherein the conclusive presumption provisions are in effect have arisen involving the liability of a tenant who had no knowledge of the landlord's marketing contract.

29. Louisiana Farm Bureau Cotton Growers' Coop. Ass'n v. Clark, 160 La. 294, 107 So. 115 (1926). This legislative presumption was considered violative of the once vital doctrine of "liberty to contract" and equal protection of the laws. See note 32 *infra*. See also, Louisiana Farm Bureau Cotton Growers' Coop. Ass'n v. Bannister, 161 La. 957, 109 So. 776 (1926); Louisiana Farm Bureau Cotton Growers' Coop. Ass'n v. Bacon, 164 La. 126, 113 So. 790 (1927). In Staple Cotton Coop. Ass'n v. Hemphill, 142 Miss. 298, 107 So. 24 (1926) the court expressed doubts as to the constitutionality of the presumption but found it unnecessary to decide that question since the contract involved was executed prior to the enactment of the provision. The Supreme Court of California, however, seemingly would uphold such a provision. Olson v. Biola Coop. Raisin Growers' Ass'n, 33 Cal.2d 664, 204 P.2d 16 (1948).

the landlord could in no manner control or encumber this portion of the crop, the landlord could not be responsible in damages in event the sharecropper sold on the open market.[30] And, although a contrary rule existed in those jurisdictions where the conclusive provision was upheld, the Louisiana court considered the tenant's knowledge of the landlord's contract to be immaterial. Thus, the association's remedies of specific performance were not available as against the tenant.[31]

While the reasoning of the Louisiana tribunal with respect to the constitutional issue is based on obsolete doctrines,[32] the denouncement of the conclusive presumption provision is warranted. The association's contention that the loss of patronage in permitting the tenant to dispose of his share elsewhere is to some immeasurable degree valid.[33] It is unrealistic, however, to contend that resort will be had to the share tenancy to avoid the member's obligation under the contract. The utilization of a share arrangement does not free the landowner to market elsewhere and he remains under a duty to continue the delivery of his share of the crop to the association.[34] The result of independent marketing operations on the part of the tenant does not financially benefit the landlord. On the other hand, the conclusive presumption clause imposes a considerable restriction upon the member-landowner if he is to avoid the payment of substantial liquidated damages. As previously noted, the term of marketing agreements is for a considerable number of years. Should a contingency arise which renders impossible the

30. Louisiana Farm Bureau Cotton Growers' Coop. Ass'n v. Clark, 160 La. 294, 306, 107 So. 115, 119 (1926). See Tobacco Growers' Coop. Ass'n v. Bissett, 187 N.C. 180 S.E. 446 (1924); Book, *A Note on the Legal Status of Share Tenants and Share Croppers in the South*, 4 LAW & CONTEMP. PROB. 508 (1937).

31. Louisiana Farm Bureau Cotton Growers' Coop. Ass'n v. Clark, 160 La. 294, 310, 107 So. 115, 120-21 (1926).

32. The Louisiana Court's decision of 1926 is understandable in view of the vitality of the "liberty of contract" concept at that time. However, the threat of invalidation under the Federal Constitution since Nebbia v. New York, 291 U.S. 502 (1934), is relatively insignificant. See Parker v. Brown, 317 U.S. 341 (1942); Liberty Warehouse Co. v. Burley Tobacco Growers' Coop. Marketing Ass'n, 276 U.S. 71 (1928).

However the impotency of Federal Constitution does not preclude the identical result under the corresponding clauses of the state constitutions. See Paulsen, *The Persistence of Substantive Due Process in the States*, 34 MINN. L. REV. 91 (1950).

33. See NOURSE, *op. cit. supra* note 1, at 33.

34. Main v. Texas Farm Bureau Cotton Ass'n, 271 S.W. 178 (Tex. Civ. App. 1925); Long v. Texas Farm Bureau Cotton Ass'n, 270 S.W. 261 (Tex. Civ. App. 1925). The landlord would be liable for his share regardless of the form in which such share was received. Thus, the landlord could not avoid the contract by having the tenant sell the entire crop and account for the landlord's share in cash.

The landlord is responsible for all crops "acquired" as well as grown. Thus, should the landlord receive a portion of tenant's share in satisfaction for advancements made throughout the year, he may be under a duty to deliver his crops to the association. See Lennox v. Texas Cotton Coop. Ass'n, 55 S.W.2d 543 (Comm. of App. of Texas 1932).

continued physical operation of his farm the member may be forced either to sell his land or secure a sharecropper who is willing to market exclusively through the association. The conclusive presumption as a cooperative weapon thus appears to be unnecessary to insure adequate patronage and to result only in an unreasonable burden upon the members.

Although the credit needs of many growers is most critical during the planting, growing and harvesting seasons, the majority of cooperative associations are not in a position to advance credit to the member prior to the actual delivery of the crop.[35] The producers are compelled to seek outside sources of funds resulting in the creation of security interests, usually a crop mortgage, which conflict with the association's contractual control over delivery of the crop. Accommodation of both the financial and marketing interest is essential to the welfare of the producer.[36]

Absent contractual restrictions, the member is free to mortgage his crop to obtain necessary funds for operation throughout the year.[37] Many agreements, however, require notification and approval of the association prior to the incumbering of crops and failure to secure such consent renders the producers liable in liquidated damages for any

35. See MURRAY, AGRICULTURAL FINANCE (2d ed. 1947). The short term credit for farmers as of 1947 has been approximated at 3.5 billion dollars. Of this total $2,691 million was held by private investors, and $682 million by public and semipublic agencies. *Id.* at 154. However, as of 1949, 2.8 billion dollars agricultural credit was outstanding, which was about equally divided between public and private holders. Hunt and Coates, *The Impact of the Secured Transactions Article on Commercial Practices With Respect to Agricultural Financing*, 16 LAW & CONTEMP. PROB. 165, 167 (1951). See FETROW & ELSWORTH *op. cit. supra* note 9, at 156.

36. The effect which adoption of § 9 of the Uniform Commercial Code will have on agricultural financing transactions is discussed in Hunt and Coates, *The Impact of the Secured Transactions Article on Commercial Practices With Respect to Agricultural Financing*, 16 LAW AND CONTEMP. PROB. 165 (1951). The authors point out the absence of accurate information as to actual business practices which renders difficult any meaningful attempt at codification. However, they encouragingly report a research program presently being conducted at the University of Wisconsin School of Law, under the direction of Prof. J. H. Beuscher. *Id.* at 166 n.5.

37. Bishop v. Alabama Farm Bureau Cotton Ass'n, 215 Ala. 388, 110 So. 711 (1927), the court remarking: "The contract between the parties did not deny appellant [member] the right to place a mortgage upon cotton he might raise during the year. . . . The creation of such liens is frequently necessary, no doubt, to enable the cotton grower to procure funds to carry on his farming operation and to supply his own needs during the season of growth and harvest. And since the association is not in the business of making loans, sound policy would not deny the grower the right to incumber crops for such purposes. . . . Nor is any fair vision needed to see that, if the right of members to raise money be denied, the power of the association to recruit members would be seriously impaired." *Id.* at 389, 110 So. at 712. See also Tobacco Growers' Coop. Ass'n v. Harvey & Sons, 189 N.C. 494, 127 S.E. 631 (1924); Tobacco Growers' Coop. Ass'n v. Patterson, 187 N.C. 252, 121 S.E. 631 (1924).

produce sold on the open market pursuant to a foreclosure sale.[38] Generally, the mortgagee who properly records and who is without notice of the existing contract is unaffected and may proceed to realize upon his security by applicable statutory procedures.[39] It is the consequence of knowledge on the part of the mortgagee which engenders a division of opinion among the courts. In several jurisdictions the mortgagee's knowledge of the marketing agreement does not deprive him of his foreclosure rights, since the association contract is held to create no lien upon the producer's crops.[40] The better view, however, would seem to be that a mortgagee with knowledge of the mortgagor's contract may be enjoined from interfering with the association's right to delivery.[41]

Growing or implanted crops have been excepted from the common law rule that there can be no present sale, the subject of which is not in existence, and from the rule of Section 5 of the Uniform Sales Act, which provides that an attempted present sale of future goods will be construed as a present contract to sell.[42] Therefore, if the marketing contract be construed as a present sale with title to the produce vesting in the association at the time of the sale, the subsequent mortgagee can

38. Kansas Wheat Growers' Ass'n v. Leslie, 126 Kan. 694, 271 Pac. 284 (1928); Kansas Wheat Growers' Ass'n v. Loehr, 125 Kan. 491, 264 Pac. 735 (1925); North Carolina Cotton Growers' Coop. Ass'n v. Bullock, 191 N.C. 464, 132 S.E. 154 (1926); Lennox v. Texas Farm Bureau Cotton Ass'n, 55 S.W.2d 543 (Tex. Com. App. 1932). In Kansas Wheat Growers' Ass'n v. Brooks, 125 Kan. 296, 263 Pac. 787 (1928), the producer was precluded from asserting that a mortgage was existing at time of execution of agreement since the contract contained a warranty by the member that his crops were unincumbered.

39. Kansas Wheat Growers' Ass'n v. Loehr, 125 Kan. 491, 264 Pac. 735 (1925). If, in such a case, the cooperative takes possession without consent of the holder of the superior lien or without accounting, it may be liable in conversion. Alexander Production Credit Ass'n v. Horn, 199 So. 430 (La. App. 1940); Mississippi Cooperative Cotton Ass'n v. Walker, 186 Miss. 870, 192 So. 303 (1939).

40. Bishop v. Alabama Farm Bureau Cotton Ass'n, 215 Ala. 388, 110 So. 711 (1927); Louisiana Farm Bureau Cotton Growers' Coop. Ass'n v. Clark, 160 La. 294, 107 So. 115 (1926); Tobacco Growers' Coop. Ass'n v. Harvey & Son Co., 189 N.C. 494, 127 S.E. 545 (1925).

41. Redford v. Burley Tobacco Growers' Coop. Ass'n, 205 Ky. 522, 266 S.W. 24 (1924); Kansas Wheat Growers' Ass'n v. Ast, 118 Kan. 247, 234 Pac. 963 (1925); Kansas Wheat Growers' Ass'n v. Floyd, 116 Kan. 522, 227 Pac. 336 (1924); Dark Tobacco Growers' Coop. Ass'n v. Dunn, 150 Tenn. 614, 266 S.W. 308 (1924).

42. Sun-Maid Raisin Growers of California v. Jones, 96 Cal. App. 650, 274, Pac. 557 (1929). Under this unique doctrine a seller or mortgagor of crop who holds an interest in land is considered to have potential possession of unplanted and future crops to be grown, which may be the subject of a present contract of sale as distinguished from an executory contract to sell or mortgage. Title passes and vests in the purchaser the instant such crops become capable of ownership and is paramount to intervening claimants between the date of sale and harvesting. Professor Williston criticizes the employment of this doctrine in states which have enacted the Uniform Sales Act. WILLISTON, SALES § 133-138 (Rev. ed. 1948). See Williston, *Transfers of After Acquired Personal Property*, 19 HARV. L. REV. 557 (1906); Comment, *Mortgages on Future Crops as Security for Federal Loans*, 47 YALE L.J. 98 (1937).

acquire no interest from the mortgagor grower.[43] Although no cases have applied this reasoning to deny an innocent mortgagee his foreclosure rights, it may provide the inarticulated basis for the result in those decisions where the interest of the mortgagee with notice of the marketing contract is held secondary to the contractual rights of the association.[44]

Even where the agreement imparts a present contract to sell, the mortgagee with notice would acquire a lien secondary to the association's claims. It is accepted that the cooperative's remedy for failure to deliver is inadequate at law and additional equitable remedies of injunction and specific performance are necessary.[45] Therefore, as in the case of contract to sell land, the marketing agreement confers an equitable lien which is protected against a subsequent mortgagee with notice.[46] However, prior to insistence upon the superior claim, the association may defer to the mortgagee's rights in view of future reluctance of local financiers to extend this essential credit.[47]

Failure to provide means whereby the potential security holders may readily ascertain the existence of a marketing agreement is the primary source of conflict. While reliance upon a recording system for introducing certainty into financial transactions has many shortcomings, especially as to businessmen's natural disinclination to careful inquiry, it does provide an orderly method of allocating the priority of rights and tends to eliminate the difficult factual determination as to notice. Recog-

43. The good faith mortgagee for value may prevail over the cooperative's title by virtue of Section 25 of the Uniform Sales Act, which protects subsequent bona fide purchasers where a seller remains in possession of the goods. Pacific Wool Growers v. Draper, 158 Ore. 1, 73 P.2d 1391 (1934). Similarly, under Section 26, if such retention of possession by the seller is fraudulent in fact or under any rule of law the creditors of the seller may treat the sale as void. Many states have made such retention either conclusive or presumptive evidence of fraud. However, the court in Sun-Maid Raisin Growers of California v. Jones, 96 Cal. App. 650, 274 Pac. 557 (1929) rejected the contention that these sections were applicable to the sale of growing crops. Sections 25 and 26 were considered inapplicable where by the nature of the subject of the sale, it was impossible for the seller to take possession at the time of the sale. The same result could be reached on the basis that the cooperative statutes excepted the sale of crops from the Uniform Sales Act provisions. See Goldsmith, *Passage of Title Under Cooperative Marketing Contracts,* 18 ORE. L. REV. 157 (1939).

44. See cases cited in note 41 *supra.*

45. See cases cited in note 12 *supra.*

46. WALSH, MORTGAGES § 127 (1934). See WALSH, EQUITY §§ 59, 60 (1930).

47. To encourage federal lending to farmers, through the Farm Security Administration and other agencies concerned with agricultural relief, several states have enacted preferential legislation insuring the Government adequate security interests. See discussion of these statutes in Comment, *Mortgages on Future Crops as Security for Federal Loans,* 47 YALE L.J. 98 (1937). However, such acts may be repealed by states adopting the Uniform Commercial Code, in which event the United States will be placed in an equal position with private lending institutions. See Hunt and Coates, *supra* note 35, at 170.

nizing this need several states have enacted provisions for the recording of marketing agreements.[48] Generally, the statute permits the filing of a uniform or "pilot" agreement in the county wherein the crops are grown or the member resides, with an attached affidavit of the names of the producers who have contracted with the cooperative. Although, unfortunately, the effect of recordation is not prescribed with the desired clarity, it may be reasonably construed so as to give constructive notice of such contracts to all subsequent purchasers and mortgagees.[49] With the exception of a Maine statute, since repealed,[50] no provision is included as to rights of a mortgagee who has accepted a mortgage with actual or constructive notice of the recorded contract. However, the former Maine statute had prescribed, with commendable detail, a solution which accommodated both the interests of the cooperative in securing delivery and the mortgagee in realizing upon his lien. If a mortgagee accepted a mortgage on the crop subsequent to the recordation of the marketing contract and prior to delivery to the association, there was constructive notice of such contract. The mortgage lien attached, however, and the only penalty incurred was the forfeiture of the right to possession or foreclosure. The member remained under a duty to deliver in accordance with the contract, and the association's right to receive was unimpaired. In the absence of action by the association to compel delivery, the mortgagee was permitted to realize on his lien.[51] If the crop had been delivered to the association under the contract, the mortgagee, upon notice to the cooperative of his lien, acquired by virtue

48. ARIZ. CODE ANN. § 49-714 (1947); ME. LAWS c. 294 (1945), as amended, c. 324 (1947); N.M. CODE ANN. § 48-1314 (1941); ORE. LAWS ANN. § 77-503 (1940); S.C. CODE ANN. § 8890 (1942); VA. CODE ANN. §§ 13-280 to 283 (1950); WIS. STAT. ANN. § 185.08(3) (1937).

49. ARIZ. CODE ANN. § 49-714 (1949): ". . . [recording] shall constitute full notice of such agreements"; N.M. CODE ANN. § 48-1316 (1941): ". . . [recording] shall operate as notice thereof to all subsequent purchasers and encumbrancers. . . ."; ORE. LAWS ANN. § 77-503 (1940): ". . . [recording] shall operate as constructive notice of the existence of such contract . . . and all persons contracting or dealing with any such member in relation to such products . . . shall be bound thereby, and all rights and liens acquired by any such person in such products subsequent to the date of recordation shall be subject in all respects to the rights of the association. . . ."; WIS. STAT. ANN. § 185.08(3) (1937): "From and after the date of such filing the title to all property [crops covered by the contract] is vested in the association. In case of a purchase thereafter . . . no title of any kind or nature shall pass to such other purchaser and said association may recover the possession of such property. . . ." The Wisconsin provision was construed in Spencer Co-op. v. Schultz, 209 Wis. 344, 245 N.W. 99 (1932); Watertown Milk Producers Co-op. Ass'n v. Van Camp Packing Co., 199 Wis. 379, 225 N.W. 209 (1929). See Note, *Recent Development of Wisconsin Law on Co-operative Marketing*, 23 MARQ. L. REV. 76 (1939).

50. ME. REV. STAT. §§ 32-39 (1944), repealed by Me. Laws c. 294 (1945) in adopting the Uniform Cooperative Corporation Act.

51. *Id.* § 32.

of the statute an interest in the proceeds received on the sale of the member's crop.[52] Remedies were conferred on the mortgagee to compel the cooperative to sell and account to the extent of the mortgagee's lien.[53]

When it is realized that the present conflict is not between two security holders, the practicality of the solution enacted by the Maine legislature becomes more apparent. The association's lien is not for credit advanced but solely to insure delivery of the entire crop. The purpose of taking a mortgage by the lender is to insure preference over general creditors and have definite property from which to realize proceeds for satisfaction of his debt. This interest of the mortgagee is served by his lien attaching to the proceeds of a sale by the cooperative, as the amount realized through such sale will be equal, if not more, than could be expected at a foreclosure sale. Enactment of such legislation in other jurisdictions with applicability extended to all third party security holders would do much to eliminate the conflicts in this area.

While the agreement prescribes in considerable detail the consequences of the producer's default, there is significantly absent any reference to the effects of a breach of the marketing contract by the cooperative association. While settled contract principles suggest that a sufficiently material default should relieve the member from his duty of further performance under the contract,[54] persuasive countervailing considerations, inherent in the peculiar economic objective of the agreement, indicate that a member should not be released from the contract, regardless of the seriousness of the association's default. It has been argued that since the producer's contract is not solely with the association as an entity, but is in consideration for and interdependent with the contracts of all other producers,[55] the release of one member for any breach by a cooperative officer would be to the injury of the other producers.[56] This argument concludes that, as in the case of an unin-

52. *Id.* § 33: ". . . a lienholder, who has acquired a lien subsequent to a filing and recording of the marketing agreement . . . shall no longer be entitled to any lien, interest in, or claim against such crop, but he shall instead acquire a lien on the claim of the member against the association for the net proceeds of sales by the association. . . ."

53. *Id.* §§ 35-39.

54. RESTATEMENT OF CONTRACTS § 274 (1932): "*(1)* In promises for an agreed exchange any material failure of performance by one party not justified by the conduct of the other discharges the latter's duty to give the agreed exchange even though his promise is not in terms conditional."

55. McCauley v. Arkansas Rice Growers' Co-op. Ass'n, 171 Ark. 1155, 287 S.W. 419, 423 (1926): "Appellants [producers] signed the 'marketing contract' with other members of the association. Hence appellants' agreements were made on consideration of like agreements of other members and for their mutual advantage." Kansas Wheat Growers' Ass'n v. Massey, 123 Kan. 183, 253 Pac. 1093 (1927).

56. HULBERT, LEGAL PHASES OF COOPERATIVE ASSOCIATIONS 149 (F.C.A. BULL. No. 50, 1942).

corporated association, default by the association's agent may confer a right to appropriate action for removal of the delinquent officer or other redress within the association, but does not operate to excuse the producer from further performance under the contract.[57] On the other hand, without specific reference to the interdependence of marketing contracts, a number of courts have considered material defalcations by the association to constitute a valid defense for refusal to deliver or grounds upon which to seek cancellation of the contract. Thus, where the contract was interpreted as imposing an absolute duty to receive member's crops, the failure to accept delivery was held to excuse the producer's future performance under the agreement.[58] Even where such failure is justified due to adverse marketing conditions, the association's refusal to permit the producer to market his crops elsewhere has been considered sufficient to terminate the contract at the producer's election.[59] Similarly, the conditioning of the association's performance upon the producer's installation of expensive machinery not called for in the contract,[60] or insisting upon delivery at a price below production cost,[61] or failure properly to account for produce delivered,[62] may justify a producer's release from his contractual obligations. However, frequently the statement is made that a refusal to deliver may not be predicated upon "mere mismanagement" of the cooperative officers.[63]

57. *Id.* at 151. Mr. Hulbert concludes: "Generally speaking, it is submitted that when members of an association believe that the directors they have elected to manage the association, or its officers or other agents, are not complying with its charter, by-laws, or marketing contract, they should be required to seek relief within the association through the election of new directors and officers, or the enjoining of them, or through other corrective measures."

58. Kansas Wheat Growers' Ass'n v. Toothaker, 128 Kan. 469, 278 Pac. 716 (1929); Frame v. Trenton Milk and Cream Co., 125 Misc. 86, 210 N.Y. Supp. 591 (County Ct. 1925); Central Texas Dairymen's Ass'n v. Jones, 67 S.W.2d 896 (Tex. Civ. App. 1934). But see, California Canning Peach Growers v. Harris, 91 Cal. App. 654, 267 Pac. 572 (1928), holding that member had no right to rely on agent's unauthorized refusal to accept delivery.

59. Mountain States Beet Growers' Marketing Ass'n v. Monroe, 84 Colo. 300, 269 Pac. 886 (1928); Guglielmelli v. Walla Walla Gardners' Ass'n, 157 Wash. 109, 288 Pac. 251 (1930); Wisconsin Cooperative Milk Pool v. Saylesville Cheese Mfg. Co., 219 Wis. 350, 263 N.W. 197 (1935).

60. Watertown Milk Producers' Co-op. Ass'n v. Van Camp Packing Co., 199 Wis. 379, 225 N.W. 209, 226 N.W. 378 (1929). See also Myrold v. Northern Wisconsin Co-op. Tobacco Pool, 206 Wis. 244, 239 N.W. 422 (1931) (refusal to regrade grower's tobacco unless he agreed to a modification of the marketing agreement).

61. Miami Home Milk Producers' Ass'n v. La Course, 117 Fla. 345, 158 So. 117 (1934); New Jersey Poultry Producers' Ass'n v. Tradelius, 96 N.J. Eq. 683, 126 Atl. 538 (Ct. Err. & App. 1924).

62. Brown v. Georgia Cotton Growers' Co-op. Ass'n, 164 Ga. 712, 139 S.E. 417 (1927); Tobacco Growers Co-op. Ass'n v. Bland, 187 N.C. 356, 121 S.E. 636 (1924); Dryden Local Growers v. Dormaier, 163 Wash. 648, 2 P.2d 274 (1931).

63. Nebraska Wheat Growers' Ass'n v. Smith, 115 Neb. 177, 212 N.W. 39 (1926); Pittman v. Tobacco Growers Co-op. Ass'n, 187 N.C. 340, 121 S.E. 634 (1924).

Indicative of the tendency to confuse the membership relationship with that of the producer in a contractual capacity, one court has held that a release by the association of some producers from their contracts excuses other producers from future performance.[64]

The adoption, as a rule of law, of either automatic release of a member in the event of the association's default or the opposite extreme of denying rescission despite the character of the defalcation seems an outmoded mechanical approach. A more flexible rationale is illustrated by *Nebraska Wheat Growers Ass'n v. Smith.*[65] In an action by the association for equitable relief and liquidated damages, the defendant producers alleged a prior breach by the association in the negligent marketing of their crop during the preceding year as a defense for failure to deliver in the immediate year and as basis for a cross claim for cancellation of the marketing contract and membership in the association. While the agreement was considered as an "entire" contract, it was clearly "divisible" into annual installments with a duty to deliver by the producer and a corresponding duty on the part of the cooperative to accept, market and account.[66] Prior to enactment of Section 45 of the Uniform Sales Act authority in this country held that a failure to accept or to make payment for a delivered installment constituted a material breach which entitled the seller to treat the default as "total" and rescind as to the remainder of the contract.[67] Section 45 altered the prior rule and made the "materiality", and therefore the legal consequence, of either party's defalcation dependent in each instance upon

64. Staple Cotton Co-op. Ass'n v. Borodofsky, 143 Miss. 558, 108 So. 802 (1926). *Contra,* Phez. Co. v. Salem Fruit Union, 103 Ore. 514, 201 Pac. 222 (1921). Such release may be binding upon the association without the consent of all members if the release was given in exchange for valuable consideration. Washington State Hop Producers' v. Elgin, 6 Wash.2d 585, 108 P.2d 329 (1940). However, rescission has been denied on grounds: that the member knew of the prior release and had waived objection by continued exercise of membership rights, Beaulaurier v. Wash. State Hop Producers, 8 Wash.2d 79, 111 P.2d 559 (1941); or that the association is not obligated to prosecute those allegedly released in any particular order and may still bring such an action, California Bean Growers Ass'n v. Rindge Land & Navigation Co., 199 Cal. 168, 248 Pac. 658 (1926).

65. 115 Neb. 177, 212 N.W. 39 (1924).

66. *Id.* at 41. The court accepted only for purposes of decision that the marketing agreement constituted an entire agreement. If the agreement be classified as a series of annual separate contracts, the breach by the association on one contract would have no effect upon the producers' duty to perform in subsequent years. However, the element of continuing performance and interdependency of membership would make the classification of the agreement as an "entire and divisible" contract quite reasonable. See CORBIN, CONTRACTS §§ 687-699 (1951); WILLISTON, CONTRACTS §§ 860-863 (Stud. ed. 1938); RESTATEMENT OF CONTRACTS § 266 (1932).

67. WILLISTON, CONTRACTS § 867 (Stud. ed. 1938). This view was established by the leading case of Norrington v. Wright, 115 U.S. 188 (1885).

"the terms of the contract and the circumstances of the case".[68] In applying this principle to the instant facts, the Nebraska court concluded that alleged defaults of the association were not sufficiently material to justify the defendant producers considering their obligations under the agreement as terminated.[69]

The myriad of factual situations and possible relevant considerations which may be determinative in the application of this flexible standard renders the formulation of an exact verbal rule impossible.[70] However, there are certain basic factors which will appear with sufficient uniformity to merit their enumeration. The producer, by signing the long term marketing contract, foregoes the freedom to seek the best market possible in disposing of his annual yield in exchange for a stable and assured marketing agency. Perhaps the granting of equitable relief or damages will be sufficient in the majority of cases to rectify the sporadic although serious breach by the officers of the association. However, the grower is not in a position to bear the resulting credit risk imposed

68. UNIFORM SALES ACT § 45(2): "*Delivery in Instalments.* Where there is a contract to sell goods to be delivered by stated instalments, which are to be separately paid for, and the seller makes defective deliveries in respect of one or more instalments, or the buyer neglects or refuses to take delivery of or pay for one or more instalments, it depends in each case on the terms of the contract and the circumstances of the case, whether the breach of contract is so material as to justify the injured party in refusing to proceed further and suing for damages for breach of the entire contract, or whether the breach is severable, giving rise to a claim for compensation but not to a right to treat the whole contract as broken." See Helgar Corp. v. Warner's Features, 222 N.Y. 449, 119 N.E. 113 (1918).

69. Nebraska Wheat Growers' Ass'n v. Smith, 115 Neb. 117, 212 N.W. 39 (1927). The alleged defaults consisted of failure to properly "store, mix and process" the producers wheat, marketing through unauthorized channels, and excessive deductions from the price received by the association. The Supreme Court in reversing the lower judge's dismissal of the association's complaint went on to find these violations unsupported by the evidence in the record, and at most a mere error in judgment on the part of the officers of the cooperative. *Id.*, 212 N.W. at 45.

A similar result was reached in McCauley v. Arkansas Rice Growers' Co-op. Ass'n, 171 Ark. 1155, 287 S.W. 419 (1949). The court denied the plaintiff producers' request for the appointment of a receiver and cancellation of their contracts on the grounds that the cooperative officers' retention of excess deductions from proceeds and other defaults constituted a breach of independent covenants. Thus, the producers were entitled to an accounting but were obligated to continue performance under their marketing contracts. See also California Prune and Apricot Growers, Inc. v. Baker, 77 Cal. App. 393, 246 Pac. 1081 (1926); California Bean Growers Ass'n v. Rindge Land & Navigation Co., 199 Cal. 168, 248 Pac. 658 (1926).

70. RESTATEMENT OF CONTRACTS § 275 (1932). The accompanying comment to Section 275 states: "It is impossible to lay down a rule that can be applied with mathematical exactness to answer the problem—when does a failure to perform a promise discharge the duty to perform the return promise." Of course, the very flexibility introduced by Section 45 of the Sales Act and Section 275 of the Restatement would indicate that defaults which are sufficient to constitute a "total" breach with respect to ordinary commercial contracts may be treated as only a "partial" breach, when pertaining to a cooperative marketing contract.

by consistent failure to account promptly. Cooperatives, although legislatively and judicially favored, have no claim to a sovereign immunity in their contractual relationships. Thus, if association's defaults are of such a nature as to deprive the producer of the economic certainties in the marketing of his crop which induced his execution of the contract, then the producer should be relieved of future performance. Unjustifiable refusals to accept, process or market the produce, or unreasonable delays in accounting to the producer may fully merit his release from assuming the identical risks in the future.

It is not to be implied that there are not mitigating factors supporting the cooperatives' plea for careful consideration prior to the release of a member. The primary economic objective of utilizing marketing contracts is to insure complete patronage by each member. The loss of even a fractional part of this source to the open market tends to lessen to some extent the association's control of supply and endangers its ability to stabilize prices.[71] The consequent loss of membership proportionately increases prorated expenses to the remaining producers and impairs the association's ability to fulfill existing contracts with commercial buyers. There is undoubtedly some damage to the cooperative's prestige by the discharge of recalcitrant producers.[72] Impressive to one court was the prediction that if the breach affected a sufficiently large number of producers, widespread resort to the privilege of cancellation could cripple and even destroy the cooperative association.[73]

The courts in fashioning the decree for the particular case would seem to possess broad discretion in weighing these competing interests. Whether the breach occurred as to a single or relatively few producers or affected the entire membership, while having no logical relevancy, will be influential. There are grounds for questioning the present tendency to fuse the membership and contractual aspects of the producer's position. However, liberality in permitting redress in the capacity of member or owner is likely to render, in the opinion of the courts, less acute the need for contractual remedies.

71. Minnesota Wheat Growers' Co-op. Marketing Ass'n v. Huggins, 162 Minn. 471, 203 N.W. 420 (1925); Kansas Wheat Growers' Ass'n v. Schulte, 113 Kan. 672, 216 Pac. 311 (1923).

72. See NOURSE, THE LEGAL STATUS OF AGRICULTURAL CO-OPERATION 328 (1927).

73. In McCauley v. Arkansas Rice Growers' Co-op. Ass'n, 171 Ark. 1155, 287 S.W. 419 (1927), where 118 producers sought cancellation of their contracts, the court concluded: "If appellants [producers] could be absolved from performance of the contract because the officers of the association had committed breaches of the contract in certain respects, it is certain that the other members of the association would suffer by this course. The action of the appellants in rescinding the contract would tend to cripple the association and thereby harm the other members of it." *Id.*, 287 S.W. at 423.

Frequently, the marketing contract contains language to the effect that the member sells or agrees to sell, and the association buys or agrees to buy. These terms lend themselves to a construction that the transaction is an ordinary purchase and sale vesting title in the association. However, many of the same contracts further provide that the purpose of the arrangement is to constitute the association the "selling agent" of the member.[74] This latter phrase is conducive to an interpretation that the association is not in fact a purchaser but merely an agent for purposes of marketing the member's crop. Courts have seized upon the purchase and sale phrase in some cases to hold that title is in the association,[75] and upon the agency terminology in other instances to support their conclusion that title remains in the member.[76] While it might appear that the element of certainty has thus been completely eliminated, the decisions reveal a definite tendency to recognize title in one party or the other according to the result most favorable to the cooperative.[77]

That the location of title is crucial in the outcome of many cases can be illustrated by a brief review of situations in which the courts have relied upon that concept to resolve the dispute in issue. In *Sun-Maid Raisin Growers of California v. Jones*,[78] the court, giving effect to the title-passing language of the marketing agreement, held that the association could recover in a conversion action against a sheriff who had

74. See California Grape Control Board v. Boothe Fruit Co., 220 Cal. 279, 29 P.2d 857 (1934), involving a typical marketing contract employing phraseology of both purchase and sale and of agency.

75. Calif. & Hawaiian Sugar Refining Corp. v. Commissioner, 163 F.2d 531 (9th Cir. 1947); California Grape Control Board v. Boothe Fruit Co., 220 Cal. 279, 29 P.2d 857 (1934); Sun-Maid Raisin Growers of Calif. v. Jones, 96 Cal. App. 650, 274 Pac. 557 (1929); Texas Certified Cottonseed Breeders' Association v. Aldridge, 59 S.W.2d 320 (Tex. Civ. App. 1933); Texas Farm Bureau Cotton Association v. Stovall, 113 Tex. 273, 253 S.W. 1101 (1923).

76. Poultry Producers of Southern Calif. v. Barlow, 189 Cal. 278, 208 Pac. 93 (1922); Colorado-New Mexico Wool Marketing Ass'n v. Manning, 96 Colo. 186, 40 P.2d 972 (1935); Tomlin v. Petty, 244 Ky. 542, 51 S.W.2d 663 (1932); City of Owensboro v. Dark Tobacco Growers' Ass'n, 222 Ky. 164, 300 S.W. 350 (1927); Tobacco Growers' Co-op. Ass'n v. L. Harvey & Son Co., 189 N.C. 494, 127 S.E. 545 (1925); Texas Certified Cottonseed Breeders' Ass'n v. Aldridge, 122 Tex. 464, 61 S.W.2d 79 (1933); Long v. Texas Farm Bureau Cotton Association, 270 S.W. 561 (Tex. Civ. App. 1925).

77. The relative ease of title manipulation has long been recognized as a convenient means to an end. In commenting upon this phenomenon as applied to controversies between farmers and elevatormen holding possession of grain, one writer observed: "If one were forced to make a generalization about title-passing in this field . . . one might say: if the elevator burned down, title had passed; if the elevatorman went into bankruptcy, title had not passed." Latty, *Sales and Title and the Proposed Code*, 16 LAW & CONTEMP. PROB. 3, 20 n.83 (1951). While in these cases the title concept was employed to the farmer's advantage, the opposite is generally true when a cooperative association is substituted for the independent elevatorman.

78. 96 Cal. App. 650, 274 Pac. 557 (1929).

seized, under a creditor's writ of attachment, raisins remaining in the possession of a member. However, in *Colorado-New Mexico Wool Marketing Ass'n v. Manning*,[79] a case indistinguishable on the facts, the court refused to give effect to the contractual provision that an absolute title was intended to pass to the cooperative. Consequently, the association's conversion action failed. Theorizing that if a true sale were intended, certain additional stipulations in the agreement reciting that the association should enjoy rights traditionally incident to title[80] would have been unnecessary, and further noting the expressed provision that the risk of loss remained with the member, the court concluded that title had not passed to the cooperative. Admittedly, under these circumstances, the term "absolute title" may have been an unfortunate choice of words. Nevertheless it would seem that all the provisions in the contract should, if possible, have been interpreted so as to harmonize with one another.[81] There is nothing inconsistent in the parties providing not only that one should have title, but that he should also possess certain specific rights or duties which that phrase implies. Indeed, the latter provision would appear to confirm, rather than derogate from, the import of the title-vesting language. Conversely, there would seem to be no valid reason why a seller who retains one attribute of title, such as possession, should not also agree to retain another, such as the risk of loss.

The incidence of title likewise is regarded by the courts as determinative of the result in cases where the goods under contract are destroyed or damaged. For example, in *Texas Certified Cottonseed Breeders' Ass'n v. Aldridge*,[82] certain seed in the possession of the association was destroyed by fire. The cooperative, despite the fact that it had previously received $1.75 per bushel upon an insurance policy covering the goods, was successful in its suit to recover from the member the $1.00 per bushel which he had been paid. While ostensibly complying with the intent of the parties regarding title, the court in fact, by pre-occupying itself with the welfare of the cooperative, reached a result diametrically opposed to the expressed terms of the contract, which clearly provided that title was vested in the association.[83] A finding that the

79. 96 Colo. 186, 40 P.2d 972 (1935).

80. In addition to providing that title should pass to the association, the contract further stipulated that the association could sell, borrow on, commingle, and exercise all other rights over the crop.

81. Connelly v. Beauchamp, 178 Ark. 1036, 13 S.W.2d 28 (1929); Bank of Commerce & Trust Co. v. Northwestern Nat'l Life Ins. Co., 160 Tenn. 551, 26 S.W.2d 135 (1930); Stone v. Robinson, 180 S.W. 135 (Tex. Civ. App. 1915); AM. JUR., *Contracts* § 241.

82. 122 Tex. 464, 61 S.W.2d 79 (1933), *reversing* 59 S.W.2d 320 (Tex. Civ. App. 1933).

83. The contract explicitly provided that "[u]pon delivery to warehouse, negotiable warehouse receipts shall be issued in favor of Association and promptly delivered thereto,

association had title, thought the court, would be tantamount to holding that it was not a true cooperative marketing organization.[84] In effect, it was implied that a "true cooperative association" cannot legally buy its members' produce. Such a result is neither warranted by the facts of this case, nor the necessity of encouraging cooperative agricultural marketing.[85] Indeed, being deemed the title-holder is often advantageous to the association, as indicated by the *Sun-Maid Raisin* case.

The proponents of cooperation maintain that among its aims are economic gain to agricultural producers as a class and substantial equality of treatment among members.[86] That these are worth-while objectives cannot reasonably be denied. But the courts, in their zeal to lend judicial support to the purposes and philosophy underlying cooperative endeavor, frequently appear to frustrate those objectives by viewing too narrowly the considerations involved. Thus, where a member invests time, money and effort in the production of his crops, only to have them rendered un-

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which warehouse receipts shall *in and of themselves* pass title thereto to the association." (emphasis added). The member had complied with all the terms of the contract and the cooperative had been presented with the negotiable warehouse receipts.

84. After observing that the clear intention of the parties was to create a true cooperative marketing association, the court concluded: ". . . to hold in the face of this intention that the delivery of the seed to the association was an absolute sale would destroy it as a cooperative marketing association." *Id.* at 473-474, 61 S.W.2d at 83.

85. It is apparent that the cooperative method of activity has enlisted the aid of both the courts and the legislatures. In Calif. Canning Peach Growers v. Harris, 91 Cal. App. 654, 267 Pac. 572 (1928), the court stated that an agreement between an association and its members was entitled to "extraordinary protection." The "extraordinary protection" which the court in that case so generously afforded consisted of allowing the association to recover liquidated damages from a member who, after being told by the association's agents that his crop would not be received or accepted, proceeded to sell to another non-cooperative buyer, thus preventing an impending insolvency.

The policy section of the Indiana Agricultural Cooperative Act, IND. STAT. ANN. § 15-601 (Burns' 1933), is a typical example of the legislative solicitude bestowed upon cooperative associations. It is there stated that the "public interest demands that the farmer be encouraged" to market his crops cooperatively, rather than through the "blind, unscientific and speculative" method of merchandising to which he was subjected prior to the advent of cooperative marketing associations. The courts have given effect to the legislative determination, holding that it is the ". . . expressed public policy of this state . . . to aid and encourage the cooperative marketing of farm products." Burley Tobacco Growers Co-op. Ass'n v. Rogers, 88 Ind. App. 469, 479, 150 N.E. 384, 387 (1928). See also Burley Tobacco Society v. Gillaspy, 51 Ind. App. 583, 100 N.E. 89 (1912).

86. See HULBERT, LEGAL PHASES OF COOPERATIVE ASSOCIATIONS 1-3 (F.C.A. BULL. No. 50, 1942). Mr. Justice Brandeis, dissenting in Frost v. Corp. Commission, 278 U.S. 515, 536 (1928) stated: "The farmers seek through [cooperative associations] to secure a more efficient system of production and distribution and a more equitable allocation of benefits. But this is not their only purpose. Besides promoting the financial advantage of the participating farmers, they seek through co-operation to socialize their interests—to require an equitable assumption of responsibilities while assuring an equitable distribution of benefits. Their aim is economic democracy on lines of liberty, equality and fraternity."

marketable by some fortuitous occurrence,[87] the underlying purposes which justify the existence of his association may perhaps be better served by utilizing the association as a conduit for distributing the loss among those who have joined together for their mutual benefit. Such an approach would certainly equate the unfortunate party with his fellow-members, and would do much toward stabilizing the relative economic position of members as a group.

Judicial reluctance to recognize title in the cooperative where to do so would be detrimental to the association is also exemplified in cases involving tax liability. Thus in a leading case, *City of Owensboro v. Dark Tobacco Growers' Ass'n*,[88] the Kentucky Court of Appeals refused to give effect to the clear language of the contract that title was intended to pass to the association. By so holding, the court allowed the cooperative to escape a property tax assessment on almost half a million dollars worth of tobacco which, by the terms of the contract and Kentucky's Bingham Co-operative Marketing Act,[89] it owned. The strained contractual interpretation which the court employed[90] not only resulted

87. In Haarparinne v. Butter Hill Fruit Growers' Ass'n, 122 Me. 138, 119 Atl. 116 (1922), subsequent to the associations sorting, packing and stamping the apples, a large portion of the crop was frozen while still in the possession of the member. While no formal contract had been entered into, the organizational by-laws contained language indicative of an intent that title to all crops acquired from members was to pass to the association. Nevertheless, the court chose to disregard these provisions and held that since the association was acting as a mere selling agent and did not have title, it was not responsible for the value of the damaged crop. The reason why one acting as a selling agent should not be responsible for damage occurring after his assumption of control over the goods was not explained.

88. 222 Ky. 164, 300 S.W. 350 (1927). See also Dep't of Treasury v. Ice Service, Inc., 220 Ind. 64, 41 N.E.2d 201 (1942).

89. The court construed the statute as authorizing cooperative associations to either buy and become the absolute owner of the member's produce, or to act as a mere selling agent and enter into a contract for that purpose alone. It apparently was the considered, intelligent judgment of the parties that the former arrangement was the most adaptable to their enterprise. Hence the contract provided that the association should have an absolute title to the tobacco upon delivery.

90. "Isolated expressions in the instrument," observed the court, "are not necessarily controlling." 222 Ky. 164, 166, 300 S.W. 350, 352. Most authorities on contracts will admit the validity of this observation. Miller v. Robertson, 266 U.S. 243 (1924); Seuss v. Schubert, 358 Ill. 27, 192 N.E. 668 (1934); 12 AM. JUR., *Contracts* § 241. But one is justified in questioning its applicability to this particular contract, since *all* of the expressions in the instrument were consistent with passage of title to the association. Not content with merely disregarding what they considered as "isolated expressions" in the contract, the court went completely outside the contract and looked to the "conditions which brought about the organization" of the association and concluded: ". . . that the whole thing was nothing more nor less than the transfer by an aggregation of growers of the naked title to their product . . . to an association formed and organized by the growers themselves and which they absolutely controlled." 220 Ky. 164, 166-167, 300 S.W. 350, 352. This conclusion would seem to be a clear admission that title had vested in the association, and that the cooperative's liability for the tax in question should have been sustained.

in complete disregard for the expressed intent of the parties,[91] but also constituted an encroachment upon the domain of the legislature. Surely, that body is competent to provide, as it did here, that cooperatives are capable of holding title to their members' produce, and to prescribe the method whereby that result can be accomplished.[92] Furthermore, if cooperative associations are to be exempt from tax burdens which other forms of business enterprise must bear, that exemption should derive from a mandate of the legislative branch of government, rather than from a title-shuttling technique of the judiciary.[93]

These representative cases reveal the inadequacy of the title concept as an instrument for solving the problems arising from cooperative marketing of agricultural products.[94] Much of the confusion surrounding cooperative-title problems is attributable to the courts' failure to perceive that it is legally possible and entirely reasonable for a cooperative acting as an agent to hold legal title to the subject matter of the agency.[95] Even where the marketing agreement expressly provides for a sale, specifies the time at which title to the goods shall pass, and indicates that the intention of the parties is to pass title, the association still may retain the character of an agent.[96] Despite the fact that it has

91. The court was well aware that title manipulation would produce the desired result. That result was clearly indicated when the court formulated the issue as follows: "If the contract in question is one whereby the association became the absolute owner of the grower's tobacco, then under the terms of the . . . statute the product was . . . necessarily subject to the tax assessed. On the contrary, if the contract between the grower and the association is only a contract of agency" the association could escape the tax liability. *Ibid.*

92. See HULBERT, *op. cit. supra* note 86, at 122.

93. Another interesting tax case is that of Calif. & Hawaiian Sugar Refining Corp. v. Commissioner, 163 F.2d 531 (9th Cir. 1947). While the court recognized that title had passed to the association, it went further and euphemistically labelled the purchase and sale agreement a "trust instrument." By holding that the provision in the agreement for the deduction of expenses was not a reduction of the price paid for the commodity, but rather an expense of the "trust administration," the cooperative was permitted to escape the tax liability.

94. *Cf.* Judge Learned Hand's statement in *In re* Lake's Laundry, Inc., 79 F.2d 326, 328-9 (2d Cir. 1935): "'title' is a formal word for a purely conceptual notion; I do not know what it means and I question whether anybody else does, except perhaps legal historians."

95. Some legislatures have anticipated judicial reluctance to effectuate purchase and sale provisions in marketing contracts and have provided that "If they contract a sale to the association, it shall be conclusively held that title to the products passes absolutely and unreservedly, except for reported liens, to the association upon delivery; or at any other specified time if expressly and definitely agreed in the said contract." See CALIF. AGRIC. CODE § 1208.

96. Comment, *Interpretation of Contracts Employed by Cooperative Marketing Associations*, 43 YALE L.J. 119 (1933). The Comment discusses many of the cases interpreting cooperative marketing contracts and concludes ". . . that the marketing agreement, regardless of its express wording, is whatever the courts wish it to be in the light of the particular circumstances." *Id.* at 127.

title, the cooperative remains, in theory, a non-profit enterprise operating for the benefit of and at the control and direction of its members.[97] There is nothing anomalous in such a relationship; the courts frequently have recognized, in cases not involving cooperatives, that an agent is legally capable of holding title.[98]

A second source of difficulty is the seemingly insistent demand by some courts that there must rest with the party who is said to have title, all the legal rights, powers, duties, and obligations incident to that

97. A few well-considered opinions recognize that even though the association has title to the products held by it for the benefit of the members, it does not thereby free itself from the limitations which are inherent in the cooperative type of business activity. In Rhodes v. Little Falls Dairy Co., 230 App. Div. 571, 245 N.Y.S. 432 (1930), the contract was clearly drafted in terms of purchase and sale. In holding for the member in his action against the association for an accounting of his proportionate share of the earnings (or "savings," as the cooperatives like to call it) the court said: "We do not agree . . . that the contract is the *ordinary* one of purchase and sale. *Even though title may have passed,* still the arrangement is for co-operative marketing. The status of the parties partakes of a trust or fiduciary character, and is not the simple relation of vendor and vendee. . . ." (emphasis added.) 245 N.Y.S. at 434, 435. See also Texas Farm Bureau Cotton Ass'n v. Stovall, 113 Tex. 273, 253 S.W. 1101 (1923), where the contract was similarly couched in terms of purchase and sale. In enjoining the member from selling to others, and in decreeing specific performance in favor of the association, the court indicated an awareness that the sale there contemplated between the member and the association was not *in pari materia* with the usual commercial sale. "We do not find it necessary," said the court, "to determine whether this contract was one of ordinary sale and purchase or an agency contract . . . [since] provisions in the contract show that it was the manifest purpose of the parties that the association should take title to the cotton delivered to it. . . ." The court concluded that "in view of the statute, and the express language of the agreement declaring the instrument a contract of sale and purchase, we must regard it as such a contract in so far as the parties here are concerned." *Id.* at 288-289, 253 S.W. at 1107. *Cf.* Mountain States Beet Growers Marketing Ass'n v. Monroe, 84 Colo. 300, 269 Pac. 886 (1928). Even the most eminent of the cooperative spokesmen admits that there is some basis to the proposition that the association retains its fiduciary obligations although the member has relinquished title. HULBERT, *op. cit. supra* note 86, at 125.

98. When a holder endorses and delivers a note or other commercial paper to an agent for the purpose of collection, legal title passes to the agent. Citizens' State Bank v. E. H. Tessman & Co., 121 Minn. 34, 140 N.W. 178 (1913). In case a commercial agent becomes insolvent with agency goods on hand, the courts have been disposed in many cases to hold the transaction a sale, giving rise to a general claim merely, and have denied the principal's claim for the specific return of the goods. Miller Rubber Co. v. Citizens' Trust & Savings Bank, 233 Fed. 488 (9th Cir. 1916). In non-cooperative tax cases, Steffen states that if any trend is to be found, it is that the transaction is termed a sale or an agency depending on which will reach the result that the property is taxable. STEFFEN, CASES ON AGENCY 65 (1933). It will be noted that this observation is opposed to the trend in cooperative cases, where, as the *Sugar Refining* and *Dark Tobacco Growers'* cases indicate, the transaction will be deemed a sale or an agency depending on which will result in non-taxibility to the association.

In comparing the trust relation to that of an agency, Seavey uses language apropos to the problem under discussion: "It is true that the trustee always holds a title and usually is not subject to the control of the *cestui,* while the agent is always subject to control and *usually* has no title. Where, however, an *agent acquires a title* or a trustee submits, by agreement, to control by the *cestui,* there is a double relationship of agent-trustee created." (emphasis added.) SEAVEY, STUDIES IN AGENCY 75 (1949). This would seem to be a clear acknowledgement that an agent may, and often does, hold title.

concept. However, there is no compelling necessity for this result. It has long been recognized that possession, one of the foremost attributes of title, could be reposed in one other than the title-holder. Similarly, all of the beneficial aspects which normally attach to the ownership of goods can be severed from the legal owner and vested in another. Consequently, title alone should not be considered determinative of all the legal consequences flowing from transactions involving goods. Rather, that concept may more accurately be viewed as embodying a group of severable rights and duties, not necessarily attached to any one person or rendered static by doctrinal considerations. Thus, parties to a marketing contract may agree that certain historical aspects of title should be in one party, while the remaining aspects should be in the other. In the absence of a strong public policy demanding a contrary result, courts should give effect to the arrangement. If there are policy considerations preventing effectuation of the relationship contemplated by the parties, enforcement should be denied on that ground, rather than by resort to a questionable application of the antiquated concept of title.

If title is not to be determinative of the result in a particular controversy, it is apparent that some other, more workable, criterion must be adopted.[99] The approach of the framers of the proposed Uniform Commercial Code offers a starting point and one which should receive serious consideration.[100] The Code, apparently recognizing that to say a certain result follows because title is in a given place is only to avoid the necessity for providing a reason for a supposedly desirable result, deliberately belittles title as a universal panacea for solution of the problems involved in the transfer of goods. Instead, the issues which traditionally have been sought to be resolved by the application of the title concept are dealt with specifically. For example, in considering the risk of loss, the Code provides that where the contract requires or authorizes the seller to ship the goods, "the risk of loss passes to the buyer when the goods are duly delivered to the carrier. . . ."[101] It will be noted that

99. Professor Seavey also demonstrates that the title concept should not be the controlling criterion in determining the character of the relationship of parties to commercial transactions. "The 'power of control' test has been used in the many cases distinguishing an agent, who sells goods for a principal, from a buyer who acts on his own account. The courts also sometimes uses the passage of title as a test, finding that if the transferee acquired title to the goods, he was a buyer rather than an agent. It would appear, however, that the state of the legal title may be unimportant or that, like the power of control, it may be merely a factor in determining whether the transferee is a fiduciary with a duty primarily of protecting the interests of the transferor in the transactions it is proposed that he shall perform or whether he is a person who has a contract of purchase, the subsequent transactions to be on his own account." *Id.* at 164.

100. In the following discussion, references to the Code are to the Sales Article, Article 2 of the Spring 1950 draft, as modified by the November 1951 Final Text Edition.

101. CODE, § 2-509.

there is no reference to the evasive, intangible test of title; rather, a more tangible criterion of delivery is substituted as a method of determining upon whom a loss falls. Other specific problems are similarly dealt with without resort to the title concept. However, since all issues likely to arise cannot be foreseen in advance, the Code contains a section to be applied only when the controversy involved has not been separately treated. This section provides that "unless otherwise expressly agreed, title passes to the buyer at the time and place at which the seller completes his performance with reference to the physical delivery of the goods. . . ."[102] This provision manifestly strives to make a concrete, determinable physical act the title-passing test. The purpose of this approach, in the words of the draftsmen of the Code:

> . . . is to avoid making practical issues between practical men turn upon the location of an intangible something, the passing of which no man can prove by evidence and to substitute for such abstractions proof of words and actions of a tangible character.[103]

The Code approach to problems historically solved by the title concept, if applied to cooperative marketing contracts, would appear to be a workable, effective method of resolving conflicting interests between associations and their members. For example, in the event a member's crop is fortuitously damaged or destroyed and the issue of risk of loss is presented,[104] it would seem desirable for the court resolving that issue to formulate, not some broad generalization concerning title, but rather a statement which takes into consideration the real issues involved, *viz.*, whether the member is to bear the loss alone.[105] Furthermore, the rule announced should be limited by the particular facts and problems which it is designed to accommodate. Therefore, with respect to unrelated questions such as the association's liability for a tax assessment, its standing to sue for conversion, or its ability to recover amounts previously paid, the court would be free to formulate another rule of decision which would again realistically reflect the considerations involved. Such individual treatment would do much toward

102. CODE, § 2-401.

103. CODE, Comment to § 2-101.

104. See Texas Certified Cottonseed Breeders' Ass'n v. Aldridge, 59 S.W.2d 320 (Tex. Civ. App. 1933), and Haarparinne v. Butter Hill Fruit Growers' Ass'n, 122 Me. 138, 119 Atl. 116 (1922), both discussed *supra* note 14 and accompanying text.

105. In proposing such an approach, no claim is laid to originality. Professor Latty, in his excellent study, has demonstrated that many cases which have been decided on the basis of title, could have better, and with much less confusion, been decided by approaching the specific legal consequences directly instead of working through title. See Latty, *supra* note 4, at 3.

eliminating the present obvious inconsistency of holding that title has passed for some purposes but not for others.[106] In addition, some semblance of certainty upon which the parties may rely in planning their transactions could be achieved.

Conclusion

The present significance of the cooperative marketing contract in terms of actual use is indeterminable. Perhaps the success and maturity of cooperatives renders unnecessary a binding legal device to insure adequate patronage. The relative infrequency of present litigation suggests that the offering of an indispensable service in the marketing of farm products will be availed of regardless of a pre-existing contractual responsibility. However, the re-occurrence of a serious economic depression as witnessed in the agricultural industry during the 1920's and '30's may again bring resort to entire output contracts in preservation of the cooperative method of marketing. .

In the final analysis, however, the marketing contract provides no substantial basis for insuring the success of the cooperative enterprise. Whenever the association ceases to perform the economic purpose which predicates its existence, the presence of marketing contracts cannot be relied upon to sustain its continuance. Further, prosecutions of recalcitrant producers is likely to be more harmful than beneficial with respect to public relations and internal harmony. The crucial question as to whether the agricultural cooperatives have justified the favoritism demonstrated by the courts and legislatures in the past and are in need of similar solicitude in the future is answerable in terms of political and economic factors beyond the scope of this discussion. The identical question pervades the succeeding inquiries into the antitrust laws and Federal income tax exemptions granted cooperative organizations.

106. See note 4, *supra.*

Part IV

Cooperatives and the Antitrust Laws

The foremost legal hazard to the organization and operation of agricultural cooperatives has been the common law and statutory prohibitions against monopolies and restraints of trade. Following many adverse decisions during the 1890's and in the early part of the twentieth century, the courts and legislatures have generally accepted the mere formation of agricultural cooperatives as lawful. Consequently, antitrust proceedings have been sporadic and usually unsuccessful since World War I. Nevertheless, the state and, more importantly, the federal antitrust laws continue as a potential check on the activities of both purchasing and marketing cooperatives. The extent and effectiveness of their application to cooperatives necessarily requires consideration in an appraisal of agricultural cooperation.[1]

The position of cooperatives in our economy is intimately connected with the difficulties posed by the long-term existence of surplus farm production. Shrinkage of the foreign market, a tremendous increase in output per unit of land due to mechanization and technological advances, changes in food consumption habits, and a decrease in the rate of growth of the United States' population have combined to make farm surpluses a recurrent problem, especially since the first World War.[2] Individual farmers, lacking adequate storage facilities and dependent upon a rapid turnover of harvested crops to meet operating expenses, occupy an extremely disadvantageous bargaining position in disposing of overabundant production to much larger, highly concentrated purchasers.[3] The consequent depression of farm prices, such as occurred during the 1920's, drastically reduces farmer income. In turn, decreased purchasing

1. Although the present discussion will consider only the limitations placed upon cooperative activities by the antitrust laws, it should be noted that cooperatives are frequently an effective means of fostering the over-all purpose of the antitrust laws, the checking of monopoly power. One of the most important factors in the rapid growth of agriculture cooperatives has been the desire to avoid the depressed prices resulting from markets controlled by one or a limited number of buyers. See BLANKERTZ, MARKETING COOPERATIVES 16 (1940); NOURSE, THE LEGAL STATUS OF AGRICULTURAL COOPERATION 12 (1927).

2. DEP'T OF AGRIC., ACHIEVING A BALANCED AGRICULTURE 6-17 (1934); EZEKIEL AND BEAN, ECONOMIC BASES FOR THE AGRICULTURAL ADJUSTMENT ACT 32-39 (Dep't of Agric. 1933); SCHOFF, A NATIONAL AGRICULTURAL POLICY c. 3 (1950).

3. EZEKIEL AND BEAN, *op. cit. supra* note 2, at 40; HERMANN AND WELDEN, DISTRIBUTION OF MILK BY FARMERS' COOPERATIVE ASSOCIATIONS 1 (F.C.A. CIRC. No. C-124, 1941); Note, 23 NOTRE DAME LAW. 110, 114 (1947).

power at the farm level is an important factor in disruptions of the entire economic system.[4]

The importance of agricultural prosperity both to the farmers and to the national economy has contributed to extensive private and governmental efforts to ameliorate the surplus and other farm problems. Among the earliest methods employed by farmers was collective action through marketing cooperatives. Elimination of middlemen, establishment of storage space, and cumulation of the bargaining power of individual members into a united front served to reduce the farmer's economic disadvantage.[5] Government action was initially limited to encouragement of cooperative associations. However, following the severe dislocations of the Great Depression, Government measures dealing directly with the surplus problem have multiplied.[6] The relation of cooperatives to the antitrust laws may well be influenced by future developments in the control of surpluses and the respective roles of Government and cooperatives therein.

STATE ANTITRUST LAWS

Marketing associations endeavor to assure control over a portion of the available supply of the commodity handled, sufficient to create effective bargaining power, by requiring that the member's full production be marketed through cooperative channels.[7] However, at one time, some state courts refused to enforce these full production agreements as contravening common law, statutory, or constitutional proscriptions against restraint of trade and monopolies.[8]

4. EZEKIEL AND BEAN, *op. cit. supra* note 2, at 8; SCHOFF, *op. cit. supra* note 2, c. 5. See, generally, MEANS, INDUSTRIAL PRICES AND THEIR RELATIVE INFLEXIBILITY, SEN. Doc. No. 13, 74th Cong., 1st Sess. (1935).

5. NOURSE, *op. cit. supra* note 1, at 7; Note, 23 NOTRE DAME LAW. 110 (1947). The failure of cooperatives to achieve significant success in improving farm conditions during the crisis years of the 1920's is noted in DEP'T OF AGRIC., ACHIEVING A BALANCED AGRICULTURE 16 (1934); EZEKIEL AND BEAN, *op. cit. supra* note 2, at 40-44.

6. For some descriptions of the farm program of the Federal Government and proposals for future action, see DEP'T OF AGRIC., ACHIEVING A BALANCED AGRICULTURE (1934); EZEKIEL AND BEAN, *op. cit. supra* note 2; BLAISDELL, GOVERNMENT AND AGRICULTURE c. III (1940); MCCUNE, THE FARM BLOC c. 2 (1943); SCHOOF, *op cit. supra* note 2; SCHULTZ, REDIRECTING FARM POLICY (1943); WALLACE, AMERICA MUST CHOOSE (World Affairs Pamphlet No. 3, 1934); Shields and Shulman, *Federal Price Support for Agricultural Commodities*, 34 IOWA L. REV. 188 (1949).

7. See PART III, pp. 404-405, *supra*.

8. Georgia Fruit Exchange v. Turnipseed, 9 Ala. App. 123, 62 So. 542 (1913); Burns v. Wray Farmers' Grain Co., 65 Colo. 425, 176 Pac. 487 (1918); Atchinson v. Colorado Wheat Growers' Ass'n, 77 Colo. 559, 238 Pac. 1117 (1925); Ford v. Chicago Milk Shippers' Ass'n, 155 Ill. 166, 39 N.E. 651 (1895); Ludewese v. Farmers' Mutual Co-Operative Co., 164 Iowa 197, 145 N.W. 475 (1914); Reeves v. Decorah Farmers' Co-Operative Society, 160 Iowa 194, 140 N.W. 844 (1913). *Contra*: *Ex parte* Baldwin

Statutory exemptions of cooperatives from the state antitrust laws were thwarted temporarily by the United States Supreme Court in *Connolly v. Union Sewer Pipe Co.*[9] Exception of agricultural cooperatives was considered an unreasonable classification violating the equal protection clause of the Fourteenth Amendment. However, the states continued to enact exclusionary legislation, and the *Connolly* case was soon distinguished[10] and eventually overruled.[11] Presently, all states have cooperative marketing statutes,[12] which usually authorize formation of marketing cooperatives and the execution of entire output contracts with members.[13] Under such succoring legislation, the intrastate activities of agricultural cooperatives have almost uniformly prevailed against attacks based on state antitrust laws.[14]

The trend of the statutes and decisions reflects a strong public policy favorable to agricultural cooperation. Supporting propositions are that cooperatives benefit the entire public by alleviating the depressed status of agriculture while merely affording farmers protection from unfair prices offered by organized purchasers. And, further, monopolization is impossible or has not occurred.[15] Hence, any restraints on competition are reasonable within the common law "rule of reason" or similar statutory exceptions. However, there are occasional intimations

Co. Producers Corp., 203 Ala. 345, 83 So. 69 (1919); Burley Tobacco Society v. Gillaspy, 51 Ind. App. 583, 100 N.E. 89 (1912); Commonwealth v. Hodges, 137 Ky. 233, 125 S.W. 689 (1910) (statute); Owen County Burley Tobacco Society v. Brumback, 128 Ky. 137, 107 S.W. 710 (1908) (statute); Castorland Milk and Cheese Co. v. Shantz, 179 N.Y. Supp. 13 (Sup. Ct. 1919); Phez Co. v. Salem Fruit Union, 103 Or. 514, 201 Pac. 222 (1921). For discussions of these and other similar cases, see HULBERT, LEGAL PHASES OF COOPERATIVE ASSOCIATIONS 199 (F.C.A. BULL. No. 50, 1942); NOURSE, *op. cit. supra* note 1, c. 14; Hanna, *Cooperative Associations and the Public*, 29 MICH. L. REV. 148, 159 (1930); Tobriner, *Cooperative Marketing and the Restraint of Trade*, 27 COL. L. REV. 827 (1927); Note, 27 VA. L. REV. 674 (1941).

9. 184 U.S. 540 (1902).

10. Liberty Warehouse Co. v. Burley Tobacco Growers Co-Operative Marketing Ass'n 276 U.S. 71 (1928); International Harvester Co. v. Missouri, 234 U.S. 199 (1914).

11. Tigner v. Texas, 310 U.S. 141 (1940).

12. Collected in Jensen, *The Bill of Rights of U.S. Cooperative Agriculture*, 20 ROCKY MT. L. REV. 181, 191 n.29 (1948). The prototype of the majority of these statutes is the Bingham Act, first enacted by Kentucky in 1922. KY. REV. STAT. c. 272 (1946).

13. NOURSE, *op. cit. supra* note 1, at 107; Note, 22 NOTRE DAME LAW. 414 (1947).

14. *E.g.*, Warren v. Alabama Farm Bureau Cotton Ass'n, 213 Ala. 61, 104 So. 264 (1925); Rifle Potato Growers Ass'n v. Smith, 78 Colo. 171, 240 Pac. 937 (1925); Clear Lake Cooperative Ass'n v. Wier, 200 Iowa 1293, 206 N.W. 297 (1925); Dark Tobacco Growers' Cooperative Ass'n v. Robertson, 84 Ind. App. 51, 150 N.E. 106 (1926); Tobacco Growers' Co-operative Ass'n v. Jones, 185 N.C. 265, 117 S.E. 174 (1923); List v. Burley Tobacco Growers Co-Operative Ass'n, 114 Ohio St. 361, 151 N.E. 471 (1926); Northern Wisconsin Cooperative Tobacco Pool v. Bekkedal, 182 Wis. 571, 197 N.W. 936 (1924). See NOURSE, *op. cit. supra note* 1, c. 15; Note, 27 VA. L. REV. 674, 676 (1941).

15. See Arndt, *The Law of California Co-Operative Marketing Associations*, 8 CALIF. L. REV. 281, 284 (1920); Hanna, *supra* note 8, at 165; Tobriner, *supra* note 8; Note, 27 VA. L. REV. 674, 676 (1941).

that, even under state permissive legislation, cooperative restraints are lawful only when "reasonable;"[16] that cooperatives may not restrict production or enhance prices beyond their "true value".[17] Yet, cooperative restrictions on production, although a relatively common practice,[18] have escaped judicial condemnation by the state courts within recent years. And, of course, the "true value" of a product, at least in monetary terms, would not seem to be capable of determination.

At the most, reservations as to "reasonableness" signify that the cooperatives may not engage in flagrantly predatory activities. In view of the general ineffectiveness of the state antitrust laws[19] and the present favorable attitude of the judiciary and legislatures, this should not prove to be a very stringent restriction. Illustrative of the present liberal approach is a recent Ohio case, *Superior Dairy, Inc. v. Stark County Milk Producers' Ass'n.*[20] The dairy sought a declaratory judgment that the defendant cooperative, comprising over 90% of the milk producers in the area, violated the state antitrust laws in refusing to sell milk to the plaintiff-distributor unless the plaintiff discontinued a discount system which it had established. A further allegation was that the cooperative intended to fix prices charged milk consumers in the area and to prevent competition in the sale of milk. A demurrer to the complaint was sustained on the ground that the Ohio Cooperative Agricultural Marketing Act,[21] broadly construed in the light of public policy, exempted the defendant's alleged activities from the state antitrust laws.

The *Superior Dairy* case indicates that marketing cooperatives may enforce retail price maintenance by refusals to sell.[22] Under state fair trade acts, consumer cooperatives may be required to maintain minimum retail prices.[23] These acts are normally applicable to cooperatives, and

16. *E.g., Denton v. Alabama Cotton Co-Operative Ass'n,* 30 Ala. App. 429, 7 So.2d 504 (1942); Starke County Milk Producers' Ass'n v. Tabeling, 129 Ohio 159, 194 N.E. 16 (1933).

17. *See* Tobacco Growers' Co-Operative Ass'n v. Jones, 185 N.C. 265, 280, 117 S.E. 174, 181 (1923); List v. Burley Tobacco Growers Co-Operative Ass'n, 114 Ohio St. 361, 151 N.E. 471, 476 (1926); Washington Cranberry Growers Ass'n v. Moore, 117 Wash. 430, 438, 201 Pac. 773, 776 (1921). See Keegan, *Power of Agricultural Co-Operative Associations to Limit Production,* 26 MICH. L. REV. 648 (1928).

18. Tobriner, *supra* note 8, at 835.

19. Comment, 43 ILL. L. REV. 205, 220 (1948); Legis., 32 COL. L. REV. 347, 364 (1932).

20. 89 Ohio App. 26, 100 N.E.2d 695 (1950).

21. OHIO GEN. CODE Ann. § 10186-1 *et seq.* (Cum. Supp. 1951).

22. *But Cf.* Hy-Grade Dairies v. Falls City Milk Producers Ass'n, 261 Ky. 25, 86 S.W. 2d 1046 (1935). *Compare* United States v. Colgate & Co., 250 U.S. 300 (1919), *with* F.T.C. v. Beech-Nut Packing Co., 257 U.S. 441 (1922). See Comment, 58 YALE L.J. 1121 (1948), for a general commentary on the legality of refusals to sell.

23. Bunn, *Consumers Co-Operatives and Price Fixing Laws,* 40 MICH. L. REV. 165, 171 (1941). See, on the fair trade laws generally, McLaughlin, *Fair Trade Acts,* 86

a special exemption by a Wisconsin statute was declared unconstitutional by the state court.[24] However, patronage refunds should not be condemned under the fair trade laws since refunds neither constitute price cutting on any particular item nor threaten the reputation of any product.[25]

The practices of cooperatives are in certain instances closely regulated by state control measures, particularly in the milk industry.[26] When a cooperative is operating under a valid state marketing order, or other regulatory procedures, the state antitrust laws are inapplicable. And if the state order does not conflict with the operation of the Federal Agricultural Marketing Act,[27] or is not otherwise invalid, cooperatives acting in conformity with such order would not be subject to the federal antitrust laws, which do not encompass state action.[28]

Federal Antitrust Laws

The Sherman Antitrust Act[29] has been in effect for approximately 60 years, yet its application to agricultural cooperatives remains uncertain. There is considerable doubt that the Act was originally intended to apply to other than corporations and trusts engaging in interstate commerce.[30] However, an early construction included labor unions,[31] and cooperatives apparently would also be brought within the ambit of the Act. Apprehensive that the mere formation of a cooperative would be considered a combination and conspiracy in restraint of

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U. of Pa. L. Rev. 803 (1938); Shulman, *The Fair Trade Acts and the Law of Restrictive Covenants*, 49 Yale L.J. 607 (1940); Comment, 61 Yale L.J. 381 (1952).

24. Weco Products Co. v. Reed Drug Co., 225 Wis. 474, 274 N.W. 426 (1937).

25. Bunn, *supra* note 23, at 173. In accord are those cases holding that giving, with each sale, trade receipt coupons which can be used later on the purchase price of any item is permissible under the fair trade acts. Food & Grocery Bureau v. Garfield, 20 Cal. 2d 228, 125 P.2d 3 (1942); Weco Products v. Mid-City Cut Rate Drug Stores, 55 Cal. App.2d 684, 131 P.2d 856 (1943); Bristol-Myers Co. v. Lit Bros., Inc., 336 Pa. 81, 6 A.2d 843 (1939). *Contra*: Bristol-Myers Co. v. Picker, 302 N.Y. 61, 96 N.E.2d 177 (1950). *Compare* Sperry & Hutchison Co. v. McBride, 307 Mass. 408, 30 N.E.2d 269 (1940), *with* Ed. Schuster & Co. v. Steffes, 237 Wis. 41, 295 N.W. 737 (1941).

26. Cadwallader, *Government and Its Relationship to Price Standards in the Milk Industry*, 22 Minn. L. Rev. 789, 809 (1938).

27. See note 67 *infra* and accompanying text.

28. Parker v. Brown, 317 U.S. 341 (1942). Of course, a state may not insulate cooperative activity from the federal antitrust laws simply by means of permissive legislation. The state itself must provide the machinery of control to come within the *Parker v. Brown* decision. *Id.* at 351.

29. 26 Stat. 209 (1890), as amended, 50 Stat. 693 (1937), 15 U.S.C. §§ 1-7 (1946).

30. Schmidt, *The Application of the Antitrust Laws to Labor: A New Era*, 19 Tex. L. Rev. 256 (1941) surveys the controversy over the intended scope of the Sherman Act, with particular reference to labor unions.

31. Loewe v. Lawlor, 208 U.S. 274 (1908); Schmidt, *supra* note 30.

trade, as some state courts had already held,[32] cooperative associations pressed for legislative exemptions.

These efforts culminated in the Clayton Act,[33] enacted in 1914, and the passage of the Capper-Volstead Act[34] in 1922. Section 6 of the Clayton Act provides that the federal antitrust laws are not to forbid the existence or operation of non-stock, non-profit labor, agricultural, or horticultural organizations, and are not to restrain the lawful effectuation of their legitimate objects; nor are such organizations to be considered illegal combinations or conspiracies in restraint of trade.[35] The Capper-Volstead Act authorizes the organization of marketing cooperatives on a capital stock basis, and sanctions common marketing agencies and execution of necessary contracts and agreements.[36]

Uncertainty as to the precise scope of the exemption afforded cooperatives by the Clayton and Capper-Volstead Acts was partially resolved by *United States v. Borden Co.*,[37] the only relevant Supreme Court decision. A criminal action was instituted charging a combination and conspiracy among a milk cooperative and its officials, milk distributors, a labor union, and city officials to fix prices and control production in the Chicago fluid milk market. Reversing the conclusion of the lower court that agriculture cooperatives were absolutely exempt from the antitrust laws, the Supreme Court held that such an organization could violate the Sherman Act by combining and conspiring with others.

However, there is still no authoritative answer to the question whether a cooperative association acting alone or in concert with other cooperatives is entirely without the provisions of the Sherman Act. The *Borden* case is not decisive on this proposition. The opinion was expressly limited to the situation where the cooperative conspires with others. In the somewhat analogous area of the application of the Sherman Act to labor unions, a union is not subject to the Act when it proceeds independently,[38] even though conspiracy with non-union parties

32. See cases cited in note 8 *supra*.
33. 38 STAT. 730 (1914), as amended, 15 U.S.C. § 12 *et seq.* (1946).
34. 42 STAT. 388 (1922), 7 U.S.C. §§ 291-292 (1946).
35. 38 STAT. 731 (1914), 15 U.S.C. § 17 (1946).
36. 42 STAT. 388 (1922), 7 U.S.C. § 291 (1946). The Act requires qualifying associations to conform to traditional cooperative principles. The association must be operated for the mutual benefit of members, and either each member must be given one vote or dividends on stock and membership capital must be limited to 8 per cent yearly. In addition, the cooperatives may not deal with the products of nonmembers to a greater extent than with the products of members.
37. 308 U.S. 188 (1939). For a popular account of the background of this case, see *Milk in Chicago*, Fortune Magazine 80 (Nov. 1939).
38. United States v. Hutcheson, 312 U.S. 219 (1941).

is actionable.[39] Thus, in *United States v. Dairy Cooperative Ass'n,*[40] a Federal District Court refused "to scuttle the plain language of the Clayton Act, as antilabor courts scuttled the labor provisions of the same act," and held that monopolistic conduct by a cooperative was not illegal when other parties were not involved. Some support for this position can be found in the legislative history of the Clayton and Capper-Volstead Acts,[41] although there are equally persuasive statements to the contrary.[42]

A more powerful argument for a broad construction of the cooperative exemption is the divergence between government policy towards competition in agriculture as compared with the policy to encourage and protect competition contemplated by the antitrust laws. The maintenance of effective competition, the nexus of antitrust policy,[43] is not the principal consideration in the present governmental approach to agricultural problems. Rather, the emphasis increasingly has been to control and channelize competition among producers of agricultural commodities. The government has permitted, or actually enforced, limitations on production and has controlled prices of certain farm products under the Agricultural Marketing Act.[44] And it has sought to establish floors under the prices received by farmers by means of the parity formula.[45] From this, it might be persuasively contended that the Clayton and Capper-Volstead provisions were merely the first step of a government program to lessen rather than promote competition among agricultural producers and to procure higher prices for farmers rather than lower prices for consumers; consequently, the antitrust exemptions should be broadly construed to prevent the agricultural program from being crippled by the conflicting purposes of the antitrust laws.

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39. Allen Bradley Co. v. Local Union No. 3, I.B.E.W., 325 U.S. 797 (1945).

40. 49 F. Supp. 475 (D. Ore. 1943). *See* Farmers Cooperative Co. v. Birmingham, 86 F. Supp. 201, 229 (N.D. Iowa 1949); United States v. Elm Spring Farm, 38 F. Supp. 508, 511 (D. Mass. 1941). See Jensen, *supra* note 12, at 189.

41. *E.g., Speech of Senator Kellog,* 62 CONG. REC. 2049 (1922); *Speech of Senator Fletcher,* 62 CONG. REC. 2107 (1922). See Kovner, *The Legislative History of Section 6 of the Clayton Act,* 47 COL. L. REV. 749 (1947).

42. *E.g., Speech of Representative Volstead,* 61 CONG. REC. 1033 (1921). See Hanna, *Antitrust Immunities of Cooperative Associations,* 13 LAW & CONTEMP. PROB. 488, 493 (1948).

43. *See* Apex Hosiery Co. v. Leader, 310 U.S. 469, 490-500 (1939).

44. See note 67 *infra* and accompanying text.

45. Agricultural Adjustment Act of 1938, 52 STAT. 31 (1938), as amended, 7 U.S.C. § 1282 *et seq.* (Supp. 1951). This statute also provides for the governmental promulgation of marketing quotas for certain crops, including tobacco, wheat, and cotton. For further information on governmental farm legislation and policies, see BLAISDELL, *op. cit. supra* note 6, especially c. III; DEERING, USDA MANAGER OF AMERICAN AGRICULTURE (1945); LARSON, AGRICULTURAL MARKETING c. 24 (1951); Shields and Shulman, *supra* note 6.

Nevertheless, an equally convincing argument can be advanced that cooperatives, acting alone, are not totally excluded from the operation of the Sherman Act. Section 6 of the Clayton Act appears to be primarily concerned with removing the threat that the mere existence of a cooperative would be an illegal restraint of competition, and speaks of "lawfully carrying out the legitimate objects thereof." Relying upon this emphasis on legality, the Court soon construed Section 6 to leave labor unions, as organizations, subject to all the prohibitions of the Sherman Act.[46] Later decisions virtually removing unions from the restrictions of the Act were predicated on an interaction of the Norris-LaGuardia Act[47] with the Clayton Act Section 6.[48] Of course, the Norris-LaGuardia Act is not concerned with agricultural cooperatives. The Capper-Volstead Act merely extended the privilege of organizing cooperatives free from the restraints of the antitrust laws to those having capital stock and paying dividends and does not expressly purport to give a complete immunity.

Although governmental farm policy has frequently fostered controlled prices and production of some agricultural products, this control has been under the direction or supervision of government agencies. As such, it affords little justification for allowing *private* groups, responsible to no one except their own members, to exercise such powers with impunity. There would seem to be a considerable public interest in the maintenance of an abundant supply of food, and other vital farm commodities, at reasonable prices. Some public restraint should be maintained over private groups controlling, or having the potentiality to control, this fundamental segment of our economy.

Should a narrow construction of the cooperative exemption be accepted, farmers would be placed nearly on a par with corporations under the antitrust laws. Association of farmers into cooperative groups for joint action would not be *per se* illegal. Thus, farmers could mitigate the handicap of competing among themselves in a situation of almost perfect competition while buying and selling in markets often under monopoly, oligopoly, or lesser degrees of control. Yet, cooperative

46. Duplex Printing Press Co. v. Deering, 254 U.S. 443 (1921). See GREGORY, LABOR AND THE LAW c. 8-9 (Rev. ed. 1949). United States v. King, 229 Fed. 275 (D. Mass. 1915), 250 Fed. 908 (D. Mass. 1916), the only important federal case arising between the enactment of the Clayton and Capper-Volstead Acts, held that a potato cooperative which blacklisted and boycotted certain nonmembers engaged in an illegal restraint of trade under the Sherman Act. The cooperative was not exempted by the Clayton Act Section 6 since these activities were not "lawful."

47. 47 STAT. 70 (1932), 29 U.S.C. § 101 *et seq.* (1946).

48. United States v. Hutcheson, 312 U.S. 219 (1941). See Gregory, *The New Sherman-Clayton-Norris-LaGuardia Act*, 8 U. OF CHI. L. REV. 503 (1941); Schmidt, *supra* note 30, at 287.

groups, as entities, could not combine or conspire with others in restraint of trade in violation of Section 1 of the Sherman Act, nor could they legally acquire monopoly control over the market, alone or in combination with others, in violation of Section 2 of the Act.[49]

Collective action between two or more cooperatives could constitute a "combination or conspiracy with others" within the meaning of the *Borden* case, and thus be non-exempt if in restraint of trade. However, federated cooperatives are so tightly interwoven and centrally controlled that they are in fact, as well as theory, one large cooperative.[50] Hence, they should come within the exemptions which the law affords individual cooperatives, and not be considered a loose combination of their respective units. The Capper-Volstead Act expressly legalizes common marketing agents for cooperative associations coming under the Act.[51] In addition, the Cooperative Marketing Act authorizes the acquisition, interpretation, and exchange of past, present, and future crop and market statistics among associations and federations of marketing cooperatives.[52] These provisions seemingly neutralize those cases finding trade associations to be in violation of the Sherman or Federal Trade Commission Acts to the extent that such cases were based on the exchange of detailed pricing and production information and the consequent pressure to conform, inherent in the exchange.[53] But, more concrete efforts to assure adherence to uniform prices would not necessarily be legalized.

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49. Some excellent articles on the present status of the antitrust laws and the policies influencing their application are: Adelman, *Integration and Anti-trust Policy*, 61 HARV. L. REV. 27 (1949); Chadwell and McLaren, *The Current Status of the Anti-trust Laws*, (1950) U. OF ILL. L. FORUM 491; Fuchs, *Economic Considerations in the Enforcement of the Antitrust Laws of the United States*, 34 MINN. L. REV. 210 (1950); Levi, *The Antitrust Laws and Monopoly*, 14 U. OF CHI. L. REV. 153 (1947); Peppin, *Price-Fixing Agreements under the Sherman Anti-Trust Law*, 28 CALIF. L. REV. 667 (1940); Rostow, *Monopoly under the Sherman Act: Power or Purpose*, 43 ILL. L. REV. 745 (1949); Rostow, *The New Sherman Act: A Positive Instrument of Progress*, 14 U. OF CHI. L. REV. 567 (1947); Wood, *The Supreme Court and a Changing Antitrust Concept*, 97 U. OF PA. L. REV. 309 (1949).

50. See PART I, p. 364, *infra*.

51. 42 STAT. 388 (1922), 7 U.S.C. § 291 (1946).

52. 44 STAT. 803 (1926), 7 U.S.C. § 455 (1946).

53. United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940); The Sugar Institute, Inc. v. United States, 297 U.S. 553 (1936); United States v. Trenton Potteries Co., 273 U.S. 392 (1927); United States v. American Linseed Oil Co., 262 U.S. 371 (1923); American Column & Lumber Co. v. United States, 257 U.S. 377 (1921). See also, Appalachian Coals, Inc. v. United States, 288 U.S. 344 (1933); Maple Flooring Manufacturers Ass'n v. United States, 268 U.S. 563 (1925); Tag Manufacturers Institute v. F.T.C., 174 F.2d 452 (1st Cir. 1949). The activities of trade associations in assembling and distributing market statistics were important factors in these cases only when the information enabled the association members to fix prices or to engage in imperfect competition by making it possible for each member to discern what his competitors were doing, and the probable effect of his actions upon competitors and upon the market. The particularity of pricing and production information, whether

Even should the cooperative exemption be strictly construed, the control of the market necessary to constitute illegal monopolization is uncertain. The *Alcoa* case[54] found that 90% control of aluminum ingot production was monopolistic and there were dicta that two-thirds control would probably be sufficient; at least where there was a general intent to monopolize.[55] Accepting the rationale of the *Alcoa* opinion, that a monopoly is illegal *per se* because it has the power to control prices, which is illegal *per se,* an organization that acquires and exercises power to substantially affect or fix prices in the market monopolizes in violation of Section 2.[56] Where there is a specific intent to monopolize, control over a much smaller percentage of the market may comprise an illegal attempt to monopolize.[57] Furthermore, the illegal monopoly or restraint may be of an identifiable local market.[58]

Monopoly control over a market by a cooperative is improbable, whatever the lower limits of monopolization may prove to be, where a crop or livestock is grown over a large area and marketed nationally. The large number of individual farmers involved, together with the relative ease of entry and egress from the market, would make effective control over a considerable period of time nearly impossible.[59] However, cooperatives have and do exercise up to 100% control over the production and sale of certain commodities, which are either grown in a limited, contiguous geographic area, such as cranberries and citrus fruit, or have primarily a localized market, as the fluid milk market.[60]

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knowledge of past practices or future plans was disseminated, the availability of the statistics to outsiders, and the pressure, both moral and legal, brought on members to refrain from price-cutting are relevant factors having varying weight in the decision of the cases. See, generally, Donovan, *Trade Association Administration and Protection under the Antitrust and Other Laws,* 30 GEO. L.J. 17, 149 (1941); Hale, *Agreements Among Competitors: Incidental and Reasonable Restraints of Trade,* 33 MINN. L. REV. 331 (1949).

54. United States v. Aluminum Co. of America, 148 F.2d 416 (2d Cir. 1945).

55. *Id.* at 424. The court also stated that control of one-third of the market would definitely not be monopolistic. This dictum has been criticized as "unrealistic." Fuchs, *supra* note 49, at 217. See Handler, *Industrial Mergers and the Anti-Trust Laws,* 32 COL. L. REV. 179 (1932), for a description of difficulties encountered in the earlier cases in determining the percentage of market control necessary for a Section 2 violation.

56. United States v. Aluminum Co. of America, 148 F.2d 416, 427 (2d Cir. 1945). See Levi, *supra* note 49, at 175.

57. United States v. Yellow Cab Co., 332 U.S. 218 (1947), 338 U.S. 338 (1949); United States v. Columbia Steel Co., 334 U.S. 495 (1948).

58. Lorain Journal Co. v. United States, 72 S.Ct. 181 (1951); Indiana Farmer's Guide Pub. Co. v. Prairie Farmer Pub. Co., 293 U.S. 268 (1934).

59. NOURSE, *op. cit. supra* note 1, at 428; Tobriner, *supra* note 8, at 828; SEN. REP. No. 236, 67th Cong., 1st Sess. 2 (1921).

60. SEN. REP. No. 236, 67th Cong., 1st Sess. 2 (1921). The percentage of cooperative control in any particular product or area is subject to considerable variation from year to year, depending upon membership, productivity of members as compared with nonmembers, and other variables. Moreover, there is often intensive inter-product compe-

If the number of cases is any criterion, the most pressing antitrust problems involving agricultural cooperatives arise from the marketing of fluid milk. The seasonal fluctuations of supply, without commensurate variations in demand, the perishable quality of the product, and the geographically limited market create potentially ruinous competitive situations.[61] Such conditions are highly conducive to cooperation, integration, and other practices designed to limit competition and maintain profitable prices, and have contributed to almost nation-wide adoption of classified price plans for the sale of fluid milk from producers to handlers.

Essentially, the classified price plan achieves an artificial differentiation in milk prices dependent upon use. A substantially higher price is paid for Class I milk, that marketed as fluid milk to ultimate consumers, than for Class II milk, which is processed into manufactured dairy products.[62] The milk producers receive a "blend" price based upon an average of fluid and manufactured milk sales over a specified period, irrespective of the actual utilization of their particular shipments of milk.

The maintenance of this rigid price differential requires a high degree of cooperation by producers, handlers, and distributors, or alternatively monopoly control at one stage of the marketing process.

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tition among farm commodities and competition from foreign sources is frequently a potent factor.

No available single source for complete statistics on the control exercised by cooperatives over the various agricultural commodities is known. The following figures, while approximations, are thought to be somewhat representative. They are illustrative only and are not intended to be inclusive of all instances of considerable market control; nor is it suggested that a monopoly necessarily exists. Unless otherwise indicated, statistics are taken or computed from the Annual Report or other publication of the organization.

California Walnut Growers Ass'n—85% of shipments of in-shell walnuts during 1950. American Cranberry Exchange—53% of 1950 cranberry crop. Maine Potato Growers, Inc.—26.5% of 1948-49 shipments of seed potatoes. California Fruit Growers Exchange —74% of California-Arizona citrus fruit (43.4% of total U.S. production) (reported in GARDNER AND MCKAY, THE CALIFORNIA FRUIT GROWERS EXCHANGE SYSTEM 7, 14 [F. C.A. CIRC. No. C-135, 1950]). California Almond Growers Ass'n—70% of 1946-47 crop (reported in 15 News for Farmer Cooperatives 12 [Aug. 1948]). FTC, REPORT ON THE SALE AND DISTRIBUTION OF MILK PRODUCTS (1935-37) contains the findings by the Federal Trade Commission investigation of several large milk marketing areas. The percentage of milk production controlled by a single cooperative ranged up to the 85% supplied Minneapolis and St. Paul by the Twin City Producers Ass'n. See Cadwallader, *supra* note 26, at 818-821.

Monopoly control by purchasing cooperatives is also possible, especially when they have manufacturing facilities. However, as yet they do a relatively small amount of business when compared with similar non-cooperative enterprises. See Part I, pp. 356-358, *infra*. Purchasing associations do not come within the provision of the Capper-Volstead Act, which suggests that the antitrust laws may be more broadly applicable to such cooperatives.

61. Cadwallader, *supra* note 26; Hanna, *Cooperative Milk Marketing and Restraint of Trade*, 23 KY. L.J. 217, 235 (1935).

62. Under some plans, there are three classes rather than two. See the articles cited in note 61 *supra* for a more detailed exposition of the operation of these plans. Also, see *Let 'em Drink Grade "A"*, Fortune Magazine 83 (Nov. 1939).

The role of cooperatives varies from market to market. They may function only as a bargaining agency for their member producers, or in addition perform milk collection duties. Some cooperatives extend their functions to wholesale or retail distribution or both and provide facilities for manufacture of surplus milk.[63] Occasionally, they are the overall policing agency for the market. Since the cooperatives would ordinarily be forced to collaborate with other parties, there is little doubt that their activities fall within the coverage of the antitrust laws, where they have not been governmentally sanctioned. And the maintenance of a classified price plan undoubtedly can be an illegal restraint of trade. Combinations and conspiracies to fix prices are *per se* violations of the Sherman Act.[64]

Despite the apparent vulnerability of the classified price plan, and of the cooperatives supporting it, the system has continued to flourish. Partially accounting for this paradox are the relatively small-scale restraints resulting, the inadequate personnel of the Department of Justice Antitrust Division, interstate-intrastate commerce difficulties, the fact that strong competition often remains with entry into the field relatively easy, and a general recognition that unrestrained competition could be particularly ruinous.[65] Moreover, a recent proceeding against an association controlling 80% of the milk produced in the Washington, D. C. area ended in dismissal, the Circuit Court indicating that any restraint on trade by the classified price plan accompanied by contracts requiring distributors to obtain their full milk requirements from the association was reasonable under the circumstances.[66]

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63. Receiving associations collect the milk from producers, usually in outlying parts of large markets, provide necessary physical equipment for cooling, shipment, etc., and sell to the most favorable sales outlet. Bargaining associations do not actually handle the milk, but merely procure a sales outlet for each member, who ship directly to the purchasers. Distributing cooperatives take possession of the milk and dispose of it in the wholesale and retail markets. Processing cooperatives convert the milk into butter, cheese, ice cream, and other dairy products. Varying combinations of these functions in one cooperative association are frequent. See FETROW AND ELSWORTH, AGRICULTURAL COOPERATION IN THE UNITED STATES 45-60 (F.C.A. BULL. No. 54, 1947); HERMANN AND WELDEN, *op. cit. supra* note 3.

64. United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940); United States v. Trenton Potteries Co., 273 U.S. 392 (1927). But see Maryland & Virginia Milk Producers Ass'n v. United States, 193 F.2d 907 (D.C. Cir. 1951), commented upon in note 66 *infra*.

65. Investigation of the Milk Industry (Detroit, Michigan, Area), Dep't of Justice Public Statement, Oct. 15, 1938; Investigation of Milk and Dairy Products Industries (New York City), Dep't of Justice Public Statement, June 3, 1940.

66. Maryland & Virginia Milk Producers Ass'n v. United States, 193 F.2d 907 (D.C. Cir. 1951). The actual holding of the case, a criminal prosecution, was that the necessary intent to suppress and eliminate competition by means of full supply contracts providing for classification-utilization pricing had not been proven beyond a reasonable doubt. However, the court appeared to be greatly impressed by testimony that the "classified

The major support sustaining private regulation of the local milk sheds, however, is the promulgation of federal marketing agreements and orders under the Agricultural Marketing Act of 1937.[67] After proper notice and hearing, the Secretary of Agriculture may enter into marketing agreements with processors, producers, associations of producers, and others engaged in the handling of any agricultural commodity in interstate commerce.[68] Moreover, he may issue marketing orders, either in conjunction with or without a marketing agreement, governing the production and distribution in interstate commerce of certain farm commodities, including milk, tobacco, and certain fruits and vegetables.[69] Express permission is granted for inclusion in such orders of the classified system of milk pricing with payment of blended prices to producers.[70] The Secretary may select a common agency to administer the marketing order[71] and he may mediate disputes which arise.[72]

Marketing agreements formulated under the Act are specifically exempted from the antitrust laws,[73] as are arbitration awards.[74] And, of course, practices prescribed by the government marketing orders are not subject to the antitrust laws.[75] However, private restrictive practices cannot be assured judicial approval merely because they could be brought under a federal marketing order, or had previously existed under an expired order.[76] Furthermore, only the prices paid to producers

use pricing system is economically sound, [and] in practice it is responsive to competition and levels off to the same result in money as does the flat price." *Id.* at 916. The court seemingly thought immaterial the fact that an artificial differentiation in the prices charged various users was maintained so long as not shown to have been "wielded to the disadvantage and detriment of the public." *Id.* at 916. This despite the well established doctrine that price fixing is illegal *per se.* See cases cited in note 64 *supra.* For further comment on the requirements contracts aspect of this case, see p. 445 *infra.*

67. 50 STAT. 246 (1937), 7 U.S.C. § 601 *et seq.* (1946).

68. 50 STAT. 246 (1937), as amended, 7 U.S.C. § 608(b) (Supp. 1951). For a description of marketing agreements formulated under a similar statute, see NOURSE, MARKETING AGREEMENTS UNDER THE AAA (1935).

69. 50 STAT. 246 (1937), as amended, 7 U.S.C. § 608(c) (Supp. 1951). It is interesting to note that the products which may come under the marketing orders include almost all those in which monopoly control by a cooperative has been achieved or affords much possibility of achievement. See note 60 *supra* and text.

70. *Id.* § 608(c)(5). For products other than milk, the orders may limit the production of the commodity that may be marketed during any given period. *Id.* § 608(c)(6).

71. *Id.* § 608(c)(7)(C).

72. *Id.* § 671(a).

73. *Id.* § 608(b).

74. *Id.* § 671(d).

75. United States v. Rock Royal Cooperative, 307 U.S. 533, 560 (1939): "If the Act and Order are otherwise valid, the fact that their effect would be to give cooperatives a monopoly of the market would not violate the Sherman Act . . . ."

76. United States v. Borden Co., 308 U.S. 188, 198 (1939); United States v. Maryland & Virginia Milk Producers Ass'n, 179 F.2d 426 (D.C. Cir. 1949).

may be fixed under the marketing orders. If the machinery provided to administer the order is also utilized to fix prices charged consumers, there may be an unlawful conspiracy.[77]

The promulgation of federal marketing orders is usually instigated by producers in the area,[78] and the order must be approved by two-thirds of the producers or by producers of two-thirds of the volume of the product in the area during a representative period.[79] Approval by a cooperative association is deemed to be approval by each of its members in determining the percentage of producers favoring adoption of the order.[80] Frequently, the order issued is modeled after a presently existing private marketing plan developed under the ægis of cooperative associations operating in the market.[81] The combination of these factors presents the possibility of abuse. Certain of the orders are said to favor large producers and cooperatives which have sufficient numbers or volume to overcome the opposition of small groups who may be discriminatorily affected.[82] As a special advocate within the structure of the government for farming interests, the Department of Agriculture cannot be expected to assume an impartial attitude in determining the fairness to all groups of its control programs. But, it should be alert to scotch inequities in the application of controls to the individual members of the group regulated. Further, the Department is the sole public agency, short of Congress, with authority to determine and rectify misuses of the marketing order system. As such, consideration should be given not only to the welfare of producers as a whole, but also to the interests of consumers and others that may be materially affected.

The Secretary of Agriculture is empowered to issue cease and desist orders against cooperatives qualifying under the Capper-Volstead Act when an association "monopolizes or restrains trade in interstate or foreign commerce to such an extent that the price of any agricultural

77. 85 F. Supp. 622 (S.D. Ohio 1949), *aff'd per curiam*, 188 F.2d 959 (6th Cir. 1951).

78. See HOLMAN, ACTIVITIES OF THE NATIONAL MILK PRODUCERS FEDERATION 4 (Educational Series No. 42, 1952). Mr. Holman, Secretary of the Federation, attributes the disappearance of dealer resistance to the formation of milk cooperatives to the practice of the cooperatives in applying for and securing federal marketing orders. He also states that 44 milk marketing areas were operating under such orders at the end of 1951, and that the tendency has been to expand the area covered by each order. *Id.* at 22. The attractiveness of Federal Marketing Orders to milk cooperatives may be lessened by the recent decision in Brannan v. Stark, 72 S.Ct. 433 (1952). The Supreme Court held that provisions in the Boston area Order permitting payment to cooperatives from the equalization pool for services rendered only to members were not warranted by the statute.

79. 49 STAT. 753 (1935), as amended, 7 U.S.C. § 608(c)(8)-(9) (Supp. 1951).

80. *Id.* § 608(c)(12).

81. HOLMAN, *op. cit. supra* note 78, at 22.

82. See Note, 17 N.Y.U.L.Q. 86 (1939).

product is unduly enhanced by reason thereof."[83] Apparently, this power has been rarely if ever exercised, and is co-existent with the duty of the Attorney-General to proceed against antitrust violations by cooperatives.[84]

Certain other statutes, more specialized than the Sherman Act, may also be applicable to cooperatives. Section 1 of the Robinson-Patman Act,[85] amending Section 2 of the Clayton Act, in general prohibits price discrimination among different purchasers of commodities of like grade and quality not justified by cost differentials where the effect may be to substantially lessen competition or tend to create a monopoly.[86] There appears to be no basis for treating the cooperative entity, when acting as a buyer or seller, differently from other buyers and sellers in the market. Furthermore, agricultural cooperatives are not included in the specific exemptions from the Act, other than a provision that the Act is not to prevent a cooperative association from returning to its members net earnings in proportion to their sales to or purchases from the association.[87] Therefore, marketing cooperatives are precluded from charging such discriminatory prices, while purchasing cooperatives are forbidden to knowingly induce or receive them, where monopoly or reduction of competition is threatened.[88]

Section 3 of the Clayton Act makes unlawful leases, sales or contracts for sale of commodities on the condition, agreement, or understanding that the purchaser or lessee will not deal in the goods of competitors of the seller or lessor, where the effect may be to substantially lessen competition or tend to create a monoply.[89] The application of Section 3 to cooperatives may well depend upon the scope given to the Clayton and Capper-Volstead exemptions. Certainly, contracts with members requiring sale of their entire production through or to the cooperative are unaffected.[90] However, marketing cooperative contracts

83. 42 STAT. 388 (1922), 7 U.S.C. § 292 (1946).

84. United States v. Borden Co., 308 U.S. 188, 204 (1939).

85. 49 STAT. 1526 (1936), as amended, 52 STAT. 446 (1938), 15 U.S.C. § 13 (1946).

86. See Fuchs, *The Requirement of Exactness in the Justification of Price and Service Differentials Under the Robinson-Patman Act*, 30 TEX. L. REV. 1 (1951), for an excellent commentary on some Robinson-Patman Act problems. See also, Dresbach, *Cooperatives and Some Aspects of the Robinson-Patman Act* in COOPERATIVE CORPORATE ASSOCIATION LAW-1950, 545 (Jensen ed. 1950).

87. 49 STAT. 1528 (1936), 15 U.S.C. § 13(b) (1946). See Bunn, *supra* note 23, at 171.

88. Quality Bakers of America v. F.T.C., 114 F.2d 393 (1st Cir. 1940); Rathke v. Yakima Valley Grape Growers Ass'n, 30 Wash.2d 486, 192 F.2d 349 (1948). These cases are wholly in accord with the legislative intent. See, *e.g., Remarks of Representative Utterback on the Conference Report*, 80 CONG. REC. 9419 (1936).

89. 38 STAT. 731 (1914), 15 U.S.C. § 14 (1946).

90. These contracts only require the member-vendor to sell all his production to the cooperative, they do not limit the cooperative-vendee in its dealings with competitors,

requiring purchasers to obtain their full supply from the association are more vulnerable.

In *United States v. Maryland & Virginia Milk Producers Ass'n*,[91] an indictment of a cooperative association, consisting of producers of 80% of the milk sold in the Washington, D. C., area, seven corporate milk distributors, and other individuals, was sustained against a motion to dismiss. The complaint alleged that contracts between the association and the distributors provided for the classified-utilization system of milk pricing[92] and bound each distributor to purchase its full requirements from member producers assigned to it by the association as part of a conspiracy to eliminate and suppress competition in restraint of trade under Section 3 of the Sherman Act.[93] However, on appeal from the actual trial of the case, during which the defendant distributors were reduced to three handling 13.8% of the milk sales in the area, the Circuit Court held that the full supply contracts were not illegal in the absence of proof of a purpose to eliminate and suppress competition.[94] The opinion, written by the dissenting judge in the first case, gave a questionable interpretation to the previous decision[95] and apparently was influenced considerably by the economic usefulness of requirements contracts in the milk industry.

The validity of this decision is doubtful, even as to the Sherman Act.[96] But assuming that cooperative requirements contracts are without the coverage of the Sherman Act when reasonable, they may still be proscribed by Section 3 of the Clayton Act when a substantial part of the market is affected. The Supreme Court held such contracts to be illegal *per se* in *Standard Oil Co. of California v. United States*,[97] dispensing with proof of unreasonableness.[98]

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which would be necessary to come within the language of the Section. Moreover, such contracts are expressly authorized by the Capper-Volstead Act.

91. 179 F.2d 426 (D.C. Cir. 1949).

92. See note 66 *supra* for discussion of this aspect of the case.

93. 26 STAT. 209 (1890), 15 U.S.C. § 3 (1946). This Section applies the provisions of Section 1 to restraints on trade in or with the District of Columbia.

94. Maryland & Virginia Milk Producers Ass'n v. United States, 193 F.2d 907 (1951).

95. *Id.* at 918 (dissenting opinion).

96. See note 66 *supra*. But see Whitwell v. Continental Tobacco, 125 Fed. 454 (8th Cir. 1903); Lockhart and Sacks, *The Relevance of Economic Factors in Determining Whether Exclusive Arrangements Violate Section 3 of the Clayton Act*, 65 HARV. L. REV. 913, 938 (1952).

97. 337 U.S. 293 (1949). A later case to the same effect is *Richfield Oil Co. v. United States*, 72 S.Ct. 665 (1952).

98. For a general treatment of the requirement contracts question, see Lockhart and Sacks, *supra* note 96 at 913; McLaren, *Related Problems of "Requirements" Contracts and Acquisitions in Vertical Integration under the Anti-Trust Laws*, 45 ILL. L. REV. 141 (1950); Schwartz, *Potential Impairment of Competition—The Impact of Standard Oil*

Unfair methods of competition in commerce violate Section 5 of the Federal Trade Commission Act.[99] Since the section encompasses many activities which also contravene the Sherman Act, its extension to cooperative practice of this type should depend upon whether the cooperative is subject to the latter statute.[100] However, "corporation" as used in the Act is defined to include associations, and there is no obvious intent or foundation for excluding cooperatives from strictures against misleading advertising, mislabeling, and similar deceptive practices.[101]

Conclusion

The antitrust laws at present are not a serious obstacle to cooperative activities. Infrequent prosecutions and favorable statutes and court decisions have afforded agricultural cooperative associations broad immunity from the state laws. The Sherman Act in conjunction with the other federal antitrust statutes may impose a considerable restraint on cooperatives in the future. The *Borden* case brings combinations and conspiracies with independent parties under the Sherman Act, and indicates that the exemptions of the Clayton and Capper-Volstead Act may be rather narrowly construed by the federal courts when the occasion arises.

However, as yet, attempts to enforce the federal antitrust laws against cooperatives are rare and restrictions on competition are often accomplished under the protective shield of a federal marketing order. In the long run, the relationship of the antitrust statutes to cooperatives will be determined by the attitude of Congress and the courts with respect to the maintenance of competition in agriculture, and the role allotted cooperatives in our national farm policy.

Co. of California v. United States on the Standard of Legality Under the Clayton Act, 98 U. of Pa. L. Rev. 10 (1949).

99. 38 Stat. 719 (1914), as amended, 15 U.S.C. § 45 (1946).

100. F.T.C. v. Cement Institute, 333 U.S. 683, 690-693 (1948), reaffirms the rule that certain activities are encompassed by both the Sherman and Federal Trade Commission Acts and contains a resumé of the earlier cases. Under the theory of these cases, almost any conduct violating the other antitrust statutes would also run afoul of Section 5. "As early as 1920 the Court considered it an 'unfair method of competition' to engage in practices 'against public policy' because of their dangerous tendency unduly to hinder competition or create monopoly." *Id.* at 690, quoting from F.T.C. v. Gratz, 253 U.S. 421, 427 (1920). To the extent that these practices are "unfair competition" because they are against the policy of the other antitrust laws, any activity which is excluded from the coverage of those laws should no longer be considered "unfair."

101. See Chaffee, *Unfair Competition*, 53 Harv. L. Rev. 1289 (1940); Notes, 42 Ill. L. Rev. 384 (1947); 26 Tex. L. Rev. 355 (1948).

Part V

Federal Taxation of Agricultural Cooperative Associations

Congress, in first considering the effects of federal income taxation, determined it to be in the national interest to exempt certain organizations from this burden. Farmers' cooperative associations, then in the early stages of their development, were among the original recipients of such favorable legislation. The constitutionality of this preferential treatment has never been seriously questioned.[1] However, the tax privileges accorded cooperatives today are among the most controversial features of the Government's internal revenue policies. A recurring question is whether their favored position is justified. It is accordingly significant to review the present statutory provisions establishing the scope of their tax liability, and further to determine the considerations relevant to a re-examination of the policy underlying tax concessions to cooperatives.

Under the Income Tax Statute of 1913, exemption was specifically granted to "[F]armers', Fruit Growers', or like associations, organized and operated as a sales agent for the purpose of marketing the products of its members and turning back to them the proceeds of sales, less the necessary selling expenses, on the basis of the quality of the produce furnished by them. . . ."[2] This provision was repeated in the 1919 Act,[3] and the treasury regulations promulgated under this legislation interpreted its less specific terms. The Act of 1921[4] adopted some provisions of the regulations into the statute, and further specifically exempted farmers' purchasing cooperatives from the income tax. Subsequent regulations[5] liberalized earlier interpretations of the exemption by allowing cooperatives to maintain reasonable reserves for capital expenditures; by permitting payment of dividends upon capital stock up to eight percent per annum or the legal rate of interest in the state of incorporation; and by allowing the marketing of nonmember products not exceeding the

1. Stanton v. Baltic Mining Co., 240 U.S. 103 (1916); Brushaber v. Union Pacific R.R., 240 U.S. 1 (1916). In regard to the constitutionality of preferential treatment of farmers' cooperative associations by state legislation, see Tigner v. Texas, 310 U.S. 141 (1940).

2. Revenue Act of 1913, § II G(a), 38 STAT. 172 (1913).

3. Revenue Act of 1919, § 231, 40 STAT. 1076 (1919).

4. Revenue Act of 1921, § 231(11), 42 STAT. 253 (1921).

5. See Farmers Cooperative Co. v. Birmingham, 86 F. Supp. 201, 206 (N.D. Iowa 1949).

value of products marketed for members. The 1926 Act[6] incorporated these regulations, and also eliminated the requirement that a cooperative be a sales agent. No further significant changes were made in the exemption until 1934,[7] when it was provided that any business transacted with the Federal Government is to be disregarded in determining a cooperative's right to income tax exemption.

The requirements for exemption have since remained basically unchanged, and today Section 101(12) of the Internal Revenue Code, as amended by the Revenue Act of 1951,[8] establishes the prerequisites which farmers' cooperatives must meet to enable them to obtain this tax advantage. Compliance with seven conditions stipulated in Section 101 (12)(A)[9] is requisite to receipt by a cooperative of the deductions accorded under Section 101(12)(B).[10]

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6. Revenue Act of 1926, § 231(12), 44 STAT. 40 (1926).

7. Revenue Act of 1934, § 101, 48 STAT. 700 (1934).

8. Revenue Act of 1951, § 314, 65 STAT. 490 (1951).

9. INT. REV. CODE § 101: ". . . [T]he following organizations shall be exempt from taxation. . . . (12)(A) Farmers', fruit growers', or like associations organized and operated on a cooperative basis *(a)* for the purpose of marketing the products of members or other producers, and turning back to them the proceeds of sales, less the necessary marketing expenses, on the basis of either the quantity or the value of the products furnished by them, or *(b)* for the purpose of purchasing supplies and equipment for the use of members or other persons, and turning over such supplies and equipment to them at actual cost, plus necessary expenses. Exemption shall not be denied any such association because it has capital stock, if the dividend rate of such stock is fixed at not to exceed the legal rate of interest in the State of incorporation or 8 per centum per annum, whichever is greater, on the value of the consideration for which the stock was issued, and if substantially all such stock (other than nonvoting preferred stock, the owners of which are not entitled or permitted to participate, directly or indirectly, in the profits of the association, upon dissolution or otherwise, beyond the fixed dividends) is owned by producers who market their products or purchase their supplies and equipment through the association; nor shall exemption be denied any such association because there is accumulated and maintained by it a reserve required by State law or a reasonable reserve for any necessary purpose. Such an association may market the products of nonmembers in an amount the value of which does not exceed the value of the products marketed for members, and may purchase supplies and equipment for nonmembers in an amount the value of which does not exceed the value of the supplies and equipment purchased for members, provided the value of the purchases made for persons who are neither members nor producers does not exceed 15 per centum of the value of all its purchases. Business done for the United States or any of its agencies shall be disregarded in determining the right to exemption under this paragraph. . . ."

10. See note 73 *infra*. The following general analysis of the relative positions of farmers' cooperatives exempt and non-exempt from federal corporate income tax has been made by Mr. Foley in 25 TAXES 197, 199 (1947):

Non-Exempt	*Exempt*
1. Must file regular corporate income tax form (1120).	1. Must obtain letter of exemption from Commissioner and then file Form 990 annually.

It is specified that the association be organized as "farmers', fruit growers', or like associations."[11] Since the doctrine of *ejusden generis* is applied to this statutory phrase, it is settled that the terminology limits the exemption to cooperative agricultural associations which either purchase from or supply equipment to those engaged in producing agricultural products.[12]

The cooperative must operate as a marketing or purchasing agency on a cost basis, ultimately turning back all net proceeds to member and nonmember patrons.[13] The Bureau of Internal Revenue has construed

Non-Exempt	*Exempt*
2. Must pay tax on such taxable income as:	2. Does not pay such taxes.
a. Non-operating or extraneous income or capital gains.	a. No tax. [must be allocated today.]
b. Reserved operating earnings.	b. No tax, but subject to limitations.
c. All operating earnings not distributed in prescribed manner.	c. Must allocate operating savings to all patrons on a patronage basis.
d. All earnings distributed as interest or dividends on capital stock.	d. No tax, but subject to limitations.
e. All earnings done for U.S. or its agencies, if not refunded to them.	e. May distribute to all other patrons or (sic) patronage basis.
3. Must purchase and affix excise stamps to certain documents.	3. Not required.
4. No Social Security preference.	4. Not required.
5. Must maintain each year its legal and corporate basis for excluding refunds from gross income.	5. Must adhere to requisites for exemption at all times during subject year.
6. May pay any rate of dividends or interest on capital shares (but is taxed on amounts so paid or accrued).	6. Rate is limited to state rate or 8%.
7. May have unlimited capital reserves (after income tax thereon is paid).	7. Must limit such reserves and allocate them to patrons on patronage basis.
8. Must maintain patronage records.	8. Must maintain patronage and allocation records. [Must file reports of patronage today.]
9. Owned and controlled by anyone.	9. Must be substantially controlled by producer-patrons.
10. May operate in part commercially and in part cooperatively.	10. Must operate 100% cooperatively.
11. May engage in any type of business.	11. Must adhere to requisites for exemption.
12. May do business with anyone.	12. Must adhere to requisites for exemption.
13. Regular two-year carry-over and carry-back provision on losses.	13. More flexible treatment for losses of any year.

11. See note 9 *supra*.

12. National Outdoor Advertising Bureau v. Helvering, 89 F.2d 878 (2d Cir. 1937); Sunset Scavenger Co. v. Commissioner, 84 F.2d 453 (9th Cir. 1936).

The Bureau of Internal Revenue has construed the term "like association" to include a farmers' cooperative organized to operate a roadside market for its members. See I.T. 2720, XII-2 CUM. BULL. 71 (1933).

13. See note 9 *supra*.

this requirement as applicable to associations which take title to the goods involved, as well as those functioning on an agency basis. Associations which process the producers' crops also are included.[14] Moreover, a federated type cooperative may reap the benefits of the statute if it otherwise qualifies.[15] If, however, an association is engaged in two distinct lines of business, such as the marketing of agricultural products for its members and the manufacture of farm machinery to be used by its members, it must qualify with respect to each phase of its activity.[16]

Substantially all stock except non-voting, non-profit-sharing preferred stock must be owned by producers or purchaser member patrons.[17] The term "substantially all" is not susceptible of precise definition, but rather involves a question of fact which must be decided in light of the circumstances of each particular case. However, the Bureau has established a guide to aid in determining whether this prerequisite has been satisfied.[18] It has stated that an association must explain any ownership of stock by other than actual producers, and must show that ownership of capital stock has been restricted in so far as possible to actual producers who market their products through the association. If the officers of an association are required by statute to be shareholders, the ownership of a share of stock by a nonproducer who serves as an officer, to fulfill the statutory requirement, will not destroy the exemption. Similarily, the exemption will not be lost if a shareholder ceases to be a producer under such circumstances that the association is unable to retire or purchase this stock for some cause beyond its control. However, if stock is voluntarily sold to nonproducers and no extenuating explanation is forthcoming, the exemption will be denied under the statute for the period that such stock is held. Generally, where a cooperative association, in good faith, attempts to restrict ownership of all its voting stock to producing member patrons, the privileges accorded by the statute will not be withheld.[19] Presumably, the same considerations apply equally to both purchasing and marketing associations.

The fourth requirement is that dividends may not exceed eight per centum per annum, or the legal rate in the state of incorporation, whichever is greater.[20] This restriction is determined on the value of the

14. MIM. 3886, X-30-5150 CUM. BULL. 164 (1931).
15. I.T. 2000, III-1 CUM. BULL. 290 (1924).
16. MIM. 3886, X-30-5150 CUM. BULL. 164, 167 (1931).
17. See note 9 *supra.*
18. MIM. 3886, X-30-5150 CUM. BULL. 164 (1931).
19. Farmers Co-operative Creamery v. Commissioner, 21 B.T.A. 265 (1930).
20. See note 9 *supra.* See South Carolina Produce Ass'n v. Commissioner, 50 F.2d

consideration for which the stock was issued,[21] and applies to stock and cash dividends, or a combination. It is not applicable to patronage dividends since those are issued, as the term implies, on the basis of patronage rather than stock ownership. Nor does the limitation apply where an association is unable to pay dividends during one year and later makes up this arrearage, either in one year or over a period, so long as the total paid does not exceed the prescribed amount for the entire period.[22] The clarity of this requirement makes its administration relatively simple.

A cooperative may accumulate only those reserves required by state law, and other reasonable reserves for necessary business purposes.[23] Accordingly, treasury regulations permit the accumulation and maintenance of reasonable reserves for capital expenditures, such as the erection of buildings and facilities required in business or for purchase and installation of machinery and equipment.[24] Other necessary reserves may include provisions for depreciation charges,[25] overpayments to members,[26] bad debts,[27] possible loss from pending law suits, or other specifically anticipated contingencies.[28] However, reserves may not be accumulated, to any considerable extent, for activities which are not necessary to the sale of members' products.[29]

Neither the cooperative nor its member patrons may realize a discriminatory advantage over nonmember patrons.[30] The Bureau has established a guide to aid in the application of this requirement.[31] In

742 (4th Cir. 1931), where the association was denied an exempt status because it paid a 10% dividend.

21. In Farmers Mutual Cooperative Creamery v. Commissioner, 33 B.T.A. 117, 125 (1935), the court said: "Admittedly, in this case $27,140 of the outstanding capital stock of $45,680 was issued as stock dividends and the shareholders paid nothing therefor. This fact alone bars the petitioner from claiming exemption from income tax; for after the declaration of the stock dividends, the stockholders were receiving from 12 to 18 percent per annum on the amounts invested by them." Also see South Carolina Produce Ass'n v. Commissioner, 50 F.2d 742 (4th Cir. 1931).

22. HULBERT, LEGAL PHASES OF COOPERATIVE ASSOCIATIONS 254 (F.C.A. BULL. No. 50, 1942).

23. See note 9 *supra*.

24. U.S. Treas. Reg. 103, § 19.101(12)-1.

25. 6 MERTENS, LAW OF FEDERAL INCOME TAXATION 86 (1949).

26. In San Joaquin Valley Poultry Producers' Ass'n v. Commissioner, 136 F.2d 383 (9th Cir. 1943), it was held that the cooperative did not lose its exemption by setting up reserves for over payments to members since under California law these amounts belonged to members rather than the cooperative.

27. WAAS & WHITE, APPLICATION OF THE FEDERAL INCOME TAX STATUTES TO FARMERS' COOPERATIVES, 104 (F.C.A. BULL. No. 53, 1942).

28. *Ibid.*

29. Burr Creamery Corporation v. Commissioner, 62 F.2d 407 (9th Cir. 1932), *cert. denied*, 289 U.S. 730 (1933).

30. See note 9 *supra*.

31. MIM. 3886, X-2 CUM. BULL. 164, 166 (1931).

short, if the association markets products for nonmember producers, the proceeds of all business done less the ordinary deductions must be returned to the patrons without distinction between members and nonmembers.[32] The cooperative may not make a profit on business transacted with nonmember patrons and divert the proceeds from the patrons entitled to them. However, if the cooperative satisfies the other requirements of the statute, but defers payment of patronage dividends to nonmembers, the association's preferential status will not be lost if the by-laws provide for payment both to members and nonmembers and a general reserve is created for the distribution to nonmembers. The result is the same where the by-laws are silent concerning payment to nonmembers, but a specific credit to each nonmember account is set up on the books of the association; or where the by-laws are silent, but it has been the practice to make payment to nonmembers; or where patronage dividends are payable only upon their accumulation to an extent sufficient to defray the cost of membership.[33] If the cooperative is operated in such a manner so as to meet the requirement of the statute regarding equality of treatment between member and nonmember patrons, the presence of charter powers permitting discrimination will not cause the association to lose the benefit of the statute.[34] This requirement of equal treatment leads some members to question the advantages of membership since nonmembers are entitled to substantially the same rights and privileges.[35] However, only members may control the organization, formulate its internal policy, and determine with whom the association will transact its business.[36]

Finally, it is required that nonmember business must not exceed member business and furthermore, purchasing cooperatives are limited in their purchases for nonmember nonproducer patrons to fifteen percent of their total business.[37] Compliance with this requirement is determined

32. I.T. 1914, III-1 CUM. BULL. 287 (1924).

33. *Ibid.*

34. In regard to the general problem of discrimination between member and nonmember patrons as to distribution or allocation of earnings see Fertile Cooperative Dairy Ass'n v. Huston, 119 F.2d 274 (8th Cir. 1941); Farmers Cooperative Co. of Wahoo, Neb. v. United States, 23 F. Supp. 123 (Ct. Cl. 1938); Council Bluffs Grape Growers Ass'n v. Commissioner, 44 B.T.A. 152 (1941); Farmers Mutual Cooperative Creamery v. Commissioner, 33 B.T.A. 117 (1935); Central Cooperative Oil Ass'n v. Commissioner, 32 B.T.A. 359 (1935).

In addition to the prohibition as to discrimination between members and nonmembers, Farmers Union Cooperative Oil Company v. Commissioner, 38 B.T.A. 64 (1938) held that the exemption may be denied because of discrimination between actual members.

35. See WAAS & WHITE, *op. cit. supra* note 27, at 57.

36. In addition to the factors named the members of these organizations also receive dividends upon the stock which they hold in the association.

37. See note 9 *supra*. In Producers Livestock Marketing Ass'n of Salt Lake City, 45 B.T.A. 325 (1941), it was held that where the articles of an association restrict

by dollar amounts of business transacted with nonmember nonproducers and not by unit volume of product or the number of patrons in each classification.[38] Certain types of activity on the part of a cooperative association do not fall within the classification of nonproducer business.[39] Such is true of any business transacted with the United States Government or any of its agencies, for the statute specifically eliminates such business for purposes of establishing the right to its privileges.[40] Also, if the cooperative processes the goods of the member before marketing them, it is doubtful that the purchase of ingredients to be added to the basic product would be considered as nonmember nonproducer business.[41]

Cooperative associations have periodically advanced a series of arguments to justify their favorable position in regard to federal taxation. One such argument is predicated on an analogy drawn from the law of agency.[42] The agency theory of exemption arose under the provisions of the early Revenue Acts which regarded cooperatives as sales agents for their members.[43] At this particular time many of the associations actually operated in such a manner. This relationship between the association and its members, however, had inherent limitations which made it difficult to market various types of produce for a large number of producers and continue to function as a true agent.[44] More and more the cooperatives found it advantageous to take absolute title to the goods, to commingle them in common storage facilities, and thus to conduct their operations in a manner similar to other business entities with which they were forced to compete.[45] It was no longer possible to account individually with each member as an ordinary principal-agent relationship requires. Moreover, the financial requirements of the typical producer-member made it impossible for him to prolong the return of his crop investment until his produce was eventually sold on the market. For this reason it became expedient for the association to make payment

membership to common stockholders, and the cooperative does a greater volume of business with nonmembers than with members, the association is not entitled to the exemption. See Cooperative Central Exchange, 27 B.T.A. 17 (1932); U.S. Treas. Reg. 111, § 29.101 (12)-1.

38. See WAAS & WHITE, *op. cit. supra* note 27, at 99.

39. I.T. 1914, III-1 CUM. BULL. 287 (1924).

40. See note 9 *supra*.

41. See HULBERT, *op. cit. supra* note 22, at 260.

42. See Magill and Merrill, *The Taxable Income of Cooperatives*, 49 MICH. L. REV. 167, 184 (1950).

43. Revenue Act of 1924, § 231(11), 43 STAT. 282 (1924); Revenue Act of 1921, § 231(11), 42 STAT. 253 (1921); Revenue Act of 1919, § 231, 40 STAT. 1076 (1919); Revenue Act of 1913, § IIG(a), 38 STAT. 172 (1913).

44. See PART III, pp. 421-423 *supra*.

45. Farmers Cooperative Co. v. Birmingham, 86 F. Supp. 201, 215 (N.D. Iowa 1949).

in advance and take title to the goods before marketing them, or in some instances even prior to delivery from the producer.[46]

Congress in 1926 recognized the change which had transpired and deleted the requirement that cooperatives must operate as sales agents to qualify under the statute.[47] And in 1932 the Treasury abandoned the agency theory by ruling that under the Revenue Acts of 1916, 1917, and 1918, cooperative organizations which did not act as agents for their patrons, and which therefore were not exempt under the then existing law, were nevertheless authorized to deduct patronage dividends from gross income.[48]

Occasionally cooperatives continue to maintain, despite the fact that the Code does not presently require them to assume the position of agents, that the statutory benefits accorded them are justified as they are merely the agents of their members or mere conduits of the funds of their members.[49] The courts generally have denied this assertion unless the facts of the particular case substantiate the claim after an inquiry into the real substance of the relationship involved. One pre-1926 decision, involving such an argument is *Cooperative Central Exchange v. Commissioner*,[50] where the court recognized that cooperatives may not operate in fact, as a true agent:

> . . . [u]nless it is shown that titles to the farm products marketed through the petitioner remained in the producers thereof until sales were effected by it, we think the conditions contemplated by Congress and prescribed by the statutes are not satisfied. If the member cooperatives bought commodities from its producing members and resold them to petitioner for further sale to the public, it could hardly be argued that petitioner acts as agent for the producers. In our opinion the petitioner

46. For an excellent discussion of this point see Adcock, *Patronage Dividends: Income Distribution or Price Adjustment*, 13 LAW & CONTEMP. PROB. 505, 520 (1948). Another fundamental characteristic of agency is lacking, as the cooperative has no right of reimbursement or indemnity for loss resulting from transactions with a member. Accordingly, when Southern States Cooperative sustained an investment loss of one million dollars because of an unprofitable subsidiary, as disclosed in its annual report for the year ending June 30, 1950, there was no doubt that this loss fell directly upon the cooperative, not upon its members. See *Hearings before Committee on Ways and Means on Revenue Revision of 1951*, 82d Cong., 1st Sess. 1492 (1951).

47. Revenue Act of 1926, § 231(12), 44 STAT. 40 (1926).

48. I.T. 1499, I-2 CUM. BULL. 189 (1932).

49. "It is often said that a cooperative, particularly a marketing cooperative, is the agent of its producer members, and sometimes it is said that this is the reason for this rule of exclusion. But I think that is greatly oversimplifying the matter, and hardly a correct statement." Statement by Mr. Karl Loos, a representative of several well-known cooperative associations. *Hearings before Committee on Ways and Means on Revenue Act of 1950*, 81st Cong., 2d Sess. 2207 (1950).

50. 27 B.T.A. 17 (1932).

> has failed to prove that any of the members are producers or producers' marketing agents within the meaning of the statutory provisions granting tax exemption to farmers' cooperatives.[51]

The court further discussed the factual aspects of the case, concluding that this particular cooperative was no more an agent of its members than any other wholesale merchant engaged in selling supplies which are ultimately consumed by producers.

Taxable corporations have attempted to utilize the agency device to limit their tax liability. This was the controversy in the recent case of *Railway Express Agency v. Commissioner*,[52] involving an attempt by the Railway Express Co., a corporation, to limit its liability through an express contractual agency agreement with its railroad owners. The issue was whether or not the petitioner was taxable on the resulting increase in net operating income through the disallowance of certain deductions taken for depreciation. The Agency contended that it was not liable for the additional tax as the mere agent of the owner railroads, and contractually obligated to account to the owners for this amount. After considering the true substance of the relationship, the court denied this contention, holding the increase taxable and stating that *if a corporate device is used for business advantage* there is no just ground for protest when it results in tax liability.[53] The decision illustrates that courts will give credence to the agency device for reduction of tax liability only when it appears that a true agency relationship is present.[54]

The trustee theory presents an alternative basis upon which cooperatives endeavor to vindicate their favorable tax position.[55] The

51. *Id.* at 20.

52. 169 F.2d 193 (2d Cir. 1948), *cert. denied*, 336 U.S. 944 (1949).

53. *Id.* at 196.

54. In a recent case, National Carbide Corporation v. Commissioner, 336 U.S. 422 (1949), petitioners claimed a reduction in their income and excess profits taxes on the theory that, by virtue of a contract with their controlling (Airco) corporation, they were only agents of Airco to the extent of all their earnings in excess of expenses and a six percent payment on their outstanding capital stock. The Court denied these claims, holding that complete ownership of the subsidiary corporation and the control primarily dependent upon such ownership are no longer of significance in determining taxability. The Court also pointed out that the existence of the "agency contracts" requiring petitioners to pay all their profits above a nominal return to Airco did not conclusively determine that the income "belonged to Airco."

55. See Rhodes v. Little Falls Dairy Co., 245 N.Y. Supp. 432, 434 (1930), *aff'd*, 256 N.Y. 559, 177 N.E. 140 (1931), where the court said, "We do not agree with the Special Term that the contract is the ordinary one of purchase and sale. Even though title may have passed, still the arrangement is for co-operative marketing. The status of the parties partakes of a trust or fiduciary character, and is not the simple relation of vendor and vendee; the fund derived from the marketing of the product being subject to distribution among the various producers, sales of whose product had gone to make it up."

rationale of this view is that the money received by the association from its business transactions is in the nature of a fund of which the manager and directors of the association are the trustees, while the patrons are beneficiaries.[56] The cooperative, in its capacity as trustee, is authorized to deduct from the fund amounts for necessary expenses and return the balance to the patrons. This theory is subject to criticism as being unrealistic when superimposed upon the actual business procedures currently employed by most cooperatives.[57] In addition, this reference to a trust relationship actually does not support the cooperative in justifying its preferential tax treatment. For trusts which engage in ordinary business activities, as distinguished from trusts which merely receive income for distribution to the beneficiaries while exercising no managerial function, are classified as business associations and are subject to the regular corporate tax rates.[58]

The essence of a third position is that a deduction for tax purposes of patronage refunds, the principal source of controversy over the grant of tax advantage to cooperatives, is available not solely to cooperative associations, but that any business entity which chooses to refund to customers on the basis of patronage may deduct such refunds for tax purposes. However, the practical impossibility of this choice is obvious, since other business entities generally never find it expedient to operate in such manner. A corporation which distributed its earnings to customers instead of shareholders would have little reason to exist. Indeed, the earnings of any privately owned business are of necessity distributed to its owners. That the owners of a cooperative are at the same time its customers renders the cooperative method of business unique but furnishes no meaningful distinction upon which to predicate exemption.

Finally, there is advanced the price adjustment or rebate theory by those who favor special treatment for cooperatives taxwise.[59] This proposition admits that the association buys and takes title to the member producers' product and later sells it again on the market. However, it is asserted that there is no real income to the association, since the amount returned to the patron on the basis of the business transacted with the organization is a refund or rebate, equivalent to an adjustment of the initial price paid the member for the product.[60] There would be

56. See California & Hawaiian Sugar Refining Corp., Ltd. v. Commissioner, 163 F.2d 531, 533 (9th Cir. 1947), *cert. denied*, 332 U.S. 846 (1948).

57. See PART II, *supra*.

58. See Morrissey v. Commissioner, 296 U.S. 344 (1935); Hecht v. Malley, 265 U.S. 144 (1924).

59. For a discussion of this theory see Adcock, *supra* note 46.

60. See Sowards, *Should Co-ops Pay Federal Income Taxes*, 19 TENN. L. REV. 908, 914 (1947).

valid basis for this argument if the cooperative actually operated in this manner. However, such an organization usually does not refund to any one member solely upon the basis of what he has contributed to the enterprise.[61] It is entirely possible that a patron may furnish produce to the association upon which it will suffer a loss due to fluctuating market conditions.[62] Subsequently, other members may deliver produce which are marketed at a sufficiently high price to enable the cooperative to close the season with a net margin, making possible the payment of a patronage refund. The member furnishing the crops which the organization marketed at a loss would, despite the loss on his products, receive a patronage refund. In fact, if he delivered a greater volume of the particular commodity than other producers, he would receive a proportionately greater refund than the amount paid to the smaller, yet profit producing, patron. Sums returned to a member are thus not directly related to profits realized on the sale of his particular products but to profits on the marketing of all the members' products. The court in *Maryland and Virginia Milk Producers' Association v. District of Columbia*[63] was aware of this averaging principle when it stated that the cooperative sells for its own account and not for that of the member.

That a cooperative earns income seems difficult to dispute. It has assets and employees; it buys, sells, and performs services. The Supreme Court in *National Carbide Corporation v. Commissioner*[64] recog-

61. A general analysis of the business operations of cooperatives reveals the impracticability if not the impossibility of relating patronage dividends to gain or loss upon any particular transaction with any particular patron. "To say, in effect, that a sale remains open until the end of an accounting period to permit the payment of an addition to the price does not recognize facts. For example, during 1946 there were extremely wide fluctuations in the price of flaxseed, the price increasing from $3.00 to $6.00 per bushel in just a few days. Many farmers sold flaxseed to cooperative grain elevators both before and after the price increase. In the case of a farmer who before the price increase sold flaxseed which the cooperative sold after the price increase, the theory that the formal sale was not closed but was in fact open pending receipt of the additional price would require that an additional payment of almost $3.00 per bushel be made. The farmer who had received $6.00 initially and whose flaxseed was sold by the cooperative at $6.00 plus freight and margin would not be entitled to receive additional payment. But cooperative corporations do not return to each farmer the net proceeds of the sales of his produce less necessary expenses; instead, they determine the over-all net profits for flaxseed and these profits are shared by all flaxseed patrons in proportion to their patronage." Adcock, *supra* note 46, at 520-21.

62. Another example of how an individual member's transactions may result in loss to the enterprise is in the case of a purchasing cooperative where the member only purchases "loss leaders." Nevertheless, the member may receive a distribution based on profits gained in another, wholly unrelated segment of the business. Moreover, where the interval between members' transactions and distributions is protracted, the "margin" distributed may be almost entirely attributable to inventory appreciation, resulting from over-all economic inflation. See *Hearings before Committee on Ways and Means on Revenue Revision of 1951*, 82d Cong., 1st Sess. 1494 (1951).

63. 119 F.2d 787 (D.C. Cir. 1940).

64. 336 U.S. 422 (1949).

nized that funds derived from business enterprise are the profits of the organization owning the assets, employing the workers, and carrying out the commercial activities, even though a parent corporation has a legally enforceable claim to those funds. The economic realities of such a situation received full recognition by the Court in the *Carbide* case when it called attention to the petitioner's claim that they were only taxable on net income aggregating $1,350, despite the fact that during the taxable year they owned assets worth twenty million dollars and earned nearly four and one-half million dollars net.[65]

Beyond question, Congress has the power to tax cooperative associations, for the power of federal taxation is extremely broad. The Supreme Court has held that the subject matter of taxation open to the power of Congress is as comprehensive as that open to the power of the states,[66] and includes every form of tax appropriate to sovereignty. Perhaps the leading case defining income since the Sixteenth Amendment is *Eisner v. Macomber*,[67] where the Court first expounded its philosophy regarding the true scope of the federal taxing power. Not only may Congress determine what income shall be subject to tax, but has an equally broad power to determine to whom it may be taxed.[68] Congress exercised its prerogatives in the Revenue Act of 1951, where it modified[69] the scope of the tax immunity granted to agricultural cooperatives.[70]

Subparagraph (B) of IRC Section 101(12), initially abolishes the exemption, subjecting all cooperatives to the regular corporation tax rates.[71] If, however, such an organization can qualify under the prior

65. *Id.* at 438.
66. Steward Machine Company v. Davis, 301 U.S. 548 (1937).
67. 252 U.S. 189 (1920).
68. Burnet v. Wells, 289 U.S. 670 (1933).
69. See note 9 *supra;* note 71 *infra.*
70. Penn Mutual Life Insurance Company v. Lederer, 252 U.S. 523 (1920), is the only case concerning the constitutional taxability of cooperatives which has been before the Supreme Court. The Court there held that the fact that the investment resulting in accumulation is made by a cooperative as distinguished from a corporate concern does not prevent the amount from properly being classified as a profit on the investment. The Court also noted that the fact that this profit was earned by a cooperative did not afford basis for the argument that Congress did not intend to tax the ensuing profit. In other related fields of income taxation, the Court has held that the substance or true manner in which the taxpayer conducts his business, and not the legal form which he might adopt determines the manner in which he will be taxed. See Burk-Waggoner Oil Association v. Hopkins, 269 U.S. 110 (1925), where the Court held that Congress had the right to tax as a corporation a "Massachusetts trust" which was technically a partnership under state law. The same principle is illustrated in the family partnership cases, Commissioner v. Lusthaus, 327 U.S. 293 (1946); Commissioner v. Tower, 327 U.S. 280 (1946); Commissioner v. Harmon, 323 U.S. 44 (1944).
71. "*(B)* An organization exempt from taxation under the provisions of subparagraph (A) [the original exemption provision under section 101 (12)] shall be subject

requirements prescribed in subparagraph (A), it becomes entitled, by virtue of part B, to *two* important deductions not available to associations previously termed non-exempt, *i.e.*, those which do not meet the seven prerequisites of 101(12)(A).[72] These constitute deductions for dividends paid on capital stock and for amounts allocated during the taxable year with respect to income not derived from patronage.[73] A deduction for amounts paid to patrons during the taxable year as patronage refunds is available to all cooperatives, regardless of compliance with 101(12)(A).[74] In addition to these special privileges an

to the taxes imposed by sections 13 and 15 [the regular corporate tax rates imposed by the Revenue Act of 1951], or section 117 (c) (1), [capital gains] except that in computing the net income of such an organization there shall be allowed as deductions from gross income (in addition to other deductions allowable under section 23)—

(i) amounts paid as dividends during the taxable year upon its capital stock, and

(ii) amounts allocated during the taxable year to patrons with respect to its income not derived from patronage (whether or not such income was derived during such taxable year) whether paid in cash, merchandise, capital stock, revolving funds certificates, retain certificates, certificates of indebtedness, letters of advice, or in some other manner that discloses to each patron the dollar amount allocated to him. Allocations made after the close of the taxable year and on or before the fifteenth day of the ninth month following the close of such year shall be considered as made on the last day of such taxable year to the extent the allocations are attributable to income derived before the close of such year.

Patronage dividends, refunds, and rebates to patrons with respect to their patronage in the same or preceding years (whether paid in cash, merchandise, capital stock, revolving fund certificates, retain certificates, certificates of indebtedness, letters of advice, or in some other manner that discloses to each patron the dollar amount of such dividend, refunds, or rebate) shall be taken into account in computing net income in the same manner as in the case of a cooperative organization not exempt under subparagraph (A). Such dividends, refunds, and rebates made after the close of the taxable year and on or before the 15th day of the ninth month following the close of such year shall be considered as made on the last day of such taxable year to the extent the dividends, refunds, or rebates, are attributable to patronage occurring before the close of such year."

72. *Ibid.*

73. *Ibid.* See WAAS, RECENT FEDERAL INCOME TAX CHANGES AFFECTING COOPERATIVES 2 (F.C.A. MISC. REPORT No. 156, 1951).

74. *Ibid.* Senator George interpreted Section 101(12)(B) to the effect, "Patronage allocations by cooperatives are not income to the cooperatives under this section, but are excluded from gross income of the cooperative organization." 97 CONG. REC. 12202 (Sept. 24, 1951).

In the case of a non-exempt association, an exclusion from a cooperative's gross income of "patronage dividends" has been permitted by Treasury Department rulings and decisions by some lower federal courts. See Farmers Cooperative Co. v. Birmingham, 86 F. Supp. 201, 206 (N.D. Iowa 1949). Some writers feel that litigation under Section 101(12) of the Code with respect to absolute exemption will be greatly decreased in the future, and in turn litigation concerning the exclusion of patronage refunds will be greatly increased. Generally speaking, for a patronage refund to be excludable from a cooperative's gross income it must be based upon a legal obligation to pay, growing out of a pre-existing enforceable contract. See Cooperative Oil Association v. Commissioner, 115 F.2d 666 (9th Cir. 1940), where the court impliedly disapproved of the practice of the Bureau of permitting the deduction of patronage dividends paid at the discretion of the board of directors. See also American Box

organization which qualifies under the statute may take all of the deductions generally available to any taxable corporation under Section 23 of the Code.[75]

Interpretation by judicial decision or treasury regulation will be necessary of course, to ascertain fully the impact of the 1951 amendment. Under the previous statutory provisions the term capital stock, with reference to the payment of dividends, was construed broadly to include any type of capital, including such sources as debentures. There is no indication that Congress intended a different meaning; this interpretation may well be carried into effect under the new provisions. A more significant problem concerns the deductibility of dividends. If a dividend actually has been paid to stockholders there is no difficulty. And even where there has been only an accrual, its deduction should not become subject to question if the cooperative operates consistently on the accrual method and the dividend has been declared by the board of directors, whereby a legal obligation has been created. The principal question regarding dividends arises in connection with the federated cooperative organizations where dividends on capital stock are distributed to member cooperative associations. If the federated cooperative has satisfied the qualifications of Section 101(12)(A), such dividends would be deductible; but as to the association receiving the dividend a different aspect of the problem is presented. Such dividends amounts channeled to members would appear to be deductible as amounts allocated in respect to income not derived from patronage. If they were not so allocated the question arises whether they would be subject to the full corporate tax rate, or whether the member cooperative might compute a credit against its net margin for eighty-five percent of the dividends received in accordance with section 26 of the Code applicable to regular corporations. The answer is not certain, but there is substantial authority that Congress did not intend the benefits of section 26 to be available to farmers' cooperatives.[76]

Shook Export Ass'n v. Commissioner, 156 F.2d 629 (9th Cir. 1946), where the court denied the exclusion of patronage dividends because there was not a legally binding contract which required their payment. In United Cooperatives, Inc. v. Commissioner, 4 T.C. 93 (1944), the court included within the petitioner's gross income that amount of the patronage refund which might have been paid as dividends upon capital stock.

For an excellent discussion concerning the exclusion of patronage dividends from the gross income of a cooperative see Hensel, *Taxation of Cooperatives* in COOPERATIVE CORPORATE ASSOCIATION LAW (Jensen ed. 1950).

75. See WAAS, *op. cit. supra* note 73, at ¶ 14.

76. INT. REV. CODE § 26(b). Supplemental Report No. 781, part 2, of the Senate Finance Committee at page 30 states that where a cooperative is found subject to the tax under section 314, it is nevertheless "to be considered exempt from income tax for the purpose of any laws which refer to an organization exempt from income tax. Accordingly, such code provisions as Section 26(a) (credits for dividends received

The deductions available under Section 23 of the Code must also be taken into consideration, for today all cooperatives, regardless of whether they meet the requirements of 101(12)(A), must concern themselves with such items as reasonable reserves for depreciation and bad debts, pension plans, and self-insurance as well as all other questions in this area facing any taxable corporation. It is now required that all pension plans be submitted to the Commissioner for approval before they may constitute a deductible expense.[77] In the past, taxable corporations which have maintained self-insurance funds have found them to be non-deductible and undoubtedly the same will apply in the case of cooperatives. But as the new Revenue Act is not retroactive concerning these associations, such an organization could change to another plan for insurance protection if a deduction for this type of expense were found to be desirable.

The new act imposes upon cooperatives the necessity of analyzing each expense and reserve for which a deduction is sought to insure that it is reasonable in amount and comparable to those allowed to other similar taxable business entities. For if such deductions are disallowed as unreasonable for tax purposes, the consequences may include not only a greater tax liability, but also a complete loss of the special privileges accorded under 101(12)(B). To take advantage of subparagraph B of Section 101(2) of the Code, a cooperative must meet the requirements of subparagraph A; and one such requirement is that reserves be reasonable. Therefore, a judicial determination that a reserve would not be allowable as a deduction under Section 23 of the Code may also constitute a finding that it is not a reasonable reserve within the meaning of 101(12).

In respect to reserves for depreciation, certain cooperative associations, formerly exempt, may be faced by a dilemma stemming from past tendencies to both under and over depreciate assets. In the case of under depreciation, some adjustment may be required to prevent the gaining of a tax advantage under the new Act. The problem of past over-depreciation presents a somewhat more difficult question. For during the years of over-depreciation, even though the cooperative itself was not particularly benefited taxwise, the patrons received a tax benefit in respect to their personal returns because patronage refunds were correspondingly decreased. The question certain to arise is whether or not such a cooperative may set its house in order and adjust the value of

from a domestic corporation which is subject to tax) and Section 141 (dealing with consolidated returns) do not apply to cooperatives taxable under Section 101(12)(A)." U.S. Treas. Reg. 111, § 29.101(12)-1 is the applicable Treasury Regulation.

77. See Comment, 27 IND. L.J. 59 (1951).

its assets to reflect their true worth. Even if such an adjustment were not permitted, there is no reason why the amounts which normally would be charged to depreciation could not be allocated to patrons under the provisions of the new Act and thereby place the tax burden upon those who had formerly received the tax advantage resulting from over depreciation.

The 1951 amendment indicates a distinct effort to narrow the tax advantage accorded cooperatives.[78] Basically, however, and despite some need for administrative clarification, there seems to be little change in their tax liability. In substance the exemption is still available in the form of deductions allowed upon compliance with the original seven prerequisites for exemption; and apart from those requirements, all cooperatives are allowed a deduction for patronage refunds. It is these deductions, particularly those allowed for amounts allocated to patrons, which enable cooperatives to attain their favorable tax position.

The justification for special treatment taxwise has been the peculiar objectives which cooperatives have sought to achieve. These associations have served a vital function in the economy by constituting for farmers an instrument of effective bargaining strength in their contact with other private businesses.[79] Previous to the development of the cooperative movement farmers generally were forced to purchase equipment and supplies at a price set by the seller, and to sell their products at a price set by the buyer.[80] Cooperation tends to alleviate this situation by enabling farmers to exert their combined influence over the market, and thus determine to some extent the prices to be received for their commodities and those to be paid for equipment and supplies. While this movement was in a stage of development, special protection was needed and Congress properly granted assistance in the form of exemption from federal income taxation. The present controversy revolves around the question of whether the continued extension of such assistance is warranted.

From present statistics which are available, it is apparent that some cooperatives have experienced vast growth since the original granting of the exemption, and in certain instances cooperative associations have be-

78. The 1951 amendment has the effect of getting all of this income into the tax stream at least once, whether on the part of the cooperative or in the return of the individual patron. Previously that amount designated as "reasonable reserves" completely escaped taxation, either to the patron or to the cooperative. This is the real significance of the new act in regard to this particular area.

79. See PART I, pp. 373-374 *supra*.

80. See *Hearing before Committee on Ways and Means on Revenue Revision of 1951*, 82d Cong., 1st Sess. 1419 (1951).

come big business.[81] The 1947-48 survey of farmers' cooperatives compiled by the Department of Agriculture shows that for this period these associations had a total aggregate volume of business of $8.6 billion, of which $7.2 billion represented farm products marketed.[82] This survey also pointed out that, while a great majority of the reporting cooperatives were small organizations, a large percentage of the volume of business done was accounted for by 656 large scale associations operating on a regional or even a nation-wide basis.[83] The expansion indicated by these statistics has not been shared equally by all cooperatives, for figures available for the years 1942-43 reveal that forty-eight federated or centralized regional cooperatives, each with a business volume of more than ten million dollars, accounted for about forty-three percent of the total volume of marketing done by cooperatives.[84]

While the causal effect of the tax exemption upon the growth of certain cooperatives is incapable of exact determination, it would seem that the favorable tax treatment logically has provided these associations with some competitive advantage. The advantage is not reflected in the price at which these organizations sell their goods, but is utilized to secure

81. In 1946 there were 6,009 cooperatives which qualified for exemption under Section 101(1) of the Code.

Typical examples of cooperative enterprise on a large scale are: in fiscal year 1943-44 the California Cooperative Orange Growers paid $11 million for the lumber town of Westwood and 100,000 acres of timber land, thereby acquiring a new source of wood for packing cases for Sunkist citrus fruits. The Dairymen's League completed plans for a $650,000 milk plant in New York City. Southern States Cooperative paid $300,000 for the Richmond, Virginia Trust Building. And New York's G.L.F. gave Cornell University $200,000 for its school of nutrition. See *Big Business Without Profit*, 32 FORTUNE 152 (1945).

82. Farmers' marketing and purchasing associations: Estimated number of associations and business done for specified periods, 1913 to 1947-48.

(Money figures in millions)

Periods	Number of associations	Marketing	Purchasing	Total
1913	3,099	$ 304.4	$ 5.9	$ 310.3
1921	7,374	1,198.5	57.7	1,256.2
1925-26	10,803	2,265.0	135.0	2,400.0
1930-31	11,950	2,185.0	215.0	2,400.0
1935-36	10,500	1,586.0	254.0	1,840.0
1940-41	10,600	1,911.0	369.0	2,280.0
1945-46	10,150	5,147.0	923.0	6,070.0
1947-48	10,135	7,195.0	1,440.0	8,635.0
1948-49	10,075	7,297.6	2,022.4	9,320.0

Source: STATISTICS OF FARMERS' MARKETING AND PURCHASING COOPERATIVES, 1947-48. Farm Credit Administration, U.S. Department of Agriculture, 1950.

83. TAX TREATMENT OF COOPERATIVES, PART 2, p. 3, by Staffs of the Treasury and the Joint Committee on Internal Revenue Taxation (Apr. 1951).

84. *Ibid.*

a large source of reserve capital, permitting their very rapid expansion.[85] It is interesting to note that the gross income of farmers' cooperative associations in 1945 was $5.65 billion and for 1949 it was $9.3 billion.[86] Thus, in four years the percentage increase has been 65 percent or an average of approximately 16 percent per year. While in theory the savings or net margins of cooperatives are returned to their members in the form of patronage dividends, such has not always been the case. From the information available for 1946, it appears that exempt cooperatives with gross receipts of $50,000 or more had aggregate net margins, before patronage dividends or other distributions to members, of $140 million. The breakdown of this amount shows $28 million specifically set aside for reserves, six million dollars paid as dividends on capital stock, and $106 million paid as patronage dividends. In respect to this latter amount, however, approximately $16.5 million only was paid in cash, with the remainder credited to members as patronage dividends but not actually distributed.[87] Therefore, of the aggregate net margins of $140 million, approximately $118 million was retained for working capital, capital expenditures, and reserves. And under present internal reserve provisions, the entire amount would be allowed as a deduction for tax purposes.

Clearly, the question of whether the special treatment accorded cooperatives taxwise can be presently justified must continue to be answered with reference to the function which cooperatives perform. Their legitimate objective, to constitute an instrument of economic and

85. The advantages which the exemption permits may best be illustrated by a specific example. First, it must be remembered that an exempt cooperative pays no federal income tax. Consumers Cooperative Association of Kansas City, Missouri, does not fall within the exempt status but has the privilege of deducting patronage dividends from their net margins for tax purposes. This organization in 1948 paid federal income taxes of $400,000 on an aggregate of total business transacted of $55,000,000, and if they had paid on the same basis as competing corporations, they would have been obligated to pay approximately $2,000,000. *Hearings before Committee on Ways and Means on Revenue Revision of 1951,* 82d Cong., 1st Sess. 1260 (1951). Their patronage dividends paid in cash for the same year were $62,134 out of a total net savings of $8,019,160. See, 1948 AND 1949 HANDBOOK ON MAJOR REGIONAL FARM SUPPLY PURCHASING COOPERATIVES 10 (F.C.A. MISC. REP. 1950). Converting these figures to percentages, it appears that this cooperative earned 14.5 percent on total sales and 61.5 percent on total patrons equity which would be the equivalent of invested capital in an ordinary corporation.

The same cooperative built a 3,400-barrel oil refinery at Phillipsburg, Kansas, several years ago. Out of its tax free earnings it was able to pay for the entire plant in about two years, although an average taxpaying company, building the same refinery, might well have required from ten to fifteen years to this capital expenditure. Sowards, note 23 *supra,* at 921.

86. The general inflationary trend which occurred during this period must be considered.

87. See TAX TREATMENT OF COOPERATIVES, *op. cit. supra* note 83, at 4.

socio-psychological benefit to farmers, cannot reasonably be questioned. The crux, then, is whether tax privileges are necessary to continued achievement of this goal. Cast inevitably into this mold, the inquiry is solely a matter for legislative policy judgment,[88] aided in part by an analysis of the present relative efficiency, capital requirements, and economic strength of cooperatives.

The issue should not be confused by pleas for symmetry in the tax laws, nor by indignant reference to inequality of treatment. Neither is it relevant to engage in the fiction of classifying the cooperative as an agent, or a trustee, or to assert that it is a mere conduit of funds with no income of its own. Such arguments are meaningless in themselves, and they further have the effect of speciously concealing the only valid approach to a solution of the cooperative tax problem.[89]

A provision of the new internal revenue act requires cooperatives to submit detailed and comprehensive reports concerning certain aspects of their financial affairs.[90] In accordance with the notion that their

88. See Packel, *Cooperative and the Income Tax*, 90 U. OF PA. L. REV. 137 (1941).

89. The confusion in the entire field can best be illustrated by the manner in which the cases and writers attempt to deal with some of the problems. Where under the applicable state statutes a cooperative is authorized to act both as agent and purchaser, the parties may expressly adopt by agreement and practice the seller-purchaser relationship in order to secure economic advantages. See Clinton Co-op. Farmers Elevator Ass'n v. Farmers Union Grain Terminal Ass'n, 223 Minn. 253, 26 N.W.2d 117 (1947). Writers have also argued that the cooperating members are the real parties in interest in any transaction undertaken by the association; that the cooperative is a legal entity and takes legal title to goods in order to adapt itself to the usages of trade and that this legal title preserves the rights of members and exists only for a special and limited purpose, *i.e.*, for the benefit of those who deal with the association in good faith and in the normal course of business. Henderson, *Cooperative Marketing Associations*, 23 COL. L. REV. 91 (1923); Note, 23 NOTRE DAME LAW 342 (1948). Also see O'Meara, *The Federal Income Tax in Relation to Consumer Cooperatives*, 26 ILL. L. REV. 60 (1941).

90. Section 314 further provides: "Such dividends, refunds, and rebates made after the close of the taxable year and on or before the 15th day of the ninth month following the close of such year shall be considered as made on the last day of such taxable year to the extent the dividends, refunds, or rebates, are attributable to patronage occurring before the close of such year." See note 71 *supra*. In view of the statutory language three connotations of this section are possible. First, since no other reporting date has been prescribed, it may be assumed that all such organizations will operate on a calendar year reporting on March fifteenth in accordance with Section 53 of the Code, with the privilege of amendment concerning patronage dividends attributable to patronage during the taxable year until the fifteenth day of the ninth month. The second possible interpretation is in view of the language "such taxable year" in the statutory provisions that such an organization may operate either on a calendar or fiscal year and follow the procedures outlined above. Third, this section may also be construed in effect that the reporting date shall be the fifteenth day of the ninth month for all cooperative associations qualifying under the section. This interpretation would provide the greatest ease of administration; however, the ambiguousness of the language will permit the Commissioner to use discretion in selecting the method which presents the greatest ease of administration for both the Bureau and the organizations falling under the section.

In regard to this problem Senator George has said: ". . . the bill as it was pre-

tax position presents a legislative problem only, it is suggested that the ready availability of data taken from this source might aid a congressional re-evaluation of the government's taxing policy toward cooperatives.

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pared by the Senate Finance Committee gave to the cooperatives until the 15th day of the third month after the close of their fiscal year to make their distribution or rebates of allocation of earnings. I submit that the time is too short within which farm cooperatives can have audits made of their books and notify their large number of shareholders and patrons. . . . I am proposing to strike the word 'third' and inset the word 'ninth', so that the cooperatives would have until the middle of the ninth month after their fiscal year began to complete their audits, make their distributions and allocations, and notify their members." 97 CONG. REC. 12202 (Sept. 24, 1951).

For the calendar year 1951 the returns on Forms 1096 and 1099 must include patronage dividends, rebates and refunds totaling $100.00 or more during the calendar year. A separate Form 1099 must be prepared for each patron to whom an allocation of $100.00 or more has been made during the calendar year.