

NOTES

AGRICULTURAL COOPERATIVES

Part I

The Development and Significance of Agricultural Cooperatives in the American Economy

At the close of the 1949-50 marketing season, there were 10,035 agricultural cooperative organizations in the United States.¹ Their membership exceeded six and one-half million persons, representing participation in cooperation by an estimated three out of every five farmers in the country.² Total business for the season amounted to more than eight and one-half billion dollars;³ approximately thrice the volume of a decade ago.⁴

This present economic prominence is the result of an evolutionary growth which may be traced in its entirety through many centuries. Group effort in economic enterprise was advocated in ancient communal societies, in the guilds of the Middle Ages, and in the writings of Plato, More, and Bacon.⁵ Following the Industrial Revolution, cooperation became a socio-reformistic movement led by Blanc, Fourier, and Owen to alleviate the sordid conditions under which early industrial employees lived and worked.⁶ The emergence of the basic tenets of modern cooperation is generally attributed to the famed Rochdale experiment.⁷ It

1. 18 NEWS FOR FARMER COOPERATIVES No. 6, p. 11 (1951).

2. *Ibid.*

3. *Ibid.*

4. *Ibid.*

5. See BLANKERTZ, MARKETING COOPERATIVES 20-41 (1940).

6. *Id.* at 29-37. HENNELL, AN OUTLINE OF THE VARIOUS SOCIAL SYSTEMS AND COMMUNITIES WHICH HAVE BEEN FOUNDED ON THE PRINCIPLE OF CO-OPERATION (1844).

7. The famed Rochdale pioneers were a group of flannel workers living in Rochdale, England. Blighted by poverty and unemployment, they banded together in 1844 to open a store to sell the staples of their existence. The principles of their Equitable Pioneers' Society have become the basis of later cooperation and are seven in number: open membership; democratic control based on one vote per member; limited interest on capital; patronage refunds; political and religious neutrality; cash trading; and the promotion of education. See BLANKERTZ, MARKETING COOPERATIVES 45 (1940); HOLY-

was at this time, the middle of the 19th century, that the movement took root in the United States,⁸ beginning a development through six stages.⁹

The first period, in the years preceding 1870, was one of experimentation with no more than sporadic and scattered attempts to achieve effective cooperation. The most successful of these early efforts were in the dairy business, although similar activity occurred in the fruit, cotton, livestock and wool industries.¹⁰ The Civil War culminated in an agricultural depression which saw the National Grange emerge as spokesman for the farmers. The Grange contemplated total cooperation on both marketing and purchasing levels and presented the Rochdale principles to the nation in 1875 by indorsing them at the national convention and promulgating a set of rules based thereon.¹¹

By 1880 the Grange was no longer nationally significant.¹² Nevertheless, the third period, lasting from its decline until World War I, was one of gradual expansion. The cooperatives organized during this time were predominantly local in nature and devoted to the marketing of particular commodities, such as the cotton and grain growers of Texas, the cheese rings and creameries of Wisconsin and the New England

OAKE, *THE HISTORY OF THE ROCHDALE PIONEERS* (1907); 1 AND 2 HOLYOAKE, *THE HISTORY OF COOPERATION* (1906).

8. One of the first attempts at agricultural cooperation occurred in 1841 when a group of Wisconsin farmers endeavored to cooperatively market their dairy products. See: HANNA, *THE LAW OF COOPERATIVE MARKETING ASSOCIATIONS* 4 (1931); 2 HOLYOAKE, *THE HISTORY OF COOPERATION* c. XXXI (1906); *HISTORY OF COOPERATION IN THE UNITED STATES*, Johns Hopkins University Studies in Historical and Political Science (1888).

9. In general see: *Frost v. Corporation Commission*, 278 U.S. 515, 529 (1928) (Brandeis' dissenting opinion); BAKKEN & SCHAARS, *ECONOMICS OF COOPERATIVE MARKETING* 66-71 (1937); BLANKERTZ, *MARKETING COOPERATIVES* 20-41, 72-98 (1940); FETROW & ELSWORTH, *AGRICULTURAL COOPERATION IN THE UNITED STATES* 103 (F.C.A. BULL. No. 54, 1947); HANNA, *THE LAW OF COOPERATIVE MARKETING ASSOCIATIONS* 3-7 (1931); NOURSE, *THE LEGAL STATUS OF AGRICULTURAL COOPERATION* 25-119 (1927); *THE COOPERATIVE LEAGUE YEARBOOK* 1-57 (1950); Hamilton, *Judicial Tolerance of Farmers' Cooperatives*, 28 *YALE L.J.* 936 (1929).

10. BAKKEN & SCHAARS, *ECONOMICS OF COOPERATIVE MARKETING* 68 (1937).

11. Journal of the Proceedings of the Ninth Session of the National Grange of the Patrons of Husbandry 94-100, as quoted in HANNA, *THE LAW OF COOPERATIVE MARKETING ASSOCIATIONS* 6 (1931); NOURSE, *THE LEGAL STATUS OF AGRICULTURAL COOPERATION* 35-38 (1927).

12. Other farm organizations related to cooperative growth included the Farmers' Alliance, organized about 1875 with special development in the southern states. The Rochdale principles found their first operative expression in consumers' stores in America in the Sovereigns of Industry, which lasted from about 1874 to 1879. The Farmers Educational and Cooperative Union, popularly called the Farmers Union, was founded in 1902 and had particular influence in the promotion of the cooperative sale of livestock and cotton in the southwest. It now has approximately 455,000 members. See BLANKERTZ, *MARKETING COOPERATIVES* 81-82 (1940); *THE GENERAL FARM AND NATIONAL COOPERATIVE ORGANIZATIONS OF THE UNITED STATES, THE AMERICAN INSTITUTE OF COOPERATION* (1951).

area, and the livestock shipping associations of Nebraska and other western states.¹³

The large foreign markets for agricultural products created by the first World War caused an agricultural boom which quickly receded into a depression when these markets ceased to absorb the American exports.¹⁴ The result was a rapid development of agricultural cooperation during the fourth period, from 1916 through the 1920's, stemming largely from propitious federal legislation. Cooperation was considered to be a cure for the farmers' economic ills, and the favorable legislation was encouraged by the courts and scholars.¹⁵ The first federal income tax exemptions had been granted in 1913.¹⁶ Section 6 of the Clayton Act of 1914¹⁷ removed the authorized activities of certain types of these associations from the antitrust laws. In 1922, Kentucky adopted the favorable Bingham Cooperative Marketing Act,¹⁸ which rapidly became the standard state incorporation act for marketing associations. The Capper-Volstead Act¹⁹ specifically authorized the cooperative association of agricultural producers; and, in addition, it clarified their antitrust exemption. The Federal Farm Board, predecessor to the present Farm Credit Administration, was created by the Agricultural Marketing Act of 1929²⁰ with a 500 million dollar revolving fund available for lending to cooperative businesses so as "to promote, protect, and stabilize the marketing of agricultural commodities." The board organized national cooperatives for many commodity groups including grain, cotton, and livestock.²¹ The number of associations increased from 5,149 in 1915

13. HANNA, *THE LAW OF COOPERATIVE MARKETING ASSOCIATIONS* 7 (1931).

14. Between 1916 and 1920, farm prices rose spectacularly and the value of farm land increased in some areas by 300 to 450 percent in three years. Following the usual economic cycle, the depression found agriculture among its first victims, and farm incomes plummeted from \$17 billion in 1919 to \$9 billion in 1921, to \$5.3 billion in 1922. Total land values decreased from \$78.5 billion in 1920 to \$43.3 billion in 1932. See BLANKERTZ, *MARKETING COOPERATIVES* 87-88 (1940).

15. "Agricultural depression is giving great impetus to the co-operative movement. There are many who believe that the co-operative marketing system is the most hopeful measure yet inaugurated to improve the financial condition of the farmer and to enable the producer to obtain just returns." Ballantine, *Co-operative Marketing Associations*, 8 MINN. L. REV. 1 (1923). In general see: Arnold, *Can the Courts Aid Cooperative Marketing?* 15 MINN. L. REV. 40-74 (1930); Hamilton, *Judicial Tolerance of Farmers' Cooperatives*, 38 YALE L.J. 936-954 (1929); Henderson, *Co-operative Marketing Associations*, 23 COL. L. REV. 91-112 (1923); Miller, *Farmers' Co-operative Associations as Legal Combinations*, 7 CORNELL L.Q. 293-309 (1922); Sapiro, *The Law of Cooperative Marketing Associations*, 15 KY. L.J. 1-21 (1926); Tobriner, *The Constitutionality of Co-operative Marketing Statutes*, 17 CALIF. L. REV. 19-34 (1928).

16. Revenue Act of 1913, § II, G, 38 STAT. 172 (1913). See PART V, p. 447, *infra*.

17. 38 Stat. 730, 731, 15 U.S.C. § 12 (1946). See PART IV, p. 437, *infra*.

18. Ky. Laws 1922, c. 1; KY. REV. STAT. c. 272 (1948).

19. 42 STAT. 388 (1922), 7 U.S.C. § 291 (1946).

20. 46 STAT. 11 (1929), 12 U.S.C. § 1141(a) (1945).

21. See BLANKERTZ, *MARKETING COOPERATIVES* 90-91, 112 (1940).

to 10,546 in the 1929-30 season, and their seasonal volume of business jumped from 624 million to over two billion dollars in the same period.²²

Despite government aid and encouragement, economic failure beset cooperatives in the 1930's after their original expansion following World War I. The number of farmers' marketing and purchasing associations declined from 10,546 in their peak season of 1929-30, to 7,943 in the 1940-41 season; and their total business fell from about two and one-third billion dollars to approximately one and three-quarters billion in the 1939-40 season.²³ Of the total number of associations which discontinued operation in the years down to 1942, 84 percent of them did so from 1920-39. The greatest decline occurred in 1930, when about three cooperatives closed for every banking day.²⁴

The Great Depression was brought to a definite end by World War II, which began the sixth and final period of cooperative development. In conjunction with the general upsurge of business activity following the War,²⁵ cooperative business volume reached an all time high of more than nine billion dollars in the 1948-49 season.²⁶ In the 1949-50 season, however, there was a decline of nearly six percent which was accounted for entirely by the marketing associations,²⁷ attributable largely to the eight percent drop in the farmers' cash receipts.²⁸ Of the various marketing organizations, dairy cooperatives had the largest volume of business; grain, which had led in previous years, dropped to second place; livestock associations ranked third; and fruits and vegetables were fourth.²⁹

In the same season, marketing associations comprised 69 percent of all agricultural cooperative organizations, 62 percent of the membership, and 81 percent of the total volume of business.³⁰ Purchasing co-

22. FETROW & ELSWORTH, *op. cit. supra* note 9, at 210, 212 (Tables 30 and 32).

23. *Ibid.* The decrease in cooperative business of approximately 25.1 percent, which occurred from 1929 to 1939, reflected the general decline of wholesale prices. The wholesale price index for farm products in 1929 was 104.9 as contrasted with 65.3 in 1939, a 37.7 percent drop. The decrease in cooperative business was thus not as severe as might have been expected. See 1950 STATISTICAL ABSTRACT OF THE UNITED STATES 279.

24. FETROW & ELSWORTH, *op. cit. supra* note 9, at 187-190.

25. The total sales of all business increased from 133.4 billions of dollars in 1939 to 458.3 billion in 1948. Total sales declined 5.8 percent in 1949 to 431.5 billions of dollars. The fluctuation of the business volume of agricultural cooperatives thus roughly paralleled that of the total business sales. 1950 STATISTICAL ABSTRACT OF THE UNITED STATES 445 (Table 519).

26. 18 NEWS FOR FARMER COOPERATIVES No. 6, p. 11 (1951).

27. *Ibid.*

28. *Ibid.*

29. Dairy Cooperatives did a total business of \$2.032 billion; grain \$1.953 billion; livestock \$1.3 billion; and fruits and vegetables \$784 million. *Ibid.*

30. *Ibid.*

operatives accounted for 31 percent of the number of such organizations, 38 percent of the membership, and 19 percent of the business. Within the last decade, however, the purchasing cooperatives have shown an average rate of increase in number, membership, and business of 5.96 percent over marketing associations.³¹ At the close of 1950, there were 3,113 farm purchasing cooperatives, having a total membership of a little over two and one-half million, and doing almost one and two-thirds billion dollars worth of business.³² Allowing for duplication, regional purchasing cooperatives served two out of every five farmers in the United States in 1950, as compared with one out of every five in 1942, the first year in which figures were collected.³³ A study of twenty major regional farm supply purchasing cooperatives reveals that their total volume of business in 1950 exceeded all other years to reach a total of 835 billion dollars.³⁴ The business of wholesale and retail outlets have each nearly tripled since 1942,³⁵ although the number of retail cooperatives declined five percent from 1949.³⁶ The 1950 savings for members were 29 million dollars, a 46 percent increase over 1949, but 24 percent less than 1948, the peak year.³⁷

The heaviest concentration of agricultural cooperatives has consistently been found in the north central area of the country.³⁸ In the 1949-50 season, this region accounted for about 60 percent of their num-

31.	<i>Associations</i>		<i>Membership</i>		<i>Business</i>	
	1940	1950	1940	1950	1940	1950
Marketing	74.9%	69%	71.2%	62%	83.8%	81%
Purchasing	25.1	31	28.8	38	16.2	19

Ibid.

32. 18 NEWS FOR FARMER COOPERATIVES No. 6, p. 11 (1951).

33. *Id.* at 7.

34. This was due to a five percent increase in sales of feed, eight percent in petroleum products, and ten percent in fertilizer. The 1950 farm supply dollar of the twenty major regional purchasing cooperatives may be broken down into the following items: feed, 42.4%; petroleum products and related supplies, 28.1%; fertilizer, 9.5%; seed, 4.1%; lumber, paint and hardware, 2.8%; packaged materials, 2.4%; farm machinery, 3.2%; others 7.5%. 18 NEWS FOR FARMER COOPERATIVES No. 5, p. 7 (1951).

35.	1942	1950
Wholesale outlets:	\$229,901,601	\$679,357,811
Retail outlets:	54,211,449	155,420,992
	<hr/>	<hr/>
	\$284,113,050	\$834,778,803

Ibid.

36. 18 NEWS FOR FARMER COOPERATIVES No. 5, p. 7 (1951).

37. *Ibid.* See 1949-1950 HANDBOOK OF MAJOR REGIONAL FARM SUPPLY PURCHASING COOPERATIVES (F.C.A. MISC. REP. No. 150, 1951).

38. The Farm Credit Administration defines this area as including the states of Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio, South Dakota, and Wisconsin. 18 NEWS FOR FARMER COOPERATIVES No. 6, p. 12 (1951).

ber, more than 55 percent of the total membership, and nearly 53 percent of the estimated total business.³⁹

Comparative statistics regarding the volume of cooperative and non-cooperative business in agricultural industries are both rare and incomplete. Available figures indicate that in the dairy industry, cooperatives market approximately 21.7 percent of all milk sold from farms in the United States,⁴⁰ 15 percent of the cheese, 40 percent of the butter, and 60 percent of nonfat, dry milk solid.⁴¹ Cooperatively marketed cranberries have not fallen below 50-65 percent of the total crop in the last forty years.⁴² In 1948, approximately 74 percent of the California and Arizona citrus fruit shipments were marketed through the California Fruit Growers Exchange,⁴³ and forty percent of the shipped fresh fruit from Florida was handled by cooperatives.⁴⁴ Purchasing cooperatives, while experiencing a gradual growth, have remained relatively small as compared with other business organizations in most areas of the country. With the possible exception of the feed business, purchasing cooperatives do not account for a large proportion of the total volume of business in the various industries in which they operate.⁴⁵

Despite its recent growth, the cooperative method of business is not precisely described nor readily distinguishable from other corporate endeavor. No single definition of cooperation exists.⁴⁶ Concepts vary and fluctuate around the seven original Rochdale principles of open membership; democratic control, based upon one vote per member; patronage refunds; limited interest on capital; political and religious neutrality; cash trading; and promotion of education.⁴⁷ These principles were

39. *Ibid.* The exact reasons for this have never been determined. Some attribute it to the fact that large segments of the population of this area are of Scandinavian origin; and since cooperation has long flourished in the Scandinavian countries, it is thought that they brought cooperative principles with them. See CHILDS, SWEDEN THE MIDDLE WAY (Rev. ed. 1947).

40. ACTIVITIES OF THE NATIONAL MILK PRODUCERS FEDERATION, EDUCATION SERIES No. 42, p. 4 (1951).

41. 14 NEWS FOR FARMER COOPERATIVES No. 7, p. 15 (1947).

42. FETROW & ELSWORTH, *op. cit. supra* note 9, at 73.

43. GARDNER & MCKAY, THE CALIFORNIA FRUIT GROWERS EXCHANGE SYSTEM 22 (F.C.A. CIRC. C-135, 1950).

44. 16 NEWS FOR FARMER COOPERATIVES No. 3, p. 11 (1949).

45. In 1951, cooperatives owned less than one-half of one percent of the total producing oil wells in the United States, and they refined about two percent of the total amount refined by thirty principal oil companies. Their investment was less than one percent of that of the same leading thirty companies. 18 NEWS FOR FARMER COOPERATIVES No. 9, p. 11 (1951). The same general situation prevails as to the cooperative manufacture of farm machinery and equipment. See FRANCIS, DISTRIBUTION OF MACHINERY BY FARMERS' COOPERATIVE ASSOCIATIONS (F.C.A. CIRC. C-125, 1941).

46. FETROW & ELSWORTH, *op. cit. supra*, note 9, at 4.

47. BAKKEN & SCHAARS, ECONOMICS OF COOPERATIVE MARKETING c. VII (1937); BLANKERTZ, MARKETING COOPERATIVES c. 20 (1940).

directed toward the creation of a business enterprise in which the individual member retained control and received as a patron the benefits of such cooperative effort.

While political and religious neutrality and promotion of education are still in effect practiced by cooperatives in free countries,⁴⁸ they are ethical or social principles and are not concerned with the actual cooperative method of business; so that of the original seven tenets, only five constitute a *modus operandi*. Open membership is interpreted to refer to occupation, and membership in agricultural cooperatives is usually open only to those connected with agricultural production.⁴⁹ Cash trading was a necessity to the Rochdale pioneers due to their lack of operating capital. Although still encouraged, particularly on the retail level, it has often given way today to credit transactions.⁵⁰ The remaining trinity, democratic control, the patronage refund, and limited

48. Cooperation is, of course, world-wide, and the international organization is the International Cooperative Alliance which was founded in 1895 and is a union of the federated cooperative societies. In 1938, it had an affiliated membership of more than 71 million. At the I.C.A. Congress of 1937 endorsement of the Rochdale principles was attempted, but the conflicting political and ideological theories of the nations represented prevented the adoption of either religious and political neutrality or of educational promotion as obligatory principles. These, together with cash trading, were merely recommended; while open membership, democratic control with one vote per man, distribution of surplus to members in proportion to their transactions, and limited interest on capital were adopted as required principles for agricultural cooperatives. See: COLE, *A CENTURY OF COOPERATION* (1944); *THE COOPERATIVE MOVEMENT IN THE AMERICAS, AN INTERNATIONAL SYMPOSIUM* (1943); WARBASSE, *THE INTERNATIONAL COOPERATIVE MOVEMENT, CO-OPS PLAN FOR THE POST-WAR WORLD, Report of International Planning Done at the Washington Conference* (1944); WARBASSE, *COOPERATIVE DEMOCRACY* c. III (5th ed. 1947). As to the cooperative role in rehabilitation and reconstruction, see *THE COOPERATIVE MOVEMENT AND PRESENT-DAY PROBLEMS*, International Labour Office Studies and Reports Series H, No. 5 (1945).

At the 1951 Congress of the I.C.A., open membership, democratic control, and freedom from outside interference or persuasion from governments or political parties were established as the criteria for admission to the I.C.A. By a new rule, members are obliged to conform in their activity to the principles of Rochdale. *International Cooperation Congress, Copenhagen, 1951* 74 MONTHLY LABOR REV. No. 1, p. 45 (1952).

49. *E.g.*, the Indiana Cooperative Marketing Act places this restriction on those eligible to hold common stock: "Such individuals or political subdivisions must be engaged in the production of agricultural products. A lessor or landlord of land used for such production or any natural person devoting a substantial part of his time in assisting others to produce agricultural products, whether employed by a farmer, or an agricultural cooperative corporation or an association, shall be considered so engaged. Except as above provided, the holders of common stock in any associations limited by its articles of incorporation to one (1) or more of the particular agricultural services shall be such producers of agricultural products as use the articles or services to which the activities of the association are so limited." IND. ANN. STAT. § 15-1606(b) (Burns' Repl. Vol. 1950).

50. See: 16 NEWS FOR FARMER COOPERATIVES No. 9, p. 11 (1949); 15 NEWS FOR FARMER COOPERATIVES No. 2, p. 7 (1948); 12 NEWS FOR FARMER COOPERATIVES No. 12, p. 11 (1946); *Id.* at No. 3, p. 12; 11 NEWS FOR FARMER COOPERATIVES No. 12, p. 10 (1945); 9 NEWS FOR FARMER COOPERATIVES No. 8, p. 8 (1943).

interest on capital, is believed to constitute the distinction between cooperation and other corporate enterprise.⁵¹

Democratic control, originally considered the most revolutionary aspect of cooperation,⁵² substitutes membership for capital interest as the basis for voting. The cooperative has been conceived of as a representative body in which each member is a delegate and a spokesman for his economic unit in the aggregate.⁵³ Cooperative incorporation laws of approximately three-fourths of the states restrict each member to one vote regardless of the amount of stock owned or the extent of patronage,⁵⁴ and it has been estimated that about 86 percent of the cooperatives in the United States adhere to this principle.⁵⁵ Where deviation occurs, it is usually to base voting on the number of shares held or upon the amount of patronage given, but even then a maximum number of votes is normally established.⁵⁶ By so limiting the voting power of each

51. FETROW & ELSWORTH, *AGRICULTURAL COOPERATION IN THE UNITED STATES* 10-12 (F.C.A. BULL. No. 54, 1947); LARSON, *AGRICULTURAL MARKETING* 449 (1951); VENNES & BINKLEY, *FARMER COOPERATIVES*, Agricultural Extension Division, College of Agricultural and Home Economics, 484 University of Ky. Circ. c. III (1950).

52. EMELIANOFF, *ECONOMIC THEORY OF COOPERATION* 192 (1942).

53. *Id.* at 90.

54. FETROW & ELSWORTH, *op. cit. supra* note 51, at 10.

55. 1947 *AMERICAN COOPERATION* 24.

56. FETROW & ELSWORTH, *op. cit. supra* note 51, at 10; PACKEL, *THE LAW OF THE ORGANIZATION AND OPERATION OF COOPERATIVES* 104-107 (2d ed. 1947).

Of the 10,752 cooperative associations in 1938, the following bases of voting were used by the number of associations indicated:

one vote per member	9,219	85.74%
stock or other financial unit	1,335	12.42
patronage (including 60 assoc. in which basis in combination of membership & patronage)	125	1.16
other and unknown	73	.68
	10,752	100.00%

STATISTICAL HANDBOOK OF FARMERS' COOPERATIVES 55 (F.C.A. BULL. No. 26, 1938). But see the results of a survey made of approximately 100 cooperative marketing associations in the states of Arizona, Utah, Nevada, and California showing that only 42% of them had equal voting with the remaining 58% providing for unequal voting generally based upon patronage. BAKKEN & SCHAARS, *ECONOMICS OF COOPERATIVE MARKETING* 154-156 (1937).

The Indiana Act provides that the articles of incorporation or the by-laws of the association may provide that after a stated time, or under stated conditions, "no one shall own more than a stated percentage of its outstanding common stock and/or that no member or stockholder shall be entitled to more than one (1) vote, regardless of the amount of capital invested, or number of shares of stock owned, by such member." IND. ANN. STAT. § 15-1613 (Burns' Repl. Vol. 1950). It is significant that this limitation is expressed in discretionary language. The 1931 amendment to the act deleted provisions limiting ownership by one stockholder to one-eleventh of the common stock and limiting each member or stockholder to one vote regardless of size of

member, it is thought that equality of membership is fostered, in keeping with the democratic spirit which permeated the conception of co-operation.

Equally significant is the principle of the patronage refund. Instead of distributing business returns to stockholders, as is done in non-cooperative enterprises, the cooperative attempts to direct the benefits of corporate activity to those who utilize its services. This is accomplished through the patronage refund which, in theory, returns to the patron-member the remuneration received by the organization in the conduct of its business after allowance for costs and reasonable reserves.⁵⁷ This return is at times referred to as the savings realized by participating in the cooperative method of business.

To further de-emphasize the importance of the organization as a distinct entity, interest is limited on capital to discourage speculation in cooperative stock. The profits to be gained from cooperative enterprise are not in the trading of its stock, but in the use of its method of business.⁵⁸ In addition, many states place restrictions on the amount of stock which may be held,⁵⁹ together with limitations on the extent of non-member business.⁶⁰ These restraints accent the fact that a coopera-

holdings, Acts. 1931, c. 34 § 10, p. 79. It would thus appear that the intent of the legislature was to enable cooperatives to depart from the principle of one man, one vote without limiting stock ownership.

57. See: BLANKERTZ, *MARKETING COOPERATIVES* 134-136 (1940); DIGBY, *THE WORLD COOPERATIVE MOVEMENT* 19-20 (1948); EMELIANOFF, *ECONOMIC THEORY OF COOPERATION* 83 (1942); ENFIELD, *CO-OPERATION: ITS PROBLEMS AND POSSIBILITIES* 6-8 (1927); HOLYOAKE, *THE HISTORY OF THE ROCHDALE PIONEERS* c. IX, 278-281 (1893); NOURSE, *THE LEGAL STATUS OF AGRICULTURAL COOPERATION* 21-24 (1927); PACKEL, *THE LAW OF THE ORGANIZATION AND OPERATION OF COOPERATIVES* 190-194 (2d ed. 1947); Adcock, *Patronage Dividends: Income Distribution or Price Adjustment*, 13 *LAW AND CONTEMP. PROB.* 505-525 (1948).

58. BLANKERTZ, *MARKETING COOPERATIVES* 129, 349-50 (1940); DIGBY, *THE WORLD COOPERATIVE MOVEMENT* 19 (1948); FETROW & ELSWORTH, *AGRICULTURE COOPERATION IN THE UNITED STATES* 11 (F.C.A. BULL. No. 54, 1947); HOLYOAKE, *HISTORY OF CO-OPERATION* 277-278 (1906); PACKEL, *THE LAW OF THE ORGANIZATION AND OPERATION OF COOPERATIVES* 196-197 (2d ed. 1947).

59. The cooperative marketing statutes of nearly half of the states expressly limit the number or proportion of shares which can be owned by a single member, or empower the cooperative to do so. The limitation is either as to percent of total or as to dollar volume. See BLANKERTZ, *MARKETING COOPERATIVES* 128-129, 178-179, 350 (1940). This restriction is discretionary with the cooperative in Indiana. *IND. ANN. STAT.* § 15-1613 (Burns' Repl. Vol. 1950).

60. In Indiana, non-member business must not exceed in amount the total of similar business transacted by the association for its own members during the same fiscal year. *IND. ANN. STAT.* § 15-1605(a) (Burns' Repl. Vol. 1950). The same restriction must be met to come within the provisions of the Agricultural Marketing Act so as to be entitled to borrow from the various federal agencies, 46 *STAT.* 11 (1929), 12 *U.S.C.* § 1141(j) (1945). See PART V, pp. 452-453, *infra*; PACKEL, *THE LAW OF THE ORGANIZATION AND OPERATION OF COOPERATIVES* 159-162 (2d ed. 1947).

tive is an organization whose members have equal standing and whose primary purpose is the benefit of its patron-members.

The three fundamental tenets of cooperation, democratic control, patronage refund, and limitation of interest on capital, distinguish the agricultural cooperative from other types of corporate enterprise. The importance of the distinction is not in the mechanics of the organizational structure. Rather, the significant differential lies in the general emphasis of cooperative organization, which stresses the benefit of patron-members by facilitating and promoting their functioning as individual economic units.⁶¹

An agricultural cooperative is categorized according to the territory served as a local, regional, or national association; while in terms of administrative organization it may be classified as centralized or federated.⁶² The local, centralized association was, naturally, predominant among the early forms of agricultural cooperative organization in the United States.⁶³ But like all creatures, once conceived, the local associ-

61. Other definitions are: "Cooperative organizations represent the aggregates of economic units [the individual farms]. . . . An aggregate of economic units is a plurality or group of these units coordinating their activities but each fully retaining its economic individuality and independence. [It is the] . . . center of their coordinated activities or . . . an agency of associated economic units, owned and controlled by them, through which they conduct their business activities." EMELIANOFF, *ECONOMIC THEORY OF COOPERATION* 248 (1942).

"Co-operation is organized self-help. . . ." 2 HOLYOAKE, *HISTORY OF CO-OPERATION* 589 (1906).

"An agricultural cooperative association is a business organization, usually incorporated, owned and controlled by member agricultural producers, which operates for the mutual benefit of its members or stockholders, as producers or patrons, on a cost basis after allowing for the expenses of operation and necessary reserves." HULBERT, *LEGAL PHASES OF COOPERATIVE ASSOCIATIONS* 1 (F.C.A. BULL. No. 50, 1947).

"A Cooperative is an association which furnishes an economic service without entrepreneur or capital profit and which is owned and controlled on a substantially equal basis by those for whom the association is rendering service." PACKEL, *THE LAW OF THE ORGANIZATION AND OPERATION OF COOPERATIVES* 3 (2d ed. 1947).

"It is indicated that cooperative corporations in general possess many of the essential attributes of ordinary business corporations, the most noticeable differences being in the matters of voting power and the basis of distribution of their net earnings. In the cooperative corporation each member or stockholder has one vote regardless of the number of shares he may hold, whereas each share of stock is entitled to one vote in the ordinary business corporation. . . . The business corporation usually divides part of its profits among its shareholders in proportion to the shares owned, while a cooperative corporation, after distributing part of its profits to shareholders in the form of a dividend not exceeding a rate generally fixed by statute, distributes the remainder in proportion to the volume of members' purchases and sales. Because of a definite and limited return accruing to an investor in a cooperative, his status has been distinguished from that of a stockholder in a business corporation and analogized rather to that of a bondholder." *Farmers Cooperative Co. v. Birmingham*, 86 F. Supp. 201, 211 (N.D. Iowa 1949).

62. See: BAKKEN & SCHAARS, *ECONOMICS OF COOPERATIVE MARKETING* 212-241 (1937); BLANKERTZ, *MARKETING COOPERATIVES* 102-103 (1940).

63. BLANKERTZ, *MARKETING COOPERATIVES* 79 (1940).

ation began to grow, and the need for inter-cooperative and large-scale organization became apparent. Farmers within a region, functioning through their respective cooperatives or individually, foresaw the advantages inherent in quality control, standardization of production and operating methods, and procedures designed to decrease costs of handling and distribution. The results sought to be achieved were an effective bargaining position in the market and, in general, the extension of cooperative services and their more efficient rendition to the members. The transition to large-scale cooperation was effected both within the framework of the centralized organizational structure and through the development of the federated societies, thus culminating in the formation of these two distinct schemes of cooperative administrative organization.

Large centralized associations first became numerous during the years from 1920-25, beginning on the Pacific Coast and spreading particularly to the South in the cotton and tobacco industries.⁶⁴ Many such organizations which came into existence in this early period were the result of high-pressure promotional campaigns which stirred farmers to sign long-term marketing agreements.⁶⁵ Unlike the composition of federated associations, there are no autonomous local organizations in the centralized cooperative. Control and authority are thus concentrated in the headquarters of the group, and the members directly elect the board of directors. Features which recommend this administrative structure are the ease with which it may be organized and the strong central control which it provides. Business and policy matters may be dealt with in a more direct and expeditious manner than a decentralized management is able to exert. Moreover, it may provide the volume which is essential to reduce costs, to insure more economical use of by-products, and to acquire greater bargaining power in the market. This method of organization has been used by purchasing cooperatives⁶⁶ and also in the marketing field, chiefly by the cotton, rice, and tobacco interests of the South and by the wheat growers of the Middle West.⁶⁷ The California dried fruit cooperatives also are organized in this manner, as are many of the wool producers of the Pacific Northwest.⁶⁸ Marketing

64. See: BAKKEN & SCHAARS, *ECONOMICS OF COOPERATIVE MARKETING* 219-222 (1937); HANNA, *THE LAW OF COOPERATIVE MARKETING ASSOCIATIONS* 9-10 (1931).

65. BLANKERTZ, *MARKETING COOPERATIVES* 109 (1940).

66. The giant Cooperative Grange League Federation Exchange, Inc. is one of the leading centralized purchasing cooperatives. In 1950, it distributed a total dollar volume of farm supplies of \$245,559,300. ABRAHAMSEN & SCEARCE, 1949-50 *HANDBOOK ON MAJOR REGIONAL FARM SUPPLY PURCHASING COOPERATIVES* 2-6 (F.C.A. MISC. REP. No. 150, 1951).

67. HANNA, *THE LAW OF COOPERATIVE MARKETING ASSOCIATIONS* 7 (1931),

68. *Ibid.*

associations in the dairy industry are centrally managed to a limited extent.⁶⁹

The federated association is, however, the more common method of large-scale cooperative organization in the United States. A federation has the dual task of assisting its local member-associations in their production and sale problems while conducting its own affairs as a terminal marketing or purchasing agency.

Within the marketing category, a federation may be one of three types.⁷⁰ It may be a regional marketing association, actually handling its members' products and assembling, grading, standardizing, processing, packing, branding, storing, financing and selling them. Or, it may be a regional bargaining association, having as its main function the bargaining for prices, terms, and conditions at which members will sell to local dealers who perform the actual marketing functions. This is an arrangement frequently used in the milk industry.⁷¹ Finally, it may be a regional sales agency which merely sells members' products on a commission basis and performs no other marketing function.

Within the federated organization, a pyramidal hierarchy of command is adopted which, in theory, retains the local members' control over the peak association. The local farmer-member elects the board of directors for his local cooperative which, in turn, elects one or two representatives to the board of the regional. The directors of each regional in turn choose directors of organizations with which they may be affiliated.

As other business entities within the competitive economy, agricultural cooperatives have shown a tendency gradually to assume organizational characteristics necessary for large-scale operation. Once a modicum of success was achieved at the local level, these associations encountered the same two forces which have constantly affected other businesses: the desire created by success to become more successful, and the competition of non-local large-scale business. Together, these have produced the pyramidal expansion of the local cooperative.

To further achieve the efficiencies of size with the resulting increase in bargaining strength, injurious competition among cooperative associations is now being discouraged and greater coordination of effort is urged.⁷² Accordingly, consolidation might well be termed a major policy

69. *Ibid.*

70. See BAKKEN & SCHAARS, *ECONOMICS OF COOPERATIVE MARKETING* 215-219, 223-225 (1937).

71. See *DISTRIBUTION OF MILK BY FARMERS' COOPERATIVE ASSOCIATION 1* (F.C.A. CIRC. C-124, 1941).

72. "Cooperatives have made tremendous progress in coordinating their efforts in

of modern agricultural cooperation.⁷³ It was largely due to this policy that the Farm Credit Administration attributed the decrease in the total number of agricultural cooperatives in the United States from 10,700 in the 1938-39 marketing season to 10,035 in the 1949-50 season.⁷⁴ Moreover, in recent years relatively few of these organizations have a substantial portion of all cooperative business.

By the end of 1945, large-scale marketing cooperatives, embracing varied economic activities and extending over a wide geographic area, accounted for over 50 percent of the business done by all marketing associations.⁷⁵ Yet, the organizations responsible for this portion of the total business numbered but 7.3 percent of all cooperatives engaged in marketing functions.⁷⁶ In the purchasing area, only 3.5 percent of all purchasing cooperatives operating on a large scale handled more than 40 percent of the total volume of business.⁷⁷ Of all the cooperative marketing and purchasing associations in the same 1944-45 season, 6.2 percent accounted for 48.7 percent of the total business and 42.6 percent of the total membership.⁷⁸

It thus can be seen that agricultural cooperation, unlike its former character as a small, directly controlled economic influence in a particular community, has assumed in large measure the administrative, economic, and geographic proportions of big business. The natural inquiry is whether this substantial metamorphosis has produced a modification in the basic cooperative principles. A further question, if alteration has occurred, is whether the result has been to diminish the desirability of cooperation as a distinct form of economic enterprise for farmers.⁷⁹

recent years and there is reason to believe that such coordination will greatly increase as the problem of reducing excessive competition is courageously tackled.

"There is an answer to the problem of excessive competition between cooperatives. It lies in more cooperation wherever this will benefit cooperative members." 16 NEWS FOR FARMER COOPERATIVES No. 11, p. 18 (1950); See 16 NEWS FOR FARMER COOPERATIVES No. 12, p. 3 (1950); 1949 AMERICAN COOPERATION 341-376.

73. "Few realize the extent to which local cooperatives have joined regional cooperatives in recent years. In fact, there are now relatively few local cooperatives that are not affiliated or are not members of larger organizations. The 17 major regional purchasing cooperatives now have over 4,000 member associations as compared to 2,500 about 7 years ago. Grain, dairy, and other types of marketing cooperatives have also federated in many areas." 16 NEWS FOR FARMER COOPERATIVES No. 11, p. 18 (1950). See, *Big Business without Profit*, 32 FORTUNE 152 (1945).

74. 18 NEWS FOR FARMER COOPERATIVES No. 6, p. 11 (1951).

75. FETROW & ELSWORTH, AGRICULTURAL COOPERATION IN THE UNITED STATES 191, (Table 26 F.C.A. BULL. No. 54, 1947).

76. *Ibid.*

77. *Ibid.*

78. *Ibid.*

79. The tendency is well described by the T.N.E.C.: "The vaster they [the corporations] become the more difficult are the structural problems of organization, coor-

PRINCIPLES IN PRACTICE

The tenet that interest return on capital must be limited has at times proved the most inconvenient to cooperative development. However, this fundamental principle has been adhered to closely. It was evolved as a means to reduce the speculative character of cooperative stock and to emphasize the fact that a cooperative does not furnish primarily a source of investment, but rather a method of performing for members some needed service at cost. Both federal and state laws have recognized this principle. The Capper-Volstead Act⁸⁰ establishes a maximum interest rate of eight percent, but only if members vote on any basis other than one vote per member. If voting is so limited, then the interest rate is unrestricted. However, to come within the exemption provisions of the federal revenue act, a cooperative must limit its interest to either eight percent or to the legal rate in the state of incorporation, whichever is greater.⁸¹ The state agricultural cooperative acts either specify an interest rate or require that the corporate by-laws establish a fixed rate that is reasonable.⁸²

The result of the limited interest principle was to deprive the early cooperatives of much needed capital,⁸³ for individuals were loath

dination, and control, and the human problems of incentive and leadership. Large corporations, like other large human enterprises, are bureaucratic. They tend to live by fixed rules rather than acumen, by the meshing of many component parts rather than the quick decision of an entrepreneur. Organization grows in importance as size increases. . . . And like other large organisms, the larger the modern corporation becomes, the more it tends to move slowly, adapt itself with increasing difficulty, be increasingly concerned with its inner rules and procedures. Hence, it stands in danger of losing that flexibility of price adjustment and resiliency of managerial outlook which is the most valuable social asset of free competition." DIMOCK & HYDE, BUREAUCRACY AND TRUSTEESHIP IN LARGE CORPORATIONS 3-4 (TNEC Monograph 11, 1940).

This thought, as applied to cooperatives, was expressed by one writer in this manner: "As I sit in the meetings of farmer cooperatives and listen to the discussions and decisions of management, I am impressed with the fact that the rules of the game are becoming more and more the rules of big business. . . . You must meet changing conditions. But perhaps this too brings new problems and new orientation. . . . I am beginning to question more and more whether the expansion of cooperatives through the establishment of new departments or of new enterprises is in the interest of our rural economy. To what extent is it a move, and an understandable one, on the part of management to foster vested interests?" Wood, *Cooperatives, Competition and Free Enterprise*, 1950 AMERICAN COOPERATION 217.

80. 42 STAT. 388 (1922), 7 U.S.C. § 291 (1946).

81. INT. REV. CODE § 101 (12) (a).

82. The Indiana Act sets an eight percent maximum on dividends of any kind or class of stock based upon par value of the respective stock, and if no par then upon book value. IND. ANN. STAT. § 15-1613 (Burns' Repl. Vol. 1950).

In 1940, one state limited interest on capital to 5%, five states to 6%, one to 7%, eleven to 8%, and two to 10%. The remaining states specified that a fixed amount should be set by the by-laws within a fair rate of interest. BLANKERTZ, *MARKETING COOPERATIVES* 349 (1940).

83. See BLANKERTZ, *MARKETING COOPERATIVES* 349-350 (1940); FETROW & ELS-

to invest in cooperative enterprise and banks were reluctant to lend. This difficulty was partially alleviated by the establishment by the Federal Government of agricultural credit agencies, and later by the creation of central and district banks for cooperatives.⁸⁴ Of greater significance as a current method of offsetting the limitation placed upon sources of capital by the restricted interest device is the modification of another cooperative tenet, the patronage refund.

In theory, the patronage refund represents, not profits of the associations, but savings made for the members by their dealings through the cooperative.⁸⁵ Its strict application on a cash basis would result in cash flowing through the cooperative organization while such funds were critically needed for financing. In their search for capital, cooperatives began to retain a portion of the cash and to distribute instead to the patron-member some form of certificate evidencing the amount of his refund.⁸⁶ This process of retaining the cash savings and substituting certificates containing provision for possible subsequent retirement is designated as the revolving-fund plan of financing,⁸⁷ a technique which has become one of the most significant aspects of modern cooperative financial administration. For example, in 1950, the Farm Bureau Cooperative Association, Inc. of Ohio, reported a total savings to members of ten million dollars for its seventeen years of operation. Of this amount, 35 percent had been refunded in cash to the shareholders and patrons, and the balance of 65 percent had been retained and used by the association.⁸⁸ In 1946, the 6,009 agricultural cooperatives which qualified for tax exemption under Section 101 (12) of the Internal Revenue Code credited \$106 million to patronage refunds. Of these funds, approximately \$16.5 million or 15.5 percent actually was paid out in cash.⁸⁹

WORTH, AGRICULTURAL COOPERATION IN THE UNITED STATES 11 (F.C.A. BULL. No. 54, 1947); HULBERT, LEGAL PHASES OF COOPERATIVE ASSOCIATIONS 3 (F.C.A. BULL. No. 50, 1942).

84. See HULBERT, *op. cit. supra* note 83, at 311.

85. See IND. ANN. STAT. § 15-1613 (Burns' Repl. Vol. 1950); EMELIANOFF, ECONOMIC THEORY OF COOPERATION 183-185 (1942); Jensen, *Terminology in Cooperative Corporation Law*, 1948 AMERICAN COOPERATION 288.

86. At the close of their fiscal year in 1942, the then seventeen major regional purchasing cooperatives had a total net worth of \$37,646,846. Of this amount, 66% had been retained out of savings, while 33.5% represented sums accumulated through the sale of stock. 1941-42 HANDBOOK ON MAJOR REGIONAL FARM SUPPLY PURCHASING COOPERATIVES, 60 (F.C.A. MISC. REP. No. 67, 1943).

87. See PART II, pp. 394-395, *infra*.

88. 1950 ANNUAL REPORT, THE FARM BUREAU COOPERATIVE ASS'N., INC., OHIO 9.

89. TAX TREATMENT OF COOPERATIVES, PART 2, p. 4, by Staffs of the Treasury and the Joint Committee on Internal Revenue Taxation (Apr. 1951). See PART V, p. 464, *infra*.

It is thus illustrated that through the revolving fund device, a major portion of cooperative cash receipts allocated to patronage refunds is in fact diverted to financing reserves. Consequently, patronage refunds have in large measure assumed the form of deferred payment certificates, issued to members as evidence of their equity in the assets of the organization. Moreover, cooperatives have exhibited recently a discernible tendency to further restrict the return of cash savings, equivalently extending the distribution of members' equity certificates. The total net savings of the twenty major regional farm supply purchasing cooperatives for the fiscal year ending in 1950 amounted to \$28,810,648, a forty-five percent increase over 1949.⁹⁰ In the distribution of this amount, as compared with 1949, deferred patronage refunds increased 44.5 percent while cash refunds increased only 36.6 percent; although the latter exceeded the former by approximately a million dollars.⁹¹ The total amount of savings retained, including deferred refunds and reserves, increased 64.4 percent over 1949; and the retained reserves increased 96.5 percent.⁹²

This manner of administering the patronage refund principle impinges upon the third basic tenet of cooperation, that of democratic control. In an effort to avoid the concentration of control in the hands of a few, which was found to occur in regular corporate enterprise, the Rochdale principles attempted to equalize control by basing voting upon membership and not upon economic interest.⁹³ The goal has been to discourage and, if possible, to prevent the accumulation by a few individuals of inordinate economic interest in the organization by means of which they may exert greater influence upon the management of the cooperative. Accordingly, many states have restricted the amount of stock which a member may hold.⁹⁴ The amount of patronage, of course, has not been limited with the result that patronage refunds necessarily are unequal. So long as these refunds are paid in cash, whereby no

90. ABRAHAMSEN & SCEARCE, 1949-50 HANDBOOK ON MAJOR REGIONAL FARM SUPPLY PURCHASING COOPERATIVES 54 (F.C.A. MISC. REF. NO. 150 1951).

91.

Distribution of Net Savings	1949	1950	Percentage Increase
Cash patronage refunds.....	\$ 7,011,268	\$ 9,575,268	36.6
Deferred refunds	5,910,421	8,542,596	44.5
Cash dividends on stock.....	3,238,331	3,504,797	8.2
Retained in reserves	3,658,691	7,187,987	96.5
Total	\$19,819,360	\$28,810,648	45.4

92. *Ibid.*

93. *Supra*, p. 360.

94. BLANKERTZ, *MARKETING COOPERATIVES* 350 (1940). HANNA, *THE LAW OF CO-OPERATIVE MARKETING ASSOCIATIONS* c. 2 (1931).