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HOW TO ORGANIZE AGRICULTURAL MARKETING COOPERATIVES

A Handbook

Prepared by
Smith, Stein & Bernotavicz
Attorneys at Law
Hallowell, Maine



Maine State Planning Office
Executive Department

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Agricultural Marketing Cooperatives:
A Handbook

Prepared By:
Smith, Stein and Bernotavicz
Attorneys at Law
Hallowell, Maine

Under Contract With
Maine State Planning Office

Written By:
John W. Bernotavicz, Esq.
Gordon E. Stein, Esq.
Freda D. Bernotavicz, M.S.

Contract Officers:
Charles Lawton, Ph.D.
Cheryl Harrington, Attorney

FOREWORD

In today's complex economy, it has become increasingly difficult for an individual farmer or other producer of agricultural products to compete effectively with larger business organizations in the marketplace.

For these individuals to succeed, it is often advisable that they associate with other people like themselves to benefit from the economies of scale of larger organizations; develop group marketing programs; create new markets for their products; and strengthen their bargaining position in the marketplace.

This handbook is intended for use by agricultural producers who are interested in joining together to form a business association. This includes farmers, poultrymen, nurserymen, fruit and vegetable growers. At present, there is disagreement among lawyers and courts as to whether forestry products are agricultural products. This means that forestry producers who wish to form a cooperative, will have to consider different legal issues from those facing agricultural producers in general. This handbook highlights those differences as they arise in the text. In addition, an appendix dealing exclusively with the issue of forestry cooperatives is included.

This handbook is intended to:

- Provide general legal information on different kinds of business associations.
- Assist agricultural producers in deciding on the best form of business association for them.
- Provide guidelines for the legal procedures in setting up an Agricultural Marketing Cooperative.

Legal information relating to corporations, partnerships and other commonly used forms of business associations is already available from many different sources. This handbook therefore concentrates on "cooperatives" as a form of business association.

Although this handbook deals specifically with legal issues which arise in the process of putting together a cooperative and its subsequent operations, it is not intended that it be a substitute for the assistance of a qualified attorney.

There are so many specialized legal issues to be considered, that many attorneys in general practice will not be familiar with the law as it relates to cooperatives. This handbook can be used by the attorney and other readers to provide the basic legal framework for this specialized information. However, when the time comes to actually put together the legal structure of the cooperative, it is recommended that a qualified attorney be retained.

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I. BACKGROUND

The first questions which arise in deciding whether to form an association are economic and organizational. Although these issues are extremely important and often take months of meetings and discussions to resolve, they will receive only brief treatment here. This handbook is intended to deal primarily with legal issues related to the formation and operation of cooperatives. There are many economic and organizational resources already available both in the form of written material and technical assistance. A list of resources on economic and organizational issues is found in Appendix F.

To succeed in any business venture, a solid basis of support from potential members and a sound economic justification for entering into that venture are needed. Generally, a committee system is utilized to find out whether there is economic need and sufficient interest. An Organizing Committee made up of interested people is usually set up. This Organizing Committee is then divided into various subcommittees, each having the responsibility for gathering the information required to answer the following questions and reporting back to the Organizing Committee.

The following are the general questions which ought to be answered before deciding to form an association.

A. ARE ECONOMIC CONDITIONS RIGHT?

You need to find out whether it is going to be economically worthwhile to join together. Generally, economic conditions are favorable for creating an association if:

- existing commercial facilities and services are inadequate;
- capital costs prevent individuals from going into business;
- the cost of service is too high;

- the prices being received by producers are too low;
- there is a potential for increasing the individual's marketing capability.

B. IS THERE INTEREST?

To determine the level of interest, you will find it helpful to meet with people knowledgeable about cooperatives and other forms of business organizations. The Maine State Department of Agriculture has representatives, including a cooperative development specialist who will attend such a meeting. The Cooperative Development Field Office is part of the United States Department of Agriculture and is located in the office of the State Department of Agriculture, Food and Rural Resources. Appendix F also includes other resources and technical assistance which would be helpful at this stage.

The following points should be covered at the general meeting:

- information on how cooperatives and other forms of business associations are organized;
- some advantages of group action;
- some limitations of an association.

If enough interest is generated at this meeting, subcommittees should be appointed to gather the information needed to decide whether or not the venture is workable.

C. IS IT WORKABLE?

Several areas need to be examined carefully. The first problem is to get specific economic data - such as the following:

What is the Potential Return to Members?

A cooperative development specialist and/or financial advisor can be helpful in suggesting techniques for making this analysis.

An informal income/expenses statement, market projections and cash flow analysis will be needed to determine economic feasibility.

Will There Be Sufficient Volume?

The anticipated volume of production must be large enough to support the overhead and operating costs of the new organization. To ensure volume, it is recommended that members sign a preorganizational agreement. This agreement should specify that the association will be formed only if the stated number of persons sign up as members.

Is There Enough Financing?

It is essential that the association have enough money to cover anticipated costs and contingencies. Members should be encouraged to provide as much of a stake as possible. The more of their own money they invest, the more likely they are to work hard to ensure the success of the operation.

In certain cases, however, "sweat equity" (hours of work) can defray start up and operating costs and should be assessed when evaluating necessary membership commitment. Local lending institutions and private sources should be explored fully. The specifics of how to secure financing and the various sources for financing are discussed in greater detail later in this handbook.

Can you get good management?

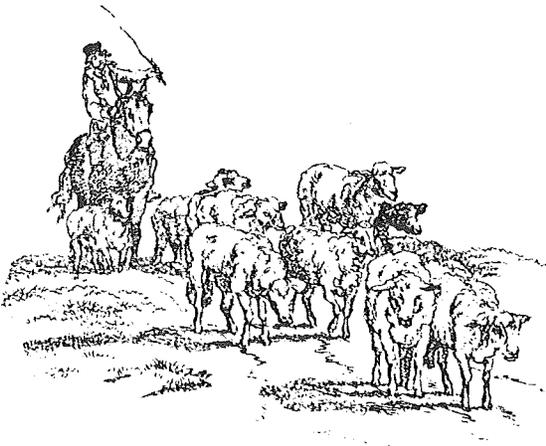
The day-to-day operations of the association will be run by a manager. It is imperative to the success of your venture that you select the right person for this position. Good managers are hard to find, but essential to the success of a business organization. A well-qualified, well-paid, full-time manager should be budgeted for.

D. WHAT FORM OF BUSINESS ASSOCIATION IS BEST FOR YOU?

A general meeting of the Organizing Committee should be held so that the various subcommittees can report on their findings. The whole committee should review those findings and make a decision regarding the form best suited to your needs and the existing facts.

The following section provides an overview of several forms of business associations which you should consider. These are: sole proprietorship, partnerships (general and limited), capital stock corporation, non-profit corporation, and cooperatives.

II. What kind of Association?



II. WHAT KIND OF ASSOCIATION?

A. SOLE PROPRIETORSHIP

Although a Sole Proprietorship is not an association since it involves only one person, it is the form of business under which many small agricultural producers operate. An understanding of what it is and how it differs from other forms of business associations will prove helpful in deciding what form is best for you.

As the name suggests, a Sole Proprietorship is a business which is solely owned by one individual who is personally responsible and liable for every aspect of the business operation. For example, Mr. John Smith owns a small dairy farm. He has 100 head of milking cows, 300 acres of pasture and \$200,000 of farm equipment, a house, a 100 acre wood lot, and a camp on a nearby lake, a new Chevrolet, and a power boat which he keeps at the camp. If Mr. Smith runs his dairy farm as a Sole Proprietorship, he has advantages and drawbacks:

Some Advantages of a Sole Proprietorship.

It is the most simple form of business and simplicity and ease of management are its principle advantages. Mr. Smith must, of course, still maintain an efficient bookkeeping and accounting system, fill out federal tax forms and comply with all state and federal regulations relating to businesses. However, in a Sole Proprietorship there is generally less paperwork and accounting than in other business organizations.

Some Drawbacks.

The disadvantages to Mr. Smith are that he cannot separate his personal property (his home, camp, power boat, etc.) from his business property. He is personally liable for all his business debts.

This means that the creditors of his business may sue him personally and attach any property belonging to him in order to satisfy any debts incurred by his business. If Mr. Smith's dairy farm were to go bankrupt, his creditors could get everything he owns. In a corporation, as will be discussed later, only the property of the corporation may be attached or sold to satisfy the debts of the business. This means that if the business fails, the owner's personal property cannot be attached by the creditors.

Another disadvantage is that a Sole Proprietorship can only raise capital through personal loans or personal savings.

B. PARTNERSHIPS

A partnership is the carrying on of a business by two or more people. There is no limit to the number of partners who can form a partnership.

A partnership agreement generally sets out the individual partners' rights and responsibilities regarding each other.

There are two forms of partnerships--general and limited.

1. General Partnership

In a general partnership, the business is owned jointly and severally by each one of the partners. This means that each partner is jointly liable and individually liable for all the debts of the partnership.

Suppose John Smith's brother, Wayne, has a dairy farm of equal size next to his brother. John and Wayne decide to form a partnership to run the farms. They reach an agreement regarding how income will be apportioned and how profits will be distributed. A separate bookkeeping and accounting system is set up for the partnership. It is important to remember that a partnership is a separate legal entity from any of the partners. The Smith Brothers partnership (Smith Bros.) will have its own federal identification number, it will have to

file a partnership income tax return and comply with all state and federal regulations relating to partnerships.

Some Advantages of a Partnership.

The main advantage of a partnership is that the responsibility of running the business is shared. The resources of the individual partners all contribute to the business, and the organization has the benefit of a team approach to business rather than an individual approach. Smith Bros. consists of a 200 head dairy farm, with 600 acres of pasture, \$400,000 worth of equipment and two experienced dairy farmers to combine their knowledge and experience in the operation of the business.

Some Drawbacks.

The disadvantages are that the partners' personal liability is still not separated from business liability. Each partner is personally liable for the debts of the partnership. This means that if the Smith Brothers business were to go bankrupt, the creditors could attach the personal property of both John and Wayne Smith. In addition, each partner is liable for the acts of the other partners if those acts relate to the carrying on of the business. If Wayne, without consulting John, purchases new milking equipment, John is liable for that debt.

2. Limited Partnership.

Suppose the Smiths have another brother, Elton. Elton is a successful car dealer in Massachusetts and wants to invest \$50,000 in his brothers' dairy farm partnership. John and Wayne both want the money, but realize that their brother, Elton, knows nothing about dairy farming and do not want him to be involved with the operation of the business. If John, Wayne and Elton form a limited Smith Brothers partnership, their needs can be met.

John and Wayne can be the general partners who run the business and who are totally responsible and liable for its operation. Elton can be the limited partner, who, by law, has no say in the operation and whose liability is limited to the amount of money he invests.

If this business were to fail, John and Wayne, the general partners, would still be personally liable for all the outstanding debts and creditors could reach their personal property. Elton, on the other hand, would have no personal liability, but would lose his \$50,000 investment.

C. CAPITAL STOCK CORPORATION

A Capital Stock Corporation is the most widely used form of business association in America. This is because it protects its owners from personal liability and because the laws are extremely flexible and allow a corporation to be structured in many different ways to meet different needs.

The basic structure of a Capital Stock Corporation is that each investor purchases certain shares of stock. The money paid by the investors becomes the capital of the corporation. In return, the investor (shareholder) receives an interest in the corporation equal to his proportionate share of all the stock of the corporation.

The corporation is run by a board of directors who are responsible for the management and policy decisions. Day-to-day operations of the corporation are run by a manager and staff. These elements are shown below:

CAPITAL STOCK CORPORATION

<u>Who?</u>	<u>Does What?</u>
Stockholders	1. Purchases Shares 2. Vote (in proportion to shares) to elect Board 3. Receive dividends (in proportion to shares)

- Board of Directors
4. Other powers as per bylaws
 1. Vote to:
 - set policy
 - make management decisions
 - hire staff
 - other powers as per bylaws
- Manager/Staff
1. Run the organization

The simplest kind of stock corporation is one owned by one person.

For example, John Smith could run his dairy farm as a corporation instead of a Sole Proprietorship. To do this, he would file the necessary papers with the Secretary of State saying that the starting assets of the corporation would be 100 head of cows, a barn, pasture and farm equipment. In return for giving all those assets to the corporation, John Smith would receive all the shares of the corporation and would be the sole owner (shareholder) in the John Smith Corporation.

He would own 100% of the shares, could elect himself to the Board of Directors and appoint himself manager of the organization.

The advantages of this form of organization over a Sole Proprietorship is that he no longer has personal liability.

If the corporation went bankrupt, John Smith could lose his barn, his cows, his pasture, and his farm equipment, but his personal property (his home, camp, etc.) would be protected.

Suppose the two Smith Brothers, John and Wayne, decided to form a corporation (SMITH BROS., INC.) instead of a general partnership, (SMITH BROS.). If each gives \$100,000, they could each receive 100 shares at \$1,000. The value given to a share when setting up a new corporation is entirely up to the person or persons incorporating. The only guideline is the value of the total amount

of shares should equal the value of the assets of the corporation.

John and Wayne would, therefore, each own 50% of the corporation as joint stockholders. They would have an equal number of votes and would probably appoint themselves as the Board of Directors and managers of the corporation.

At the end of the year, when the corporation makes a profit, the Board of Directors decides how much of that profit will be kept in the corporation and used as operating capital and how much will be paid out to shareholders in the form of dividends. The advantage of SMITH BROS., INC. over a general partnership is again the issue of personal liability. The personal property of the two brothers is protected from any potential failure of the business.

Suppose the three Smith Brothers, John, Wayne and Elton, decide to form a Capital Stock Corporation (SMITH BROS., INC.) instead of a limited partnership. Below is a description of how this might operate.

Example #1

CAPITAL STOCK CORPORATION

SMITH BROS., INC.

A. Stockholders

John Smith contributes \$100,000 in assets to the corporation; Wayne Smith contributes \$100,000 in assets; Elton Smith contributes \$50,000 in cash. They are shareholders in the business. John and Wayne own 1,000 shares each at \$100 per share. Elton owns 500 shares. Under this arrangement, John owns 40% of the corporation, Wayne owns 40% of the corporation, and Elton owns 20%.

B. Board of Directors

The three brothers, John, Wayne, and Elton, form the Board of Directors. They meet twice a year.

C. Manager/Staff

John and Wayne are joint managers of the organization, each responsible

for the day-to-day operations of his own farm.

D. Distribution of Profit

In 1979, the corporation makes a gross profit of \$120,000. After corporate taxes are paid, this is reduced to \$80,000. The Board of Directors meets and decides to retain \$20,000 in the business and to pay out the remaining \$60,000 in dividends. Since there are 2,500 outstanding shares, the \$60,000 must be divided equally, resulting in a dividend of \$24 per share. Therefore, John and Wayne would each receive \$24,000, and Elton would receive \$12,000.

This is summarized in the table below:

Shareholders' Investment:

John	\$100,000	----	1,000 shares and votes
Wayne	\$100,000	----	1,000 shares and votes
Elton	\$ 50,000	----	500 shares and votes
Total Business Transacted:	\$300,000		
Gross Profit	:	\$120,000	
Corporate Taxes	:	\$ 40,000	
Reinvestment	:	\$ 20,000	
Net Profit	:	\$ 60,000	
Dividends on Shares	:		
	John	\$ 24,000]	24% return
	Wayne	\$ 24,000]	on
	Elton	\$ 12,000]	investment

Note that all three brothers must now pay income tax on their return. However, as the example illustrates Elton received an equal return in proportion to his investment, despite the fact that he has not worked in the business.

This is an extremely simplified description of how a corporation works financially. There are many variations to this general theme. In the example,

only one kind of stock (common) was used, but it is possible to structure a corporation using several kinds of stock. Stock may differ according to voting rights, cost, how much it can be redeemed (cash in) for, the priority in which it can be redeemed, and the priority to which dividends are paid.

Some Advantages of Corporations.

A Capital Stock Corporation provides several financing options: it can borrow from banks, sell stock, borrow from investors, issue debentures (promissory notes payable with interest by the corporation at the end of a certain number of years.).

A corporation also provides flexible growth possibilities and will exist forever, regardless of the death of the members or the shareholders.

Some Drawbacks.

The disadvantages of a corporation are that all profits are taxable to the corporation according to corporate rates, which are generally higher than individual rates. The dividends which are distributed to the shareholders are also taxable to them when they are received. This results in paying taxes twice on the same money, or "double taxation".

Also, control in a Capital Stock Corporation is generally in the hands of the person who has the largest dollar investment. Large corporations will also be subjected to state and federal registration requirements for their securities (shares of stock).

D. NON-PROFIT CORPORATION

A non-profit corporation is a corporation which cannot distribute its profits or its assets to its members or shareholders.

The structure of a non-profit corporation is similar to that of a Capital Stock Corporation in that it is run by a Board of Directors elected by its members (shareholders).

Non-profit corporations are generally set up for charitable, educational, or scientific purposes and not for operating a business.

Some Advantages of a Non-profit Corporation.

The primary advantage is that the corporation may qualify as a tax exempt organization. This means that the organization does not have to pay income tax on its profits and is exempt from security registration and regulations.

Some Drawbacks.

Although a non-profit corporation can compensate its members for materials or services provided to it, it cannot pay dividends to its members on any capital they invest in the association or return to them in any manner any of the profits it makes as an organization. If the organization prospers, the members cannot benefit financially from that growth since the assets of the corporation can never by law go to the benefit of the members. A non-profit corporation is also severely restricted by federal laws and regulations as to the extent of its operation.

E. COOPERATIVES

Cooperatives are very similar to corporations in their structure. In fact, generally speaking, cooperatives are corporations. Cooperatives, like corporations, are run by a Board of Directors chosen by the membership of the cooperative. Like corporations, the individual members of the cooperative have no personal liability for the debts of the cooperative.

The differences between a cooperative and a Capital Stock Corporation are in the way it operates and the way the profits are paid out. Instead of shareholders, a cooperative is composed of members, with each member having only one vote. The members usually pay an entrance fee, and enter into a membership agreement and sometimes a marketing agreement with the cooperative. At the end

of the year, they receive their share of the profits of the cooperative in the form of patronage refunds. Patronage means the amount of business done with the cooperative, either time or volume of product transacted.

In a corporation, the shareholder receives his share of the profits in proportion to the number of shares he has (stock dividends).

In a cooperative, the member receives his share of the profits in proportion to the amount of business he does with the cooperative (patronage refund).

In a corporation, each shareholder has as many votes as he has shares of stock. In a cooperative, each member has only one vote.

In addition to having members, cooperatives may be set up as Capital Stock Cooperatives. This means that, like Capital Stock Corporations, they can issue shares of stock to both members and nonmembers. However, dividends on this capital stock are generally limited by law to eight percent.

In a Capital Stock Cooperative, when the net profit is determined, at the end of the year, the Board of Directors determines how much will stay in the cooperative; how much will be paid in dividends to the shareholders; and how much will be paid to members in patronage refunds.

The elements of a Capital Stock Cooperative are shown below:

CAPITAL STOCK COOPERATIVE

<u>Who?</u>	<u>Does What?</u>
Members	1. Pay membership fee
	2. Vote (1 vote per person) to: -elect board
	3. Do business with cooperative
	4. Receive patronage refunds in proportion to business done

- | | |
|--------------------|--|
| Stockholders | 5. Other powers as per bylaws |
| | 1. Purchase shares |
| | 2. Receive dividends (limited to maximum of 8% return) |
| Board of Directors | 1. Vote to: |
| | -set policy |
| | -make management decisions |
| | -hire staff |
| | -other powers as per bylaws |
| Manager/Staff | 1. Job is to run organization |

Suppose the three Smith Brothers decided to associate with a dairy cooperative (Tacoma Dairy Cooperative) rather than forming a partnership or corporation. The following illustrates how this might work:

Example #2

TACOMA DAIRY COOPERATIVE

A. Members

There are four existing members in the cooperative. John and Wayne each pay a membership fee of \$100 bringing the total membership to six.

B. Stockholders

One hundred seventy-five shares of stock at \$100 per share are already owned in the cooperative. John and Wayne each purchase \$5,000 worth (50 shares). Elton, as a nonmember, purchases 100 shares (\$10,000 worth).

C. Board of Directors

The six working members of the cooperative elect the Board of Directors.

Distribution of Profit

In 1979, John sells \$150,000 worth of milk to the cooperative (his

total output). Wayne sells \$75,000 of milk to the cooperative (the rest of his produce is sold through a separate agreement to a local retailer). The other members bring the total value of milk sold to the cooperative to \$600,000. The cooperative in turn sells milk to retailers for \$840,000. Of this, the gross profit is \$240,000. The Board of Directors decides to retain \$37,000 in the business, pay an eight percent dividend on shares (the maximum allowed by law), and to distribute the rest of the profit in patronage refunds.

As shareholders, John and Wayne would each receive 8% on their \$5,000 investment, i.e. \$400; Elton would also receive 8% on his \$10,000, i.e. \$800; not a very attractive return compared to the potential return in a Capital Stock Corporation indicated in the first example.

In addition, John and Wayne as working members would receive patronage refunds in proportion to the value of milk they sold to the cooperative.

Patronage refunds would be calculated as follows:

Total Patronage	\$600,000	=	100%
John Smith	\$150,000	=	25%
Wayne Smith	\$ 75,000	=	12.5%
Other Members	\$375,000	=	62.5%

This example is summarized in the chart below:

Stockholders:

Investment:

John	\$ 5,000	----	50 shares
Wayne	\$ 5,000	----	50 shares
Elton	\$10,000	----	100 shares
Others	\$17,500	----	175 shares

Members: 6 individuals

Total Sales of Milk By Coop To Retailers: \$840,000

Gross Profit	:	\$240,000
Corporate Taxes	:	---None---
Reinvestment	:	\$ 37,000
Net Profit	:	\$203,000

Dividends on Shares:

John	:	\$400]	
Wayne	:	400]	8% return
Elton	:	800]	on
Others	:	<u>1,400</u>]	investment
Total	:	\$3,000]	

Patronage Refund : (on remaining \$200,000)

John	25%	---	\$ 50,000
Wayne	12.5%	---	25,000
Elton	None	---	--None--
Others	62.5%	---	\$125,000

As the above example illustrates, cooperatives favor working members. In a corporation, investors receive compensation in proportion to the amount of money invested. In a cooperative, the members who do the most business with the cooperative receive the best return.

There are many different kinds of cooperatives:

--Consumer cooperatives which purchase consumer goods at wholesale prices and sell them to the members at cost plus expenses. Maine has several food cooperative (e.g. FedCo) which are examples of consumer cooperatives.

--Supply and service cooperatives which provide supplies and service to various types of business. For example, an agricultural grain cooperative purchases agricultural supplies for its farmer members and sells them to the members for cost plus expenses. Agway is an example of an agricultural supplies cooperative.

--Marketing cooperatives, where the members sell their commodities to the cooperative. The cooperative in turn will sell the commodity, and after deducting expenses, distribute the profits to its members. Sunkist is an example of a marketing cooperative.

Although the various forms are distinguished by the service they provide

to their members, their basic overall operation is the same. They are all self-help business associations owned and operated for the benefit of the people using the services.

This is an important distinction which separates the cooperative from the Capital Stock Corporation.

Some advantages.

Cooperatives have been given several advantages in the area of taxation which are not available to regular Capital Stock Corporations. These tax advantages will be fully discussed later. They are the primary reason why a cooperative is a desirable form of business enterprise for producers of agricultural products. Simply, the tax advantage is that the cooperative itself is not taxed on the profit it makes as a business, only the members are taxed when they receive their patronage refunds. This eliminates the problem of double taxation which exists with Capital Stock Corporations.

Some Drawbacks.

Because the return on investments is limited to 8%, they are not favored investments for banks and other large money lenders. This means that a large portion of start up costs will have to be contributed by members, either in cash or loans secured by their personal property. Another drawback is the reluctance of many individuals to commit themselves to the terms of membership and marketing agreements which are part of joining a cooperative.

The differences between cooperatives and noncooperative forms of business associations are summarized on the following page. In addition to these general advantages, there are specific reasons why farmers and other producers of agricultural products may wish to consider forming a cooperative. The rest of this handbook will focus specifically on Agricultural Marketing Cooperatives as a form of business association.

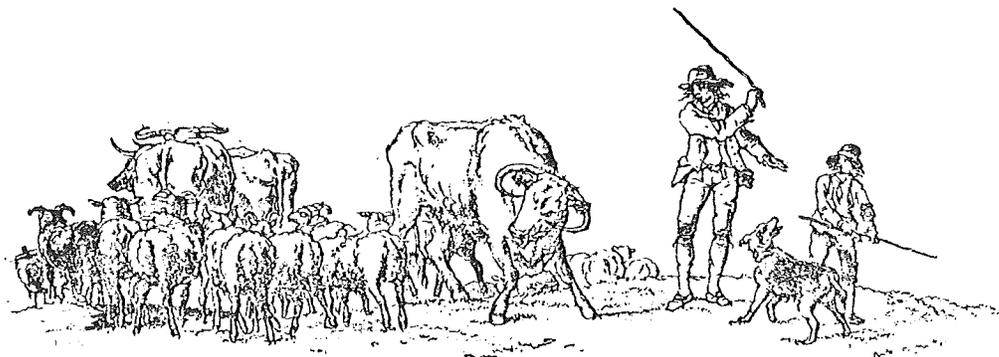
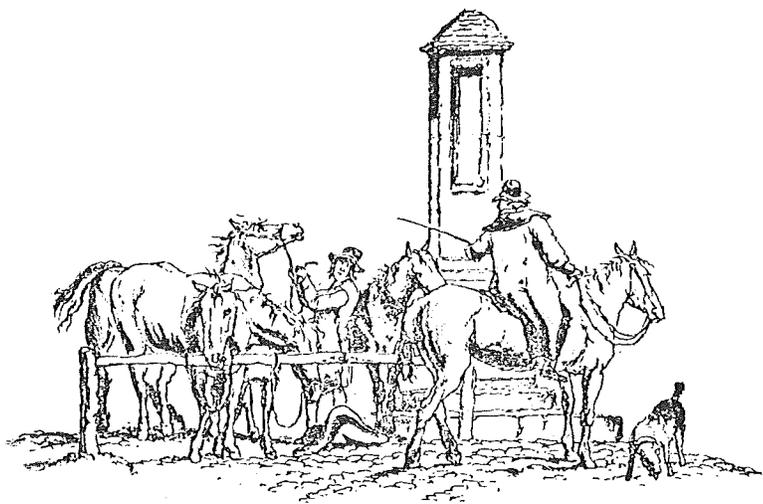
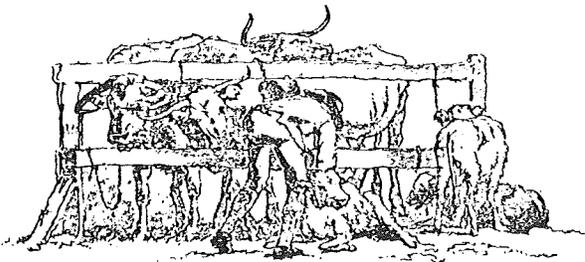
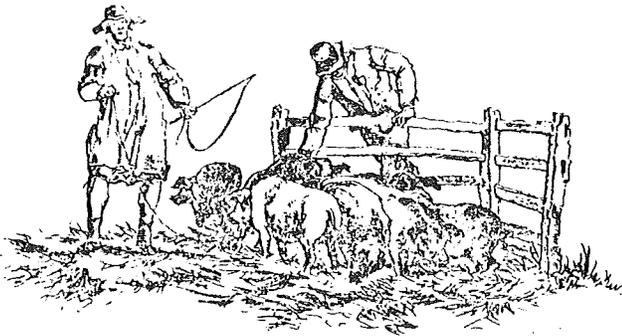
DIFFERENCES BETWEEN COOPERATIVES AND NONCOOPERATIVE CORPORATIONS

Differences	Standard Corporation	Cooperatives
Purpose	To earn profits for investors, increase value of shares, and provide employment for owners of small corporations.	To maximize net and real income of member users and provide goods and/or services at cost to member users.
	To serve public generally.	To serve its members primarily.
Organization	Incorporated under state general corporation law, no federal charter.	Organized under state cooperative law, some such as federal credit unions, under federal charter also.
	Except for closely held corporations, anyone may own stock.	Organized around mutual interests of its member users.
	Organized and owned by investors.	Organized and owned by member users.
	Stock of large corporations sold on stock exchanges or "over the counter".	No public sale of common voting stock, none listed on stock exchanges.
Control	By investors, the stockholders.	By member patrons.
	Policies determined by stockholders and directors. Voting on basis of stock ownership according to number of shares held.	Policies made by member users and directors. Voting in local associations usually on one-man-one-vote basis or patronage basis. In federations, locals vote either on number of members represented or on volume of business done with central organization.
	Proxy voting permitted. Frequently control is exercised by "inside cliques".	Generally, no proxy voting. Seldom that internal cliques can get control.
Sources of Capital	From investing public.	From member users primarily.
	From successful business operations with all or part of profits reinvested.	From net earnings on successful operations with reinvestment of part or all of savings.
Distribution of Net Margins	To stockholders in proportion to number of shares of stock held.	To patrons on a patronage basis after modest dividends on stock have been paid; reserves and, in some cases, an educational fund and bonuses to employees are set aside.
Stock Dividends	No limit - depends on amount of profits and distribution policy.	Limited to a nominal amount - generally does not exceed 8 percent.
Operating Practices	Use conventional methods of financing - sale of stock, issuance of bonds, bank loans, and reinvestment of part or all of profits.	Use revolving capital plan of financing based on amount of business transacted with patrons in addition to conventional financing procedures.
	Usually purchase products on cash basis.	Usually pool sales receipts and pay average prices by grade for products received.

DIFFERENCES BETWEEN COOPERATIVES AND NONCOOPERATIVE CORPORATIONS (continued)

Differences	Standard Corporation	Cooperatives
Operating Practices (continued)	Business done with public generally and not restricted as to clientele except in exceptional cases.	Business done primarily and in many marketing associations using marketing contracts exclusively - with members.
	Primarily interested in operational efficiency, to cut costs - less interested in pricing efficiency.	Not only interested in operational efficiency, but in pricing efficiency, so that differential pricing by grades may reveal to producers ultimate consumer preferences, tastes, and purchases.
	Charge competitive prices or what "the traffic will bear".	Charge either competitive or "break-even" prices in purchasing associations.
Initial Transaction	The purchase or sale is complete transaction.	The purchase or sale is, in a sense, a conditional transaction subject to a refund or additional payment at the end of the accounting period, if net earnings or savings are needed.
Tax Treatment	Subject to many kinds of taxes, including state and federal corporate income taxes.	Also subject to many different kinds of taxes. However, cooperatives organized under Chapter 185 do not have to pay a state corporate income tax, and if, about 10 restrictions are met, can also be exempt from paying federal corporate income taxes. Net earnings are taxable to farmer recipients.
	Privately owned electric utilities are subject to property taxes on real estate.	Rural electric cooperatives in Wisconsin are taxed on gross income, rather than on assessed property value.

III. What are Agricultural Marketing Cooperatives?



III. WHAT ARE AGRICULTURAL MARKETING COOPERATIVES?

In Maine, as in many other states, producers of agricultural products have been authorized by the state legislature to form cooperative associations called AGRICULTURAL MARKETING COOPERATIVES.

Agricultural Marketing Cooperatives differ from other types of cooperatives in the requirements listed below and the special treatment they receive under the various antitrust, tax, and securities laws.

This section discusses:

1. The requirements of Agricultural Marketing Cooperatives,
2. Antitrust considerations,
3. Tax considerations,
4. Securities considerations,
5. Financing available.
6. Accounting considerations,
7. Membership and marketing agreement considerations.

An Agricultural Marketing Cooperative is authorized by the Maine Agricultural Cooperative Act. This law allows producers of agricultural products to set up an association with or without capital stock, for the purposes of engaging in any cooperative activity in connection with:

1. Producing, selling, etc. . Producing, assembling, marketing, buying or selling agricultural products, or harvesting, preserving, drying, processing, manufacturing, blending, canning, packing, ginning, grading, storing, warehousing, handling, shipping or utilizing such products, or manufacturing the by-products thereof;
2. Equipment, feed, fertilizer, etc. . Manufacturing, buying for or supplying to its members and other patrons, machinery equipment, feed, fertilizer, fuel, seeds and other agricultural and household supplies;

3. Business or educational services. Performing or furnishing business or educational services, on a cooperative basis, for or to its members and other patrons;
4. Financing. Financing any of the above enumerated activities for its members.

A. WHAT ARE THE REQUIREMENTS?

The primary requirements of an Agricultural Marketing Cooperative relate to membership, purpose of the organization and structure of the organization.

1. Membership

According to the law, members of an Agricultural Marketing Cooperative must be engaged in agriculture as bona fide producers of agricultural products: "Floricultural, horticultural, viticultural, forestry, nut, dairy, livestock, poultry, bee and any farm products." (Section 1774).

Producers are defined simply as "Independent agricultural contractors."

Independent agricultural contractors are defined as "A person who grows under contract as his primary activity or as a part of a general agricultural activity."

As a general rule of thumb, then, producers are those who:

- a. have a financial investment in the land, equipment, and facilities needed to raise the products;
- b. are in control of the operation; i.e., the work can be done by hired hands;
- c. are subject to the financial risks involved in farming (market fluctuations, weather, etc.)

Only persons who take the risks and responsibilities of growing crops or livestock are producers. The owner of farm land who operates the farm is a producer. An owner who rents out the land is not a producer. A tenant farmer is a producer. Salaried farm managers and hired "hands" are not producers.

The questions of who is a producer becomes more complex as the product leaves its natural state and begins the process by which it will ultimately reach the consumer. Then the distinction between producer and handler becomes important.

John Smith, the dairy farmer, is obviously a producer of an agricultural product. But, the independent trucker who picks up the milk and delivers it to the processing plant is not. A farmer who grows corn on his farm is also a producer, but the owner of the grain elevator where the corn is sold or stored is not. Other examples of "handlers" would be meat packers, brokers, processors, wholesalers, etc. . . .

The cooperative laws and their accompanying special treatment status are meant only for the benefit of those people involved in the actual "production" phase, not the "handling" phase of agricultural products. The special treatment reserved for agricultural cooperatives is specifically aimed at benefiting farmers and other true producers. The laws were not intended to give this favorable treatment to the "middle men", the handlers, who are primarily business entrepreneurs.

However, there are no laws to prevent an Agricultural Marketing Cooperative from itself engaging in "handling" an agricultural product. For example, the cooperative could have a receiving, storing, grading, and marketing facility which was owned or leased by the cooperative, and staffed by the cooperative. The law prohibits having as members of the cooperative (individuals or corporations) who have nothing to do with the production of agricultural products.

For example, the Tacoma Dairy Cooperative could pick up and transport the milk, own the milk processing facility, process the milk at its own facility and market the milk at either a wholesale or a retail level. However, the people

involved in this work do not qualify as "producers" of agricultural products and cannot be members of the cooperative.

NOTE TO FORESTRY PRODUCERS

The question of whether wood cutters, the independent loggers who do not own the wood land, but who contract to cut wood and haul it to the mill, are considered to be "producers" or "handlers" is discussed more fully in Appendix A.

2. Purpose of the Organization

Under Maine law, an Agricultural Marketing Cooperative must be by definition, an organization for the mutual self-help of its members and not an investment organization.

"The primary purpose of the organization is not to pay dividends on capital stock and investment, but to render service and provide means and facilities by or through which the producers of agricultural products may market their products and obtain farm supplies and other services."

Congress and the legislature have given agricultural cooperatives special treatment under the laws. The lawmakers believed that farmers and other producers of agricultural products were economically at a disadvantage. They believed that the large corporations involved with the handling of food and other agricultural products had an advantage because of their size and their control over the marketplace.

The Agricultural Cooperative laws were passed to equalize the bargaining power of farmers and other producers with that of large corporations. Under these laws, special tax benefits and other special treatment are provided.

To qualify for this favored treatment, a cooperative must require a personal commitment, not merely a monetary one, from its membership. Patronage, not money, is the currency of a cooperative. Agricultural Cooperatives are unique

because the benefits accrue to those who work and produce and not just to those who have invested money in the enterprise. Incentives are built into the laws so that the more a cooperative member uses the cooperative, the more benefits are obtained. The corporate structure of the cooperative must reflect this distinction or the cooperative will fail to qualify for special treatment.

3. Structure of the Organization

The structure of an agricultural cooperative is similar to that of a regular business corporation in that it is comprised of a group of members who elect a Board of Directors responsible for the management and policy decisions of the organization. The Board chooses a general manager or executive director who, alone or with a staff, runs the day-to-day operations of the organization.

Maine law does not require a one member, one vote provision; however, in an Agricultural Cooperative, even a Capital Stock Cooperative, the members will generally have one vote. Maine law does require that an eight percent limitation on stock be included in the bylaws of an Agricultural Marketing Cooperative. The law also includes specific requirements relating to the following:

1. Incorporators
2. Articles of Incorporation
3. Amendments
4. Meetings
5. Directors
6. Officers
7. Members
8. Dividends
9. Net Income of Association
10. Termination of Membership.

These will be discussed under the actual procedures for setting up a cooperative.

B. ANTITRUST CONSIDERATIONS

Federal and state antitrust laws forbid the association of two or more persons for the purpose of fixing prices, controlling markets or product supplies, or making other agreements which unnecessarily restrict trade or restrain competition in any way.

Agricultural Marketing Cooperatives are made up of people who have agreed to accept one price for their goods and to sell their product as a unit rather than competing with one another. Therefore, they could be held to be in violation of antitrust laws. Because both federal and state legislative bodies have chosen to encourage the formation of cooperatives, both federal and state laws specifically exempt agricultural cooperatives for certain purposes and declare that their formation does not violate the antitrust laws. However, once formed, a cooperative is subject to the same requirements for legitimate marketing practices as any other business organization.

1. Exemptions for Agricultural Marketing Cooperatives

Federal law provides two exemptions for agricultural cooperatives.

The first is Section 6 of the Clayton Act, which provides:

"That the labor of a human being is not a commodity, or articles of commerce. Nothing contained in the antitrust laws shall be construed to forbid the existence and operation of labor, agricultural or horticultural associations, instituted for the purpose of mutual help, and not having capital stock or conducted for profit, or to forbid or restrain individual members of such organizations from lawfully carrying out the legitimate objectives thereof; nor shall such organization or the members thereof, be held or construed to be illegal combinations or conspiracies in restraint of trade, under the antitrust laws."

Since this section only exempted those cooperatives that were nonprofit and noncapital stock, Congress passed the Capper-Volstead Act in 1922 which provided:

That persons engaged in the production of agricultural products as farmers, planters, ranch men, dairy men, nut or fruit growers may act together in associations, corporate or otherwise, with or without capital stock, and collectively processing, preparing for market, handling, and marketing in interstate and foreign commerce, such products of persons so engaged. Such associations may have marketing agencies in common; and such associations and their members may make the necessary contracts and agreements to effect such purposes. Provided, however, that such associations are operated for the mutual benefit of the members thereof, as such producers, and conformed to one or all of the following requirements:

1. No member of the association is allowed more than one vote because of the amount of stock or membership capital he may own therein, or
2. That the association does not pay dividends on stock or membership capital in excess of 8% per annum.
3. That the association shall not deal in the products of non-members to an amount greater in value than goods that are handled by it for members.

Maine State law exempts agricultural cooperatives (Section 1829 of the Agricultural Cooperative Act) and specifically provides:

"No association complying with the terms hereof shall be deemed to be a conspiracy, or a combination and restraint of trade or any legal monopoly; or be deemed to have been formed for the purpose of lessening competition or fixing prices are contrarily, nor shall the contracts between the association and its members, or any agreements authorized in this subchapter, be construed as an unlawful restraint of trade or as part of a conspiracy or combination to accomplish an improper or illegal purpose or act."

The courts have been very clear in saying that the antitrust exemptions will not apply if the association has members who are not producers of agricultural products. Although the cooperative itself may engage in "non-producing" activities, its membership cannot include people whose only interest is in the handling and processing stage of production.

NOTE TO FORESTRY PRODUCERS

It should be pointed out here that the Capper-Volstead Act applies only to "producers engaged in the production of agricultural products as farmers, planters, ranch men, dairy men, nut or fruit growers . . ." Whether this includes producers of forestry products is a question of extreme importance to woodlot owners who wish to form a cooperative. This question has never been clearly decided by the courts. A more detailed discussion of this question is found in Appendix A.

2. What the Exemption Means

The federal and state exemptions from the antitrust laws apply only to the organization of any agricultural cooperative. Once the association is organized, it becomes subject to the antitrust laws in the same way as any other business organization or individual. That means the organization cannot enter into any agreements with nonmembers which fix prices, or engage in any unfair business practices such as boycotts.

The courts have been very clear in saying that the federal and state exemptions are not a privilege to set up a monopoly position, or to suppress competition among independent producers and processors. The purpose of the exemption is to permit farmers to compete on a more equitable basis with large corporations. There have been cases where cooperatives have been found to have been engaged in unfair trade practices which were restricting competition and attempting to set up a monopoly. These kinds of practices were held to be in violation of the antitrust laws:

- Where cooperative members coerced local truckers into agreeing not to transport the milk of non-members,
- Where cooperative members organized consumer boycotts of milk produced by non-members,
- Where the cooperative owned the only milk processing facility in the area and refused to buy the milk from non-members.

These "unfair practices" are forbidden to all business organizations, including cooperatives. Prospective cooperators should understand that they cannot take unfair advantage in the marketplace just because they are a cooperative.

The purpose of the antitrust exemptions is to allow the formation of cooperatives, not drive other people out of the marketplace.

3. How Do you Make Sure That Your Cooperative Qualifies For The Exemption?

To ensure that an agricultural marketing cooperative will not be subject to antitrust litigation, the association should be set up with the following requirements in mind. It should be:

1. an association of agricultural producers,
2. operated so as not to retain profits itself,
3. for the mutual benefit of its members as producers,
4. not dealing in a greater dollar volume of non-members' products than the value of products handled by it for members, and either
5. conducted on a one-member, one-vote basis, or
6. not paying dividends on capital in excess of eight percent (8%) per year.

C. TAX CONSIDERATIONS

1. BACKGROUND

An initial word of caution - the following discussion is intended to provide only a general background and outline of the tax consequences of organizing a business as a cooperative. Due to the complexity of tax law and the limited space available for its treatment, this section should not be viewed as an exhaustive treatment of cooperative tax issues. Early in the development phase of any cooperative, the proposed structure, financing package and areas of cooperative operation should be discussed with your accountant and attorney so

that an accurate analysis of the actual tax effects of your cooperative can be predicted.

Since a cooperative is a business, it will be subject to general tax principles affecting all businesses. Thus, in computing its taxable income, a cooperative, like any other business, is allowed to deduct or subtract legitimate operating expenses such as wages, the cost of fuel, the cost of supplies or inventory from its gross or total annual income. The remainder might be referred to as the net profit of the business. If the business owns "capital" items such as land or equipment, an additional deduction, depreciation, representing the fraction of the value of those items used up in the current tax year, is also allowed. There are numerous other specialized deductions which are also available to qualifying businesses. The "tax exempt" character of cooperatives is derived from some of these additional deductions. After all of the allowable deductions are taken from the gross income and/or net profit, the remaining balance is the taxable income.

For corporations, an initial federal tax rate of 20% is applied to the first \$25,000 of the taxable income of a regular business corporation. This rate increases to 22% for taxable corporate income between \$25,000 and \$50,000 and to 26% for that in excess of \$50,000. The taxable income of partnerships, qualifying small business corporations (Subchapter S corporations) and sole proprietorships is taxed at current individual rates.

The tax liability of a business is arrived at by multiplying the appropriate tax rate by the taxable income. The resulting tax due figure can be further reduced by tax credits. Tax credits are given for governmentally favored investments such as energy conservation, creation of new jobs, and purchase of new equipment. The actual tax paid by a business is its original tax due figure, less applicable credits. If there are losses or credits which are not used in a particular year

due to a low initial tax liability, these items can be carried forward for use in future years.

Normally, distributions of net corporate profits (shareholder dividends) are not deductible by a corporation and are taxable to the receiving shareholders as part of their individual income. In recognition of cooperatives as patron owned businesses, there are specific tax laws which generally result in a cooperative being able to deduct patron and/or shareholder distributions from its taxable income. This is the primary tax advantage of organizing and operating as a cooperative.

2. SPECIAL FEDERAL INCOME TAX PROVISIONS APPLICABLE TO COOPERATIVES

Like any other modern business, tax considerations and tax planning are likely to play a major role in the overall development of the structure and business activity of a cooperative. In fact, tax considerations may be more critical in the development of cooperatives than in other forms of businesses since Congress has authorized a liberal set of deductions for cooperatives which generally results in the elimination of a tax liability, provided all requirements are fully met. So broad are these deductions that cooperatives are often said to be tax exempt.

The federal tax laws deal with cooperatives in two separate, and somewhat overlapping sets of provisions. Pure agricultural cooperatives are treated in Section 521 of the Internal Revenue Code. These cooperatives are often called "Section 521 cooperatives". All cooperative, agricultural or otherwise, are also treated in Sections 1381-1388 of the Code. Cooperatives electing this treatment are often referred to as "Subchapter 'T' cooperatives". Thus, agricultural cooperative are given an option of organizing and claiming tax treatment under either Section 521, or Subchapter T. Nonagricultural cooperatives must organize under Subchapter T.

In order to more fully understand the operation and effects of these two provisions, a few basic concepts, common to both, should be noted. Cooperative taxation, under either Section 521 or Subchapter T, is based upon the principle of single taxation. Thus, funds that flow through a cooperative and back to its patrons are taxed only once, either at the business level at corporate income tax rates or at the patron level at individual tax rates.

A. Definitions

How taxes are determined will be explained shortly. First, several general terms used in cooperative taxation should be noted.

The term "patronage refund" means an amount paid to a patron by a cooperative:

(a) on the basis of quantity or value of business done with or for such a patron,

(b) under a pre-existing, valid enforceable written obligation of such organization to the patron to pay such amount, and,

(c) by reference to the net earnings of the cooperative organization from business done with or for its patrons.

The term "net earnings" for purposes of determining patronage refunds includes any unexpended portion of amounts retained by the cooperative to cover expenses. Net earnings are reduced by dividends paid on stock, but not by any tax payments.

A "qualified written notice of allocation" is a written agreement by the cooperative to pay the member his/her share of the profits as patronage refund or, in the case of a 521 cooperative, non-member's share of the profit. A written notice of allocation is "qualified" if it is redeemable within 90 days of notice, or the member has consented to take it into account at its stated amount. In either case, at least 20 percent of the patronage refund must be paid.

The "payment period" for any taxable year of a cooperative is the period beginning with the first day of the taxable year and ending on the fifteenth day of the ninth month following the close of such year. For example, the payment period for the taxable year 1980 for a calendar year cooperative is January 1, 1980 through September 15, 1981. Thus, the cooperative has its entire taxable year plus 8 1/2 months after the close thereof in which to make qualifying allocations out of earnings for such taxable year. Any allocations of the earnings for such taxable year which are made after that period must be taken into account in computing taxable income, and no deduction is permitted therefore, either when the allocation is made or when it is redeemed.

3. Section 521 Cooperatives

These cooperatives are often called exempt cooperatives, but there are some rather severe restrictions which enable them to arrive at a zero tax or exempt tax level. Eligibility for Section 521 status is limited to organizations of "farmers, fruit growers, or like associations". The regulations issued under that section also add livestock growers, and dairymen to the eligible list. These occupational groupings are generally viewed as limiting the category of tax exempt agricultural businesses to traditional farming practices. However, case law has expanded the farming definition to cover specialized semi-industrialized food production business such as poultry growers, wool producers and even aquaculture producers.

Although there is often a fine line between what will be viewed as agricultural and nonagricultural, it is safe to assume that forestry cooperatives would not be seen as agricultural. A nurseryman's cooperative, because of the planned cultivation and the similarity of horticultural and agricultural practices would have a greater chance of qualifying as a Section 521 cooperative. It should

be noted, however, that since the deductions allowed under Subchapter T are nearly as extensive as those allowed under Section 521, the failure to qualify as an agricultural cooperative for tax purposes does not result in a major financial burden for the cooperative.

The overall tax advantage of an "exempt" 521 cooperative is achieved by being able to deduct patronage refunds and stock dividends, items which are normally taxable to a regular corporation. Since these items generally account for all net corporate profits, allowing their deduction will normally result in a zero tax liability. Moreover, up to 80% of patronage refund accounts can be retained by the cooperative as part of a capital reserve account. Thus, a farmers' marketing cooperative can achieve a no-tax-due situation and still accumulate large amounts of capital for future cooperative expansion.

A 521 cooperative is also required to treat all producer/suppliers alike, regardless of whether they are members or not. This means that the 521 is required to pay non-member producer/suppliers patronage refunds.

Dealing with Nonfarm Sidelines

Since the preferential tax treatment accorded by Section 521 is limited to farmers' cooperatives, the extent to which a cooperative can deal in nonfarm items and still be entitled to Section 521 status can be a major concern. Thus, nonagricultural sidelines such as consumer goods marketed or carried by otherwise "exempt" cooperatives have often been challenged by the Internal Revenue Service as a basis of denying favorable tax treatment. It is now established that sales of 5% or less of sideline items will not affect Section 521 treatment. Emergency purchases or sales or qualified governmental sales of nonagricultural sidelines in excess of the 5% figure will not jeopardize a cooperative's Section 521 status (Rev. Rul. 67-37).

Engaging in Nonmarketing Functions

An issue related to the "sideline" concerns, is how far beyond pure marketing an agricultural cooperative can venture and still qualify for Section 521 treatment. For instance, is it permissible for a farmer's cooperative to own and use production acreage or processing equipment? Generally speaking, it will not jeopardize a Section 521 status for a cooperative to own and operate production or processing facilities so long as it performs other marketing functions. Thus, a cooperative which was originally organized and functioned to buy, sell and store agricultural commodities and which owned a grain elevator was allowed to claim Section 521 deductions. However, when the cooperative discontinued its other marketing operations and merely made its storage facilities available to members, its 521 status was disallowed.

How to Qualify for 521 Status

The mechanics of qualifying for this tax treatment can be complicated. Careful attention must be given to devising an accounting system that identifies differences in earnings based on different sales prices, quantity and quality of different agricultural products marketed by the cooperative. Once this is done, a net profit to patrons sales ratio is established and the patronage refund calculated. As noted above, 80% of this refund can be retained by the cooperative. When this is done, a written allocation receipt must be given each patron, member or non-member, establishing his share of that year's capital reserve fund. (See Pages 47-48.)

In addition to patronage refund deductions, an "exempt" cooperative can also deduct certain dividends. For Capper-Volstead purposes, deductible dividends on capital stock cannot exceed 8% of the original issue price, or the maximum legal rate of interest. Since the payment of dividends in excess of 8% may subject a cooperative to the loss of its Capper-Volstead Antitrust

exemption, the shareholders of an agricultural cooperative would be well advised to forego a slight potential increase in a dividend ratio and agree to limit dividend payments to 8% of the initial investment. Thus, to achieve maximum tax deductions, and to protect the antitrust exemptions, the Bylaws should include a provision, limiting the authority of the Board of Directors to declare stock dividends not in excess of 8% of the issue price of each share.

4. Subchapter T Cooperatives

A major tax alternative for cooperatives that do not meet or do not wish to meet the requirements of Section 521 was established by the passage of Subchapter T of the Internal Revenue Code in 1962. These are often referred to as "non-exempt" cooperatives, although they have a very limited corporate liability. Since Subchapter T applies to all cooperatives, nonagricultural cooperatives such as forestry, housing, and others will find it advantageous to file under these provisions. Subchapter T cooperatives can deduct qualified patronage refunds like Section 521 cooperatives, but are relieved from the obligation to treat members and non-members alike. They may also engage in other marketing activities and can pay dividends on capital stock in excess of 8%. However, these dividends would be subject to taxation at the corporate level. Many agricultural cooperatives formerly organized under Section 521 are now reorganizing under Subchapter T because of the relaxed restrictions.

The actual operation of Subchapter T is as follows:

Net margins (the excess of gross income over expenses) are not taxed as corporate income to the cooperative if: (1) there is a binding written obligation that requires the cooperative to pay it to the patron; (2) the refund is based on business done with the patron; and (3) the refund is determined on the basis of the net margins. If any of these conditions are not met, non-cooperative corporate tax rules apply.

Amounts paid by a cooperative are paid under a valid enforceable written obligation if such payments are required by State law or are paid pursuant to provisions of the Bylaws, Articles of Incorporation, or other written contract.

The cooperative cannot keep any net margins for itself as profit and avoid tax. The net margins must be given back to the patrons.

In general, a Subchapter T cooperative may, in computing its taxable income, deduct patronage refunds paid during the "payment period" for the taxable year. In other words, a patronage refund is not deductible in computing taxable income unless it is paid during the prescribed payment period, in money, a qualified written notice of allocation, or other property. A written notice of allocation is considered "paid" when it is issued to the patron.

5. Procedure for Filing Federal Cooperative Tax Returns

There is a two stage process for filing federal tax returns for agricultural cooperatives. First, a cooperative must apply for and receive a "Recognition for Exemption". This is done on IRS Form 1028. Once the exemption is granted, the actual tax return for the cooperative is filed on Form 990C. Subchapter T cooperatives use IRS Forms 1096 and 1099.

The tax return for a Section 521 cooperative is due on the 15th day of the ninth month following the close of its taxable year. Thus, in the case of a calendar year cooperative, the return is due on September 15. Subchapter T cooperatives, which, by their Articles, Bylaws or Marketing Contracts, are obligated to make patronage refunds of at least 50% of net earnings from patronage, use the same filing schedule. Without such a requirement, or actual patronage refund payments less than that amount, a Subchapter T cooperative must file its return by the 15th day of the third month after the close of its taxable year, generally March 15.

In addition, all Subchapter T cooperatives making patronage distributions totalling \$10 or more per year per patron must file information returns identifying the patron and the amounts paid. With a few narrow exceptions, which are rarely applicable, payments a patron or stockholder receives from a cooperative, whether it is a Section 521 or Subchapter T organization, are included in the ordinary income of the recipient. Still to be finally determined is whether an individual patron can claim his proportional share of any unused tax credits earned by the cooperative.

6. State Tax Issues

All cooperative ventures organized under the Maine Agricultural Cooperative Act are exempt from state and local taxes. This is a general exemption and applies to all taxes, including income and property taxes. In lieu of all other taxes, corporate or franchise, a \$10.00 annual licensing fee is substituted. It should be noted, however, that an annual report and report fee of \$30 must be paid.

In essence, the annual governmental dues paid by a cooperative organized under the Maine Agricultural Marketing Cooperative Act to the state will be only \$40.

D. SECURITIES CONSIDERATIONS

1. What are Securities?

Securities, briefly defined, are investment contracts used by business associations to finance their operations. The most common form of investment contract is capital stock.

2. What is Securities Registration?

Federal and state laws require that before selling securities to the public, business associations must register with the Securities Exchange Commission (for interstate sales) or with the Maine Bureau of Banking (for intrastate sales).

Registration is required in order to protect the public. The registration forms submitted by the business association contain financial and other important information about that association. In this way, the Securities Exchange Commission and/or the State Bureau of Banking, can regulate and oversee the sale of securities by businesses.

Agricultural Marketing Cooperatives, like other business associations, are subject to these federal and state securities laws. Therefore, if an Agricultural Marketing Cooperative sells a security, it must first register with the appropriate agency. This requirement applies to all Agricultural Marketing Cooperatives unless they qualify for an exemption.

3. Which Organizations are Exempt from Registration Requirements?

The federal and state laws do contain provisions which exempt certain types of organizations from these registration requirements. If an Agricultural Marketing Cooperative qualifies for federal income tax exemption under Section 521 of the Internal Revenue Code, it is exempt from the securities registration requirements.

If the cooperative does not qualify under Section 521, it is a non-exempt cooperative and is subject to all the registration laws. A Subchapter T cooperative is non-exempt.

If a non-exempt Agricultural Marketing Cooperative is organized as a capital stock cooperative and sells stock to both members and non-members, the sale of that stock is subject to both federal and state registration requirements and the cooperative must register with the appropriate agency or agencies.

4. Are Patronage Refunds and Membership Stock Considered to Be Securities?

A major issue which has faced agricultural cooperatives in recent years is whether or not patronage refund certificates, membership common stock,

or other certificates representing a member's interest in the cooperative are considered to be securities.

The answer appears to be that they are not.

a. The Supreme Court Position

The Supreme Court said in 1946 that:

"The test is whether the scheme involves an investment of money in a common enterprise, with profits to come solely from the efforts of others."

More recently in United Housing Foundation, Inc. vs. Forman, the Supreme Court held that shares of common stock, which entitled the purchaser to lease an apartment in a housing cooperative, did not constitute "securities". The Court noted the absence of the kinds of profits traditionally associated with securities investments.

"What distinguishes a security transaction - and what is absent here - is an investment where one parts with his money in the hope of receiving profits from the efforts of others, and not where he purchases a commodity for personal consumption or living quarters for personal use."

In Forman, the Supreme Court set forth the characteristics traditionally associated with a security. These characteristics are:

- (1) the right to receive dividends contingent upon apportionment of profits;
- (2) negotiability;
- (3) ability to be pledged;
- (4) voting rights in proportion to the number of securities owned; and
- (5) ability to appreciate in value.

Members and other patrons generally are not attracted to an agricultural cooperative because of financial returns. The critical evaluation is whether

patrons will obtain better prices and services than would be available through competitive sources. They are attracted by the prospects of obtaining a secure market and better prices for their commodities and lower costs for their supplies through cooperative marketing and supply activities than would be available through competitive sources. This distinction is critical under the securities laws and confirms the position taken by both the Securities Exchange Commission and the Maine Bureau of Banking as follows.

b. The Securities and Exchange Commission Position

Although there have been no definitive court cases passing on the necessity of registering membership and patronage interests issued by an agricultural cooperative, the Securities and Exchange Commission has taken the position that registration is not required. Since this is simply an administrative position, this result could change in the future. Therefore, an agricultural cooperative would be wise to observe some of the guidelines established in those cases where non-registration has been approved.

- (1) Membership interest should increase in value only in proportion to the volume of business done with the cooperative.
- (2) The interests should not be transferable and thus there should be no market trading in the certificates.
- (3) The interests should be subject to the losses, if any, of the cooperative.
- (4) There should be no fixed maturity dates for the certificates.

c. The Position of the Maine Bureau of Banking

The Maine Bureau of Banking has recently taken the same position and stated that registration under 32 MRSA §852, 853 and 871 generally will not be required in connection with the offer of membership and patronage interests by agricultural cooperatives, provided that the following characteristics are present:

- (1) Such interests shall not pay any dividends or bear any interest.
- (2) Such interests shall not be transferable.
- (3) Such interests shall not be of a type for which an active trading market exists.
- (4) Such interest shall be redeemed only at face value.
- (5) No commission shall be paid in connection with the sale or issuance of such interests.

5. Registration of Brokers and Dealers

Federal and state securities laws also require that anyone who sells or deals in the sale of securities be registered as a broker or dealer.

These registration requirements require that brokers and dealers satisfy net capital requirements or be bonded.

The issue facing Agricultural Marketing Cooperatives is whether their employees who might dispense securities as part of their job should be considered brokers or dealers.

The Securities Exchange Commission staff has tried over the years to establish who are and who are not "brokers" and "dealers". With respect to sales of membership common stock by employees of an agricultural cooperative, the Securities Exchange Commission staff stated that, since the employees had substantial other regular duties and were not compensated for any shares of stock sold, they should not be deemed to be "brokers".

To provide guidance to issuers, the Securities Exchange Commission has proposed adoption of Rule 3a 4-1 under the 1934 Securities Registration Act. The proposed rule is intended to provide a "safe harbor" for officers, and employees of an issuer provided they: (1) confine their participation to certain enumerated types of transactions which have not generally raised substantial problems of investor protection; (2) are bona fide employees of the issuer who

is not continuously involved in the distribution process; (3) and restrict their participation to that of a passive nature.

6. Summary

Unless an Agricultural Marketing Cooperative is an exempt organization, it will be required to register the sale of any capital stock, or other investment contract securities.

Membership certificates, membership common stock, or patronage refund certificates will not have to be registered so long as the guidelines set forth by the Securities Exchange Commission and the Bureau of Banking are followed.

Employees who deal with these membership certificates, will not be required to register as brokers, provided they follow the guidelines described above.

However, because the securities question is complex and subject to many interpretations, it is recommended that each new cooperative association seek a ruling from either the Securities Exchange Commission or the Bureau of Banking or both, based upon the precise character of the financial structure of that association.

E. FINANCING

The problems of financing a new agricultural co-op are similar to those of any new business venture. The primary difference is that the federal government has developed several programs aimed specifically at assisting agricultural producers in obtaining financing.

Both public and private lending institutions agree that for a cooperative to succeed, the individual members must have a substantial financial stake in the venture. They feel that if the individual members do not have a financial commitment to the cooperative, the cooperative will not succeed.

The success of a cooperative depends on how much its members use it. Financial organizations believe that unless the members have a financial investment in the venture, they will use the organization only when it suits them. If the market fluctuates and a better deal is available elsewhere, they will take the better deal. If members have a financial commitment to the cooperative as an organization, they will stick with it through the hard times, especially in the beginning.

Before making a decision to form an association, and after carefully studying the feasibility to form an association, you should contact several potential sources of financing and get specific information on what monies are available, what terms and rates are presently available, whether a direct loan or guarantee is available, what the eligibility criteria of the respective agencies are, etc. This information will help you in deciding how to set up your association. Following are several potential sources of financing. Addresses and names of people to contact are in Appendix D.

1. Public Sources

National Consumer Cooperative Bank

This bank is the newest federal program for financing cooperatives. At the present time, ninety percent (90%) of its funds have been earmarked for consumer cooperatives, and only ten percent (10%) for other types. This ten percent; however, is a substantial amount and this bank should be considered as a potential source for funding. Indeed, the percentage allocated for producer cooperatives may be increased if it appears that there is a significantly large demand.

Farmers Home Administration (FmHA)

The Farmers Home Administration has money available for the financing of the purchase of stock in agricultural cooperatives. The FmHA takes the same

position as private lending institutions that the more secure the loan is the one made to the individual rather than to the organization. As of May 5, 1980, these individual loans were available at 12.5% annual interest with terms for repayment up to seven years.

Although this is the extent of the assistance FmHA is prepared to make to agricultural cooperatives, it could possibly be persuaded to expand their assistance into the areas of its Business and Industry Loan Guarantee Program and its Limited Resources Loan Program.

These arguments can be based on federal regulations and an agreement which has recently been entered into between the FmHA and the State of Maine requiring FmHA to concentrate more on agricultural development rather than on residential housing.

Small Business Administration (SBA)

The Small Business Administration is not a good place for agricultural cooperatives to seek financing. Historically, the SBA is set up to assist business ventures which will ultimately produce jobs. Since cooperatives are primarily marketing ventures and since marketing ventures produce jobs only secondarily, the SBA will not finance agricultural cooperatives.

Maine Guarantee Authority

The Maine Guarantee Authority has a program of interest to prospective cooperators.

This is a state loan guarantee program for "eligible projects" defined at Title 10 of the Maine Revised Statutes at Section 703 (3).

The loan guarantees would be for money borrowed to purchase land and/or buildings in connection with an economic development project. An agricultural cooperative could, in certain situations, qualify as an economic development project, provided it met the requirements of the law.

These requirements are:

1. The purpose of the project being financed is to enlarge opportunities for jobs and stimulate private investment and expand agricultural and other industrial enterprises.
2. The project involves the construction or development of buildings and/or lands which will be used for processing or manufacturing of raw products for the marketplace.

This is a "bricks and mortar" program and would not be available when the need is for "operating" capital. Note also, that since it is a loan guarantee program, you would have to acquire the actual loan from another source.

Economic Development Administration (EDA)

Both direct loans and loan guarantees are available from the EDA. The EDA has a history of making some loans to agricultural cooperatives. The EDA's primary concern is with projects which will produce jobs and serve to enhance the overall economic development of an area. Areas of the state which have been classified as "economically distressed" qualify for low interest loans.

Further information can be obtained by contacting the EDA representative in Augusta.

Other public sources of financing which might be explored are:

- Maine Capital Corporation, Augusta, Maine; and
- National Rural Development Loan Fund, Washington, DC.

2. Private Sources

Private Lending Institutions

Private lending institutions (banks, savings and loan associations) will not lend money directly to a new agricultural cooperative any more than they would lend money directly to a new business corporation. They will, however, like the FmHA, lend money to individuals to purchase shares in the cooperative.

Community Development Corporations (CDC)

Community Development Corporations are also a viable option for new cooperatives. Most have money specifically committed for assisting economic enterprises with their start-up costs. In addition, CDC's can provide new cooperatives with a wealth of technical assistance.

Private Foundations

Foundations are another source of private funds which may be available to cooperatives. A list of foundations and their areas of interest is available at the State Law Library in Augusta, and at the Research Center Library, University of Southern Maine in Portland.

Bank for Cooperatives

An old source of financing is the Bank for Cooperatives. This is a bank set up by federal laws as part of the Farm Credit System (FCS) specifically to assist cooperatives. The bank engages in some direct financing.

Although the Bank for Cooperatives lends many dollars to cooperatives throughout the country, it is reluctant to lend money to the low equity small farmer and, particularly, the low equity beginning farmer. This is due to the risks involved and the high demand for loans from more stable, established small farmers.

However, if you are interested in forming a cooperative, you would be advised to contact the Bank for Cooperatives in Springfield, Massachusetts, and discuss the various options available to you.

3. Self-Help Financing

Capital can also be raised through the members of the cooperative in various ways.

Sale of Stock

Shares in the cooperative may be sold to members and non-members.

Individuals may participate in the cooperative as stockholders, as well as members. In addition to receiving their patronage refunds, they would also receive dividends. Non-members can also purchase stock.

Borrowing

Members can loan funds to the cooperative and receive interest on these funds at a fair market value.

Sales of Debentures

The cooperative can sell debentures. Debentures are promissory notes issued by the cooperative agreeing to pay the buyer of the debenture the price he paid plus interest after a period of time.

Other ways of raising capital from members are:

Membership Fees

Assessments

Retentions and Revolving Funds

F. ACCOUNTING CONSIDERATIONS

1. Why Accounting Is Important To A Cooperative

For tax and management needs, any business must maintain a basic set of books which show income and expenditures and allocate each according to functional categories. In a cooperative, "bookkeeping" is double important since:

- patronage refund and capital reserve ratios must be determined on an annual basis;
- in a multi-product marketing cooperative, different profit margins on different goods must be accounted for;
- sufficient information must be compiled to make responsible dividend declarations in a stock cooperative.

Although the actual maintenance of the books in a small cooperative may not require an accountant, it is essential that the accounting system for

even the smallest cooperatives be set up by an accountant, preferably one with cooperative experience. This will ensure that the bookkeeping system produces the desired information in the most efficient form.

2. Setting up the Books

Accounting concerns unique to agricultural marketing cooperatives are:

- accumulation of product quantities and values;
- allocation of expense and income items to a particular year for calculation of the annual patronage refund;
- calculation of patronage refunds retained for capital growth;
- coordination of individual investment costs so as not to exceed the 8% limit on dividends.

A model accounting system must be capable of isolating:

- the transactions of an individual patron;
- the annual profit on sales of a particular type of goods;
- the equity position of each patron, regardless of the date shares were purchased.

While these tasks are formidable, they are not impossible. Publications noted in the section of the bibliography devoted to accounting assist a local accountant in designing a properly functioning system.

A simple accounting system could be devised to handle the cooperatives' transactions. For example, patronage refund accounts could be separately coded for each product, and grade of product. Dollar amount and volume of sales could then be allocated to each category. At the end of the year, the system could segregate each product by quantity and quality and secure a quantity, quality and dollar grand total for each product. An apportionment could then be made from each category to each individual based upon the volume of patronage generated that year. Finally, an allocation could be made to each patron in accordance with a predetermined ratio.

3. Accounting Issues to Consider

Periodic Reports

The bylaws should provide for periodic reports to the board of directors in such form as to give a complete analysis of all the operations of the cooperative. The annual report to the members should include, as the minimum, a statement of assets and liabilities, a profit and loss statement and a general analysis of retained and disbursed patronage refunds for the fiscal year.

Auditing

Regardless of the size of a cooperative, the books should be audited by a certified public accountant. This will ensure membership confidence in this shared business venture. The accountant for an ensuing year should be selected at the annual meeting of the members. In the smallest organizations, the members could appoint a committee, which should not include any officer, director, or employee, and which should, at least, check the annual reports to be submitted to the members and report thereon directly to the members. Under some situations, directors and officers can be held liable for failure to furnish proper reports either to an administrative agency or to the members of the cooperative.

Fiscal Year

The fiscal year of the cooperative can be fixed so as to conform with the calendar year. On the other hand, it can be geared to the particular needs of the cooperative, depending upon an examination of a number of factors. The determination should be made only after receiving the recommendations of the accountant. The accountant will usually recommend that the fiscal year should end at the time of the year when the affairs of the cooperative will be at its lowest level of volume.

Tax Status

The cooperative will also want to consult with its accountant regarding the selection of Section 521 or Subchapter T tax status. In this fashion, the accounting system can be tailor-made to the tax information needs of the cooperative.

Patronage Refunds

Finally, the accountant should be roughly appraised of the method of paying patronage refunds. Due to the difference in the time when per unit retail certificates (at delivery) and certificates of allocation (at the close of the accounting period) are issued, the accountant may find it useful to structure the accounting system differently, depending on which procedure is used.

G. MEMBERSHIP AND MARKETING AGREEMENT CONSIDERATIONS

1. What Is It?

The membership and marketing agreement is a contract between the cooperative and each individual member. Each member must sign the contract prior to becoming a member, and in so doing, legally binds himself to the terms contained in the contract.

The contract should set out the rights and responsibilities of a member: what he is expected to give, in terms of patronage (use of the cooperative) fees, capital contributions, etc. . . what he is expected to receive, in terms of reduced costs, dividends, etc. . .

2. What Areas Should Be Covered?

In addition to standard contract provisions, identifying the parties and stating the amounts of money or other items of value to change hands, the following topics should be considered in the preparation of a joint membership application and marketing agreement.

MEMBERSHIP

- a. Qualification. To ensure a responsive and dedicated membership, more than involvement in the particular branch of agriculture should be required to qualify for membership. Often membership is restricted to producers from a certain geographical area. Since a cooperative requires a commitment of time and money to succeed, members may also be required to market an exclusive or high percentage of sales through the cooperative and the attendance of a certain percentage of the meetings held within any one year might also be required.
- b. Fees: Agreements can provide for one time, annual or percentage of production membership fees. Reference should also be made to any prorata capital contribution assessment contained in the bylaws. Fees should be based on a realistic estimate of the capital required to make the cooperative function as a business. Token fees which are appropriate for non-profit businesses should be avoided.
- c. Transferability: Restrictions are generally placed on the assignment or transfer of membership. A member may not transfer his membership in the cooperative. This can be an outright ban on transfers, a requirement of board approval, or the cooperative can have the right to buy out the member.

- d. Duties and Obligations: Members are generally asked to pledge exclusive marketing through the cooperative and not to compete against the cooperative. Members are generally relieved of all debts of the cooperative.
- e. Termination: Rights of the producers and the cooperative should be considered. If a producer is to be given a unilateral right to withdraw, the length of notice of withdrawal should be specified. Automatic termination based on a breach of any portion of a member's duties can be restated from the bylaws.

MARKETING:

- a. Goods covered: A description of the type, quantity and quality of products should be specified. If less than an entire crop is to be marketed through the cooperative, this should be specified. (The cooperative, of course, should strive to become the exclusive marketing agent for each member.) The time and manner of delivery, if any, should be specified.
- b. Duties of the cooperative: In addition to the obvious obligation to market the goods under contract, the cooperative may be obligated to give technical assistance with regard to crop development, and market expansion. Forestry cooperatives might spell out woodlot management services to be furnished by the cooperative. These duties could, of course, also be listed under the membership section.
- c. Rights of the cooperative: The cooperative will want to have the right to inspect, classify and grade products at different

stages of development to coordinate its marketing plans. Interim financing might also require offering financial institutions a security interest in the products. To accomplish this, the cooperative should be guaranteed clear title to the crops and have the right to pledge them for security of loans.

- d. Payments: The price and the time and manner of its payment must be covered as well as less obvious deductions such as operating expenses and an amount for capital reserves. All of this must be supported by clear and detailed accounting records.
- e. Remedies for breach: Since the cooperative itself and other members must rely on each contract for the overall success of the cooperative marketing plan, agreements generally provide that members can be ordered by the courts to abide by their contracts (injunctive relief and specific performance). In addition, liquidated or precalculated damages, are often called for in view of the difficulty and cost of establishing the actual loss occasioned by the breach of one producer contract.

3. Other Considerations

Since a cooperative is, in essence, a vehicle of patronage investment rather than capital investment, the regulation of patrons through membership and marketing agreement, is a major issue. Thus, membership agreements should be structured to induce as many participants to join as possible, while still limiting membership to those with whom and for whom the cooperative will generate the greatest benefit. Fair, even-handed membership agreements with individual

protections and clear benefits provisions generally will attract large numbers of those already disposed to cooperative business approaches. Exclusive marketing provisions, noncompetition clauses and restrictions on cash returns will normally be effective in weeding out the uncommitted.

It is also appropriate for a cooperative in its marketing agreements to consider special production requirements, such as the use of organic agricultural practices to stimulate marketing. In a marketplace which is increasingly concerned about unnecessary environmental waste and prefers "natural" products, an effective marketing strategy can be built into the cooperative framework through creative use of membership and marketing agreement provisions.

It is important to recognize that membership, or marketing agreements may be a critical organizing issue. Since such agreements relate directly to the individual participants, a well drafted, well tailored set of membership and marketing contracts can provide an effective organizing tool for the developing cooperative. Prospective members may not care to spend the time to analyze and understand even the most readable examples of cooperative articles or bylaws. However, they are likely to consider in depth the commitments they are making and benefits they will receive under the cooperative's membership and marketing agreements. With these concepts in mind, a membership and marketing agreement, intended for a market garden or truck farming cooperative, included in Appendix E should be reviewed for its application to the needs of your cooperative. This agreement is based upon patronage refunds represented by the issuance of certificate allocation, rather than per unit retains.

4. The Maine Agricultural Marketing and Bargaining Unit

Agricultural cooperatives are given assistance in asserting market pressure and avoiding market "close outs" by the Maine Agricultural and Bargaining

Act 13 MRSA 1953-1965. This act, passed in 1973, allows "qualified associations of producers" (cooperatives) who sold over fifty (50) percent of the agricultural goods purchased by a handler or processor in the last twelve months and who have some sales to those handlers or processors in two of the last three years, to force such middlemen to bargain in good faith with regard to price and other terms of sale. While negotiations are being pursued under this act, the handlers or processors are unable to negotiate with any other suppliers as long as the "cooperative" is able to supply all or substantially all of their requirements. Once the cooperative and the processor agree to terms, it becomes unlawful for the processor to buy goods from others on better terms to them without first offering to purchase the same items from the cooperative at the more favorable terms. Both the cooperative and the processors are forbidden to engage in any "unfair practices" such as coercion, discrimination as to price, quantity, quality or time, including breaches of membership and/or marketing agreements.

The Marketing and Bargaining Act is largely untested and underutilized. Nonetheless, it does offer potential access to markets which might otherwise be denied to aggressive new cooperatives. This protection can be enforced by court order, if necessary.

It is, however, interesting to note that this act does not extend to producers of "forest products" (13 MRSA 1955.5). Despite the fact that forestry cooperatives can organize and enjoy all the rights under the Agricultural Cooperative Act, they cannot enlist the protection afforded by the Marketing Act.

IV. Setting up an Agricultural Marketing Cooperative.



IV. SETTING UP AN AGRICULTURAL MARKETING COOPERATIVE

A. MEETING THE LEGAL REQUIREMENTS FOR THE STRUCTURE OF THE COOPERATIVE

As discussed already, there are two major legal requirements for an Agricultural Marketing Cooperative:

1. That all members be producers of agricultural products; and
2. That the members receive their dividends based on patronage and not on capital investments.

When you are sure that your potential association can meet these two requirements, you then need to make some further decisions about your association before you actually begin the process of setting it up.

There are technical legal requirements relating to the following areas:

1. Incorporators
2. Articles of Incorporation
3. Amendments
4. Meetings
5. Directors
6. Officers
7. Members
8. Dividends
9. Net Income of Association
10. Termination of Membership.

Each of these areas should be discussed and decisions made as to how you want your association to be set up. Following are the legal requirements you will have to meet:

1. Incorporators

"Incorporators" is the name given to the people who form a cooperative. To form an Agricultural Marketing Cooperative, the law requires a minimum of:
five (5) individuals or two (2) associations.

An association which would qualify would be any existing association which consisted of producers of agricultural products, e.g., an already existing agricultural cooperative. This means that two separate cooperatives could combine and form a new cooperative, or two existing partnerships of agricultural producers could form a cooperative.

2. Articles of Incorporation

The overall framework of the association must be set down in a legal document called the Articles of Incorporation. The Articles must contain:

- (a) Name of the cooperative;
- (b) Purposes for which the association is formed;
- (c) Powers and limitations of the association;
- (d) The names of the incorporators;
- (e) The names of the first Board of Directors;
- (f) Stock or non-stock;
- (g) Rights and interests of members;
- (h) Location of office; and
- (i) Duration of cooperative.

The following section has details on the information to be included in each of the above areas.

The Articles must be signed by all members of the Board of Directors and filed with the Secretary of State and with the Registry of Deeds in the county where the cooperative is located.

Acceptance of the Articles by the Secretary of State makes the association a legally recognized Agricultural Marketing Cooperative.

3. Amendments

Once the Articles of Incorporation have been filed with the Secretary of State, they can be changed or amended by the membership of the cooperative,

provided they follow the rules for amending the Articles of Incorporation. These rules require a written notice to be mailed or delivered to each member containing the time, place and date of the meeting at which the Articles will be amended, as well as the substance for the proposed amendments. After such notice, the Articles of Incorporation may be amended by a two-thirds vote of all the members attending that meeting.

4. Meetings

The law requires that a special meeting must be called whenever requested by ten percent (10%) of the membership.

Members must be notified at least ten (10) days in advance of every meeting called and the notice must contain information regarding what will be discussed at the meeting.

The bylaws of the association (see next section) will contain information on how, when and where regular meetings of the membership will be held. A meeting may also be called at any time by the Board of Directors.

5. Directors

The law requires a minimum of three directors on any board of directors and also requires that they be members of the cooperative.

Removal of the Directors is accomplished by five (5%) of the members submitting a request to the Board for the removal of a Director. The issue can then be voted on at the next meeting. A two-thirds vote of the membership is required for any such removal. The Director whose removal is being sought is entitled to notice of the charges against him/her at least ten days prior to the meeting and has the right to be heard and present evidence at that meeting.

6. Officers

The Board of Directors must elect a President, a Vice-President, a Secretary and a Treasurer. The same person may be the Secretary and Treasurer.

The President must be a Director, and any Vice-President who will be succeeding the President must also be a Director.

Removal of Officers is accomplished in a similar manner as the removal of the Directors. The differences are that the petition to remove the Officer must be filed by ten percent (10%) of the membership. Removal is accomplished by a majority vote of the Board rather than the membership. The Officer whose removal is being sought is entitled to the same rights as a Director subject to removal.

7. Members

Members must be producers of agricultural products or associations of producers (as discussed in the section on What is an Agricultural Marketing Cooperative). The law requires that the bylaws of the cooperative should state that if a member ceases to be a producer of agricultural products, he/she shall automatically lose his/her right to vote.

8. Dividends

If the cooperative should issue capital stock, no dividends in excess of eight percent (8%) on the actual cash value of the money received by the cooperative shall be paid on either common or preferred stock.

9. Net Income of Association

Any net income of the association after payment of dividends and additions to reserve (money retained to operate the cooperative) must be paid out to the members on a patronage basis. There is no limitation on the return which a member can receive as a result of his/her patronage.

10. Termination of Membership

On termination of membership, or within a reasonable time thereafter, a member is entitled to receive, the value, in money, of his/her membership interest in the cooperative as appraised by the Board of Directors.

B. PREPARING THE ARTICLES OF INCORPORATION AND BYLAWS

The Articles of Incorporation provide the association with a basic framework and overall structure. The bylaws are the rules by which the association operates.

The section on legal requirements discussed the rules which are required by law. There are other rules which are discretionary and which should be discussed with all the members.

1. Articles of Incorporation

The following provisions should be discussed and included in the Articles:

a. Name

As with any other form of business, the name must be available. That is, it must not be in use already by some other business. It is often wise to call the Secretary of State's office prior to submitting the Articles of Incorporation and ask if the name is available. You may also reserve a name for a small fee.

b. Purpose of the Association

This section should specifically outline the purpose for which you are forming the association -- e.g., procure goods and services for members; provide marketing services; etc. . .

Remember, that when the IRS and others are evaluating whether or not you are a cooperative and what kind of cooperative you are, they will look carefully at the Articles of Incorporation to determine your purpose.

c. Powers and Limitations

These provisions relate to the powers the cooperative will have as it carries on its business. Generally, the cooperative will have the powers

of all business corporations, to borrow money, to buy and sell, or lease land, and to operate as a business. It may also have the power to operate as agent for all its members in the carrying out of its business.

The provisions on limitation ordinarily deal with the issue of how the cooperative transacts business with non-members. These will vary depending upon the tax status the cooperative is attempting to obtain. If, for example, this section will contain language requiring that it deal with non-members exactly as it deals with members. If the cooperative wants to seek Subchapter T status, this section would allow it to treat non-members differently than members.

d. Place of Business

This is important in order to ensure that the official address of the business is a matter of public record.

e. Period of Duration

This makes the length of time the business is organized for a matter of public record. It may be perpetual.

f. Directors

This provision tells how many people make up the Board of Directors, who they are and what their elected terms are. It also generally contains a provision that the first Board of Directors will sit only until the first official meeting of the members at which time their successors will be elected.

g. Membership

This section outlines the requirements of membership (that members must be producers of agricultural products) and the rights of the members. This section should also state that the business will operate as a cooperative for the mutual benefit of its members, and that the members shall have property rights and interests in the business in an amount equal to their patronage. It will also contain the one-person, one-vote provision.

This section will vary depending on whether or not the cooperative is a Capital Stock Cooperative. If there is capital stock, the rights of the stockholders will also have to be described.

h. Capital Structure

If there is capital stock, this section will determine the capital structure of the association, e.g.:

- How many classes of stock;
- What kind of stock - common or preferred;
- Par value or no par value;
- Rules relating to buying and redeeming stock; and
- Value of all stock sold at beginning of the corporation.

A sample set of Articles is included in Appendix E.

2. Bylaws

The bylaws are the rules by which an association operates. They may repeat, but must always be consistent with the Articles of Incorporation.

Among the many elements which should be dealt with are the following:

- a. Name.
- b. Purpose.
- c. Place of Business.
- d. Members.

In determining how your bylaws should read, be careful to fully consider the following:

--Membership must be restricted to those who qualify under the statutory and case law. (i.e., producers of agricultural products) Failure to accurately list the requirements for membership could subject you to legal action.

--The bylaws should also clearly outline the standards for continuing membership and provide clear guidelines for termination of membership, both voluntarily and involuntarily. The termination of membership bylaws should clearly define how the departing member will receive compensation for his/her share of the business. Membership should also be stated to be non-transferable.

--Any requirements of members, should be clearly and unequivocally stated under a section entitled REQUIREMENTS OF MEMBERS. For example, that members must claim as income all amounts allocated to them as patronage refund, even that amount retained as capital reserve. This is to avoid the possibility of a member denying he or she was not aware of the requirements. This is also required by the tax laws.

e. Meetings

The bylaws should include the following requirements regarding meetings:

--Regular Meetings. How and when regular meetings are to be called. Requirements of quorum (the number of members needed to make the meeting official) and the manner of voting should also be included.

--Annual Meetings. The bylaws should include the requirement of an annual meeting. Among other business, the Directors whose terms are expiring should be replaced or re-elected at the annual meeting.

--Special Meetings. The bylaws should include the requirements described above for special meetings, the notice required and the items which can be considered.

f. Board of Directors

The bylaws should include the following information regarding the Board of Directors:

--The number of Directors on the Board,

--How long the terms of office are,

- Procedure for electing, removing and replacing the Board,
- Powers and duties of the Board should be described,
- Meetings of the Board should be provided for (when, how often, how called, regular meetings and special meetings),
- Committees of the Board should be provided for, (what they are, what their functions are, how members are chosen to sit on such committees),
- Compensation and quorum requirements should be stated.

g. Officers of the Corporation

The bylaws should include the following information on the Officers:

- What the positions are (e.g, President, Secretary, Treasurer),
- What the duties are,
- Procedures for removing and replacing Officers,
- Bonding and insurance requirements.

h. Manager

The following should be included:

- Procedures for choosing, replacing or removing the manager,
- Compensation,
- Duties.

i. Capitalization

How stock is authorized and issued, how the value is to be determined, requirements of purchasers, if any.

j. Distribution of Patronage Refund Dividends

This is one of the most important aspects of the bylaws. It determines how dividends are to be made to the members and non-members. It must contain language requiring the cooperative to pay out its profits to the members in qualified certificates of allocation.

k. Operation of the Association

This section should provide for all aspects of the operation of the association as it effects the members. Following are the areas which should be considered: Title to products referred to in any marketing agreement; delivery requirement; grading procedures; risk of loss. The bylaws should require the association to operate at cost and to return all profit to its stockholders and members in dividends and patronage refunds.

l. Capital Reserve Account

If the association desires to keep a capital reserve account or revolving fund, the bylaws should provide and should specifically outline the applications of such fund.

m. Marketing Agreements

(See discussion on Marketing and Membership Agreements.)

n. Amendment to Bylaws and Articles of Incorporation

Provision should be made as to how the bylaws are amended.

o. Dissolution and Property Interest of Members

This section should clearly spell out how the association is dissolved and how the interest of each member will be determined upon dissolution.

A sample of a set of bylaws is included in Appendix E.

C. THE PROCESS OF INCORPORATION

Following are the steps you must go through to make the Association legal and operational:

1. Sign Organizational Agreements
2. Prepare Remaining Legal Documents
3. Hold Organizational Meeting of Incorporators
4. Hold First Annual Meeting of Members
5. Hold First Annual Meeting of Board of Directors.

1. Sign Organizational Agreements

The first formal step you should take after deciding to form a cooperative is to prepare an Organization Agreement which all the individuals who want to start the cooperative will be asked to sign.

In signing the Organization Agreement, the persons are committing themselves legally to enter into the business association. The Organization Agreement is a legal and binding contract among all the parties who sign it. It allows the parties to withdraw from their commitment only if they cannot get enough people to sign to make it a profitable venture. The question of whether enough have signed is left up to the organizers. Either a set number can be included in the Agreement or it can be left up to a vote of the majority of signers.

The Agreement will commit the signers to participate in some or all of the following areas:

- (a) payment of membership fee,
- (b) purchase of stock,
- (c) signing of membership agreement,
- (d) signing of marketing agreement,
- (e) adherence to bylaws,
- (f) adherence to Articles of Incorporation.

Practically speaking, the signer should understand that they will be required to make commitments in the following area:

- (a) carrying out recommendations of the association,
- (b) accepting and honoring long-term contracts,
- (c) renewing contracts - especially short-term contracts,
- (d) using own land as collateral for borrowing capital for the association,

- (e) performing harvesting, farming or logging activities on own land,
- (f) making substantial investments in the association,
- (g) supplying produce on either a scheduled or continuous basis; and,
- (h) actively participating in the normal business affairs of the association.

A sample Organization Agreement is included in Appendix E.

2. Prepare Remaining Legal Documents

The Organization Agreement, the Articles of Incorporation, the bylaws, the Membership and Marketing Agreements, and all other legal documents should be prepared by an attorney of the organizers' choice. The issues which the attorney will have to consider when he or she drafts these documents have been discussed in the preceding section so that the organizers will be able to understand the importance and meaning of these documents. As a result, the organizers will be able to tell the attorney what they want and the attorney can then translate those requirements into legal language.

After the Organization Agreement is signed, and it is determined that there is sufficient number of members, the next step is to prepare the written Articles of Incorporation, bylaws, and Membership and Marketing Agreements. Each of these areas has been discussed at length in preceding sections, however, it is worth emphasizing at this point that these documents are the rules under which the business will operate. If the business is to succeed, these documents must be prepared with care and understanding of how the business should operate.

3. Organizational Meeting of Incorporators

Those individuals who have signed the Organization Agreement and who have committed themselves to the business are also known as the "incorporators".

It is the incorporators' responsibility to file the Articles of Incorporation with the Secretary of State's office. The filing is an application to the Secretary's office to be recognized as a legal cooperative. To do this, the incorporators need to hold an organizational meeting.

At this meeting, all the incorporators come together to do the following. They elect the first Board of Directors. They accept and sign the Articles of Incorporation. The Board of Directors elects its Officers. The President, Treasurer and a majority of the Board of Directors sign a Certificate (which should be prepared by an attorney) containing the names and addresses of the Officers. This Certificate is attached to the Articles of Incorporation.

The Articles and Certificate are then sent to the Secretary of State's office. The Secretary of State reviews the Articles to see if they are legally correct and forwards the Certificate and Articles to the Registry of Deeds in the county where the cooperative has its principal place of business. After they are recorded at the Registry of Deeds, they are sent back to the Secretary of State. The cooperative at that point becomes a legally recognized business association.

4. First Annual Meeting of Members

The law requires that the bylaws of the cooperative be adopted by a majority of the "members" of the cooperative. The Articles of Incorporation and the bylaws should state the initial Board of Directors will serve only the first meeting of the members, at which time the members will elect new Directors (or the same ones, as will be the case in most instances).

Because of this, it is important that the first meeting of the members be held within a reasonable time after formal recognition by the Secretary of State.

At the first meeting, the members will:

Adopt the Articles of Incorporation

Although the Articles will have already been approved by the Secretary of State, they should be discussed and formally adopted by the members. If there are requests for amendments, they can be handled as explained above. Of course, all amendments are subject to approval by the Secretary of State.

Adopt the Bylaws

As stated above, the law requires that the members adopt the bylaws, not the Board of Directors. During this meeting, the bylaws should be fully explained and formally adopted. Amendments to the bylaws can be handled as explained above.

Elect New Board of Directors

Although the law does not require that the Board of Directors be chosen by the membership, it is clear that the only way the membership can maintain any real control over the cooperative is to provide in the Articles of Incorporation and bylaws that the Board will be chosen by the membership.

The first Board, chosen initially by the incorporators, are elected to serve only until the first meeting of the members. At this first meeting, the new Directors should be elected by the membership. It is recommended that the first Board be elected to staggered terms to avoid a complete turnover each year. For example, on a nine member Board, at the first meeting of members, the members would elect three Directors to a one-year term, three to a two-year term, and three to a three-year term.

Their successors would be chosen at each annual meeting to a straight three-year term. This would, under normal circumstances, provide for a one-third turnover on the Board each year.

Conduct Other Business

The members may then wish to discuss other matters such as:

- The membership/marketing agreements,
- Regularity of Board meetings,
- Regularity of Director meetings,
- Management decision.

After this first meeting, there will usually be only one meeting of the membership each year. The purpose of this annual meeting is to:

- Elect new Directors,
- Report to membership,
- Make any changes in the organization which require the vote of the membership.

Appendix E contains a sample set of minutes to illustrate the kind of business conducted at the first annual meeting.

5. Hold First Annual Meeting of Board of Directors

Once these two major meetings have been held, the cooperative is fully operational. The Board of Directors should meet as soon as possible after the first meeting of the membership and should take the following action:

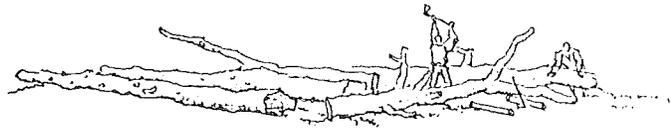
- Hire an Executive Director (and staff),
- Authorize the cooperative to open savings and checking accounts,
- Grant authorization to procure necessary bonds for Treasurer, and others where required.

The Board should also discuss and resolve any other matters that require its immediate action.

The Board should continue to meet at regular intervals.

A sample set of minutes for the first meeting of the Board is included in Appendix E.

V. Appendices.



APPENDIX A

PARTICULAR PROBLEMS RELATED TO PRODUCERS
OF FORESTRY PRODUCTS

If a group of persons involved in forestry determines that the cooperative form of business association is the best form for them to use, several unique questions arise.

These questions relate to the following areas:

1. Antitrust
2. Taxation
3. Securities Registration
4. Marketing and Membership.

1. ANTITRUST PROBLEMS

As discussed in the main text, any group of individuals who come together and form an association to fix prices and agree to sell their goods at a set price, can be accused of violating the antitrust laws. The antitrust laws prohibit exactly that kind of association.

It has been pointed out, however, that the Capper-Volstead Act gives specific exemptions from the antitrust laws to agricultural cooperatives. Agricultural cooperatives are defined as associations of "producers" of agricultural products.

Two questions face persons involved in the forestry area:

- (a) Are forestry products agricultural products? and,
- (b) Are loggers "producers"?

A. ARE FORESTRY PRODUCTS AGRICULTURAL PRODUCTS?

(1) Interstate Commerce vs. Intrastate Commerce

Whether or not forestry products are considered agricultural products is a problem only so far as federal law is concerned. Maine specifically

includes forestry products in its definition of agricultural products.

Federal laws will be of concern to forestry cooperatives only if that cooperative deals in "interstate commerce". In other words, if the cooperative will be doing business exclusively in Maine and not affecting the commerce in other states, the federal law will not apply, and the cooperative will have no antitrust problems.

However, the question of whether the cooperative is doing business exclusively in Maine is a complex one. The courts have said that if the business has substantial economic effect upon interstate commerce or concerns more states than one, it is dealing in "interstate commerce".

For example, if a forestry cooperative sold only to a furniture factory in Maine, but that furniture factory was the largest producer of furniture in New England, because of the prices charged to the factory by the cooperative, the price of wooden furniture in New England could go up. In this case, a court could find that the cooperative's activities has substantial impact on "interstate commerce", even though it confined all its business dealings to Maine.

Each situation must be evaluated on its specific facts. The issue which the court will look for will be whether or not the cooperative's activities affect interstate commerce, not simply whether the products are transported across state lines.

Therefore, if the cooperative will be dealing with large mills who market these products nationally, it would be advised to attempt to qualify for federal exemption as well as state.

(2) Federal Exemption

Unfortunately, "agricultural products" are not defined in the Capper-Volstead Act. The federal courts have had only two opportunities to consider

this unique question.

Also, unfortunately, in both these instances the court skirted the precise issue and decided the cases on other reasons.

In the first case, Boise Cascade vs. Northern Minnesota Plywood 294 F. Supp. 1015 (D. Minn. 1968), a paper mill alleged that the woodcutters had organized a boycott in order to get higher prices, and was therefore, in violation of the antitrust laws. In attempting to determine whether the organization of woodcutters was exempt under the Capper-Volstead Act, the court considered the question of whether forestry products were agricultural products. However, the court made no decision on that specific issue. Instead, after citing three statutes,

1. The Capper-Volstead Act, where there is no definition of agricultural products;
2. The Cooperative Marketing Act (7 USC 451) where agricultural products are defined as including only edible products of forestry; and,
3. The Minnesota Cooperative Marketing Act, which did include forestry products in its definition of agricultural products, said it would assume arguendo that they were agricultural products. The court then went on to say that, even if they were an association of agricultural producers, the Capper-Volstead exemptions would not permit them to engage in boycott activities.

The other case dealing with this question was Abitibi vs. Michigan Independent Wood Producers, which was heard on September 9, 1977 in the Eastern District of Michigan. This case also involved the mill charging the loggers of boycott, and once again the court considered whether forestry products were agricultural products, saying:

"The court believes that this definition includes persons, like defendants, independent contractors who harvest wood and deliver it to processors. The court notes that the harvesting of wood on federal lands comes under the aegis of the US Department of Agriculture. More importantly, the court believes that the purpose of the agricultural exemption applies equally to defendants as to other agricultural workers, and the court believes it is likely that Congress intended to include pulpwood harvesters in this exemption."

Although the above quoted language is quite favorable to an interpretation that forestry products are included in agricultural products, the court reciting that language was only a trial level federal district court and as such the holding has little precedential weight.

In addition to the above two cases, it should be noted that in two separate sections of the federal law, (The Cooperative Marketing Act [7 USC 451] and the Agricultural Act of 1970 [7 USC 1282a]) the definition of agricultural products specifically excludes non-edible forestry products.

These sections, however, have no relation to the Capper-Volstead Act or to antitrust exemptions.

Unfortunately, the case law and the statutory law leaves this question largely unanswered.

B. ARE LOGGERS "PRODUCERS"?

The question of whether loggers, i.e. independent woodcutters, who do not own wood lots, but generally own their own trucks, saws, and other equipment necessary for logging, can be considered producers of agricultural products also presents some difficult problems.

As was noted in the preceding section, in the Abitibi case and the Bosie Cascade case, the courts assumed that woodcutters were producers of agricultural products. In those cases, however, the specific issue of whether the loggers were producers was not raised and the issue which was decided was

based on the supposition that forestry products were agricultural products.

In 1978, the United States Supreme Court had the opportunity to deal specifically with the "producer" issue in the context of chicken farming. In that case (National Broiler Marketing Association vs. The United States [98 S. Ct. 2122, 436 US. 816]), the National Marketing Broilers Association (NMBA) sought antitrust exemption under the Capper-Volstead Act. The court said that the Capper-Volstead Act gave antitrust exemption only to those associations composed of producers of agricultural products. The court said this means that all members of the association must be producers.

The court said that a common sense reading of the Capper-Volstead Act and the legislative history of the act "confirms the conclusion that not all those involved in bringing agricultural products to market may join cooperatives exempt under the statute. . ."

Specifically, in that case there were individuals who were members of the cooperative who did not own or control any breeder flocks, hatcheries, or grow-out facilities. Those members would merely buy hatched chicks and deliver them to an independent contractor who would grow them in his own facility. The member would then transport the chickens to the processing plant.

The court felt that these members were not producers as meant by the Capper-Volstead Act. The court said that the economic role of such members in the production of broiler chickens is indistinguishable from that of processors who enter into preplanting contracts with suppliers, or from those of packers who assist their suppliers in the financing of crops. "Their participation involves only the kind of investment that Congress clearly did not intend to protect."

Relating this court decision to the question of whether loggers are "producers", the question is: Is their investment the kind that Congress

clearly intended to protect?

The answer to this question must be no. The investment of loggers and their equipment is not comparable to the investment farmers must make in the overall production of agricultural cooperatives.

This is confirmed by looking at the court's reasoning and philosophy in discussing the Capper-Volstead exemptions in the National Broiler case. In that case, the court talked about farmers and why they should receive the anti-trust exemptions. The court said:

"Farmers were perceived to be in a particularly harsh economic position. They were subject to the vagaries of market conditions that plague agriculture generally, and they had no means individually of responding to those conditions. Often the farmer had little choice about who his buyers would be and when he would sell. A large portion of an entire year's labor devoted to the production of a crop could be lost if the farmer were forced to bring his harvest to market at an unfavorable time. Few farmers, however, so long as they could act only individually, had sufficient economic power to wait out an unfavorable situation. Farmers were seen as being caught in the hands of processors and distributors who, because of their position in the market and their relative economic strength, were able to take from the farmer a good share of whatever profits might be available from agricultural production. By allowing farmers to join together in cooperatives, Congress hopes to bolster their market strength and to improve their ability to weather adverse economic periods and to deal with processors and distributors."

This language from the most recent Supreme Court cases dealing with the issue demonstrates clearly that an association of independent loggers whose only investment was in their equipment would not qualify for antitrust exemption under the Capper-Volstead Act.

The issue becomes more complex, however, if the logger owns a small woodlot, or if the logger leases land for a term of years, or if he enters into

a multi-year stumpage contract with a land owner.

Whether or not a logger in any of the above situations would be considered a "producer" will always depend upon the particular circumstances of each case.

The first question will always be, "does the woodcutter have the kind of investment Congress wanted to protect when it granted exemptions to the antitrust laws?" Is the investment the same type that "farmers" have?

The greater the investment, the longer the term of the lease hold, on the stumpage contract, the more likely it is that the woodcutter will be considered a "producer".

SUMMARY

While it is true that individuals dealing with forestry products (both woodlot owners and/or loggers) face some still unanswered questions in the area of exemption from anti-trust laws, it is quite clear that "anti-trust" is the only problematic area facing these individuals.

This problem does not mean that individuals dealing with forestry products cannot form coops; both woodlot owners and loggers can form associations as agricultural cooperatives under the Maine Agricultural Cooperative Association Act. As such, they will then qualify for preferential tax treatment, preferential securities registration treatment and for all special benefits under state law.

If the association is formed, and if it deals in interstate commerce, and if it is challenged as being in violation of the anti-trust laws, it will have to meet the challenge in the courts.

2. TAXATION

As noted in the general treatment of cooperative taxation, the use of Section 521 is restricted to organizations comprised of "farmers, fruit growers, or like associations". Although there has been no definitive court case which

has ruled on whether forestry enterprises are included within the term "like associations", Internal Revenue Service has taken the position that cooperatives engaged in forestry, the growing of timber, or the marketing of lumber are not engaged in activities like or similar to farming. Rev. Rul. 73-570. Despite the fact that there are instances of flawed analysis in that ruling and many persuasive arguments that forestry is a business similar to other agricultural pursuits, a forestry cooperative would be well-advised to organize pursuant to the alternative requirements of Subchapter T of the Internal Revenue Code.

In addition to avoiding time and expense likely to be expended in defending a Section 521 entitlement, a forestry cooperative that organizes under Subchapter T can also gain the flexibility of treating members and non-members differently in terms of patronage payments, voting and other membership privileges. Moreover, there is no requirement in Subchapter T that the business be focused on marketing. Another important option available to a forestry cooperative under Subchapter T is the payment of dividends on capital stock at a rate in excess of 8% of the original investment. This ability could be very important in attracting the investment necessary to start up a new business. Finally, a forestry cooperative claiming Subchapter T status can be involved in a vertically integrated operation which includes production and processing as well as marketing. Thus, a forestry cooperative could own and work its own wood lots, could negotiate stumpage and mill contracts, and could even own and operate its own mill and still be able to deduct all patronage payments in arriving at its taxable income. Thus, the patron-members of the forestry cooperative can almost always avoid the double taxation possible in normal business corporations while being able to band together to enjoy the economics of scale at every phase of a forest products business.

Thanks to a definition of "agricultural products" which includes forestry products, forestry cooperatives organized under the Maine Agricultural Cooperative Act are totally exempt from all state taxes, be they based on sales, or state capital. See 13 MRSA 1774.1 and 1779.

The ability of a forestry cooperative to organize under Maine Agricultural Cooperative Act, together with the ability of such a cooperative to claim Subchapter T tax status with the resultant reduction or elimination of state and federal corporate tax liability, should itself be sufficient economic justification for any substantial multi-party forestry enterprise to be organized on a cooperative basis.

3. SECURITIES

Forestry cooperatives will not be able to claim a complete exemption from the registration requirements of the Securities Registration Act of 1933 since they do not qualify as a farmer's cooperative exempt from taxation under Section 521 of the Internal Revenue Code. Nonetheless, as noted on the general securities section, due to the fact that the membership financing interests of forestry cooperative would most likely be reviewed as not constituting investment securities, no registration would be required.

It is unlikely that forestry cooperatives would be viewed as automatically exempt from registration under the Securities Exchange Act of 1934 since that exemption is also tied to the traditional concept of a farming enterprise. However, the nature of the membership interests and the manner in which a forestry cooperative would be expected to offer them to its members suggest that broker-dealer registration is not essential.

State registration, both of the securities themselves and of potential broker-dealers, is likewise unlikely to be required in view of the position adopted by the Maine Securities Division.

In general, securities issues for forestry cooperatives are not treated differently than those presented by standard agricultural cooperatives: they are free of the registration requirements of the federal and state securities laws, not based upon a specific exemption, but based upon the non-investment character of the financing transactions.

4. MARKETING AND MEMBERSHIP

Although there is only one major legal distinction between marketing techniques available to Forestry Cooperatives and other agricultural cooperatives, there are several other practical legal adjustments Forestry Cooperatives may wish to make in view of the nature of their product. The one legal distinction rests on the exclusion of producers of forest products from the operation of the Maine Agricultural Marketing and Bargaining Act of 1973. (13 MRSA 1955.5) The importance of this denial of the use of the Bargaining Board and judicial supervision of its orders is difficult to assess, since the Act has not been widely used. Nonetheless, this is a potential area for legislative reform.

Among the practical modifications to a membership and marketing agreement a forestry cooperative might wish to make are provisions to recognize the use of greater amounts of acreage in forestry than in a pure farming context. Thus, in the section of the agreement describing the property subject to the agreement accomodation for many lots without a surveyed or even a metes and bounds description should be used. The cooperative may even have to undertake the preparation of adequate descriptions of the woodlots covered by the agreement. Also, since the period to maturity and the time available for harvest for forest products is so much longer than for other farm products, provisions relating to crop or harvest estimates, harvesting and delivery dates should be lengthened. Provisions relating to woodlot management practices from grading to haul road

layout and construction to selective harvesting requirements can also be included directly in the membership and marketing agreement. In general, any problem that woodlot owners, wood cutters, or other cooperative members have had in the past with the growth, harvesting, and sale of their products can be addressed, and hopefully eliminated, in a carefully drafted cooperative marketing and membership agreement since these contracts should be designed to benefit patron-owner as much as the cooperative itself.

In conclusion, it appears as if the only unanswered problem for producers of forestry products is in the area of anti-trust.

Because forestry cooperatives do not clearly fall under the Capper-Volstead exemptions, any group of foresters organized as a cooperative must realize that they face a possible anti-trust challenge.

This potential challenge should not necessarily deter an interested group of foresters from forming a cooperative. As noted, the law is by no means clear in this area, and there are many valid arguments that can be made in support of applying the Capper-Volstead Act to Forestry Cooperatives. It must be remembered that the law, like everything in life, is constantly changing and responding to the needs of society.

APPENDIX B

A COMPARATIVE LAW ANALYSIS OF
AGRICULTURAL COOPERATIVE ACTS

The Maine Agricultural Marketing Cooperative Act, 13 MRSA 1771 et seq., is a nearly verbatim enactment of the Uniform Agricultural Cooperative Association Act first adopted by the Commissioners on Uniform Laws in 1936. The Act was adopted by Utah in 1939 and is now codified in 3 USA Chapter 1 §1-40. Maine adopted the Act in 1945. The only other state to adopt the Uniform Law was Hawaii, which did so in 1949. It is now codified in Chapter 421 USHA §1-27.

In recognition of the intended universal nature of the Act itself, all three enacting states left the substance of the Uniform draft intact. It is significant, however, that none of the enacting states incorporated the sections in the proposed Act regulating the contracts between the Association and its members. For reference purposes, a copy of that section is attached. Many states that independently formulated a Cooperative Act made provision for the regulation of member marketing contracts. The Uniform Law was withdrawn as recommended legislation by the Commissioners in 1943, not because of any defect, but because of the "scant attention" it had received.

The Agricultural Cooperative legislation most widely found in other states is modeled on the California Act, Cal. Code: Agri. 54001, which was authored by Aaron Shapiro, a powerful force in early formulation of the west coast agricultural industry. The basic philosophy behind Acts modeled on the Shapiro formula, also known as Bingham Acts, (based upon the Tennessee enactment in 1922) was to organize a cooperative agri-business around a single product so as to tremendously increase bargaining power. Such cooperative giants as Sunkist and Land of Lakes are examples of early cooperative ventures which grew

to a dominant market position under such acts. Their strong growth was further protected by one of the strongest early provisions for use of injunctions to enforce cooperative contracts and to police interference from outsiders. These acts also authorized the execution of contracts transferring the title of goods committed to a cooperative prior to the time of actual delivery. This increases the control of a cooperative over its membership contracts and the effectiveness of injunctive relief.

Since the Uniform Agricultural Association Act was developed after the wide-spread adoption of the Shapiro or Bingham Acts, in addition to California and Tennessee, 43 TCA 16-101; Alabama, 2 ACA 10-1; Arkansas, 77 ASA 901, Georgia, 65 GCA 201; Kentucky, KRS 272.101; Mississippi, 70 MCA 19-1; Missouri, MAS 274.010; North Carolina, 54 NCGS 129; and Virginia, 13 UCA 1-312, have adopted Acts in this form, and since it contains many of the innovative fixtures of those earlier acts, it is not surprising that there is a fairly standard body of laws regarding the structure and authority of Agricultural Cooperatives across the country.

Thus, a survey of Agricultural Cooperative Acts from other states reveals little significant differences from the Maine Act and from each other. However, some provisions which might prove beneficial to the cooperative movement in Maine should be specially noted. The Montana Cooperative Marketing Act, 14 RCM 401429 contains provisions for long-term marketing contracts (§417) and provides for the use of such contracts as security for loans (§428). These provisions appear to offer attractive financing alternatives to cooperatives.

For forestry cooperatives, it is also important to note that an overwhelming number of State Agricultural Cooperative Acts specifically include forest products in their definition of agricultural products. This, of course, could be valuable evidence that there is a nationwide public policy of interpreting the meaning of the Capper-Volstead Act and Section 6 of the Clayton Act.

UNIFORM AGRICULTURAL ASSOCIATION ACT

Section 18. Contracts between Association and Member.

I. Period, Withdrawal. The bylaws may require members to execute contracts with the association in which the members agree to patronize the facilities created by the association and to sell all or a specified part of their products to or through it, or to buy all or a specified part of their supplies from or through the association or any facilities created by it. If the members contract to sell to the association, the fact that for certain purposes the relation between the association and its members may be one of agency shall not prevent the passage from the member to the association of absolute and exclusive title to the products which are the subject-matter of the contract. Such title shall pass to the association upon delivery of the product, or at any other time specified in the contract. If the period of the contract exceeds three years, the bylaw and the contracts executed thereunder shall specify a reasonable period, not less than [twenty days], in each year, after the third year, during which the member, by giving to the association such reasonable notice as the association may prescribe, may withdraw from the association. In the absence of such a withdrawal provision, a member may withdraw at any time after three years.

II. Damages for Breach. The contract may fix, as liquidated damages, which shall not be regarded as penalties, specific sums to be paid by the members to the association upon the breach of any provision of the contract regarding the use of any facilities of the association or the sale, delivery, handling or withholding of products; and may further provide that the member who breaks his contract shall pay all costs, including premium for bonds, and reasonable attorney's fees, to be fixed by the court, in case the association prevails in any action upon the contract.

III. Equitable Relief. A court of competent jurisdiction may grant an injunction to prevent the breach of the contract of a member and may decree specific performance thereof. Pending the adjudication of such an action and upon filing a certified complaint showing the breach or threatened breach and a bond in such form and amount as may be approved by the court, the court may grant a temporary restraining order or preliminary injunction against the member.

IV. Recording Contracts. The association may file contracts to sell agricultural products to or through the association in the office of the [Register of Deeds] of the county in which the products are produced. If the association has uniform contracts with more than one member in any county, it may, in lieu of filing the original contracts, file the affidavit of its president, vice-president or secretary, containing or having attached thereto:

(a) A true copy of the uniform contract entered into with its members producing such product in that county;

(b) The names of the members who have executed such contract and a description of the land on which the product is produced, if such description is contained in the contract. The association may file from time to time thereafter affidavits containing revised or supplementary lists of the members producing such product in the county without setting forth therein a copy of the uniform contract but referring to the filed and recorded copy thereof. All affidavits filed under this section shall state in substance that they are filed pursuant to the provisions of this section. The [Register of Deeds] shall file such affidavits and make endorsements thereon and record and make entries thereof in the same manner as is required by law in the case of chattel mortgages, and he shall compile and make available for public inspection a convenient index containing the names of all signers of such contracts, and collect for his services hereunder the same

fees as for chattel mortgages. The filing of any such contract, or such affidavit, shall constitute constructive notice of the contents thereof, and of the association's title or right to the product embraced in such contract, to all subsequent purchasers, encumbrancers, creditors, and to all persons dealing with the members with reference to such product. No title, right or lien of any kind shall be acquired to or on the product thereafter except through the association or with its consent, or subject to its rights; and the association may recover the possession of such property from any and all subsequent purchasers, encumbrancers, and creditors, and those claiming under them, in whose possession the same may be found, by any appropriate action for the recovery of personal property, and it may have relief by injunction and for damages.

APPENDIX C

MISCELLANEOUS PROVISIONS AFFECTING
AGRICULTURAL COOPERATIVES

As one would expect, there are numerous statutes, in addition to the Anti-Trust Laws Securities Acts, and the Internal Revenue Code, which affect Agricultural Cooperatives. The following is a non-exhaustive list and brief analysis of the major additional statutes which are of interest to farmer cooperatives.

The Interstate Commerce Act, 49 USC 10521 et. seq., contains an express exemption for cooperatives. 49 USC 526 (a) (5). Thus, an agricultural cooperative which operates trucks in interstate commerce, need not register with the ICC.

The Commodities Exchange Act, 7 USC 2, gives affirmative support to agricultural cooperatives by making it illegal for a board of trade (i.e., a commodities exchange) to exclude a financially stable agricultural cooperative from board membership. A similar and somewhat redundant protection is found in 15 USC 431-433, which also bans discrimination against farmers cooperatives by board of trade.

Other laws relating to cooperatives or defining a cooperative include the Agricultural Marketing Agreement Act of 1937, 7 USC 608 (C) 5 (f). (Capper-Volstead Dairy Cooperatives granted right to "blend" markets.) The Agricultural Marketing Act of 1929, 12 USC 1141 (j) (a). (Defining a cooperative association for purpose of the Farm Credit Administration and programs thereunder in a manner similar to Capper-Volstead Act.) The Agricultural Fair Practices Act of 1967, 7 USC 2302 (C). (Capper-Volstead definition incorporated for designating cooperative associations entitled to protection from listed prohibited practices.) and the Farm Credit Act of 1971, 12 USC 2129 (qualifications for farmers and fisheries cooperatives for borrowing from the bank for cooperatives.)

APPENDIX D

SAMPLE FORMS
MEMBERSHIP AND MARKETING CONTRACT

This contract states the terms of agreement between Yankee Vegetable Growers, Inc., an agricultural marketing cooperative organized under the laws of the State of Maine, referred to as the cooperative, and _____ of _____, Maine, referred to as the producer.

RECITALS

- (a) The cooperative, through its staff, has expertise in the marketing of fresh vegetables from the central Maine area.
- (b) The producer is a grower of _____ type vegetables at its farm noted below.
- (c) Both parties are interested in increasing their access to potential markets and the prices for goods sold to those markets.

In recognition of their mutual interest, the producer hereby applies for membership fee.¹ The cooperative accepts the producer as a member of the cooperative and acknowledges receipt of the membership fee.

In further recognition of the rights and duties of membership, the parties agree as follows.

SECTION ONE

SALE OF PRODUCE

Producer shall sell and deliver to association all vegetables and produce of every kind grown, produced, or owned by him and suitable for general marketing purposes during the term of this agreement on the following described premises (describe farm, field, plot from deeds, tax maps or surveys).

¹This figure should be based upon the anticipated operating capital required, but not supplied elsewhere, divided by the anticipated number of members. The figure will generally be in excess of \$100 and, of course, can be changed by the board from year to year.

SECTION TWO

PREPARATION, DELIVERY, AND INSPECTION

Producer shall prepare all produce delivered to association according to packaging or crating requirements of the cooperative. Any deduction, charge, or loss sustained by the cooperative because of inferior produce or defective packaging furnished by producer shall be charged to producer. The determination of the cooperative as to grade, packaging, classification, and differential in prices shall be conclusive on producer.

SECTION THREE

NO CONTRARY AGREEMENTS

Producer states that he has not contracted to sell, market, consign, or deliver any produce during the term of this agreement to any person, firm, or corporation, contrary to this agreement.

SECTION FOUR

TRANSFER SUBJECT TO AGREEMENT

Any transfer of all or any part of the produce grown, owned, or controlled by producer to any person, firm, or corporation in violation of this contract and without the cooperative's written consent shall be subject to this agreement, and the transferee shall be obligated to deliver such produce under the terms hereof.

SECTION FIVE

AUTHORIZATION FOR DIRECT SALES

If producer is offered a direct contract for his vegetables, producer shall immediately report such offer in writing to the cooperative. Cooperative may permit members to contract for the sale of vegetables for limited periods directly to dealers, distributors, or other purchasers designated by the cooperative, but only on the terms and conditions authorized by the cooperative in writing,

and with the added condition that the cooperative is guaranteed full and prompt payment of all deductions authorized by this agreement or by the bylaws and rules of the cooperative with respect to such direct sales.

SECTION SIX

MORTGAGES

Producer shall notify the cooperative of any mortgage on any crop covered by this agreement and obtain permission from the mortgagee for the cooperative to market such crop in accordance with the terms hereof by permitting the cooperative to retain any deductions from the gross sales price authorized hereunder and the articles and bylaws of the cooperative. After any such deductions, producer authorizes the cooperative to apply the balance of the sale proceeds, or so much thereof as is necessary, for payment of the mortgage.

SECTION SEVEN

CROP ESTIMATES

Producer shall, on or before _____ of each year and at such other times as the cooperative may request, furnish the cooperative with an estimate of the size of his crop as well as such other information as the cooperative may request relative thereto.

SECTION EIGHT

OPERATING COST

Producer agrees that the cooperative shall be entitled to deduct and retain ____ percent (___%) of the gross sale price received by the cooperative for any produce marketed by it hereunder to cover its cost of operation, or any other percentage duly required by the direction in accordance with the articles and bylaws of the cooperative.²

² This figure is an estimate of the fractional share of overhead each member must bear. It should be sufficient to cover all costs so that the cooperative will not have to borrow operating funds at interest to pay for these costs. Surplus monies will, of course, be returned to members in patronage refunds.

SECTION NINE

BEST EFFORTS

The cooperative agrees to use its best efforts to handle, sell, and deliver the produce of producer. In selling such produce, the cooperative will pool all produce of like kind, quality, grade, and classification delivered to it by its other members under similar contracts, and it will obtain the best prices available under market conditions, taking into consideration the quality and condition of produce.

SECTION TEN

SETTLEMENTS

At such times as the directors of the cooperative may determine, the cooperative will make a partial or total settlement with producer for products sold by the cooperative. At least once each year during the term of this contract, a complete settlement for that year's business shall be made between producer and the cooperative.

SECTION ELEVEN

INSPECTION OF BOOKS AND ACCOUNTS

All books, accounts, and other documents affecting the business to be carried on by the cooperative shall at all times during business hours be open to the inspection of producer or any person designated by him who may present proper evidence of authority to make such examination.

SECTION TWELVE

PATRONAGE REFUNDS

At the annual meeting of the cooperative, the proper offices shall submit to the members, including producer, a statement showing any sums collected by the deduction of percentages from gross sales made by it over the amount necessary to cover the costs and the expenses of operation of the cooperative

for that year. Any surplus shall be refunded to the members, including producer, on a pro rata basis in accordance with the quantity and quality of produce handled and sold by the cooperative.

SECTION THIRTEEN

RESERVE FUND

If the directors of the cooperative at any time decide to create a reserve fund for the purposes authorized by the Articles and bylaws of the cooperative, and determine the percentage to be deducted from the gross sales for such purpose, the percentage so deducted may be placed in a reserve fund, and an accurate account thereof shall be permanently kept in the records of the cooperative. If the reserve fund is discontinued and refunded to the members, the cooperative shall pay producer his pro rata share of such fund, determined on the basis of his contributions thereto, plus the accumulations and earnings thereof.

SECTION FOURTEEN

FORFEITURE OF MEMBERSHIP

Violation of this agreement in any material respect by producer, or producer's failure to comply with the articles and bylaws of the cooperative shall result in a complete forfeiture of his membership in the cooperative, together with all accumulations to his credit in any fund of the cooperative, including the reserve fund, and all of his rights and privileges as a member, providing he is found guilty of such violation in the form and manner required by the bylaws of the cooperative, or any amendments thereof.

SECTION FIFTEEN

DURATION

This agreement shall become effective on _____, 19____, and shall continue thereafter until terminated by either party on ____ days' written notice.

IN WITNESS WHEREOF, the parties have executed this agreement at _____
_____ the day and year first above written.

Signed, Sealed and Delivered
in the Presence of:

YANKEE VEGETABLE GROWERS, INC.

By: _____
Its: _____
Cooperative

By: _____
Its: _____
Producer

2. ARTICLES OF INCORPORATION

ARTICLES OF INCORPORATION

of _____ Association

We, the undersigned, all of whom are residents and citizens of the
State of _____, engaged in the production of agricultural products, do hereby
voluntarily associate ourselves together for the purpose of forming a cooperative
association, without ¹ capital stock, under the provisions of the _____
Cooperative Marketing Act of the State of _____.

Article I - Name

The name of the association shall be _____ Association.

Article II - Purposes

The Association is formed for the following purposes:²

To provide or procure for its members any and all goods or services
related to producing and marketing agricultural products or any products derived

¹Cooperatives can, of course, have capital stock under the Maine statutes and
statutes existing in most other jurisdictions.

²This article may be modified in a manner consistent with the State statute to
state the specific purposes for which a particular association is formed. Modifi-
cation will be necessary if the cooperative wishes to serve non-members as well as
members.

therefrom; and to perform or make available any other services needed to operate the farm business, such as credit, irrigation, or pest control; and to exercise all such powers in any capacity on a cooperative basis.

Article III - Power; Limitations³

Section 1. Powers. This association shall have the following powers:

(a) To borrow money without limitation⁴ as to amount of corporate indebtedness or liability; to give a lien on any of its property as security therefor in any manner permitted by law; and to make advance payments and advances to members and other producers.

(b) To act as the agent or representative of any patron or patrons in any of the activities mentioned in Article II hereof.

(c) To buy, lease, hold, and exercise all privileges of ownership, over such real or personal property as may be necessary or convenient for the conduct and operation of the business of the association, or incidental thereto.

(d) To draw, make, accept, endorse, guarantee, execute, and issue promissory notes, bills of exchange, drafts, warrants, certificates, and all kinds of obligations and negotiable or transferable instruments for any purpose that is deemed to further the objects for which this association is formed and to give a lien on any of its property as security therefor.

(e) To acquire, own, and develop any interest in patents, trademarks, and copyrights connected with or incidental to the business of the association.

(f) To cooperate with other similar associations in creating central, regional, or national cooperative agencies, for any of the purposes for which this

³In this, as in other organization matters, the statute under which an association is being incorporated should be considered.

⁴In some states, the law requires that the maximum indebtedness which may be incurred by a corporation be stated in its articles of incorporation.

association is formed, and to become a member or stockholder of such agencies as now are or hereafter may be in existence.

(g) To have and exercise, in addition to the foregoing, all powers, privileges, and rights conferred on ordinary corporations and cooperative marketing associations by the laws of this State and all powers and rights incidental or conducive to carrying out the purposes for which this association is formed, except such as are inconsistent with the express provisions of the act under which this association is incorporated, and to do any such thing anywhere; and the enumeration of the foregoing powers shall not be held to limit or restrict in any manner the general powers which may by law be possessed by this association all of which are hereby expressly claimed.

Section 2. Limitations.⁵ This association shall not market the products of non-members in an amount the value of which exceeds the value of the products marketed for members. It shall not purchase supplies and equipment for non-members in an amount the value of which exceeds the value of the supplies and equipment purchased for members. It shall not purchase supplies and equipment for persons who are neither members nor producers of agricultural products in an amount the value of which exceeds fifteen percent (15%) of all its purchases. Business done for the United States or any of its agencies shall be disregarded in determining the limitations imposed by this section.

Article IV - Place of Business

The association shall have its principal place of business in the city of _____, County of _____, and State of _____.⁶

⁵If the association desires to transact business with members only, this section will require revision. If the association does not desire to qualify under Section 521 of the Internal Revenue Code of 1954, this section can be partially or wholly omitted, depending upon the requirements of the State statute.

⁶Some state laws require the inclusion of the name of a resident agent upon whom process may be served.

Article V - Period of Duration⁷

The term for which this association shall exist is _____ years from and after the date of its incorporation.

Article VI - Directors

The number of directors of this association shall be _____.⁸ Of the first elected board of directors, ____ shall be elected for 1 year; ____ for 2 years; and ____ for 3 years; and thereafter all directors shall be elected for 3 years. The names and addresses of those who are to serve as incorporating directors until the first annual meeting of the members or until their successors are elected and qualified are:

Name	Address
_____	_____
_____	_____
_____	_____
_____	_____

Article VII - Membership

This association shall not have capital stock, but shall admit applicants to membership in the association upon such uniform conditions as may be prescribed in its bylaws. This association shall be operated on a cooperative basis for the mutual benefit of its members as producers. Membership in the association shall be restricted to producers and associations of producers who shall patronize the association.

⁷If the law under which the association is organized permits perpetual existence this article may read, "This association shall have perpetual existence."

⁸If the statute under which an association is to be incorporated will permit, it is preferable to state in the articles of incorporation only the minimum number of directors that the association will have, providing in the bylaws, which may be more easily amended, for the actual number.

The voting rights of the members of the association shall be equal and no member shall have more than one vote upon each matter submitted to a vote at a meeting of the members.⁹

The property rights and interests of each member in the association shall be unequal; and shall be determined and fixed in the proportion that the patronage of each member shall bear to the total patronage of all the members with the association. But, in determining property rights and interests, all amounts allocated to each patron or evidenced by certificates of any kind shall be excluded, and, upon dissolution, the equity interests of members and patrons shall be determined as provided in the bylaws. New members admitted to membership shall be entitled to share in the property of the association in accordance with the foregoing general rule.

If the association is formed with capital stock, this Article might read as follows:

Article VII - Capital Stock

Section 1. Authorized Amounts; Classes. The capital stock of the association shall consist of ____ shares, divided into ____ share of common stock of the par value \$____ per share, and ____ share of preferred stock of the par value of \$____ per share.

Section 2. Common Stock. The common stock of this association may be purchased, owned, or held only by producers (1) who patronize the association in accordance with uniform terms and conditions prescribed by it, and (2) who have

⁹If voting on any other basis is permitted by the State law and the incorporators desire to provide for another basis, this sentence should be revised accordingly.

been approved by the board of directors. "Producer" shall mean and include persons (natural or corporate) engaged in the production of _____, or other agricultural products, including tenants of land used for the production of any such product, and lessors of such land who receive as rent therefor part of any such product of such land, and cooperative associations (corporate or otherwise) of such producers.

Each member shall hold only one share of common stock and each eligible holder of common stock shall be entitle to only one vote in any meeting of the stockholder.¹⁰ In the event the board of directors of the association shall find, following a hearing, that any of the common stock of this association has come into the hands of any person who is not eligible for membership, or that the holder thereof has ceased to be an eligible member, or that such holder has not, for a period of two (2) years, marketed through the association the products covered by a marketing contract or contracts with it, or has not otherwise patronized the association, such holder shall have no rights or privileges on account of such stock, or vote or voice in the management or affairs of the association other than the right to participate in accordance with law in the case of dissolution. The association shall have the right, at its option, (a) to purchase such stock at its book or par value, whichever is less, as determined by the board of directors of the association; (b) to require the transfer to any such stock at such book or par value to any person eligible to hold it; or (c) to require such holder of any such stock to convert it into shares of preferred stock of equal value.

In exercising its right to purchase or to require the transfer or conversion of common stock into preferred stock if such holder fails to deliver

¹⁰If voting on any other basis is permitted by the State law and the incorporators desire to provide for another basis, this sentence should be revised accordingly.

the certificate evidencing the stock, the association may cancel such certificate on its books and issue a new certificate of common or preferred stock, as the case may be, to the party entitled thereto.

The common stock of this association may be transferred only with the consent of the board of directors of the association and on the books of the association, and then only to persons eligible to hold it. No purported assignment or transfer of common stock shall pass to any person not eligible to hold it, the rights or privileges on account of such stock, or a vote or voice in the management of the affairs of the association. This association shall have a lien on all of its issued common stock for indebtedness of the holders thereof to the association. No dividends shall be paid on the common stock.¹¹

Section 3. Preferred Stock. The preferred stock of this association may be issued to any person, association, co-partnership, corporation or other organization, in series. It shall carry not voting rights.¹² Noncumulative dividends of not to exceed six percent per annum (6%) may be paid on preferred

¹¹If desired, provision may be made for dividends on common stock. A number of cooperatives, however, are choosing to eliminate such dividends because their members prefer to receive all returns on a patronage basis. Also, a cooperative that does not qualify under Section 521 of the Internal Revenue Code of 1954, has been taxable on net margins equal to the maximum permissible dividends payable on stock, if the board had discretion to determine the dividend rate. United Cooperatives, Inc. 4 TC 93 (1944). But Revenue Ruling 69-621, 1969-2 Cum. Bull. 167, applies a somewhat different rule under Subchapter T of the Code. Dividends on stock actually paid by a cooperative were less than the maximum amount permitted under the bylaws. The bylaws also required the net amount remaining after payment of dividends on stock to be distributed on a patronage basis to all patrons. The cooperative was allowed to deduct as a patronage refund under Section 1382 of the Code the net amount remaining after payment of dividends on stock. The ruling does not indicate whether the cooperative qualified under Section 521.

¹²In some states, all classes of stock are entitled to vote. If necessary, this provision should be revised accordingly; but in such cases care should be taken to restrict the right to hold preferred stock to producers who patronize the association.

stock, when, if, and as declared by the board of directors.

Preferred stock may be transferred only on the books of the association; and may be redeemed in whole or in part on a pro rata basis at par, plus any dividends declared thereon and unpaid, at any time on thirty (30) days' notice by the association, provided said stock is redeemed in the same order as originally issued by years. On the failure to deliver the certificate or certificates evidencing any such stock, the association may cancel the stock on its books. Stock which has been redeemed may, in the discretion of the board of directors, be reissued or retired. All such preferred stock so redeemed shall be paid for in cash at the par value thereof, plus any dividend declared thereon and unpaid; and such stock shall not bear dividends after it has been called for redemption.

This association shall have a lien on all of its issued preferred stock for all indebtedness of the holders thereof to the association.¹³

At the discretion of the board of directors, all dividends or distributions of the association or any part thereof may be paid in certificates of preferred stock or credits on preferred stock or ad interim certificates representing fractional parts thereof, subject to conversion into full shares.

Notwithstanding, any of the foregoing provisions the board of directors shall have the power, from time to time and at any time, to pay off or retire or secure a release or satisfaction of any preferred stock certificates to compromise

¹³ Whether a lien should be provided on preferred stock may depend on the intended use of such stock in the operations of the association. Some cooperatives use such stock primarily as a means of raising capital by sale to investors, who may or may not be patrons. If this is the intent, it may be undesirable to provide a lien, since this may tend to restrict the salability and circulation of the stock in a free market. On the other hand, if the stock is issued primarily to patrons in payment of patronage refunds, it may be deemed advisable to provide for a lien to aid the association in collecting indebtedness from patrons.

or settle a dispute between a holder thereof and the association, to settle an estate of a deceased or bankrupt stockholder, or to close out a stockholder's interest when he has moved from the territory.

Upon dissolution or distribution of the assets of the association, the holders of all preferred stock shall be entitled to receive the par value of their stock, plus any dividend declared thereon and unpaid before any distribution is made on the common stock.

In testimony whereof, we have hereunto set our hands this ____ day of _____, 19____.

State of _____
County of _____ SS.

Before me, a notary public, within and for said county and State, on this ____ day of _____, 19____, personally appeared _____ known to me to be one of the identical persons who executed the within and foregoing instrument and he acknowledged to me that he had executed the same as his free and voluntary act and deed for the uses and purposes therein set forth.

Witness my hand and official seal the day and year above set forth.

Notary Public

In and for the County of _____, State of _____.

My Commission expires _____.

3. BYLAWS

Article I - Membership

Section 1. Qualifications. Any person, firm, partnership, corporation, or association, including both landlords and tenants in share tenancies, who is a producer of agricultural products and who pays such membership fee and meets such other uniform conditions as may be prescribed by the board of directors (hereinafter called the "board"), may become a member of the association. This association shall issue a certificate of membership to each member which shall be in such form as may be prescribed by the board, but shall not be transferable.

Section 2. Suspension or Termination. If, following a hearing, the board shall find that a member has ceased to be an eligible member or has not, for a period of two (2) years, marketed through the association the products covered by a marketing contract or contracts with the association or has not otherwise patronized the association, it may suspend his rights as a member or terminate his membership. Upon termination of membership in the association, all rights and interests of such member in the association shall cease and such member shall be entitled only to payment or credit for the equitable appraised value of his property rights and interests in the association, as conclusively determined by the board.¹⁴ In determining property rights and interests, all amounts allocated to each member or evidenced by certificates of any kind shall be excluded, and any such amounts shall be accounted for to members in accordance with the terms and conditions applicable thereto. No action taken hereunder shall impair the obligations or liabilities of either party under any contract within the association, which may be terminated only as provided therein.

¹⁴ The State law may prescribe the rights of a person whose membership is terminated, in which case this provision should be made consistent.

If the association is formed with capital stock, this Article might read:

Article I - Membership

Each member of this association shall be the holder of one fully paid share of its common stock. The requirements for ownership of common stock are set forth in the articles of incorporation. Any corporate member may be represented by any individual duly authorized in writing filed with the association.

Article II - Meetings of Members

Section 1. Annual Meeting. The annual meeting of the members of this association shall be held in the town of _____, State of _____, at _____ o'clock ____ .m., on the _____ day of _____ of each year, or on any date which the board shall designate at least 30 days in advance of the date specified above.

Section 2. Special Meetings. Special meetings of the members of the association may be called at any time by order of the board, and shall be called at any time by order of the board, and shall be called at any time upon written request of at least _____ percent (%) of the members, provided, however, that in no case shall the required number of signatures to such a request be less than _____ (). The request shall state the time, place, and object of the meeting.

Section 3. Notice of Meetings. Written or printed notice of every regular and special meeting of members shall be prepared and mailed to the last

¹⁵ A delegate system of member representation might be used at the annual meeting. Delegates might be elected at district meetings by members.

known post office address of each member not less than ten (10) days before such meeting. Such notice shall state the object or objects thereof and the time and place of meeting. No business shall be transacted at special meetings other than that referred to in the call.

Section 4. Voting. Each member shall be entitled to only one vote upon each matter submitted to a vote at a meeting of the members. All questions shall be decided by a vote of a majority of the members voting thereon.¹⁶ Voting by proxy or cumulative voting shall not be permitted. Absent members may vote on specific questions other than the removal of directors by ballots transmitted to the secretary by mail. Such ballots shall be counted only in the meeting at the time in which such vote is taken, provided that all members have been notified in writing, pursuant to action by the board, of the exact wording of the motion or resolution upon which such vote is taken, and a copy thereof is forwarded with and attached to the vote of the member voting.

Section 5. Quorum. As long as the total number of members does not exceed _____ hundred, ten (10) members or ten per centum of the total number of members present in person, whichever shall be the larger, shall constitute a quorum. In case the total number of members shall exceed five hundred, fifty members or five per centum of the members, present in person, whichever shall be the larger, shall constitute a quorum. If less than a quorum is present at any meeting, a majority of those present in person may adjourn the meeting from time to time without further notice.

Section 6. Order of Business. The order of business at the annual meeting shall be:

¹⁶If voting on any other basis is permitted by the State law and it is desired to provide for another basis, this sentence should be revised accordingly.

1. Determination of quorum.
2. Proof of due notice of meeting.
3. Reading and disposition of minutes.
4. Annual reports of officers and committees.
5. Unfinished business.
6. New business.
7. Election of directors.
8. Adjournment.

Article III - Directors and Officers

Section 1. Number and Qualifications of Directors. The association shall have a board of _____ (_____) members.¹⁷ Each director shall be a member of this association.¹⁸ No person shall be eligible for the office of director if he is in competition with or is affiliated with any enterprise that is in competition with the association. If a majority of the board finds at any time following a hearing that any director is so engaged or affiliated he shall thereupon cease to be a director.¹⁹

Section 2. Election of Directors. At the first annual meeting of the members of this association, directors shall be elected to succeed the incorporating directors. _____ (_____) directors shall be elected for 1 year; _____

¹⁷ If an association wishes to encourage associations of producers to join as members, it may add, unless prohibited by statute, the following, "except the board may create one or more additional directorships to accomodate associations of producers desiring to become members of this association.

¹⁸ If permitted by statute, provision may be made authorizing representatives of incorporated members to be directors.

¹⁹ Some cooperatives include a provision like the following: "No director after having served for _____ consecutive terms shall be eligible to succeed himself, but after a lapse of one year shall be eligible again."

(_____) directors for 2 years; and _____ (_____) directors for 3 years. Thereafter, each director shall be elected for 3 years.²⁰ At least two candidates shall be nominated for each directorship. All directors shall be elected by secret ballot and the nominee receiving the greatest number of votes shall be elected.

Many cooperatives find it desirable to use a nominating committee. The following language may be included as a separate section:

Section 2. Nominations. The board shall appoint, not less than thirty days nor more than sixty days before the date of a meeting of the members at which board members are to be elected, a committee on nominations consisting of _____ members who shall be selected from different sections so as to ensure equitable representation. No member of the board may serve on such committee. The committee shall prepare and post at the principal office of the association at least twenty days before the meeting a list of nominations for board members which shall include at least two candidates for each board position to be filed by the election. The secretary shall be responsible for mailing at least ten days before the date of the meeting a statement of the number of board members to be elected and the names and addresses of the candidates nominated by the committee on nominations. Any fifteen or more members acting together may make other nominations by petition and the secretary shall post such nominations at the same place where the list of nominations made by the committee is posted. Nominations made by petition must be received at least five days before the meeting and shall be included on the official ballot. Later nominations by petition shall be treated as nominations from the floor.

²⁰ Some State laws may not permit staggered terms. If so, this sentence should provide that all directors shall be elected each year.

If the association wishes to select directors by districts, it is suggested that Article III, Section 2 might read as follows:

Section 2. Election of Directors. The incorporating directors shall serve until the first annual meeting of the members or until their successors shall have been elected and qualified. The incorporating directors shall divide the territory served by the association into _____ districts on the basis of geographic areas in which the number of members or the volume of business done with the association is approximately the same.

Each year the board shall establish a redistricting committee comprised of one member other than a director from each district. The redistricting committee shall meet at least 120 days prior to the annual meeting and may redistrict the territory as may be deemed advisable. A map and description of the current districts shall be maintained in the principal office of the association.

The board shall determine the time and place within each district for meetings to nominate directors.²¹ Such district meetings shall be held not less than thirty days nor more than ninety days before the annual meeting. Notice of district meetings, together with a statement of the purpose, shall be mailed to each member in the district at least ten (10) days before the meeting. Those members present shall constitute a quorum. The chairman selected by the members present shall certify to the secretary of the association within five days the selection of not more than two nominees.

Beginning with the year _____, _____ (_____) directors shall be elected for 1 year; _____ (_____) directors for 2 years; and _____ (_____) directors for 3 years. Thereafter, each director shall be elected for _____

²¹ Some associations, in lieu of holding district nominating meetings, may wish to provide for a nominating committee, appointed by the board. To prepare a list of nominees on a district basis, or that directors be elected at district meetings.

three years.²² The director for each district shall be elected at an annual membership meeting by secret ballot from the nominees selected at the district meetings and other nominations of members residing in the district that may be made from the floor. If necessary, additional ballots shall be taken for the two with the largest vote until one is elected by majority vote.²³

Section 3. Election of Officers. The board shall meet within _____ (_____) days after the first election and within _____ (_____) days after each annual election and shall elect by ballot a president, vice-president, secretary, and treasurer (or a secretary-treasurer), each of whom shall hold office until the election and qualification of his successor, unless earlier removed by death, resignation, or for cause. The president and vice-president only need be members of the board. Vacancies in such offices shall be filled by the board through election by ballot.

Section 4. Vacancies. Whenever a vacancy occurs in the board, other than from the expiration of a term of office, the remaining directors shall appoint a member to fill the vacancy until the next regular meeting of the members.

Section 5. Board Meetings. In addition to the meetings mentioned above, regular meetings of the board shall be held (monthly, quarterly, or semi-annually) or at such other times and at such places as the board may determine.

Section 6. Special Meetings. A special meeting of the board shall be held whenever called by the president or by a majority of the directors. Any

²² Some State laws may not permit staggered terms. If so, this sentence should provide that all directors shall be elected each year.

²³ Some associations may wish to provide for the election of directors at district meetings, rather than at the annual meeting.

and all business may be transacted at a special meeting. Each call for a special meeting shall be in writing, signed by the person or persons making the same, addressed and delivered to the secretary, and shall state the time and place of such meeting. On the signing of a waiver of notice of a meeting, a meeting of the board may be held at any time.

Section 7. Notice of Board Meetings. Oral or written notice of each meeting of the board shall be given each director by or under the supervision of the secretary not less than 48 hours prior to the time of the meeting, but such notice may be waived by all the directors, and appearance at a meeting shall constitute a waiver of notice thereof.

Section 8. Compensation. The compensation, if any, of the members of the board and of the executive committee shall be determined by the members of the association at any annual or special meeting of the association. No member of the board shall occupy any position in the association on regular salary.

Section 9. Quorum. A majority of the board shall constitute a quorum at any meeting of the board.

Article IV - Duties of Directors

Section 1. General Powers. The board shall direct the business and affairs of the association and shall exercise all of the powers of the association except such as are by law, the articles of incorporation, or these bylaws conferred upon or reserved to the members. The board shall adopt such policies, rules and regulations not inconsistent with law, the articles of incorporation, or these bylaws, as it may deem advisable.

Section 2. Employment of Manager. The board shall have power to employ a manager, define his duties, and fix his compensation.

Section 3. Bonds and Insurance. The board shall require the manager and all other officers, agents, and employees charged by the association with

responsibility for the custody of any of its funds or property to give adequate bonds. Such bonds, unless cash security is given, shall be furnished by a responsible bonding company and approved by the board and the cost thereof shall be paid by the association. The board shall provide for the adequate insurance of the property of the association, or property which may be in the possession of the association, or stored by it, and not otherwise adequately insured, and in addition, adequate insurance covering liability for accidents to all employees and the public.

Section 4. Accounting System and Audit. The board shall have installed and maintained an adequate system of accounts and records. At least once in each year the board shall obtain the services of a competent and disinterested public auditor or accountant, who shall audit the books and accounts of the association and render a report in writing thereon, which report shall be submitted to the members of the association at their annual meeting. This report shall include at least a balance sheet, and an operating statement for the fiscal period under review.

Article V - Duties of Officers and Manager

Section 1. Duties of President. The president shall (1) preside over all meetings of the association and of the board (2) call special meetings of the board, (3) perform all acts and duties usually performed by an executive and presiding officer, and (4) sign all membership²⁴ certificates and such other papers of the association as he may be authorized or directed to sign by the board; provided, however, that the board may authorize any person to sign any or all checks, contract, and other instruments in writing on behalf of the association.

²⁴ If the association is formed with capital stock, this word should be changed to "stock".

The president shall perform such other duties as may be prescribed by the board.

Section 2. Duties of Vice-President. In the absence or disability of the president, the vice-president shall perform the duties of the president.

Section 3. Duties of Secretary. The secretary shall keep a complete record of all meetings of the association and of the board and shall have general charge and supervision of the books and records of the association. He shall sign all membership certificates with the president and such other papers pertaining to the association as he may be authorized or directed to sign by the board. He shall serve all notices required by law and by these bylaws and shall make a full report of all matters and business pertaining to his office to the members at the annual meeting. He shall keep the corporate seal and affix it to all papers requiring a seal. He shall keep complete membership²⁵ records. He shall make all reports required by law and shall perform such other duties as may be required of him by the association or the board.

Section 4. Duties of Treasurer. The treasurer shall perform such duties with respect to the finances of the association as may be prescribed by the board.

Section 5. Duties of Manager. The manager shall perform such duties and shall exercise such authority as the board may from time to time vest in him. Under the general supervision of the board, the manager shall have general charge of the ordinary and usual business operations of the association, including the purchasing, marketing, and handling of all products and supplies handled by the association. He shall render annual and other statements in the form and in the

²⁵ If the association is formed with capital stock, this word should be changed to "stock ownership".

manner prescribed by the board. He shall employ, supervise, and dismiss any and all employees of the association.

Article VI - Executive Committee and Other Committees

Section 1. Powers and Duties. The board may, in its discretion, appoint from its own membership and executive committee of _____ (____) members, determining their tenure of office and their power and duties. The board may allot to such executive committee all or any stated portion of the functions and powers of the board, subject to the general direction, approval, and control of the board. Copies of the minutes of any meeting of the executive committee shall be mailed to all directors within seven (7) days following such meeting.

Section 2. Other Committees. The board may, in its discretion appoint such other committees as may be necessary.

Article VII - Membership Certificates

The board shall cause to be issued appropriate certificates of membership.

If the association is organized with capital stock, this Article might read as follows:

Article VII - Stock Certificates

Section 1. Common Stock. Each certificate of common stock shall show on its face its designation by class and the privileges, voting rights, or restrictions and qualifications applicable to shares of such class as specified in the articles of incorporation.

Section 2. Preferred Stock. Each certificate of preferred stock shall show on its face the preferences, privileges, voting rights, or restrictions and qualifications of such stock as specified in the articles of incorporation.

Article VII is suitable for an association organized on a stock or non-stock basis serving members only. If the association serves non-members and it is intended that members and non-members be treated alike in patronage distributions, insert at the places marked by an asterisk (*) the following: "members and non-members alike,". If, however, non-members are not to be treated like members in patronage distributions, provisions accomodating the desired treatment should be added.

Article VII - Operation at Cost and Patrons' Capital

Section 1. Operation at Cost. The association shall at all times be operated on a cooperative service-at-cost basis for the mutual benefit of its patrons. No interest or dividends shall be paid by the association on any capital furnished by its patrons.²⁶

Section 2. Refunds and Patrons' Capital. In furnishing service, such as marketing products, providing supplies and equipment, or otherwise making facilities or services available to patrons, the association's operations shall be so conducted that all patrons * will through their patronage furnish capital for the association. To assure that the association is obligated to account on a patronage basis to all its patrons * for all amounts received from the furnishing of these services in excess of operating costs and expenses properly chargeable against the type of service furnished. All such amounts in excess of operating costs and expenses at the moment they are furnished by the patrons are received by the association with the understanding that they are provided as capital.

²⁶ This sentence must be coordinated with whatever provision is made for the payment of dividends in the articles of incorporation. See footnote 9 in this section. If dividends on common or preferred stock or other capital are authorized, a provision should be included here for their payment.

The association is obligated to make payments of all such amounts in excess of operating costs and expenses in cash refunds or by credits to a capital account for each patron.²⁷ The books and records of the association shall be set up and kept in such a manner that at the end of each fiscal year, the amount of capital, if any, so furnished by each patron is clearly reflected and credited in an appropriate record to the capital account of each patron.²⁸ The association shall, within 8 1/2 months after the close of the fiscal year, notify each patron, in the form of a written notice of allocation (as defined in 26 USC 1388), of the amount of capital so credited to his account.

All other amounts, such as interest or amounts from non-patronage sources, received by the association from its operations in excess of costs and expenses shall, insofar as permitted by law and to the extent practicable, be allocated to its patrons on a patronage basis and any amount so allocated shall be included as a part of the capital credited to the accounts of patrons as herein provided.

An operating loss shall be apportioned among the patrons during the year of loss so that such loss will, to the extent practicable, be borne by the patrons of the loss year on an equitable basis.²⁹ If in any fiscal year the association

²⁷ Such amounts are sometimes referred to as patronage refunds, patronage dividends, final pool settlements, net margins, net savings, capital credits, or the like. Associations that acquire capital by the per unit capital retain method may want to add at this point the following sentence: "Each patron also agrees to provide capital in such amounts as determined by the board based on physical units handled or a percent of gross resale price of products marketed or purchased through the association." In this connection, see also Neely and Volkin, Tax Laws Changed on Capital Retains. News for Farmer Cooperative (Reprint No. 328, March 1967, published by Farmer Cooperative Service, US Department of Agriculture.

²⁸ If the association is authorized to serve non-members, the following sentence may be added at this point: "If a non-member patron is eligible for membership, amounts credited to his capital account may be applied on the payment of his membership fee (or share of membership stock, if a capital stock association)."

²⁹ Where a cooperative engages in more than one activity, the Internal Revenue Service has indicated that, if the cooperative desires to qualify under Section 521, of the Internal Revenue Code of 1954, a loss in one activity may not be subtracted from margins in other activities.

shall incur a loss other than an operating loss, the board shall have full authority to prescribe the basis on which capital furnished by patrons may be reduced or such loss otherwise equitably apportioned among the patrons.

Section 3. Revolving Capital. If at any time, the board shall determine that the financial condition of the association will not be impaired thereby, the capital then credited to patrons' accounts may be retired in full or in part. Any such retirement of capital shall be made in order of priority according to the year in which the capital was furnished and credited, the capital first received by the association being first retired.

Notwithstanding any other provision of these bylaws, the board, at its discretion, shall have the power to retire any capital credited to patrons' accounts on such terms and conditions as may be agreed upon by the parties in any instance in which the interests of the association and its patrons are deemed to be furthered thereby and funds are determined by the board to be available for such purposes.

Section 4. Transfer. No assignment or transfer of any amount credited to the capital account of a patron shall be binding on this association without the consent of the board nor until it shall have been entered in the books of this association.

Section 5. Consent. Each person who hereafter applies for and is accepted to membership in this association and each member of this association on the effective date of this bylaw who continues as a member after such date shall, by such act alone, consent that the amount of any distributions with respect to his patronage occurring after _____, which are made in written notices of allocation (as defined in 26 USC 1388), and which are received by him from the association, will be taken into account by him at their stated dollar amounts in the manner provided in 26 USC 1385 (a) in the taxable

year in which such written notices of allocation are received by him.

Section 6. Consent Notification to Members and Prospective Members.³⁰

Written notification of the adoption of this Article, a statement of its significance and a copy of the provision shall be given separately to each member and prospective member before he becomes a member of the association.

Article IX - Dissolution and Property Interest of Members

Upon dissolution, after all debts and liabilities of the association shall have been paid, and all capital furnished through patronage shall have been retired without priority on a pro rata basis, the remaining property and assets of the association shall be distributed among the members and former members in the proportion which the aggregate patronage of each member bears to the total patronage of all such members, unless otherwise provided by law.³¹

If the association is formed with capital stock, this Article may be changed to read as follows:

Article IX - Dissolution and Property Interest of Members.

³⁰ Under Subchapter T of the Internal Revenue Code of 1954, as amended, a cooperative may not deduct or exclude from its gross income "noncash" patronage allocations to members unless the members consent to include the face amount of those allocations in their income. A simple method of obtaining members' consents is through a bylaw provision similar to Section 5 and notification to members and prospective members of its adoption and its significance as provided in Section 6. An appropriate notification could be a letter to the members and prospective members quoting the bylaw and stating that certain patronage allocations to members must be treated by them as income and that when such allocations are made, they will be accompanied by a notice to that effect. Associations that do not wish to obtain members' through a bylaw provision may delete Section 5 and 6.

³¹ Whether this or some other priority of payment should be prescribed will depend primarily (1) upon the requirements of applicable State law, and (2) the intended plan of operation.

Upon dissolution, after (1) all debts and liabilities of the association shall have been paid (2) the par value of stockholders' shares returned, and (3) all capital furnished through patronage shall have been retired without priority on a pro rata basis, the remaining property and assets of the association shall be distributed among the members and former members in the proportion which the aggregate patronage of each member bears to the total patronage of all such members, unless otherwise provided by law.

Article X - Unclaimed Money

A claim for money against the association shall be subject to the provisions of this Article whenever the association is ready, able, and willing to pay such claim, and has paid or is paying generally claims arising under similar circumstances, but payment of such claim cannot be made for the reason that the association does not know the whereabouts or mail address of the one to whom it is payable or the one entitled to payment.

If such claim be not actually paid within a period of _____ years³² after it became payable as herein provided, the association shall remove the claim as a liability on its books; provided that no such removal shall be made unless at least 30 days prior thereto the association shall have sent by registered United States post, with the return receipt requested, a written notice of the proposed removal, addressed to the person appearing from the association's records to be entitled to payment of such money at the last address of such person shown by the records of the association.

If any such claim be removed of record after giving such notice, the claim shall be deemed extinguished, but the association shall continue to maintain

³² Insert here a period of time equal to the applicable statute of limitations with respect to claims of this class.

a memorandum record of such claim and shall pay the principal amount thereof without interest to any claimant who subsequently establishes to the satisfaction of the association his right to receive payment.

Any and all amounts recovered by the association pursuant to this Article, after deducting therefrom the amount of any taxes payable thereon, shall be placed in a special account. Any claim paid after the expiration of the period of years herein specified shall be deducted from such account.

Article XI - Fiscal Year

The fiscal year of the association shall begin on the first day of January of each year and shall end on the thirty-first day of December of the same year.

If other than the calendar year is selected, this Article might read:

The fiscal year of the association shall commence on the first day of _____ each year and shall end on the last day of _____ of the following year.

Article XII - Miscellaneous Provisions

Section 1. Waiver of Notice. Any member or board member may waive in writing any notice of a meeting required to be given by these bylaws. The attendance of a member or board member at any meeting shall constitute a waiver of notice of such meeting by such member or board member, except in case a member or board member attends a meeting for the express purpose of objecting to the transaction of any business on the ground that the meeting has not been lawfully called or convened.

Section 2. Bylaws Printed. After adoption, these bylaws, preceded by the articles of incorporation, shall be printed in pamphlet form and a copy

thereof shall be delivered to each member and to each person who later becomes a member of the association as shown on the books of record.

Section 3. Seal. The corporate seal of this association shall have inscribed on it the name of the association, _____, and the year of incorporation.

Article XIII - Amendments

If notice of the character of the amendment proposed has been given in the notice of meeting, these bylaws may be altered or amended at any regular or special meeting of the members by the affirmative vote of a majority of the members present or voting by mail.

We, the undersigned, being all of the incorporators and members of the _____ association, do hereby assent to the foregoing bylaws and do adopt the same as the bylaws of said association; and in witness whereof, we have hereunto subscribed our names, this _____ day of _____, 19____.

4. ORGANIZATION AGREEMENT

Organization Agreement

The undersigned, a producer of agricultural products, hereinafter referred to as "Producer", together with other signers of agreements similar hereto, for the purpose of engaging in _____

(In the above space broadly state purposes for which association is to be organized.)

propose to organize a cooperative association without¹ capital stock under the laws of the State of _____, as hereinafter provided, and in consideration of the premises, hereby agrees for himself and for the express benefit of and for the association to be organized, as follows:

1. (a) The association shall be organized with suitable articles of incorporation and bylaws as determined by an organization committee consisting of the following persons: _____
(State names and addresses of committee members.)

(b) This committee may, in the discretion of a majority thereof, increase its membership, fill any vacancy therein, and appoint any committees deemed necessary to conduct the details of its affairs. The committee, or any committee designated by it, may prescribe an organization fee to be paid by each person signing an organization agreement similar hereto and may incur necessary obligations, make necessary expenditures, and take any such action as may, in its discretion, be deemed advisable to further the organization of the association.

2. The bylaws of the association shall provide, among other things, that _____
(Here enumerate the chief provision which it is proposed shall be contained in the bylaws.)

¹ If association is to be formed with capital stock, "without" should be changed to "with".

3. If, on or before _____, 19____, the organization committee is of the opinion that sufficient sign-up has been obtained to enable the association to operate efficiently, the committee shall, by notice to be published in one or more newspapers of general circulation in the area in which those who sign agreements like this one reside, specify a date and place for a meeting of those who sign such agreement to enable those attending such meeting conclusively to determine, by majority vote, if a sufficient sign-up has been obtained to justify the formation and operation of the association, and to consider such other business as may be deemed expedient. Notice of the action there taken shall be published in one or more newspapers of general circulation in the area.

4. The organization committee shall keep full, true and detailed accounts of all receipts and of all expenditures of every kind. It shall have such accounts audited and render a written report thereof to the board of directors of the association when organized. And it shall thereupon turn over to the association any balance remaining in its hands free of obligation. If the association is not so organized, such unexpended balance shall be prerated among those who contributed thereto.

5. Producer hereby subscribes for \$_____ of member capital and agrees to pay therefor as follows: _____

If association is to be formed with capital stock, the following may be substituted for Paragraph 5:

Producer agrees to purchase and does hereby subscribe for one share of voting common stock of the association, par value \$_____, payable on demand following the acceptance hereof, and _____ shares of nonvoting preferred stock of the association, par value \$_____ each, and agrees to pay for same as follows:

\$ _____ cash on demand following the incorporation of the association.

\$ _____ cash on or before _____, 19 ____.

\$ _____ cash on or before _____, 19 ____.

It is understood that certificates for such preferred stock shall not be issued and that no dividends shall be paid thereon until such shares have been paid in full. Producer hereby authorizes and directs the association to apply any and all dividends or distributions accruing to him during any year to the payment of any or all installments due or which may be due on such stock subscriptions for that year or for any prior year.

6. Producer applies for membership in the association when organized and expressly agrees that signature to a marketing contract shall be deemed to all intents and purposes the same as signature to this organization agreement, all of which shall be irrevocable, except as provided in Section 3 of this organization agreement and the marketing contract or the bylaws of the association, and he so agrees in order to induce other producers to sign agreements like this one for his benefit as well as for their own general benefit.

Date _____

Producer's signature _____ (_____)
Print Name Here

Address _____
(RFD or Street No.) (Town) (State and Zip Code)

Social Security No. _____ County _____

Accepted this _____ day of _____, 19 ____

_____, Inc.

By: _____, Pres.

By: _____, Secr.

5. MINUTES OF FIRST MEETING OF MEMBERS

Minutes of First Meeting of Members

The first meeting of the members of _____
(name of association)

was held at _____ o'clock ____m. on the _____ day of _____,
19____, at _____, in _____, _____.
(place of meeting) (town) (state)

The Chair ruled that the meeting was properly called and it was ascertained that all the members of the association were present. The Chair reported that the Articles of Incorporation of the association were filed on the _____ day of _____, 19____, at _____ o'clock in the _____ noon, in the office of the Secretary of State of _____, and presented a copy of said Articles of Incorporation, which was read, and on motion duly made, seconded and carried, was directed to be entered in full in the minute book. (See Page _____.) A draft of proposed bylaws for the government of the association was presented by _____ and was read to the meeting and discussed section by section and as a whole, and the proposed bylaws were unanimously adopted. Each member affixed his signature to the bylaws and the Secretary was instructed to spread the bylaws on the minutes of this meeting.

By unanimous vote, the following persons were elected to serve on the Board of Directors for the term of years following their names.

- | | |
|-------|-----------|
| _____ | One Year |
| _____ | One Year |
| _____ | One Year |
| _____ | Two Years |
| _____ | Two Years |
| _____ | Two Years |

Three Years

Three Years

Three years

There being no further business to come before the meetings, on motion duly made, seconded, and unanimously adopted, the meeting was adjourned.

(Temporary Chairman)

(Temporary Secretary)

6. MINUTES OF FIRST BOARD MEETING

Minutes of First Meeting of
Board of Directors

The first meeting of the board of directors of the _____,
(association)
_____, _____, was held at _____ o'clock _____ .m., on _____,
(town) (state)
19____, at _____, in _____, _____.
(place of meeting) (town) (state)

Upon convening, _____ was elected temporary chairman
and _____ temporary secretary of the meeting, and each assumed
his office.

The chair called for proof of notice of the meeting, whereupon
_____ presented a waiver of notice and consent to hold the
meeting, signed by all the directors of the association, which waiver and consent
was written as follows:

(Insert copy of waiver of notice and consent to holding meeting.)

Upon roll call of the directors of the association, the following
answered present:

(Record the names of all directors present.)

The chair ruled that proper and legal notice of the meeting had been
given and that a quorum was present, and announced that the meeting was open for
transacting business.

The chair stated that the meeting was called for the purpose of electing
officers of the association for the ensuing year and transacting any other business
that might properly come before the meeting.

Upon motion duly made and seconded, the following officers were unani-
mously elected to serve at the discretion of the board until the time of the first

regular meeting of the board to be held as soon as practicable following the first annual meeting of members.

(Record the names of the officers elected and the title of office.)

Following the election of the officers, the president took the chair and the secretary assumed the duties as secretary of the meeting.

Upon motion duly made, seconded, and carried, the following were appointed members of the executive committee, as provided in the bylaws.

(Record the names.)

Upon motion duly made and seconded, the following resolution was adopted:

Resolved, that the executive committee be charged with the following specific powers and duties:

(State here the specific powers and duties which it is desired to delegate during the period when the directors are not in session, subject to the general direction of the board.)

Upon motion duly made and seconded, the following resolution was adopted:

Resolved, that the president and secretary be, and they are hereby, authorized to issue certificates of membership in the form as submitted to this meeting, and each in form as follows:

(Here insert form.)

Upon motion duly made and seconded, the following resolution was adopted:

Resolved, that the president and secretary be, and they hereby are authorized to have printed a sufficient number of copies of the articles of incorporation and bylaws, so that a copy thereof may be delivered to each member

member and each person who may later become a member of the association.

Upon motion duly made and seconded, the following resolution was adopted:

Resolved that the marketing contract, in form as submitted to this meeting, a copy of which appears hereafter, is hereby approved:

(Here insert form of marketing contract.)

Upon motion duly made and seconded, the following resolution was adopted:

Resolved, that all subscriptions for member capital of the association and marketing contracts with the association, appearing on the list submitted by the secretary, be accepted, and that the president and the secretary be, and they hereby are, directed to carry out the terms and conditions thereof, and to execute all marketing contracts for and on behalf of the association.

Upon motion duly made and seconded, the following resolution was adopted:

Resolved, that the _____ Bank be selected as a depository for the funds of the association.

Upon motion duly made and seconded, the following resolution was adopted:

Resolved, that all checks drawn upon the _____ Bank, for withdrawal of funds of the association on deposit therewith, be signed by the treasurer and countersigned by either the president or vice-president.

Upon motion duly made and seconded, the following resolution was adopted:

Resolved, that the treasurer is hereby authorized to receive all funds paid into the association, endorse all checks and other media of exchange, and

deposit the same to the account of the association in _____ Bank.

Upon motion duly made and seconded, the following resolution was adopted:

Resolved, that the executive committee be, and is hereby authorized to determine the amount of the bond or bonds which the bylaws specify shall be required of all officers, agents and employees charged by the association with responsibility for the custody of any of its funds or property, and to see that the bonds, as required, are executed and presented for the approval of the board of directors.

(Similar resolutions should be adopted, providing for the insurance of the property of the association and for adequate insurance covering other contingencies. Any additional business transacted by the board should also be recorded here.)

There being no further business to come before the meeting, on motion duly made, seconded, and unanimously adopted, the meeting adjourned.

Chairman

APPENDIX E

TECHNICAL RESOURCES

1. American Institute of Cooperatives
1800 Massachusetts Avenue, NW
Washington, DC 20036
2. Bank for Cooperatives
Springfield, MA 01101
3. Cooperative Extension Service
University of Maine at Orono
Orono, ME 04473

Attention: Forrest French
4. Cooperative League of the United States
Suite 1100, 1828 L Street, NW
Washington, DC 20036
5. Economic Development Administration
Commerce Department
40 Western Avenue
Augusta, ME 04330
6. Farm Credit Service
Caribou Road
Presque Isle, ME 04769
7. Farm Credit Service of Southern Maine
P.O. Box 678
Auburn, ME 04210
8. Farmers Home Administration
40 Western Avenue
Augusta, ME 04330
9. Maine Cooperative Council
17 Third Street
Presque Isle, ME 04769

Attention: Frank Hussey
10. Maine Department of Agriculture
State Office Building
Augusta, ME 04333

Attention: Gerald Ely

11. National Consumer Cooperative Bank
2001 S Street, NW
Washington, DC 20009
12. National Council of Farmer Cooperatives
1800 Massachusetts Avenue, NW
Washington, DC 20036
13. Securities Division, Bureau of Banking
Department of Business Regulation
State House Station 36
Augusta, ME 04333
14. Securities Exchange Commission
Division of Corporation Finance
Washington, DC 20549
15. Small Business Administration (SBA)
40 Western Avenue
Augusta, ME 04333
16. US Department of Agriculture
Agriculture and Cooperative Service
Washington, DC 20250
17. US Department of Agriculture
Agricultural Cooperative Service
Augusta, ME 04333

Area Representative: Gerald Ely

APPENDIX F

PUBLISHED RESOURCES

ACCOUNTING

"Bookkeeping Forms Your Co-op Needs". Francis P. Yager, USDA, Farmer Cooperative Service. Cir. 19, Revised 1978. 32 pp.

"Guides to Co-op Bookkeeping". Francis P. Yager. USDA, Farmer Cooperative Service. Ed. Cir. 20. Revised 1978. 15 pp.

"The Cooperative Accountant". Virginia Commonwealth University. 1015 Floyd Avenue, Richmond, VA 23284. (quarterly \$15).

FORESTRY

"Articles on Forestry Cooperatives." USDA, Farmer Cooperative Service. Reprint 355. n.d. 15 pp.

"Guidelines for Establishing Forestry Cooperatives." USDA, Forest Service Research Paper NE-133, 1969. 38 pp.

"Identifying The Need for Forestry Associations." USDA, Farmer Cooperative Service. Ed. Cir. 20. 1965. 6 pp.

FORMS:

"Cooperative Associations." 5 Am. Jur. Legal Forms. Second, Chapter 71.

"Sample Legal Documents," Legal Phases of Farmer Cooperatives. Part I. USDA Farmer Cooperative Service. Information 100. 1976. 40 pp.

LEGAL:

"Cooperative Principles and Legal Foundations." USDA. Farmer Cooperative Service. Cir. 1, Sec. 1. 1977. 32 pp.

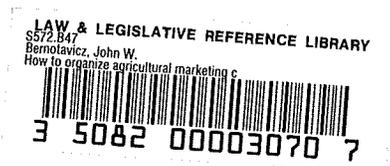
"Legal Phases of Farmer Cooperatives." Morrison Neely. USDA. Farmer Cooperative Service. Information 100. 1976. 747 pp.

MARKETING AND BARGAINING

"Cooperative Marketing Alternatives." David L. Holder. USDA Marketing Research Report No. 1081. 40 pp.

"Cooperative Market Pooling." T. M. Hammond. USDA Farmer Cooperative Service. Cir. 657. 1976. 56 pp.

"Legal Implications in Coordinating Activities of Bargaining Associations". David Volkin. USDA, Farmer Cooperative Service. Information 63. 1969. 14 pp.



PURCHASING

"Integrated Petroleum Operations of Farmer Cooperatives." J. Warren Mather and John M. Bailey. USDA, Farmer Cooperative Service. Research Report 21. 1971. 19 pp.

"Midsize Farm Supply Cooperatives: Characteristics and Growth Strategy." USDA Farmer Cooperative Service. Research Report 45. 1978. 40 pp.

TAXATION

"CCH Private Foundation Reporter." \$45.10 to 45.15.2. Exempt Organization Handbook.

BNA Tax Management Portfolio #229. "Taxation of Agricultural Cooperatives."

(The) Farm Cooperative and The Federal Income Tax. 44 NDCR 490 (1968).

"Farmers Cooperatives: Obtaining and Maintaining The Tax Exempt Status of Section 521." 1 Agricultural L.J. 199 (1980).

"Federal Income Tax." Legal Phases of Farmer Cooperatives, Part II. USDA Farmer Cooperative Service, Information 100. 1976, 101 pp.

"Tax Techniques for Foundation and Exempt Organizations." Weithorn, Vols. 1-5.