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## CO-OPERATIVE MARKETING ASSOCIATIONS

BY HENRY W. BALLANTINE\*

### 1. CO-OPERATION AND COLLECTIVE MARKETING

AGRICULTURAL depression is giving great impetus to the co-operative movement.<sup>1</sup> There are many who believe that the co-operative marketing system is the most hopeful measure yet inaugurated to improve the financial condition of the farmer and to enable the producer to obtain just returns. In over thirty states, acts providing for the formation of co-operative marketing associations, along lines followed by the raisin growers, prune and apricot growers in California, have recently been enacted. Large marketing associations covering certain commodities produced in whole states or even groups of states, have been organized, notably by the cotton and tobacco growers in Texas, Oklahoma, Mississippi, Kentucky, North Carolina, Virginia, Wisconsin and other states. The large fruit growers' co-operatives on the Pacific coast are a dominant factor in the marketing of fruit products and have an annual

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<sup>1</sup>On co-operative marketing associations, see article by Henderson in 23 Columbia L. Rev. 91. Arndt, *The Law of California Co-operative Marketing Associations*, 8 Cal. Law Rev. 281, 384, 9 Cal. Law Rev. 44, and L. S. Hulbert, *Legal Phases of Co-operative Associations*, Bull. 1106, U. S. Dept. of Agriculture (a pamphlet published by the Department of Agriculture, designed to assist persons engaged in forming these associations); see also 22 Columbia L. Rev. 470; Miller, 7 Cornell L. Quar. 293; 32 Yale L. Jour. 819; Brown, 1 N. Car. L. Rev. 216; Sapiro, 8 Iowa L. Bull. 193; *Farmers Co-operation in Minnesota*, (1917-1922) February 1923, H. B. Price, Div. Agr. Econ. U. of Minn., Bull. 202; *Local Co-operative Potato Marketing in Minnesota*, Black, Div. Agr. Econ. Sept. 1921, Bull. 195; *Co-operative Central Marketing Organizations*, forthcoming bulletin by Black and Price, Div. Agr. Econ.

Special acknowledgment for suggestions is due to Mr. George Wicker and Mr. Hay of the Minn. Dept. of Agr., to Mr. Aaron Sapiro of San Francisco, and to J. D. Black and H. B. Price of the Div. of Agr. Econ. U. of Minn.

turnover estimated at over \$300,000,000. Co-operative marketing on a national scale is now being urged for the salvation of the wheat growers.

In Minnesota we have had statutes for the organization of co-operative associations since 1870.<sup>2</sup> The number of such associations, the membership and the quantity of products handled are very large. Much has been done in this state by local co-operatives, but the greatest discussion at present is with reference to the possibilities of central or federated marketing.<sup>3</sup> We have here at present eleven such organizations. In Minnesota in 1922 there were 4,500 local co-operatives; among these there are 63 co-operative cheese factories; 644 co-operative creameries; 699 co-operative live stock shipping associations; 183 co-operative stores; 149 potato growers' associations; 161 township mutual fire insurance companies; 1,739 farmers' rural telephone companies; and 260 miscellaneous associations. Some 2,000 of these are selling organizations; some 200 are buying organizations; some 500 are production organizations. No other state has so large a percentage of farmers selling their products through co-operatives.

A new act drafted especially to authorize the organization of large co-operative marketing associations was adopted by the 1923 legislature.<sup>4</sup> This is substantially the same as a standard act drafted by Mr. Aaron Sapiro of San Francisco and recently adopted in about thirty states. The policy of the law in providing for the organization of these marketing associations is declared in a preamble of the act to be in substance as follows:

To promote the intelligent marketing of agricultural products; to eliminate speculation by middlemen; to make the distribution of agricultural products as direct as possible between producer and consumer; and to stabilize the market. It is recognized

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<sup>2</sup>Minn., Laws, 1870, chap. 29; Minn., G. S., 1878, chap. 34, sec. 155; Minn., G.S., 1894, sec. 2903-2912; Minn., R.L., 1905, sec. 3073-3078; Minn., G.S., 1913, sec. 6479-6485. See also Minn., Laws, 1919, chap. 382; Minn., Laws, 1921, chap. 23; Minn., Laws, 1923, chap. 326.

<sup>3</sup>In the "federated" type of organization the central organization or exchange often acts merely as the selling agent for the locals, with little or no effort at collective bargaining. In the "centralized" type, the organization seeks control of a large part of the supply of the crop or commodity to be marketed, so that the flow can be regulated and the price influenced. The difference between the two is in the degree of centralization and control over the supply and the movement to market; and the status of the local associations. See Co-operative Central Marketing Organizations, Bulletin by Black and Price.

<sup>4</sup>Minn., Laws, 1923, chap. 264.

that agriculture is characterized by individual production, and the public interest demands that the farmer be permitted and encouraged to attain group or collective marketing, and the advantages that may be derived from combination and the exercise of the merchandizing skill exhibited by large manufacturing and commercial corporations.

The defects of individual marketing by agricultural producers are notorious.<sup>5</sup> There is usually no uniform system of grading or packing. There is variation in price for the same grade between individuals in the same market. Owing to lack of handling and of storage facilities, prices are depressed and the market is frequently glutted during the harvesting period. There is no adequate financing or marketing skill. The buying interests are highly organized and possibly in collusion, whereas the individual sellers are weak financially and at a bargaining disadvantage. By co-operative marketing, the theory is that the farmer may collectively market his farm products with proper grading, packing, storage, shipping, advertising, and financing, and sell them through expert selling agents, as the market can absorb the product. The net proceeds are distributed equally, not as profits on capital, but as the price of the commodities. It is claimed that central co-operative marketing will provide for control of quality and the standardizing of production; the adjusting of production to consumption by scientific information as to the demand; the control of the flow of commodities to the market by selling a certain proportion of the crop each month instead of dumping it all at once, thus taking advantage of the seasonal variation in the price; the distribution of the product among different markets which can absorb it; and the elimination of middlemen, profiteers and speculators.

The individual producer and the local co-operative association are frequently not in a strong enough position as sellers to realize a full price for their products; hence the need for "collective bargaining." The purpose is to put the seller upon an equal basis of bargaining power with the buyer and take away from the buyer any unfair advantages. The idea is not that of creating a monopoly in favor of agricultural producers, but to allow such combination and co-operation as to give equality of advantage. It has been said by the North Carolina court in *Tobacco Growers*

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<sup>5</sup>See Sapiro, 8 Iowa L. Bull. 193; Brown, 1 N. Car. L. Rev. 216.

*Co-operative Ass'n v. Jones*,<sup>6</sup> "the co-operative association purposes to prevent artificially forced reduction in the price paid to the producers. Instead of creating a monopoly, the object is by a rational method of putting the raw product on the market from time to time as there is a legitimate demand for its manufacture, and by the extension of credit to farmers" to enable them to secure a fair and reasonable price without oppressing the consumer. "Middlemen, speculators, and people who stood between the producers and consumers derived excessive profits from this situation, while the producers and laborers were denied a living, and from the consumers were extorted enormous profits."

The movement is thus explained by one prominent organizer:<sup>7</sup>

"The one great aim of co-operative marketing is to abolish the individual dumping of farm produce and to substitute for it the merchandising of farm products, the controlled movement of crops into the markets of the world at such times and in such quantities that those markets can absorb the crops at fair prices. . . . Thousands of small local movements, good for certain localized purposes, do not realize how futile and useless they have been as marketers. . . . The farmers still dump their grain or their butter or their cheese against each other, and they break their own markets."

What is being urged is that the local plants federate for orderly marketing and centralized selling on a co-operative basis.

The co-operative features of these organizations which distinguish them from ordinary business corporations are, in the first place, that the profits are divided among the members or patrons in proportion to the amount of products or patronage, giving only a limited return to the stockholders in the nature of interest rather than of speculators' profit. Dividends on capital stock are generally limited to eight per cent, and the proceeds of the business go to the producer rather than to the capitalist. It is also one of the leading ideas that the management shall not be dominated by a few large stockholders, but that the principle of "one man, one vote" shall be observed. Membership is limited to producers or those who furnish the business, although some business may be done for non-members. Stock cannot be transferred except with the consent of the directors. The services rendered by the association are in general to be conducted at cost for the benefit of patrons rather than for the profit of stockholders.

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<sup>6</sup>(N. Car. 1923) 117 S.E. 174, 178.

<sup>7</sup>Sapiro, 8 Iowa L. Bull. 193.

In *Mooney v. Farmers Mercantile & Elevator Co.*,<sup>8</sup> the question was whether the method of distributing the earnings of the company, a co-operative association organized in 1899, as fixed by a by-law, pro rata to the amount of business each had furnished during the year in the form of products, violated the right of a stockholder who claimed distribution to the stockholders in proportion to the stock held by each. It was held that under the statute then in force, such distribution was authorized although in an ordinary corporation formed for commercial purposes, profits must be evenly divided among the stockholders according to the amount of stock held by each. But in a co-operative association, the fundamental purpose is to distribute the profits, aside from a fair return on capital, to those who by their patronage make a realization thereof possible, and in proportion as they thus contribute to the business and prosperity of the company.

In considering some of the outstanding legal problems that arise in connection with co-operative marketing and the organization of co-operative associations, we shall take up first the relation between the corporation and the state, particularly the constitutionality of laws which exempt the farmer from the anti-trust acts, federal and state, which make it illegal for persons to enter into combinations for the purpose of stifling competition. Related to this is the question of the validity of the so-called "membership contracts" for exclusive marketing through the association, one purpose of which often is to control as large a proportion of the supply as possible and to dominate the market, as well as to furnish an assured volume of business and basis of credit. These contracts present an exception to the policy of untrammelled competition in the channels of state and interstate trade, which is ordinarily considered necessary to prevent undue enhancement of prices.

Next the relation between the association and its members will be considered, under contracts of agency and sale, particularly with reference to the question whether there is in reality a relation of agency or trusteeship even when the contract purports to be an out and out sale. In connection with the membership contracts, the special remedies provided for their enforcement are a matter of considerable practical importance. The Minnesota legislation relating to co-operative marketing associa-

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<sup>8</sup>(1917) 138 Minn. 199, 164 N.W. 804.

tions and co-operative associations generally, will be summarized and compared, with a view to indicating the peculiar co-operative features of these corporations, showing the advantages offered by the different statutes under which organization may take place, and tabulating the surprising variation in the different acts drawn by different factions in the legislature, but having the same general purpose. Finally the method of securing exemption from federal income taxes will be indicated.

## II. THE CO-OPERATIVE MARKETING ACTS ARE CONSTITUTIONAL BOTH UNDER THE STATE AND FEDERAL CONSTITUTIONS.

By the Minnesota anti-trust act, trusts and combinations in restraint of trade are prohibited.<sup>9</sup> It is provided by this act:

"No person or association of persons shall enter into any pool, trust agreement, combination, or understanding whatsoever with any other person or association, corporate or otherwise, in restraint of trade, within this state, or between the people of this or any other state or country, or which tends in any way or degree to limit, fix, control, maintain or regulate the price of any article of trade, manufacture, or use bought and sold within the state, or which limits or tends to limit the production of any such article, or which prevents or limits competition in the purchase and sale thereof, or which tends or is designed so to do."

Violation is made a felony. Even though competition be so keen as to be ruinous, combination to eliminate it is illegal.<sup>10</sup> A combination contract, or understanding, the direct and necessary effect of which is to stifle or restrict competition in trade, violates the anti-trust statute, whatsoever may have been the intention of the parties.<sup>11</sup> Agreements between dealers which attempt to control the market, fix prices, and avoid competition, are, in general, held illegal as in restraint of trade.<sup>12</sup>

The co-operative marketing acts adopted in most of the states provide expressly that co-operative associations of farmers organized thereunder, shall not be deemed to be combinations in restraint of trade or illegal monopolies. By the standard co-operative marketing act, adopted by Minnesota in 1923,<sup>13</sup> it is

<sup>9</sup>Minn., R. L., 1905, sec. 5168; Minn., G. S., 1913, sec. 8973; Minn., Laws, 1923, p. 311.

<sup>10</sup>State v. Creamery Package Co., (1910) 110 Minn. 415, 431, 126 N.W. 126, 623.

<sup>11</sup>See State v. Duluth Board of Trade, (1909) 107 Minn. 506, 121 N.W. 395, 23 L.R.A. (N.S.) 260. See also note, 11 A.L.R. 1185.

<sup>12</sup>Brent v. Gay, (1912) 149 Ky. 615, 149 S.W. 915, 41 L.R.A. (N.S.) 1034; People v. Butler, (Mich. 1923) 192 N.W. 685. 3 Williston, Contracts, secs. 1648, 1653, 1658.

<sup>13</sup>Minn., Laws, 1923, chap. 264, sec. 28.

declared that such associations shall not be considered in restraint of trade.

“No association organization (sic) hereunder shall be deemed to be a combination in restraint of trade or an illegal monopoly; or an attempt to lessen competition or fix prices arbitrarily; nor shall the marketing contracts or agreements between the association and its members or any agreement authorized in this act be considered illegal or in unlawful restraint of trade, or as a part of a conspiracy or combination to accomplish an improper or illegal purpose.”

By the general co-operative association act,<sup>14</sup> co-operative associations are authorized to sell the products of their members or patrons either individually or collectively, and to negotiate prices individually or collectively and to join with other co-operative associations to form district, state, or national organizations, or marketing agencies.

By the federal Capper-Volstead Act approved February 18, 1922, it is provided that persons engaged in the production of agricultural products may act together in associations, corporate or otherwise, with or without capital stock, in collectively marketing such products in interstate and foreign commerce. Such associations are authorized to have marketing agencies in common and to make the necessary contracts to effect such purposes. This act is a statutory declaration by Congress that “collective marketing” by such associations, (a term borrowed from the “collective bargaining” of labor unions), shall not be deemed a violation of the federal anti-trust laws. A safeguard is, however, provided in the duty imposed on the secretary of agriculture, if he shall have reason to believe that any such association monopolizes or restrains trade in interstate or foreign commerce to such an extent that the price of any agricultural product is unduly enhanced, to serve upon such association a complaint requiring the association to show cause why an order should not be made declaring it to cease from such restraint. His order may be enforced by proceedings in the federal courts.

Associations in order to come within this act must comply with the following conditions: They must be operated for the mutual benefit of the members thereof, as producers; they must be so organized that 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, that the association does not

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<sup>14</sup>Minn., Laws, 1923, chap. 326, sec. 1, p. 467.

pay dividends in excess of eight per cent per annum. The association must not deal in the products of non-members to an amount greater in value than such as are handled by it for members.

The Clayton Act<sup>15</sup> passed by Congress in 1914 provided in section 6 that nothing contained in the anti-trust laws shall be construed to forbid the existence and operation of labor, agricultural, or horticultural organizations, instituted for the purposes of mutual help, and not having capital stock or conducted for profit; nor shall such organizations be held or considered to be illegal combinations or conspiracies in restraint of trade under the anti-trust laws. The Capper-Volstead Act of 1922, however, applies to associations with or without capital stock. The brakes are taken off in order that higher prices may be obtained by the farmers than they can get by selling individually.

The question that first arises in connection with this legislation is as to the constitutionality of acts which exempt farmers' co-operative marketing associations from the anti-trust laws. May the states by general laws prohibit combinations in restraint of trade, make the maintenance of competition the general rule, and at the same time permit farmers to combine to restrict competition and market their products collectively for the purpose of obtaining fair and remunerative prices? Is this class legislation? Does the law create a special privilege in the attempt to exempt farmers to this extent from a law applicable to others? Is this equal protection of the laws?

It is believed that the co-operative marketing acts are constitutional both under the state and the federal constitutions. The public policy of the United States and of the states now favors the organization of farmers for collective marketing in order to obtain a fair return, and the classification of farmers as a group distinct from citizens engaged in other callings is reasonable and natural. It is not vicious class legislation, but in the common interest.

As we have already seen, co-operative marketing is collective selling. One aim is to make possible better profits by massed selling through large organizations. It aims to eliminate ruinous individual competition. It aims to control, where possible, the sale of more than half of the supply, and to be the largest factor in the market. The larger the proportion of the crop of a given commodity that is pooled, the greater the control of the market

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<sup>15</sup>38 Stat. at L. 730.

and the more stabilizing the effect on prices. The system of exclusive marketing contracts by which the member is bound to deliver his crop to the association for a period of years, tends to insure both a volume of business and a control of the market. Some co-operative marketing associations already control the sale of more than half the commodities in which they are operating. All of them are striving to become as large as possible, and to market a dominant portion of the crop. These crops are necessities of life. Is there any danger here from oppressive monopolies or trusts?

It is believed that as a matter of practical economics co-operative marketing associations have not the power to become dangerous trusts. They cannot control or limit production. Unduly increased prices will promptly increase production and lower prices will follow.

The principal authority against the validity of legislation exempting farmers from state anti-trust acts, is the case decided in 1902 by the Supreme Court of *Connolly v. Union Sewer Pipe Company*.<sup>16</sup> In that case it was held that the exemption of farmers from the anti-trust statute of Illinois rendered the act unconstitutional and that the whole statute was void. Since that case was decided, the attitude of the courts in the construction of the anti-trust laws has undergone a change. It is now recognized that not all combinations or contracts which in any degree tend to restrict competition are per se illegal. Such a strict rule would invalidate innumerable legitimate business transactions. If the main purpose and effect of a combination are to foster trade and increase business, and if it does not exercise improper control or unduly and unreasonably restrict competition, then it is held not to be in violation of the law.<sup>17</sup> It is now the view of the United States Supreme Court that the illegality of combinations depends upon the test whether their power is abused and whether prejudice results to the public interest.<sup>18</sup> To give immunity to farmers to do acts harmful to others would be unconstitutional; but if farmers' combinations are in fact not injurious, their existence is permissible. Courts must consider the actual economic conditions to determine whether there has been an abuse of the power of classification in legalizing co-operative or collective

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<sup>16</sup>(1902) 184 U.S. 540, 22 S.C.R. 431, 46 L. Ed. 679.

<sup>17</sup>*State v. Duluth Board of Trade*, (1909) 107 Minn. 506, 544, 121 N.W. 395.

<sup>18</sup>*Standard Oil Co. v. United States*, (1910) 221 U.S. 1, 55 L. Ed. 830, 31 S.C.R. 704.

marketing by farmers. The decision of the constitutionality of laws often turns upon a judgment upon practical matters of business policy and not upon anything contained in the constitution.

It has accordingly been held in a number of recent cases that the legislature may legalize combinations of farmers for the purpose of obtaining fair and remunerative prices; and that the classification of farmers as a class distinct from those engaged in other business is reasonable. It is based upon economic differences between agriculture and other lines of industry.<sup>19</sup>

As is well said by Mr. J. D. Miller in an article on Farmers' Co-Operative Associations as Legal Combinations:<sup>20</sup>

"It is safe to assume that the changed conditions since the decision in the case of *Connolly v. Union Sewer Pipe Co.*,<sup>21</sup> will cause the Supreme Court to restrict the authority of that case to its own facts. This it has essentially done in *International Harvester Co. v. Missouri*;<sup>22</sup> while the facts found by the legislature of the state of New York show that such laws were not an arbitrary discrimination, but rather a reasonable classification that would permit farmers to market their products in a way that would inure to the benefit of all the people of the state. . .

"The result is not that farmers are exempted from liability for a wrong done or threatened, but that it is legislatively declared that their combined efforts are not injurious but beneficial to the public interest. . . . The law is not so poor a thing that it prevents the state from authorizing combinations that will promote the public good and at the same time prohibiting combinations detrimental to the public good."

### III. EXCLUSIVE MARKETING CONTRACTS DO NOT RESTRAIN TRADE.

Co-operative marketing associations, as we have seen, are lawful organizations and their creation is within the legislative power. So long as they carry out legitimate objects by lawful means and use their combined power fairly they call for public encouragement. It has been contended, however, that the system of exclusive marketing contracts with members and patrons should be held void as against public policy and contrary to state anti-

<sup>19</sup>*Tobacco Co-operative Ass'n v. Jones*, (N. Car. 1923) 117 S.E. 174; *Hollingsworth v. Texas Hay Ass'n*, (Tex. Civ. App. 1922) 246 S. W. 1068; *Kansas Wheat Growers Ass'n v. Schulte*, (Kan. 1923) 216 Pac. 311, 315; *Owen Co. Burley Tob. Soc. v. Brumback*, (1908) 128 Ky. 137, 107 S.W. 710; *Brown v. Staple Cotton Co-op. Ass'n* (Miss. 1923) 96 So. 849.

<sup>20</sup>7 Cornell L. Quart. 293-308.

<sup>21</sup>(1902) 184 U.S. 540, 22 S.C.R. 431, 46 L. Ed. 679, affirming 99 Fed. 354.

<sup>22</sup>(1914) 234 U.S. 199, 58 L. Ed. 1276, 34 S.C.R. 859.

trust acts and the Sherman anti-trust law. The problem here is how far co-operative organizations may limit the freedom of their members and interfere with the chances of competing buyers. Would it be lawful, for example, to make a contract or by-law which would place a limitation on the company's members in disposing of their products which might last for life? It has been held by the English courts that such by-laws would be an unreasonable restraint of trade in view of the unlimited duration of the contract as it imposes a greater restraint than is reasonably required for the protection of the organization.<sup>23</sup> Stipulations unduly restricting personal liberty are invalid.

Agreements for exclusive dealing are valid except where such contract is part of a scheme by which it is sought to establish an unlawful monopoly. A contract to buy from or deal in the goods of one person has generally been held valid.<sup>24</sup> As we have seen, there is little practical danger of an agricultural monopoly. If the restraint of competition is reasonable, if it does not result in oppression of competitors, the manipulation of prices to the public injury, it may be lawful. In certain decisions, however, such exclusive dealing contracts have been held invalid. Thus in the *Turnipseed Case* in Alabama, it was pointed out that the parties to the contract were attempting to become masters of the situation so far as concerned the sale and disposition of at least sixty per cent of the peach crop of the country, by contracts giving the corporation the absolute right under penalty to handle their fruit crop. It was held that these contracts were contrary to public policy, since the desire of the parties was to stifle and destroy competition at the various markets among the growers who became members of the association.<sup>25</sup>

In *Burns v. Wray Farmers Grain Company*,<sup>26</sup> a by-law of a corporation organized to purchase farm produce, the stock of which was held by the farmers of a community, imposed a penalty on any member who sold produce to a competitor of the corporation. It was held that this was invalid as an unreasonable restraint of competition. It was a combination to prevent other grain buyers from doing business at Wray. It would tend to give the association or company a monopoly.

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<sup>23</sup>*McEllestrim v. Ballymacelligott, etc., Society*, [1919] App. Cas. 548, 564.

<sup>24</sup>See 3 Williston, Contracts, sec. 1645.

<sup>25</sup>*Ga. Fruit Exchange v. Turnipseed*, (1915) 9 Ala. App. 123, 62 So. 542. Cf. *Ex parte Baldwin Co. Producers Ass'n*, (1919) 203 Ala. 345, 83 So. 69.

<sup>26</sup>(1918) 65 Colo. 428, 178 Pac. 487, 11 A.L.R. 1179.

The leading decision against the validity of exclusive dealing contracts is *Reeves v. Decorah Farmers' Co-operative Society*.<sup>27</sup> The action was brought by a middleman who complained of interference with his right to carry on business as a hog buyer. The defendant company was a corporation whose stockholders consisted for the most part of farmers producing hogs. Defendant's business was to buy hogs from these producers and others and to resell them. One of its by-laws required members to sell to it exclusively all their marketable produce and live stock and prescribed as penalty for sale to others the forfeiture of part of the purchase price, viz. five cents per one hundred pounds. Reeves, as a competing buyer in the same market, sued to enjoin the defendant society from collecting from its members any sum for such forfeiture. The Iowa statute forbade contracts and combinations in restraint of free competition in buying and selling commodities and gave a remedy to any person injured. It was held that selling agencies are not illegal, but to annex a penalty to the exercise of the right to sell to outsiders freely is to restrict trade and competition. This was an undue restraint of competition injurious to the plaintiff; therefore an injunction was granted against enforcing it. The court said:

"That such fine or penalty made the society an illegal one is to our minds too clear for argument. Plaintiff was placed at a disadvantage and could not compete with the society in purchasing hogs from its members, and the members were not free to deal with plaintiff."

The ground of this decision is not entirely clear; but it seems that the wrong to the plaintiff was based upon an unlawful conspiracy to boycott or eliminate middlemen in the local market and market products collectively. The decision has been criticized on the ground that the purpose of the by-laws was in fact simply to establish a selling agency for the handling of the products of the members; it was apparently not the purpose to increase the price of the produce to the consumer, but rather to obtain, as far as possible, the full price paid by the consumer, and eliminate the expense of the middleman. The case may perhaps be explained as an application of the Iowa anti-trust statute. The combination would prevent competition among the organized growers in the local market in order that they might avail themselves of prices made in wider markets. The decision seems out of line with the recent statutes and the present policy of the

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<sup>27</sup>(1913) 160 Iowa 194, 140 N.W. 844, 44 L.R.A. (N.S.) 1104.

state and federal governments in regard to authorizing collective marketing for the purpose of eliminating such expenses as those involved in employing the services of middlemen and speculators.

Combination of laborers or producers for the betterment of their members are not necessarily illegal because they sever business dealings with an outsider. As Justice Holmes points out,<sup>28</sup> the organization of the world means an ever increasing might and scope of combinations. In labor cases, the law has come to countenance associations of laborers to secure united and so effective action to carry on business profitably, to bargain on a collective basis, to boycott non-union employers, and to enforce concessions from combinations or individuals with whom they deal. Farmers cannot successfully carry on business as so many unrelated, isolated units. The individual farmer cannot be expected to pit his feeble bargaining power against the might of organized capital.

The existence of co-operative associations and collective marketing are expressly authorized by the law of this state and of the United States. By one of our statutes it is declared that the marketing contracts or agreements between the association and its members requiring the members to sell for any period of time, not over five years, all or any specified part of their agricultural products exclusively to or through the association, are valid and shall not be considered illegal or an unlawful restraint of trade, or as a part of an illegal conspiracy or combination. What is specifically authorized under one act could hardly be held invalid under the other, especially where such exclusive dealing contracts are a proper means of carrying out the general purposes which are authorized.

This, of course, does not mean that a co-operative association is privileged to carry on a harmful monopoly or indulge in arbitrary methods. Contracts between co-operative associations and their members for exclusive dealing over a period of years, especially where authorized by statute, have now been upheld by a number of states as not being an undue restraint of trade. It is recognized that they are part of a system of collective marketing, that the purpose is merely to secure a fair and reasonable price for the products and that such contracts are not to be condemned where they are not in fact hostile to the public welfare.<sup>29</sup>

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<sup>28</sup>*Vegelahn v. Guntner*, (1896) 167 Mass. 92, 44 N.E. 1077, 35 L.R.A. 722, 57 A.S.R. 443.

<sup>29</sup>*Brown v. Staple Cotton Ass'n*, (Miss. 1923) 96 So. 849; *Burley Tobacco Society v. Gillespie*, (1912) 51 Ind. App. 583, 100 N.E. 89;

## IV. AGENCY OR SALE OR TRUST?

It is the view of some experts on co-operative marketing, though not of all, that each association should have a strong and stringent contract with its grower members and patrons providing for the delivery of their entire crop to the association for a period of from three to seven years. The products may then be graded and pooled for selling over a period of time. The association agrees to deduct only the cost of doing business and some reasonable reserves. The net proceeds are to be distributed among the members so that each grower will receive as his pro rata share of the proceeds, the average price of the season or of the pooling period.

These exclusive dealing contracts furnish not only a control of the market and an assured volume of business, but also a strong credit basis. The farmer must deliver his crop and can be paid only the net proceeds. He agrees to deliver to the association outright all of the commodity that he raises for several years. If this becomes an asset of the association, next year's crop guarantees the obligations of the association.

The standard act authorizes and suggests in some detail the terms of this marketing contract which the association may make with its members, requiring the members to sell for any period of time, not over five years, all or any part of their products exclusively to or through the association. The kind of contract adopted by the association may be either one of sale or one of agency. If a contract of sale is adopted, it is declared that it shall be conclusively held that the title to the products passes absolutely and unreservedly, except for recorded liens, to the association upon delivery. In a contract of sale, the price may be fixed by the amount realized on a re-sale, or at a fixed minimum price plus the increase secured on re-sale.

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Anaheim Citrus Ass'n v. Yeoman, (1921) 51 Cal. App. 759, 197 Pac. 959; *Ex Parte Baldwin County Ass'n*, (1919) 203 Ala. 345, 83 So. 69; *Louisville and Nashville R. R. Co. v. Burley Tobacco Ass'n* (1912) 147 Ky. 22, 143 S.W. 1040; *Tobacco Growers Ass'n v. Jones*, (N. Car. 1923) 117 S.E. 174; *Oregon Growers Co-operative Ass'n v. Lentz*, (Ore. 1923) 212 Pac. 811; *Washington Cranberry Growers v. Moore*, (1921) 117 Wash. 430, 201 Pac. 773, 25 A.L.R. 1077; *Oregon Growers Co-operative Ass'n v. Lentz*, (Ore. 1923) 212 Pac. 811; *Casterland Milk and Cheese Co. v. Shantz*, (1919) 179 N.Y.S. 131; *Bullville Milk Producers Ass'n v. Armstrong*, (1919) 108 Misc. 582, 178 N.Y.S. 612; *Texas Farm Bureau Cotton Ass'n v. Stovall*, (Tex. 1923) 253 S.W. 1101, reversing 248 S.W. 1109; *Phez County v. Salem Fruit Union*, (1922) 103 Ore. 514, 201 Pac. 222, 205 Pac. 970, 25 A.L.R. 1113; *Kansas Wheat Growers Ass'n v. Schulte*, (Kan. 1923) 216 Pac. 311.

An agency contract may appoint the association the exclusive marketing agent to sell the crop without taking title. The agency contract will usually be a part of a pooling plan under which the association agrees to divide ratably the proceeds of the sale of the products of like variety and grade, after deducting all necessary selling, overhead and other costs and expenses as in the sale contract. The grower agrees to consign and deliver his crop to the association as his agent and to surrender the exclusive control and disposition of it to the association. Whether the contract be one of agency or of sale, the same remedies will be provided and the contract may be specifically enforced.

An important question has been raised, whether even under the contract of sale, the association does not stand in the relation of agent or trustee rather than of buyer, and whether the members do not stand in the position of principals or beneficiaries of a trust rather than of sellers. In a recent article, Mr. G. C. Henderson puts the following questions: Is the contributor to a pool an equitable tenant in common of the mass? Is his right an equitable property right in a fund or a mere contractual claim? It may be contended that since the association has no claim upon any profits, it has taken title merely for convenience in making sales for the benefit of individual growers or in administering certain property for the pro rata benefit of the members of a pool.<sup>30</sup> If this trust theory is adopted, it will have many important consequences. The property in each pool, as Mr. Henderson points out, could be administered solely for the benefit of the members of that pool, and the association must segregate receipts and maintain a separate trustee account for each pool. Distribution to members of a pool could be made only out of receipts from that pool. The commodities in the pool could be pledged only to secure advances for members of the pool. They would not be corporate assets.

It is believed, however, that the fact that the price is to be governed by the amount realized on resale after deducting proper expenses, is not a strong indication of a trust relationship. It is a mere method of determining the purchase price. It is believed that Mr. Henderson conjures up a variety of complications and complexities that are entirely foreign to the intention of the parties, and without basis in their contract. If his suggestions were well founded, the trust property would not be liable for the

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<sup>30</sup>Henderson, *Co-operative Marketing Associations*, 23 *Columbia L. Rev.* 91, Feb. 1923.

debts of the association, and could not be levied on unless the association were authorized to use such property for the general purposes of the association. It would seem that when the crops are delivered, they become corporate assets. If the association incurs debts, it is possible that the proceeds even of the crops of subsequent years could be applied to these debts.

In *Oregon Growers v. Lentz*,<sup>31</sup> the court speaks of the contract as an agency contract, appointing the association as agent of the grower to market his product for his benefit and without profit to the association. The contract itself provided that the association should buy and that the grower agreed to sell all his crop. The question whether the contract was one of agency or of sale was, however, not before the court.

In *Texas Farm Bureau Cotton Association v. Stovall*,<sup>32</sup> the court said:

"We do not find it necessary to determine whether the contract was one of ordinary sale and purchase or an agency contract. The fact that the association is created primarily for cooperative purposes, and not for profit, lends color to the theory that it is an agency contract. But when the statute is examined and the contract analyzed, it is quite plain that in essential aspects, the contract is not one of agency as the term is ordinarily understood."<sup>33</sup>

The court concludes that it is clear that the parties intend that the association shall take title and shall exercise all the rights of ownership, and that the grower shall lose all dominion over the crop. But the court said by way of dictum: "It is true that the grower has at all times a beneficial interest in the net proceeds of the pool." This may be doubted on the ground that the division of the proceeds is merely the method prescribed for measuring the price. The member's remedy is not against the crop or the proceeds, but on a contract with the association, which is under a contractual duty to pay to the seller an amount determined by the net proceeds realized on resale. It is believed that it is an entirely unwarranted theory to say that the object of the parties in clothing the transaction in the terms of a sale rather than in terms of agency, trust or consignment, is merely to enable the association to deal with the goods freely, and that in essence it is merely a trust or agency.

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<sup>31</sup>(Ore. 1923) 212 Pac. 811.

<sup>32</sup>(Tex. 1923) 253 S.W. 1107.

<sup>33</sup>See 23 R.C.L., 1216. *D. M. Ferry & Co. v. Hall*, (1914) 188 Ala. 178, 66 S. 104, L.R.A. 1917B 620.

The question put by Mr. Henderson would then be answered according to the understanding of those who drafted this law and the marketing contracts under it, as follows: Q. Must each pool be administered as a fiduciary unit? A. No; but an accounting could be demanded, if necessary, in order to ascertain the purchase price. Q. Can property in one pool be pledged to secure advances to members of another pool? A. Yes; and if the amount realized upon resale were not sufficient to take care of the advances, a readjustment could be made by collections from the members who received the advances. Excessive advances may be recovered by the association.<sup>34</sup> Q. Must the property in each pool be administered for the sole benefit of the members of each pool? A. No, not as a matter of trust, but only insofar as is required by the contract to pay a purchase price ascertained in a particular way. Q. Are pool assets liable for association debts? A. Yes, because there are no such things as pool assets distinct from association assets. Commodities when delivered become the absolute property of the association. Q. Is the association simply an administrator of property for the benefit of individuals, and does the equitable title belong to the pool members? A. No, the association takes absolute title to the product; mingles it with similar products delivered by other members; sells it; deducts the cost of doing business, and then distributes the proceeds so that each gets the same as every other person for the same quantity, quality and grade of product. The contract is one carefully drawn by experienced lawyers with a clear theory of the legal result which it was desired to accomplish. The association undertakes to pay the growers for the goods delivered to it, but there is no mention of a trust relation of any kind, and such would be contrary to the intention of the parties, and would involve the association in undesirable difficulties and complications.

#### V. REMEDIES FOR BREACH OF MARKETING CONTRACT.

It is provided in the special co-operative marketing act<sup>35</sup> that the by-laws or the marketing contract may fix as liquidated damages specific sums to be paid by the member or stockholder upon the breach by him of any provisions of the marketing contract regarding the sale or delivery or withholding of products, and such provisions shall not be regarded as a penalty. It is also provided that the association shall be entitled to an injunction to

<sup>34</sup>California Fruit Growers Ass'n v. Abbott, (1911) 160 Cal. 601, 117 Pac. 767; Farmers Union Co-op. v. Schultze, (Kan. 1923) 212 Pac. 670.

<sup>35</sup>Minn., Laws, 1923, p. 342, chap. 264, sec. 18.

prevent the breach of such contract and to a decree of specific performance thereof. Under the general law providing for co-operative associations,<sup>36</sup> there are no similar provisions, but the courts would no doubt consider themselves authorized to administer similar remedies. It is, of course, true that under the general act, the remedies would depend on the contract and upon the common law. Even if the grower agrees in his contract to be subject to the remedies of injunction and specific performance, the court would probably not feel bound to afford such relief unless under the circumstances of the case this would be in accordance with the usual principles of equity.<sup>37</sup> The remedies of specific performance and injunction might well be allowed the association to enforce the exclusive marketing contract, even without a statute, in view of the inadequacy of the remedy by damages.

In a number of recent cases, co-operative associations have sought to enjoin their members from selling crops to parties other than the association in violation of contract. In almost all of these cases, the relief has been granted. In a California case, however, where the plaintiff sought specific performance of a contract between a producer of poultry and a corporation organized by poultry men for co-operative marketing, by which each producer agreed to sell all eggs through the corporation, the relief was denied. This was placed on the ground that under the civil code of California an injunction could not be granted restraining the violation of a contract, the performance of which could not be specifically enforced. It was held that since the marketing of the product called for services by the corporation of a highly skilled and personal nature, extending over a period of years, the contract could not be specifically enforced as against the corporation, and hence under this statute could not be specifically enforced against the producer.<sup>38</sup>

The objections to equitable relief present in the California case would, of course, disappear where the statute expressly authorizes it. For breach of the membership contract damages are an entirely inadequate remedy. The strength of the co-operative association depends upon its control of a sufficient supply to

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<sup>36</sup>Minn., Laws, 1923, chap. 326.

<sup>37</sup>Oregon Growers Co-operative Ass'n v. Lentz, (Ore. 1923) 212 Pac. 811.

<sup>38</sup>Poultry Producers of Southern Cal. v. Barlow, (Cal. 1922) 208 Pac. 93; on specific performance of co-operative marketing agreements, see 37 Harv. L. Rev. 145; 10 Cal. L. Rev. 518.

be a factor in the market. Dumping on the market has been an important cause of the low prices to the farmer. The association seeks such control that it may feed out the supply as the market is able to absorb it. It must be able to sell large quantities of the commodity. If the members fail to deliver their crops and dump them on the market independently all at one time, the whole movement tends to break down. Damages to the associations and to its members cannot be computed in any definite way. The only adequate remedy is to force delivery of the crop to the association and prevent the member from selling to others.

The marketing contracts usually fix a certain percentage to be paid by the owner upon sales outside the association. Such a liquidated damage provision has generally been upheld. In Alabama this was sustained where it appeared that the "penalty" was in the same amount as the authorized deduction which could be made by the association from the proceeds of products actually delivered.<sup>39</sup> Such a provision is valid where the sum fixed may be regarded as liquidated damages, but invalid if it is to be regarded as a penalty. Calling a sum "liquidated damages" will not prevent a court from finding that it is a penalty. Nor will the use of the term "penalty" show that it is not a valid provision for liquidated damages. The reasonableness of the agreed sum is the important thing. It should not be out of all proportion to the actual damages.<sup>40</sup> Such liquidated damages may no doubt include an estimate of the proportion of fixed charges which a member may be expected to pay whether he deliver his produce to the association or not, and the damages by interference with the system of orderly marketing. Insofar as the contract provides a penalty in addition to liquidated damages, it is unenforceable. The remedies by specific performance and injunction as authorized by the standard act are also freely granted.<sup>41</sup> In view of

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<sup>39</sup>Ex Parte Baldwin Co. Prod. Corp., (1919) 203 Ala. 345, 83 So. 69; see also Poultry Producers of Southern Cal. v. Barlow, (Cal. 1922) 208 Pac. 93; Bullville Milk Producers Ass'n Inc. v. Armstrong, (1919) 108 Misc. 582, 178 N.Y.S. 621; Castorland Milk and Cheese Co. v. Shantz, (1919) 179 N.Y.S. 131.

<sup>40</sup>Taylor v. Times etc. Co., (1901) 83 Minn. 523, 86 N.W. 760, 85 A.S.R. 473; Womack v. Coleman, (1903) 89 Minn. 171, 93 N.W. 663; Blunt v. Egeland, (1908) 104 Minn. 351, 116 N.W. 653; Chapman v. Propp, (1914) 125 Minn. 447, 147 N.W. 442.

<sup>41</sup>Phez Co. v. Salem Fruit Union, (1921) 103 Ore. 514, 201 Pac. 222, 205 Pac. 970, 25 A.L.R. 1113; Washington Cranberry Growers' Ass'n v. Moore (1921) 117 Wash. 430, 201 Pac. 773; Kansas Wheat Growers Ass'n v. Schulte, (Kans. 1923) 216 Pac. 311; Texas Farm Bureau Cotton Ass'n v. Stovall, (Tex. 1923) 253 S. W. 1101; Oregon Growers Co-operative Ass'n v. Lentz, (Ore. 1923) 212 Pac. 811; Tobacco Growers Ass'n v. Jones, (N. Car. 1923) 117 S.E. 174; Pierce

the existence of the remedy of specific performance, it may be that a mortgagee who acquires his lien with notice of the membership contract, would take subject to the right of the association to market the crop and deduct the expenses thereof, before he would be entitled to the proceeds. The equitable title to the crop would be in the association which has the right of specific performance. Where a stranger wrongfully induces another to commit a breach of contract, he may be held liable in a tort action.<sup>42</sup> The co-operative marketing act makes persons who knowingly induce or attempt to induce a member to break his marketing contract liable to the association in a penalty of \$500 for each offence.

#### VI. THE MINNESOTA STATUTES AS TO CO-OPERATIVE ASSOCIATIONS.

It is advisable that those who are forming a co-operative marketing association should give careful attention to the question of determining which is the most advantageous statute under which to incorporate. The requirements of the Capper-Volstead Act and the revenue law should also be considered. In Minnesota we now have two more or less parallel statutes under which co-operative marketing associations may be organized, which may for convenience be referred to as the general act,<sup>43</sup> and the special or Sapiro Act.<sup>44</sup>

There is certain other recent legislation which should also be mentioned, namely, an act authorizing the incorporation of co-operative associations to promote the production and marketing of live stock by the extension of credit,<sup>45</sup> and a somewhat similar act<sup>46</sup> to authorize the organization of co-operative credit associations to lend money to parties engaged in the production and the marketing of various kinds of staple agricultural products, including live stock. These two acts are the first to provide for co-operative banking in Minnesota. Reference should also be made to an act for the establishment of public produce

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County Dairymen's Ass'n v. Templin, (Wash. 1923) 215 Pac. 352; Hollingsworth v. Texas Hay Ass'n (Tex. Civ. App. 1922) 246 S.W. 1068; Brown v. Staple Cotton Co-op. Ass'n, (Miss. 1923) 96 So. 849; Owen Co. Burley Tobacco Soc. v. Brumback, (1908) 128 Ky. 137, 107 S.W. 710; Louisville & Nashville R. R. Co. v. Burley Tobacco Ass'n, (1912) 147 Ky. 22, 143 S.W. 1040.

<sup>42</sup>Joyce v. Great Northern Ry Co., (1907) 110 Minn. 225, 110 N.W. 975, 8 L.R.A. (N.S.) 756.

<sup>43</sup>Minn., Laws, 1923, chap. 326.

<sup>44</sup>Minn., Laws, 1923, chap. 264.

<sup>45</sup>Minn., Laws, 1923, chap. 131.

<sup>46</sup>Minn., Laws, 1923, chap. 141.

warehouses which may be of use in connection with co-operative marketing.<sup>47</sup>

The special co-operative marketing act,<sup>48</sup> adopted by the 1923 legislature, is similar in its terms to laws recently enacted in about thirty other states. The general statutes relating to the organization of co-operative associations were revised and consolidated into a new act in 1919.<sup>49</sup> This new act was further amended in 1921 and again in 1923.<sup>50</sup> There seems to have been some rivalry and antagonism between the advocates of the standard or special act<sup>51</sup> and those who have sponsored the revision of the existing acts authorizing co-operative associations.

It may be well, with a view to the possible consolidation and revision of the more or less conflicting provisions of these laws, to summarize the principal points of difference between them. These may be tabulated in the favorite peacemaker's form of "fourteen points."

1. The general act provides for a corporate lifetime of thirty years; the special act allows fifty years without renewal. It may well be doubted whether the fixing of any definite limit of duration on corporate existence is not apt to do more harm than good. If a corporation inadvertently does business after its charter has expired, by the weight of authority it is not a defacto corporation, and its members will be held liable as partners.

2. The special act commands that the by-laws shall provide that one director may be appointed by the commissioner of agriculture or any other public official or commission.

3. The special act provides that the articles shall define the property rights of members if the association is organized without capital stock. It also suggests by-laws to determine the value of a member's interest with provision for its appraisal and purchase upon the death or withdrawal or expulsion of a member. No such provision is made in the general act.

It may be pointed out that in the case of non-stock corporations not for profit, one who ceases to be a member of the corporation from any cause loses his interest entirely. So one who resigns or is expelled is not entitled to any compensation for his interest in the association property or business. Those remaining constitute the true association and are entitled to the use and

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<sup>47</sup>Minn., Laws, 1923, chap. 270, p. 352.

<sup>48</sup>Minn., Laws, 1923, chap. 264.

<sup>49</sup>Minn., Laws, 1919, chap. 382.

<sup>50</sup>Minn., Laws, 1921, chap. 23; Minn., Laws, 1923, chap. 326.

<sup>51</sup>Minn., Laws, 1923, chap. 264.

enjoyment of the association's property.<sup>52</sup> This doctrine might not apply to a co-operative non-stock association, but it would be well to make the matter entirely clear both in the statute and in the articles and by-laws of the association.

4. The general act requires submission of the articles and amendments to the attorney general for approval as to form and purposes. The special act does not require this.

5. The general act requires a debt limit to be specified. The special act does not.

6. The general act requires the rather useless formality and expense of publishing the articles as in the case of business corporations. The special act does not.

7. The general act requires acknowledgment of the articles by all the incorporators while the special act requires the articles to be acknowledged only by one.

8. The general act requires the filing of the articles with the secretary of state and with the register of deeds; the special act requires the filing with the secretary of state and with the public examiner, but the corporate existence is complete on filing with the secretary of state. The general act omits any express provision for filing proof of publication with the secretary of state, and does not specify when corporate existence begins.

9. The general act suspends the right to commence business until twenty per cent of the capital stock has been subscribed and paid in. No teeth are provided for the enforcement of this restriction which is one not yet adopted in this state as to business corporations generally. There is the same restriction without a sanction in the two co-operative credit association acts. The special act imposes no such restriction on associations created under that act.

10. The general act limits the amount of stock which may be held by an individual to a par value of \$1,000, or in case of an association to ten per cent of its paid in capital and permanent surplus. The special act limits the stockholder to not more than one-twentieth of the common stock of the association.

11. The general act provides that only the common stock shall carry voting power. The special act provides that the association may issue preferred stock with or without the right to vote, which may be sold to any person.

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<sup>52</sup>Clearwater Citrus Growers Ass'n v. Andrews, (Fla. 1921) 87 So. 903.

12. The special act has detailed suggestions as to the by-laws covering such matters as the form of marketing contract between the association and its members which every member may be requested to sign. A provision is also suggested for the power to levy assessments on each member or stockholder from time to time, to carry on the business of the association. Provision may be made for the automatic suspension of the rights of a member when he ceases to be eligible to membership in the association.

13. The special act has provisions for the recall of officers and directors and for the referendum of matters of policy to the stockholders for decision.

14. The general act has in section 7 elaborate provisions for building up reserves for depreciation and other possible losses, for new buildings and equipment, and also for a permanent surplus. An association is required to set aside at least ten per cent of the annual net income until the reserves for permanent surplus shall equal fifty per cent of the paid up capital. After provision has been made for such reserves, the balance of the net income will be available for distribution among the members on the basis of patronage, and the by-laws may provide that non-member patrons shall participate in the distribution of such undivided surplus upon equal terms with member patrons. No method is, however, provided for enforcing the requirement as to reserves and preventing the distribution of all the income.

It has been suggested that this provision in regard to reserves does not fit the pooling system and that it was apparently not drawn with a view to the methods of conducting business of a large proportion of the co-operative associations. Pooling is regarded as one of the most important features of the business methods of co-operative marketing associations. It means that each producer receives his share of the proceeds, less expense, for his products. There are no net earnings coming to the association upon which deductions for reserves can be computed. The provision seems to have been framed to fit the methods of the association which buys or sells for cash and then makes returns in the form of trade dividends. This section might be redrafted so as to give it more adaptability to the needs of the business.

If deductions are made from the proceeds of the crops to build up a permanent surplus reserve, it may seem that the co-operative principle is violated and that the patrons of the co-operative association are mulcted for the benefit of the stockholders. The surplus and the permanent improvements created

by withholding a percentage of the proceeds payable to the patrons for their products belong to the stockholders or members. The ultimate beneficiaries of the surplus, additions and improvements will, upon dissolution, be the stockholders. It may, however, be pointed out that this is only a fair reward to the stockholders for the risk taken by them in organizing the company, and a fair protection against the dangers of stockholders' liability. The stock is limited to a fixed dividend, not cumulative, amounting only to a legal rate of interest. A number of co-operative associations have failed disastrously for lack of an adequate reserve fund, accumulated during seasons of prosperity to meet periods of depression. A strong reserve is needed to enable the co-operative to compete with private concerns of strong financial backing. The present and future patrons of the association will benefit from the use of the added capital and facilities which are usually required in order to carry on the business efficiently.

Brief mention may now be made of the co-operative credit association acts. Chapter 141, Laws 1923, provide for incorporating co-operative credit associations, in order to promote and facilitate the production and marketing of the various kinds of staple agricultural products, including live stock. This is to be accomplished by advancing and lending money to parties engaged in the production and marketing of such products upon the obligations of the borrowers when secured by satisfactory collateral such as warehouse receipts or chattel mortgages. This statute follows substantially the provisions of chapter 326 relating to co-operative associations generally, except that the articles must be submitted to the superintendent of banks for approval. The corporation may commence business when not less than \$10,000 of the capital stock has been subscribed and paid in, but no individual liability is imposed to enforce this provision. A reserve fund is to be established to equal the paid up capital stock. Dividends to be paid on the stock shall not exceed eight per cent. After creating the reserves provided for, net profits shall be disbursed by uniform dividends based upon business transacted in the way of loans made, which may be in the form of credits upon interest due and upon the wages and salaries received by its employees. Non-stockholders shall receive dividends to the extent of one-half those paid to stockholders.

Chapter 131 Laws 1923 provides for the incorporation of co-operative credit associations to loan money upon the obligations of the members of such associations who are producers of live

stock, secured by satisfactory collateral or chattel mortgages on live stock owned by members of the association. This act is in general similar to chapter 141 except that loans may be made only members who are producers of live stock, and net earnings are to be disbursed to the stockholders on a pro rata basis upon the amount of interest paid by the stockholders to the association on loans. It is difficult to see why this entire matter of co-operative banking associations should not be consolidated in one statute, or indeed why it might not be covered in the general act relating to co-operative associations.

Provision has been made so that co-operative associations and others may establish licensed public produce warehouses and issue warehouse receipts upon which money can be borrowed. By chapter 270, Laws 1923, provision is made by which the commissioner of agriculture may issue licenses, require bonds, and inspect and supervise such warehouses. The purpose is to make the warehouse receipts approved collateral upon which the banker may rely. Co-operative marketing organizations may have subsidiary corporations to provide facilities for warehousing. It will, no doubt, be better to have warehouse receipts issued by a separate organization as bailee, in order that the marketing association may not have to issue warehouse receipts to itself for its own produce upon which it wishes to borrow money.

#### VII. STOCKHOLDERS' CONSTITUTIONAL LIABILITY.

Members of non-stock associations are not liable for the debts of the association, except to the extent of the unpaid balance due on the membership fee. A certificate of membership would differ from a certificate of stock mainly in carrying no right to dividends. Stockholders of a co-operative association, however, are subject to the constitutional double liability for its debts if the corporation is not organized solely for manufacturing or mechanical purposes.<sup>53</sup> In *Kraemer v. Tellin*,<sup>54</sup> a corporation organized for the manufacture of butter, cheese, and other products of milk and cream, and to sell and dispose of said products when manufactured, and to carry on all business essential thereto, which shall include the buying of dairy stock and selling it to the farmers to encourage the dairy industry, was held not organized exclusively for the purpose of carrying on a manufactur-

<sup>53</sup>*Lebens v. Nelson*, (1921) 148 Minn. 240, 181 N.W. 350; *Lindeke v. Scott Co. Co-op. Co.*, (1914) 126 Minn. 464, 148 N.W. 459.

<sup>54</sup>(Minn. 1923) 191 N.W. 735.

ing or mechanical business; and hence creditors could if need be invoke the constitutional liability of stockholders.

As was pointed out in an article by the writer on *Stockholders Liability in Minnesota*:<sup>55</sup>

"Our constitutional double liability is contrary to the public interest and out of date except as to banks and financial corporations. It results in substantial public inconvenience and loss; it is a sword hanging over the head of unsuspecting investors; it discriminates unfairly against Minnesota corporations in favor of foreign corporations, and deprives the state of a large and legitimate source of income from corporation fees and taxes because new enterprises are forced to seek incorporation in other states."

The only remedy is a constitutional amendment by which this double liability may be destroyed. One can see no justification for continuing it as to Minnesota corporations when foreign corporations are necessarily permitted to do business in the state without such liability. With this removed there would be no difficulty in authorizing non par stock corporations such as may be organized in most of the other states.

#### VIII. EXEMPTION FROM FEDERAL INCOME TAX.

Co-operative associations may claim exemption from federal income taxes provided they bring themselves within the provisions of the revenue act and of the regulations under it. The federal revenue act of 1921, section 231, (11) provides that the following organizations, among others, shall be exempt from income tax:

"Farmers', fruit growers', or like associations organized and operated as sales agents for the purpose of marketing the products of their members, and turning back to them the proceeds of sales, less the necessary selling expenses, on the basis of the quantity of produce furnished by them; or organized and operated as purchasing agents for the purpose of purchasing supplies and equipment for the use of members and turning over such supplies and equipment to such members at actual cost, plus necessary expenses."

If the proceeds of the business are distributed in any other way than on such a proportionate basis, the association does not meet the requirement of the statute and is not exempt.

Article 522 of the regulations under the revenue act of 1921 provides that:

"The accumulation and maintenance of a reasonable reserve for depreciation or possible losses or a reserve required by state statute or a reasonable sinking fund or surplus to provide for

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<sup>55</sup>7 MINNESOTA LAW REVIEW 79, 112.

the erection of buildings and facilities required in business, or for the purchase and installation of machinery and equipment, or to retire indebtedness incurred for such purposes, will not destroy the exemption. A corporation organized to act as a sales agent for farmers, or to market co-operatively the products of the farm, and having a capital stock on which it pays a dividend not exceeding the legal rate of interest in the state in which it is incorporated and in which substantially all of the outstanding capital stock is owned by actual producers, will not for such reasons be denied exemption, but any ownership of stock by others than actual producers who market their products through the association must be satisfactorily explained in the application for exemption. In every case the association will be required to show that the ownership of its capital stock has been restricted as far as possible to actual producers, and that the association has not voluntarily sold or issued any stock to non-producers . . . In order to be exempt . . . an association must establish that it has no net income for its own account, other than that reflected in a reserve, sinking fund or surplus specifically authorized in paragraph (a)."

Co-operatives do not lose their exemption if they transact business with and for non-members provided such business does not exceed that transacted with and for members of the association. But if they do not pay a refund to non-members in the same manner and amount as to members, they are not entitled to exemption and must pay taxes on their net income.<sup>56</sup>

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<sup>56</sup>It is required that a co-operative association which desires to establish its right to exemption shall file an affidavit with the collector in the district in which it is located, showing the character of the organization and various other matters. When an association has established its right to exemption, it need not thereafter make a return of income so long as it continues to operate on the same basis. The services of the accounting division of the department of agriculture of the state are available to all co-operative associations in the state under the provisions of chapter 284, Laws 1923. Associations desiring accounting services in the matter of installing accounting systems or of income tax exemptions and refunds, should direct their inquiries to the Commissioner of Agriculture, Old Capital, St. Paul, Minnesota. Forms for incorporation under the general act can be procured from the same source.