

SAN JOAQUIN AGRICULTURAL LAW REVIEW

VOLUME 7

1997

NUMBER 1

ARTICLES

AGRICULTURAL COOPERATIVE MEMBER EQUITY: YOU DON'T HAVE TO DIE FOR IT!¹

*Sharlene F. Roberts-Caudle**

"I didn't make money by giving it away." Marvin Johnson, owner of the former agricultural cooperative, House of Raeford Farms, Inc.²

"It's not bearing any interest, so there's really no reason to pay it. It's sort of like owing money to yourself." Marvin Johnson discussing redemption of a revolving equity certificate by a small family farming

¹ See Robert C. Rathbone, *Status of Equity Redemption (Do You Have to Die to Get It?)* AMERICAN COOPERATION, 1994 at 110.

* B.A., California State University, Fresno. J.D., University of Missouri-Columbia, LL.M., University of Arkansas, Fayetteville. Ms. Roberts-Caudle lives near Exeter, CA, and specializes in researching and writing on agricultural issues. Special thanks to Professor Mary Beth Matthews at the University of Arkansas School of Law.

² Kathryn Quigley, *He Gobbles a Big Share of Bird Sales*, FAYETTEVILLE OBSERVER-TIMES, May 7, 1995, at A1.

corporation.³

*"[V]iewing a co-operative as a corporation distorts its true nature because an ordinary corporation may exist and operate from its own detached power base whereas a co-operative cannot exist apart from a body of people who are its members."*⁴

INTRODUCTION

In 1975 HAJMM,⁵ a small family farming corporation, contributed \$387,500 in capital to an agricultural cooperative, House of Raeford Farms, Inc. Within nine years the cooperative had redeemed every other initial revolving fund equity certificate, except that held by HAJMM. In 1986 HAJMM asked the cooperative to redeem its revolving fund equity certificate. The cooperative refused. At the relevant directors' meeting the board of directors president and major patron, Marvin Johnson, said the board "decided that we didn't need to bother with it; it shouldn't be paid, it wasn't good business"⁶ Although cooperative bylaws governed redemption of certificates, Johnson later said "[T]he by-laws wasn't [sic] that important to me. I, I've never read them all the way through. I just glanced at them, that's about it."⁷ The cooperative's bylaws made redemption subject solely to the board of directors' discretion and the interest-free use of the money represented by HAJMM's revolving fund equity certificate allowed the cooperative to operate at a lower cost.

HAJMM sued the cooperative for redemption of its equity. The cooperative defended the suit by claiming that the certificates were redeemable, "if at all, in the sole discretion" of the board of directors.⁸ HAJMM won a jury verdict which was upheld on appeal by the North Carolina Supreme Court.⁹ The appellate court did agree with the cooperative that "mere financial ability of a corporation to pay is insuffi-

³ HAJMM Co. v. House of Raeford Farms, Inc., 379 S.E.2d 868, 873 (N.C. Ct. App. 1989), *aff'd* 403 S.E.2d 483 (N.C. 1990).

⁴ STUART BAILEY, UNIV. OF SASKATCHEWAN CENTRE FOR THE STUDY OF COOPERATIVES, ENCOURAGING DEMOCRACY IN CONSUMER AND PRODUCER COOPERATIVES 1 (1986).

⁵ An acronym for the first names of the family members which belonged to this farming corporation: Hervey, Ann, John, McNair, and Murphy. HAJMM Co. v. House of Raeford Farms, Inc., 379 S.E.2d 868, 873 (N.C. Ct. App. 1989) *aff'd* 403 S.E.2d 483, 485 (N.C. 1990).

⁶ HAJMM Company, 379 S.E.2d 868 at 873.

⁷ *Id.*

⁸ *Id.* at 873.

⁹ *Id.* at 870.

cient to prove an abuse of discretion.”¹⁰ The court also noted that “the business judgment rule protects corporate directors from being judicially second guessed when they exercise reasonable care and business judgment.”¹¹ The appellate court held, however, that sufficient evidence existed to go to the jury on the question of whether the cooperative unreasonably exercised its discretion in refusing to pay the certificate.¹² The appellate court therefore upheld the jury’s finding the cooperative owed a fiduciary obligation to members that it had abused in refusing to pay the certificate.¹³ In addition to compensatory damages, the jury assessed the cooperative \$100,000 in punitive damages.¹⁴

The issue of deferred patronage refunds is one of the most troublesome problems for cooperatives and their former members.¹⁵ This Article will explore the fiduciary relationship between agricultural marketing cooperatives and members. It will also analyze the consequences of the cooperative’s fiduciary duty toward members in the redemption of deferred patronage refunds.¹⁶ This Article argues that cooperatives are in a fiduciary relationship with members and a cooperative’s refusal to redeem former members’ deferred patronage refunds could subject the cooperative to tort liability. Whether such liability is imposed generally depends upon a court’s willingness to apply the business judgment rule in defense of the decision. This Article argues that when courts allow the cooperative board of directors to use the business judgment rule to shield these decisions from the courts’ review

¹⁰ *Id.* at 873.

¹¹ *Id.*

¹² *Id.*

¹³ *Id.* at 870.

¹⁴ *Id.* Unlike the deferred patronage refunds that are the focus of this article, the equity in this case was initial investment by members. That this court found a *fiduciary* obligation on the part of the cooperative in connection with these funds seems to argue more strongly that funds derived directly from marketing activity, a fiduciary activity, also would have a fiduciary character. *But see* Roger G. Ginder, *Managing Cooperative Equity: Problems on the Horizon?*, AMERICAN COOPERATION, 1995 at 85, 86 (distinguishing between equity purchased with cash and earned with patronage-latter would have been kept by for-profit company).

¹⁵ 14 NEIL E. HARL, AGRICULTURAL LAW § 131.04(2)(e) (1993) (citations omitted). *See also* Neil D. Hamilton, *Agricultural Law*. By Julian Juergensmeyer & James Bryce Wadley, 43 LA. L. REV. 1585, 1591 (1983) (book review).

¹⁶ *See generally* U.S. DEP’T OF AGRIC., LEGAL PHASES OF FARMER COOPERATIVES note 32, 482-83 (1976) [hereinafter *Phases*]. The term “deferred patronage refunds” will be used throughout this article though these funds go by many names, e.g., patronage refunds, patronage dividends, final pool settlement, net margins, net savings, capital credit, book credits, certificates, revolving fund certificates, certificates of equity, certificates of ownership. *Id.* at 472.

for fairness, they disregard the conflict of interest between former members and cooperatives.

This Article argues that cooperatives and former members have conflicting interests and therefore courts should not allow use of the business judgment rule defense in these cases. Where there is a conflict of interest, independent judgment is precluded and abuse of discretion is created. The presence of abuse of discretion bars the use of the business judgment rule standard so that a court must review the decision for fairness. If courts review these decisions as they should, cooperatives will be subject to greater liability. Greater liability is harmful to cooperatives and may be bad for the agricultural industry. This Article suggests a legislative solution to clarify the issues and provide guidelines for cooperatives and courts to avoid these negative consequences.

The public has a vital interest in a healthy agricultural industry and experts have long recognized that agricultural cooperatives are essential in providing a market presence for small and medium-sized farming operations.¹⁷ Farmers are price takers. In other words, farmers pay whatever suppliers charge and sell their produce for whatever buyers want to pay.¹⁸ Farmers can exercise more market power by combining through cooperatives than can one individual farmer.¹⁹

Several reasons account for the importance of agricultural cooperatives to the future of the agricultural economy. First, production agriculture is increasingly separating into two distinct sectors: large corporate industrialized operations and the small and medium-sized operations which comprise most of the farms.²⁰ This trend makes cooperatives more important to the agricultural economy.²¹ The growing concentration of agricultural production in large corporate farms forces medium and smaller farms to find niches such as the production of organic food and exotic livestock.²² These farmers need cooperatives in

¹⁷ WAYNE D. RASMUSSEN, U.S. DEP'T OF AGRIC, AGRIC. & INFO. BULLETIN 621, FARMERS, COOPERATIVES, AND U.S.D.A.: A HISTORY OF AGRICULTURAL COOPERATIVE SERVICE 17-18 (1991).

¹⁸ RASMUSSEN, *supra* note 17.

¹⁹ RASMUSSEN, *supra* note 17. See also Neil D. Hamilton, *Agriculture Without Farmers? Is Industrialization Restructuring American Food Production and Threatening the Future of Sustainable Agriculture?*, 14 N. ILL. U. L. REV. 613, 626 (1994).

²⁰ Neil D. Hamilton, *Agriculture Without Farmers? Is Industrialization Restructuring American Food Production and Threatening the Future of Sustainable Agriculture?*, 14 N. ILL. U. L. REV. 613, 615 (1994).

²¹ RASMUSSEN, *supra* note 17, at 16.

²² Hamilton, *supra* note 20, at 631.

order to market their products economically.²³ Second, the new farm bill,²⁴ which eliminates government manipulation of markets, will make cooperatives more necessary to the survival of many family farms. Without government price supports and deficiency payments the operators of small and medium-sized farms must band together for bargaining strength.²⁵

Incorporated cooperatives, however, are entities subject to liability just as other corporations and individuals.²⁶ Uncertainty in the law about member rights in deferred patronage refunds exposes agricultural cooperatives to the risks of tort liability. This exposure could threaten the public's interest in a healthy agricultural economy.²⁷

I. BRIEF HISTORICAL BACKGROUND OF COOPERATIVES

One commentator offers a simple definition of a cooperative as "any two or more persons who join together for their mutual benefit to promote a common purpose."²⁸ She writes that cooperative organizations have always been part of most civilizations, noting that the Pilgrims operated as a cooperative organization.²⁹ Farmers were organized in different forms throughout the 1900's in order to more efficiently market their produce. Beginning in 1914, federal statutes were enacted to clarify the rights of cooperatives to operate and to define the boundaries of their protection from laws regulating antitrust activity.³⁰

²³ Hamilton, *supra* note 20, at 651-52.

²⁴ Federal Agriculture Improvement and Reform Act of 1996, Pub. L. No. 104-127, 110 Stat. 888.

²⁵ See Hamilton, *supra* note 20, at 652.

²⁶ 14 NEIL E. HARL, AGRICULTURAL LAW § 131.06 (1993).

²⁷ See Hamilton, *supra* note 20, at 690, where he states that agricultural cooperatives are one of the most important elements of the agricultural community in the nation.

²⁸ Barbara J. Hoekstra, *The Fiduciary Duty Owed by the Farm Credit System Cooperatives to Their Member-Borrowers*, 13 J. AGRIC. TAX'N & LAW 3, 6 (1991).

²⁹ Hoekstra, *supra* note 28, at 7. See also *Phases*, *supra* note 16, at 3. See Sherman Peer, *Cooperatives and Proprietary Corporations: Distinctions Without a Difference*, 34 CORNELL L.Q. 416, 419 (1948), stating that: "Producer cooperatives are authorized by statute for the sole purpose of assisting members as patrons."

³⁰ See *Phases*, *supra* note 16, at 532-33. See also Clayton Act, ch. 323, § 1, 38 Stat. 730 (1914) (current version at 15 U.S.C. § 12 (1988)); Capper-Volstead Act, ch. 57, § 1, 42 Stat. 388 (1922) (current version at 7 U.S.C. § 291 (1980)); Robinson-Patman Act, ch. 592, 49 Stat. 1526 (1936) (current version at 15 U.S.C. §§ 13, 13b. (1990)). See generally RASMUSSEN, *supra* note 17 (complete history of U.S. agricultural cooperatives and their relationship with the government).

A. Nature of Cooperatives

Any definition of a cooperative must account for four operationally-unique cooperative principles. First, cooperatives are owned and democratically controlled by the producers who use their services.³¹ Second, the cooperative distributes its net income to producers in proportion to their use of the cooperative.³² Third, returns on ownership capital are limited.³³ Fourth, producers who use the cooperative substantially finance its operation.³⁴ The issue of redemption of deferred patronage refunds may be affected by all four of these unique cooperative principles.

Four types of agricultural cooperatives have developed in the United States: production, marketing, purchasing, and service cooperatives. Today many cooperatives combine two or more of these functions. For example, Sioux Honey Association, an Iowa cooperative, operates as a supply cooperative when it buys apiary supplies in large amounts and sells the supplies to member-beekeepers. It operates as a marketing cooperative when it contracts with member beekeepers to buy their honey and processes and holds the honey for sale on a favorable market. This Article will focus on incorporated agricultural cooperatives which have marketing functions.

The establishment of incorporated cooperatives is similar to the establishment of other corporations. Cooperatives, however, are fundamentally different from for-profit corporations.³⁵ Agricultural cooperatives are incorporated under special state cooperative statutes.³⁶ As with for-profit corporations, shareholders, or members, own the cooperative.³⁷ Unlike for-profit business corporations, however, an essential attribute of the cooperative is that its member-owners also use the cooperative.³⁸ The cooperative is unique because it is owned, controlled,

³¹ RASMUSSEN, *supra* note 17, at 3.

³² RASMUSSEN, *supra* note 17, at 3.

³³ RASMUSSEN, *supra* note 17, at 3.

³⁴ RASMUSSEN, *supra* note 17, at 3.

³⁵ *Denes v. Countrymark, Inc.*, 580 N.E.2d 1135, 1137-38 (Ohio Ct. App. 1989). See *Phases*, *supra* note 16, at 8 (function of a cooperative determines its character and therefore a business incorporated under business corporate statutes may be entirely cooperative in nature). See generally BAILEY, *supra* note 4, at note 3.

³⁶ HARL, *supra* note 26, § 131.01(1).

³⁷ *Denes*, 580 N.E.2d at 1138. See, e.g., *Phases*, *supra* note 16, at 3.

³⁸ *Denes*, 580 N.E.2d at 1138. See also *Phases*, *supra* note 16, at 3; Sherman Peer, *Cooperatives and Proprietary Corporations: Distinctions Without a Difference*, 34 CORNELL L.Q. 416, 417 (1948) (owned by users).

and used by its members.³⁹

As with labor unions, members use the cooperatives. But unlike the labor unions, members of a cooperative not only use but also own the cooperative.

B. Relationships Between Parties to the Cooperative Agreement

The relationship between agricultural cooperatives and members is more complex than that between corporations and their shareholders.⁴⁰ The incorporated agricultural cooperative is a singular type of business organization,⁴¹ created through contractual relationships with members to meet the needs of its producer members.⁴² These needs may include service, marketing, processing, or supply functions.⁴³ The relationship created is one of mutual dependency - the members depend upon their cooperative and the cooperative depends upon its members.⁴⁴

1. Traditional Cooperative Relationships

Most cooperatives are incorporated to take advantage of the limited liability and the formal structures for decision making available under corporation law.⁴⁵ In an incorporated cooperative, the functions of a cooperative are analogous to those of a for-profit corporation.⁴⁶ Like a corporation, decisions about how to operate the business are made by the cooperative's board of directors, officers, and managing employees.⁴⁷ As to decisions about day to day management, such as hiring, firing, promotion, salaries of employees, expansion, downsizing, the purchase or sale of assets, and merger, the cooperative operates like a for-profit corporation.⁴⁸ In this sphere the relationship between the co-

³⁹ Denes, 580 N.E.2d at 1138.

⁴⁰ Denes, 580 N.E.2d at 1138-39.

⁴¹ GLYNN MCBRIDE, *AGRICULTURAL COOPERATIVES: THEIR WHY AND THEIR HOW* 93-97 (1986).

⁴² Denes, 580 N.E.2d at 1138. *See also* Ayers v. Burley Tobacco Growers Coop. Ass'n, 344 S.W.2d 836, 839 (Ky. 1961) (contract between state and cooperative and between association and each member).

⁴³ *Phases*, *supra* note 16, at 18-19.

⁴⁴ *See* HARL, *supra* note 26, § 133.01 (two roles of members as both owners of cooperative and primary source of its business).

⁴⁵ *See generally Phases*, *supra* note 16, at 38.

⁴⁶ *Phases*, *supra* note 16, at 38. *See also* Peer, *supra* note 29, at 416 (corporate investor wants a return on the investment while the cooperative member takes a back-seat as investor, her primary goal to further her interest as a user).

⁴⁷ HARL, *supra* note 26, § 131.01.

⁴⁸ *Phases*, *supra* note 16, at 39; LEON GAROYAN & PAUL O. MOHN, *COOPERATIVE*

operative and its members is similar to the relationship between a corporation and its shareholders.⁴⁹

Cooperatives, like other corporate employers, are liable for the acts of their employees and agents (board of directors and officers) within the scope of their employment.⁵⁰ A cooperative, like other corporations, can be liable when it causes injury to another.⁵¹ This Article addresses the liability of the cooperative when it is not acting as a mere corporation but as a fiduciary to its members.

2. Cooperative as Agent and Buyer

The cooperative may assume the role of a fiduciary of its members in addition to its corporate capacity.⁵² To meet the needs of member producers the cooperative has the power to act as more than a mere corporate pool of capital. Through agreements with members, the cooperative may act as an agent for its members in, among other functions, marketing member produce.⁵³ In the alternative, the marketing cooperative may contract to buy its members' products directly for sale.⁵⁴ In both cases cooperative law and the terms of the agreement generally entitle the cooperative to deduct designated amounts of money from the selling price of the members' products.⁵⁵ These de-

EXTENSION, UNIV. OF CAL. DIV. OF AGRIC. & NATURAL RESOURCES PUBLICATION 4060, THE BOARD OF DIRECTORS OF COOPERATIVES 73-78 (1985).

⁴⁹ See generally *Phases*, *supra* note 16, at 38. See also *Peer*, *supra* note 29, at 416.

⁵⁰ *Phases*, *supra* note 16, at 334-35.

⁵¹ HARL, *supra* note 26, §§ 131.05-131.06.

⁵² See generally Robert Cooter & Bradley J. Freedman, *The Fiduciary Relationship: Its Economic Character*, 66 N.Y.U. L. REV. 1045, 1046 (1991):

Familiar forms of fiduciary relationships include trustee-beneficiary, agent-principal, corporate director/officer-corporation, and partnership In any of these paradigmatic forms, a beneficiary entrusts a fiduciary with control and management of an asset. Ideally, for the beneficiary, this relationship would be governed by specific rules that dictate how the fiduciary should manage the asset in the beneficiary's best interests. In fact, however, the fiduciary's obligations are open-ended.

⁵³ *California Raisin Growers' Ass'n v. Abbott*, 117 P. 767, 769 (Cal. 1911) (cooperative is incorporated for the purposes, inter alia, of acting as an agent with the power to contract). See also *Santo Tomas Produce Ass'n v. Smith*, 362 P.2d 977, 978 (N.M. 1961); *Phases*, *supra* note 16, at 158-72 (discussion of agency in context of marketing contracts); HARL, *supra* note 26, § 133.02(2). See *Peer*, *supra* note 29, at 419 (in operating a business at cost cooperatives are agents of patrons, but courts sometimes state the relationship as one of trust).

⁵⁴ E.g., *Phases*, *supra* note 16, at 183.

⁵⁵ *Phases*, *supra* note 16, at 473; See, e.g., James R. Baarda, *Farmers Cooperative*

ductions include all costs connected with marketing.⁵⁶ The cooperative is also generally entitled to deduct and withhold funds to provide working capital for the cooperative.⁵⁷ It is expected that the cooperatives will eventually return these "deferred patronage refunds" to members in proportion to their use of the cooperative.⁵⁸

C. Board of Directors—Standards of Conduct

Like a for-profit corporation, the cooperative is a legal fiction which is acting and being exposed to liability through its directors, executive officers, employees, and other agents.⁵⁹ The board of directors may be liable to both the cooperative and to members.⁶⁰ The board of directors of a cooperative owes a fiduciary duty to the cooperative⁶¹ and must obey the cooperative's articles of incorporation, membership agreements, bylaws, and marketing agreements.⁶² Cooperative boards of directors are subject to specific standards of conduct in the discharge of their managerial responsibilities.⁶³ Failure of the board to follow these standards in conducting the cooperative's business may be a breach of the board's fiduciary obligation to the cooperative.⁶⁴ To enforce the liability of the board to the cooperative a member may bring a derivative suit on the cooperative's behalf.⁶⁵

Equity Conflicts: Judicial Decisions in the 1980's, 12 HAMLINE L. REV. 699, 700-01 (1989) (discussion of various means in which member may have investment in cooperative capital).

⁵⁶ *Santo Tomas Produce Ass'n v. Smith*, 362 P.2d 977, 978-9 (N.M. 1961).

⁵⁷ *E.g.*, Baarda, *supra* note 55, at 700.

⁵⁸ *Buford v. Florin Fruit Growers Ass'n*, 291 P. 170, 171 (Cal. 1930) (refunds sued for were essentially balance due member for fruit sold through the exchange). *See* Baarda, *supra* note 55, at 700; *Phases*, *supra* note 16, at 472.

⁵⁹ HARL, *supra* note 26, § 131.01. *See id.* § 131.04 (co-op board of directors like that of corporation but governed by statutes under which cooperative is organized).

⁶⁰ ALLEN C. HOBERG ET AL, U.S. DEP'T OF AGRIC., AGRIC. COOP. SERV., DIRECTOR LIABILITY IN AGRICULTURAL COOPERATIVES, STAFF REPORT 8-9 (1984). *See id.* at 22 (cooperative's fraud or negligence necessarily depends on acts and intents of officers); *id.*, at 37 (cooperative as principal is liable for actions of agents that violate the law); *Phases*, *supra* note 16, at 335-36 (in Arkansas, cooperatives are made tortiously liable by statute). *Cf.* HOBERG ET AL, *supra*, at 2 (though board of directors may be liable, trend is to hold cooperatives liable).

⁶¹ HOBERG ET AL, *supra* note 60, at 3.

⁶² HOBERG ET AL, *supra* note 60, at 6-7.

⁶³ HARL, *supra* note 26, § 131.05(1). *See also* HOBERG ET AL, *supra* note 60, at 6 (obedience duty founded on directors' dual role as trustee and agent for cooperative); GAROYAN, *supra* note 48, at 26.

⁶⁴ HOBERG ET AL, *supra* note 60, at 2-3, 6.

⁶⁵ *Lake Region Packing Ass'n v. Furze*, 327 So. 2d 212 (Fla. 1976). *See also* Ho-

The board of directors and managing officers of the cooperative also have a fiduciary duty to the members.⁶⁶ Members who suffer individualized harm distinct from that of the cooperative may sue the board of directors and executive officers directly for breach of fiduciary duty.⁶⁷

D. Board of Directors' Defenses

Like the board of directors of for-profit corporations, the cooperative's board may raise the business judgment rule in defense of its decisions.⁶⁸ The business judgment rule is a court-created doctrine which grants the board of directors a degree of leeway in making business decisions. When a court finds the business judgment rule applicable to a board decision, the court will not intervene in the operation of the cooperative unless it first determines that the board or officer acted outside the scope of office, with gross negligence, was guilty of culpable mismanagement,⁶⁹ or abused her or his discretion.⁷⁰ As long as the

BERG ET AL, *supra* note 60, at 3 (most extensive area of liability is connected with director's obligation to act in good faith for the benefit of the cooperative without breach of trust). See generally HARL, *supra* note 26, § 131.06(3) (elements of a cause of action in a derivative suit against cooperative directors).

⁶⁶ Snyder v. Colwell Coop. Grain Exch., 3 N.W.2d 507 (Iowa 1942). See also HOBBERG ET AL, *supra* note 60, at 3, 7-8.

⁶⁷ Atwood Grain & Supply Co. v. Growmark, Inc., 712 F. Supp. 1360, 1364, (N.D. Ill. 1989). See HARL, *supra* note 26, § 131.07(7)(b),(c). Cf. HOBBERG ET AL, *supra* note 60, at 25 (cooperatives are liable for abuse of director discretion in redemption decision). See generally HARL, *supra* note 26, §§ 131.07(8), 131.07(4)(j) (cooperatives may be authorized to indemnify their board of directors, officers, and some employees).

⁶⁸ HARL, *supra* note 26, § 131.05(3)(d), See also HOBBERG ET AL, *supra* note 60, at 9-10, which states: "If a director has acted diligently and in good faith, and the loss results from an honest mistake of independent judgment, the director may invoke the protection of the business judgment rule."

⁶⁹ Parish v. Maryland & Virginia Milk Producers Ass'n, 277 A.2d 19, 48 (Md. 1971).

⁷⁰ Lake Region Packing Ass'n v. Furze, 327 So. 2d 212 (Fla. 1976). "[C]orporate directors generally have wide discretion in the performance of their duties and a court of equity will not attempt to pass upon questions of the mere exercise of business judgment which is vested by law in the governing body of the corporation." *Id.* at 216. If members "can demonstrate that the directors of the Association abuse their discretion or breach their trust by establishing charges to the producers at an inordinately low rate in relationship to the competitive market, by permitting the accumulation of excessive reserves, or by any other conduct, respondents have recourse to the courts . . ." *Id.* at 217.

See also Evandenko v. Farmers Union Elevator, 191 N.W.2d 258, 261 (N.D. 1971) stating that a member "may be able to show that the financial condition of the cooperative is such that the denial of the payment by the board of directors within some

decision was reasonable, the court will not attempt to decide if it was the correct decision or if a different decision would have been more reasonable.

E. The Contractual Relationship Which Forms Cooperative May Also Create Fiduciary Relationships

The contractual relationships between members are based upon the membership agreement, the corporate bylaws, articles of incorporation, and any marketing agreements. These agreements form the cooperative.⁷¹ Through the contractual relationship, the cooperative acts in a contractual capacity with members⁷² and, therefore, is exposed to actions for breach of contract.⁷³ However, as discussed earlier, in addition to a contractual relationship the agreement may also create fiduciary relationships.

The contractual relationship between members and the cooperative may create a fiduciary relationship in two connected yet operationally

reasonable period of time after the member's death would be an abuse of discretion"; *Collie v. Little River Coop.*, 370 S.W.2d 62, 64 (Ark. 1963) (abuse of discretion found on economic basis); *Claassen v. Farmers Grain Coop.*, 490 P.2d 376 (Kan. 1971). In *Claassen*, cooperative's bylaws gave the board of directors discretion to redeem on death. The board refused to redeem for member's widow although it had redeemed for another estate. The court refused to substitute its judgment for the judgment of the board of directors. Although it may appear unfair, said the court, the member knew when he joined that he would be responsible for taxes on the deferred patronage refunds even though they were not received. The court states: "We cannot get involved in the financial structure of this [cooperative] to determine whether the board of directors acted reasonably under these circumstances." *Id.* at 381. *Cf. Sanchez v. Grain Growers Ass'n of California*, 176 Cal. Rptr. 655, 659 (Ct. App. 1981) (actions of the board are subject to good faith and reasonable business judgment).

⁷¹ *Phases*, *supra* note 16, at 199. *See also* Hoekstra, *supra* note 28, at 30; *Rifle Potato Growers' Coop. Ass'n v. Smith*, 240 P. 937, 938 (Colo. 1925). *See generally* Baarda, *supra* note 55, at 713 (application of contract law elements of bylaws to determine rights and obligations with respect to equity investment).

⁷² *Phases*, *supra* note 16, at 167. *See also* HARL, *supra* note 26, § 133.02(2).

⁷³ *E.g.*, *Phases*, *supra* note 16, at 158-66 (discussion in context of milk contract). For example, in *Dryden Local Growers v. Dormaier et ux. Same v. Harnden et ux. Same v. Krause et ux.*, 2 P.2d 274 (Wash. 1931), a cooperative entered a contract with a member producer in which the producer agreed to deliver fruit to the cooperative. The cooperative made deductions from the proceeds of the produce which were not authorized by the contract and the producer notified the cooperative it would not deliver more fruit. In a breach of contract suit by the cooperative, the court held for the producer, saying the unauthorized deductions by the cooperative were a breach of its contract. *See generally* HARL, *supra* note 26, § 133.01(2)(b) (cases addressing and resolving important issues often dated 1920's and 1930's because many cooperative laws passed in those decades).

distinct activities.⁷⁴ The first is the agency or trust relationship that cooperative documents may create between the cooperative and the member regarding the marketing of member products, as mentioned earlier.⁷⁵ The second concerns deferred patronage refunds retained by the cooperative from the sale of the member's produce and returned to members over time.⁷⁶ The existence of a fiduciary relationship depends upon a common law duty and creates potential tort liability for breach.⁷⁷ Because of the dual nature of an agricultural cooperative, as discussed above, its actions may be characterized as either those solely

⁷⁴ See Austin W. Scott, *The Fiduciary Principle*, 37 CAL. L. REV. 539, 552 (1949) As trustees, corporations have the same obligations of loyalty as individual trustees with two exceptions in connection with the duty of loyalty. Corporate trustee can't use the corpus to buy shares in its own corporation—for trustee/bank, deposit of corpus problematic because of temptation to leave it for an unreasonably long time, because deposit is making money for the trustee. However, in both cases the beneficiary may consent. The second exception seems analogous to use of deferred patronage refunds by the cooperative, consent given because of the purpose of the corpus. Former members may wish to "withdraw" their "consent" because the "deposit" is no longer a benefit to the beneficiary.

⁷⁵ Hoekstra, *supra* note 28, at 28 (duties of a cooperative agent). See also Emanuel S. Tipton, *Co-Operative Associations: Rights in Equity Credits or Patronage Dividends*, 50 A.L.R.3d 435, § 3 (1973) (citing *Reinert v. California Almond Growers Exchange*, 63 P.2d 1114 (Cal. 1936) *sub. op. on reh.*, 70 P.2d. 190. (Cal. 1939); *Tomlin v. Petty*, 51 S.W.2d 663 (Ky. 1932), *Texas Certified Cottonseed Breeders' Ass'n v. Aldridge*, 59 S.W.2d 320 (Tex. Civ. App. 1933) 61 S.W.2d 79 *rev'd on other grounds* (Tex. 1933); Scott, *supra* note 74, at 552 (corporate fiduciaries as trustees have the same obligations as individual trustees, and purchase of shares in the trustees' own corporation must be authorized because of the conflict of interest); RESTATEMENT (SECOND) OF AGENCY § 13 (1958), stating: "An agent is a fiduciary with respect to matters within the scope of his agency."

Cf. Phases, *supra* note 16, at 554 (examples of marketing contracts); Hoekstra, *supra* note 28, at 25 (fiduciary relationship created through documents and a breach of the documents is a breach of fiduciary duty); Scott, *supra* note 74, at 1046 [in an agency-principal model fiduciary may breach its duty by misappropriation (malfeasance) or by neglect (misfeasance)].

⁷⁶ Tipton, *supra* note 75, § 4. See also HOBERG ET AL, *supra* note 60, at 26. See *Phases*, *supra* note 16, at 206 (money deducted by cooperative from proceeds of sale may be used by cooperative only for specific purposes for which it was deducted).

⁷⁷ Frank J. Cavico, Jr., *Punitive Damages for Breach of Contract - A Principled Approach*, 22 ST. MARY'S L.J. 357, 362 (1990) (tort duties are defined and imposed by operation of law and are general so that they apply to all persons within legally found range of harm created by a tortfeasor's conduct). See generally Scott, *supra* note 74, at 541 [usual fiduciary relationships include: trustee/beneficiary; guardian/ward; agent/principal; attorney/client; executor/legatee; directors and officers of corporation/corporation (to some extent at least, shareholders also); in partnership, the partners with one another; a shareholder who brings a derivative suit with the corporation].

of a corporation, or as actions of an incorporated fiduciary. Different principles of law may apply in each case. Therefore, the identification of the proper law to apply in the event of a controversy is more complex than for an ordinary business corporation.

F. Sources of Law to Resolve Cooperative Disputes

Cooperatives are subject to a variety of statutory laws. Although incorporated cooperatives are subject to state corporation law,⁷⁸ specialized state cooperative statutes generally supersede general corporation statutes.⁷⁹ Where there is a gap in cooperative statutes courts will follow general corporation statutes — but only if they are not in conflict with cooperative statutes.⁸⁰ Federal statutes, including some specialized antitrust provisions and securities regulations, also regulate cooperatives.⁸¹

Courts must look also to other sources of law to resolve controversies between cooperatives and their members. Besides state and federal laws, courts may refer to the common law of agency⁸² and of trusts to resolve conflicts between cooperatives and their members.⁸³ Courts must also apply contract law with reference to the documents which, taken together, comprise the agreement between members and the cooperative: the cooperative's articles of incorporation, bylaws, and any marketing contracts.⁸⁴ A board of directors' decision may affect only the ordinary day to day management of the corporation, or it may bind the cooperative as a fiduciary. The source of law appropriate to resolve a controversy involving a cooperative turns upon the characterization of the cooperative's conduct. It follows that a court that fails to

⁷⁸ *Phases*, *supra* note 16, at 38.

⁷⁹ *Farmers Union Coop. Gin Co. of Warren v. Taylor*, 172 P.2d 775, 777 (Okla. 1946): corporation "organized under a different law which is applicable solely to cooperative corporations and to extent it is complete in itself there is no warrant to invoke provisions of the general law."

⁸⁰ For example, in *Denes v. Countrymark, Inc.*, 580 N.E.2d 1135 (Ohio Ct. App. 1989), the cooperative statutes did not resolve a controversy over whether a cooperative's preferred shareholders were entitled to vote on a merger. The court looked at the general corporation statutes which did provide voting rights to preferred shareholders in case of merger. The court determined, however, that the general corporate statute was inconsistent with principles of the cooperative statutes and applied instead the rule provided by the relevant statutes for non-profit corporations. *Id.* at 1139-40.

⁸¹ See *HARL*, *supra* note 26, § 131.06(01)(b).

⁸² See *Tipton*, *supra* note 75.

⁸³ See *Tipton*, *supra* note 75, § 4.

⁸⁴ *E.g.*, *Baarda*, *supra* note 55, at 707-08, 713.

identify the role of the cooperative in a particular controversy may incorrectly decide the duty and liability of the cooperative.⁸⁵

G. Capitalization of the Cooperative

As indicated in the previous discussion of cooperative principles, one of the fundamental cooperative concepts is its funding by member-users.⁸⁶ This article focuses on deferred patronage refunds created by the members' use of the cooperative. The cooperative uses the retained deferred patronage refunds as capital in the operation of the cooperative.⁸⁷ The cooperative creates deferred patronage refunds when it retains either a percentage of the selling price or set amounts per unit of produce.⁸⁸ These deferred patronage refunds may result from the cooperative's activity selling the member's produce or from the cooperative's direct purchase of member produce.⁸⁹ Deferred patronage refunds stem from the cooperative's retention of money from the sale of members' produce in excess of direct overhead costs.⁹⁰

At the end of each fiscal year the cooperative may "declare" sums retained in excess of costs and payable to members.⁹¹ The cooperative must pay at least 20% of this amount in cash to qualify for special federal income tax treatment.⁹² The cooperative may return up to 80% of the excess to members in the form of "equity certificates," similar documents, or mere entries of the amount on the cooperative's books.⁹³ Members, however, pay income tax on 100% of the deferred patronage refund.⁹⁴

Cooperative laws and documents contemplate the eventual repayment of all money retained from members.⁹⁵ The repayment provision

⁸⁵ *E.g.*, Baarda, *supra* note 55, at 707.

⁸⁶ *See* Ginder, *supra* note 14, at 86; Claudia Parliament & Zvi Lerman, *Risk and Equity in Agricultural Cooperatives*, 7 J. AGRIC. COOPERATION (1992) (comparing capitalization of investor oriented businesses with cooperatives).

⁸⁷ *See, e.g.*, Baarda, *supra* note 55, at 700-01. *See generally* Phases, *supra* note 16, at 471-87 (patronage refunds).

⁸⁸ Phases, *supra* note 16, at 471-87.

⁸⁹ Phases, *supra* note 16, at 471-87.

⁹⁰ Phases, *supra* note 16, *cf.*, at 484 (sharp line between operating expenses and equity investment).

⁹¹ *See, e.g.*, Phases, *supra* note 16, at 474.

⁹² Phases, *supra*, note 16, at 481-82, 440.

⁹³ Phases, *supra* note 16, at 482-83.

⁹⁴ Phases, *supra* note 16, at 439-40.

⁹⁵ *Buford v. Florin Fruit Growers' Ass'n*, 291 P. 170, 171 (Cal. 1930) (refunds sued for were essentially balance due member for fruit sold through the exchange); *See* Baarda, *supra* note 55, at 700; Phases, *supra* note 16, at 472; *But see* James E. Muel-

is very important because it is generally the only way a member can recover this investment. No external market for cooperative common (voting) stock or deferred patronage refund certificates exists.⁹⁶

Most state statutes allow cooperatives through bylaws and other documents to control the redemption of members' and former members' deferred patronage refunds.⁹⁷ These documents may provide a variety of methods by which the cooperative redeems the deferred patronage refunds.⁹⁸ Redemption may be according to a revolving program or a special program, or a cooperative may have no specific program for redemption.⁹⁹ Cooperative boards of directors customarily have a substantial degree of discretion in their decisions to redeem deferred patronage refunds.¹⁰⁰

Cooperatives use the money provided from deferred patronage refunds as low cost capital.¹⁰¹ The use of low cost capital allows the cooperative to operate at lower cost and to charge members less for the services the cooperative provides.¹⁰²

ler, *Revolving Fund Equity Funds: An Effective Source of Equity Capital*, AMERICAN COOPERATION, 1992 at 246, 247; ABRAHAM DANIEL, UNIV. OF SASKATCHEWAN, CENTRE FOR THE STUDY OF COOPERATIVES, A NEW MODEL FOR PRODUCER CO-OPERATIVES IN ISRAEL app 6, at 36 (description of permanent capital fund that would never revolve).

⁹⁶ Cf., e.g., Baarda, *supra* note 55, at 707, citing *Christian County Farmers Supply Co. v. Rivard*, 476 N.E.2d 452 (Ill. App. Ct. 1985), where the court, in refusing to force redemption of (non-voting) preferred stock, which was freely transferrable, recognized a distinction between it and common (voting) stock, which was not.

⁹⁷ HARL, *supra* note 26, § 131.04(2)(c),(e). See also HOBBERG ET AL, *supra* note 60, at 25.

⁹⁸ HARL, *supra* note 26, § 131.04(2)(c),(e).

⁹⁹ Rathbone, *supra* note 1, at 110-12 [types of redemption programs: three types of Systematic Redemption—revolving fund; base capital; percent-of-all equities; Special Programs (based on event happening to member such as death, retirement, age, moving from area, bankruptcy); and no program].

¹⁰⁰ Baarda, *supra* note 55, at 710.

¹⁰¹ See generally Mueller, *supra* note 95, at 246; *Phases*, *supra* note 16, at 221. See also HOBBERG ET AL, *supra* note 60, at 22; HARL, *supra* note 26, § 133.02(4)(d)(I) (typical statute) (even on debt instruments cooperatives are limited to paying a "reasonable return" of interest because of the cooperative's fundamental nature as an "at-cost" operation and to qualify for special tax treatment); *Carpenter v. Commissioner of the Internal Revenue Serv.*, 20 T.C. 603 (1953), 219 F.2d 635 (5th Cir. 1955)(most cooperatives pay no interest on member investment).

¹⁰² HOBBERG ET AL, *supra* note 60, at 25. See also *Phases*, *supra* note 16, at 475.

II. REDEMPTION OF DEFERRED PATRONAGE REFUNDS

The courts have frequently addressed the problem of redemption of deferred patronage refunds of former members.¹⁰³ Courts have uniformly upheld redemption decisions made by boards of directors where decisions were subject solely to director discretion and such discretion was authorized by the relevant cooperative statutes and by-laws.¹⁰⁴ The discretion of the board is not totally unchecked, courts indicate, because board decisions must comport with the business judgment rule standard.¹⁰⁵

Though the case law cites "abuse of discretion" as one circumstance in which courts will disregard the business judgment rule standard, the courts routinely disregard real conflicts of interest. Where a conflict exists between the decision-maker and beneficiary, there can be no independence of judgment. Making a decision where there is a lack of independent judgment creates abuse of discretion.

Equity redemption disputes are likely to escalate in future years for several reasons. First, the average age of farmers is increasing each year,¹⁰⁶ so the concentration of equity in the hands of these near-retirement aged producers is growing.¹⁰⁷ Second, education about cooperatives is declining. Thus, at the same time that the number of cooperative members is likely to increase because of changes in the structure of agriculture, fewer new cooperative members will understand the nature of cooperative organization and capitalization. Misunderstanding between cooperatives and their members leads to litigation

¹⁰³ Courts addressed the problem in the following three cases: 1) In *Lake Region Packing Ass'n v. Furze*, 327 So. 2d 212 (Fla. 1976), former members sued their cooperative to force distribution of deferred patronage refunds. The cooperative's bylaws and articles, however, provided for distribution of the excess to former members only at the discretion of the board. 2) In *Claassen v. Farmers Grain Coop.*, 490 P.2d 376 (Kan. 1971), the court held that a member was not allowed to withdraw her or his interest from the cooperative if, in the opinion of the cooperative, it might disturb the financial condition of the cooperative. The board was allowed to exercise its discretion to refuse redemption, even though it had redeemed the deferred patronage refunds of a different member at death. 3) In *Driver v. Producers Coop., Inc.*, 345 S.W.2d 16 (Ark. 1961), the court had to force the cooperative's board of directors to comply with the charter and bylaws which set a scheme for retiring former members' interests; however, the court still allowed the board of directors to exercise its discretion.

¹⁰⁴ See cases cited *supra* note 103.

¹⁰⁵ See cases cited *supra* note 103.

¹⁰⁶ See Hamilton, *supra* note 20, at 630.

¹⁰⁷ Ginder, *supra* note 14, at 85-86, 90 (members over 70 years of age holding large percentage of equity in many cooperatives).

which could be avoided.¹⁰⁸

Although certainty in this area is necessary to provide economic security in the future for both cooperatives and their members, court decisions instead contribute to the confusion. For example, decisions often fail to identify clearly whether the decision is based on liability of the cooperative, board of directors and officers, or both.¹⁰⁹ Decisions also neglect to specify the capacity in which the cooperative has acted. Cooperative boards of directors need clear standards of conduct to protect the cooperative from liability for their actions.

III. ANALYSIS

A. *Parameters of Fiduciary Relationship*

When the cooperative is not acting solely in its capacity as a corporation, it *may* be acting as a fiduciary. As discussed previously, courts and commentators generally agree that cooperatives act as fiduciaries when acting as agents for members in marketing agreements.¹¹⁰ Courts have also found that buy-sell contracts between members and cooperatives create a trustee-beneficiary relationship.¹¹¹ Courts have been less clear about the nature of the cooperative's exercise of discretion in the context of redemption of deferred patronage refunds. Many courts, however, have found a fiduciary relationship in these decisions.¹¹²

Two arguments could be made against the conclusion that the cooperative is acting as a fiduciary in decisions about redemption of deferred patronage refunds. First, it could be said that board of directors'

¹⁰⁸ Ginder, *supra* note 14, at 85.

¹⁰⁹ See generally Snyder v. Colwell Coop. Grain Exch., 3 N.W.2d 507 (Iowa 1942). Cooperative was held liable because managing officers had a fiduciary relationship with shareholders and breached the duty to disclose information to shareholders.

¹¹⁰ See Tipton, *supra* note 75, § 3 (*citing* Reinert v. California Almond Growers Exch., 63 P.2d 1114 (Cal. 1936) 70 P.2d. 190 (Cal. 1939); Tomlin v. Petty, 51 S.W.2d 663 (Ky. 1932); Texas Certified Cottonseed Breeders' Ass'n v. Aldridge, 59 S.W.2d 320 (Tex. Civ. App. 1933), *rev'g* 61 S.W. 2d 79 (Tex. 1933). See also Scott, *supra* note 74, at 552 (corporate fiduciaries as trustees have the same obligations as individual trustees and must be authorized to buy shares in own corporation because of the conflict of interest); RESTATEMENT (SECOND) OF THE LAW OF AGENCY § 13 (1958): "An agent is a fiduciary with respect to matters within the scope of his agency."

¹¹¹ Bogardus v. Santa Ana Walnut Growers Ass'n, 108 P.2d 52 (Cal. Ct. App. 1941) (cooperatives agents or trustees of members with regard to money returned to local cooperative from federated cooperative for patronage). Cf. California & Hawaiian Sugar Ref. Corp. v. C.I.R., 163 F.2d 531, 533 (9th Cir. 1947).

¹¹² E.g., Pittman v. Groveowners Coop. of Loxahatchee, 534 So. 2d 1207 (Fla. 1988).

decision-making about redemption is identical to a for-profit corporate decision declaring dividends for shareholders. The for-profit corporation has no fiduciary relationship with shareholders in connection with these decisions. Second, it could be argued that when the cooperative is deciding when and how to redeem current members' deferred patronage refunds, it is acting as a corporation because the decision is no different from the cooperative's decision to make capital improvements using those same funds.

However, a persuasive reason to argue that the cooperative makes redemption decisions as a fiduciary is the special nature of these funds. First, the funds are the proceeds of an agency or other fiduciary relationship. Second, no external market exists for the certificates which represent these proceeds. The cooperative's decision to redeem is the only way in which the member can recover the remaining proceeds from the sale of her or his produce.¹¹³

Most case law does find that cooperatives make these decisions in a fiduciary capacity. However, as Austin W. Scott recognizes in his classic article, *The Fiduciary Principle*, all fiduciaries are not held to the same standard.¹¹⁴ Between the cooperative and current members there is not the same conflict of interest as between cooperatives and *former* members. One could say that current members and the cooperative have a kind of unity of interest, and that what is good for the cooperative should be good for the member.¹¹⁵ In this case the business judg-

¹¹³ Buford, 291 P. 170, 171 (Cal. 1930) (refunds sued for were essentially balance due member for fruit sold through the exchange). See Baarda, *supra* note 55, at 700; Phases, *supra* note 16, at 472. But see James E. Mueller, *Revolving Fund Equity Funds: An Effective Source of Equity Capital*, AMERICAN COOPERATION, (1992) at 246, 247; ABRAHAM DANIEL, UNIV. OF SASKATCHEWAN, CENTRE FOR THE STUDY OF COOPERATIVES, A NEW MODEL FOR PRODUCER CO-OPERATIVES IN ISRAEL, app. 6, at 36 (description of permanent capital fund that would never resolve).

¹¹⁴ See Scott, *supra* note 74, at 541. Not all fiduciary responsibilities are the same and some are more intense. "The greater the independent authority to be exercised by the fiduciary, the greater the scope of [her or] his fiduciary duty." *Id.* A fiduciary can procure consent before acting in a way which would breach the duty. See also Parish v. Maryland and Virginia Milk Producers Ass'n, 277 A.2d 19, 48 (Md. 1971):

[W]e think there is a fiduciary relationship which gives these former members a right to maintain this action, but we, nevertheless find and hold that the standard applicable to the directors upon the Bill of Complaint of the complainants in this case is the same standard as would apply generally with respect to the officers and directors of a stock corporation or a commercial organization which is a corporate entity. That standard we are all familiar with namely, that such officers and directors are liable for gross and culpable negligence.

¹¹⁵ Ginder, *supra* note 14, at 94.

ment rule, which allows the court to examine merely the decision-making process for fairness, provides sufficient protection of the interests of current members. For former members, however, the business judgment rule's focus on the fairness of the process and reasonableness of the decision does not take into account the conflict of interest between the decision-making fiduciary and its beneficiary.

B. Consequences of Recognizing a Fiduciary Relationship

The cooperative that breaches a duty imposed by law may be found tortiously liable. One consequence of recognizing a fiduciary duty by the cooperative is that when the cooperative breaches that duty, the member has a choice between contract and tort causes of action. This is because the cooperative has breached a duty imposed by law, not merely one imposed by agreement between the parties.¹¹⁶ Both remedies, however, are problematic in the cooperative context.

A second consequence of the recognition of a cooperative's fiduciary relationship with former members is that the relationship may render inappropriate the use of the business judgment rule as a defense.¹¹⁷ As discussed previously, the business judgment rule insulates a board decision from court intervention if the decision-making process is fair. However, even a fair process can cloak an unfair decision if decision-makers are biased or have a conflict of interest with members. In the cooperative's exercise of discretion in redemption decisions concerning former members, the cooperative is inherently biased. Therefore, the business judgment rule defense should not protect these decisions from a close review by the courts.¹¹⁸ Closer scrutiny of board decisions, however, creates greater exposure to liability for the cooperative.

Confusion in the law about choices of remedy and the application of the business judgment rule exists because courts fail to identify the dual function of the cooperative and explain its fiduciary relationship with members.¹¹⁹ Certainty is vital to the interests of both cooperatives

¹¹⁶ RESTATEMENT (SECOND) OF AGENCY § 401 cmt. a (1958) (possible for an agent to be liable for contract-only breach, for example if the agent agrees to act for one year and quits sooner—but if agent knowingly or negligently breaches a fiduciary duty, for example subjects the principal to liability to a third party, then agent may be liable in either tort or contract and is responsible for the loss).

¹¹⁷ HARL, *supra* note 26, § 131.05(3)(d).

¹¹⁸ HARL, *supra* note 26, § 131.05(3)(d).

¹¹⁹ See generally Mary Beth Matthews, *Recent Developments in the Law Regarding Agricultural Cooperatives*, 68 N.D. L. REV. 273 (1992), discussing confusion of court

and their members and, therefore, to the well-being of agriculture and consumers overall. The following section will explore these issues and suggest legislation as a possible solution.

1. The Fiduciary Relationship and Marketing Activity

As introduced earlier, state statutes and cooperative documents frequently authorize cooperatives to act as agents for their members.¹²⁰ In connection with this power, the cooperative may purchase supplies, seek markets, advertise, and enter into contracts for sale on behalf of its principals, the producer-members of the cooperative.¹²¹ The marketing cooperative and its members are in a fiduciary relationship because of this marketing contract.¹²² The marketing agreement may be a separate written contract or it may be embedded in other documents which, together, make up the contract between the cooperative and its members.¹²³

The cooperative undertakes the duty of a fiduciary to act primarily for the benefit of members in connection with the marketing contract.¹²⁴ The Restatement (Second) of Agency defines some of these fiduciary duties. They include the duty to account for profits which arise out of the employment,¹²⁵ the duty to refrain from competition

in *HAJMM Co. v. House of Raeford Farms*, 403 S.E.2d 483, 485 (N.C. Ct. App. 1989) and arguing against existence of independent fiduciary obligation by cooperative toward members in equity redemption decisions, only fiduciary duty that of board toward cooperative and, to some extent, toward members.

¹²⁰ *Phases*, *supra* note 16, at 167; *See also* HARL, *supra* note 26, § 133.02(2).

¹²¹ *Santo Tomas Produce Ass'n v. Smith*, 362 P.2d 977, 978 (N.M. 1961) (contract created agency/principal relationship); *See also*, HARL, *supra* note 26, § 133.01(i); *Phases*, *supra* note 16, at 332, stating as a general rule, "whatever an individual may do in person he may do through an agent."

¹²² *See* Tipton, *supra* note 75, § 3. *See also* Scott, *supra* note 74, at 552 (corporate fiduciaries as trustees have the same obligations as individual trustees and must be authorized to buy shares in own corporation because of the conflict of interest); RESTATEMENT (SECOND) OF AGENCY, *supra* note 116, § 13 stating an agent is a fiduciary with respect to matters within the scope of his agency. *See generally* HARL, *supra* note 26, § 133.02(4)(c) (failure to market is breach of marketing contract).

¹²³ *See, e.g., Phases*, *supra* note 16, at 560 (sample articles of incorporation contains "Section 1. Powers: To act as the agent or representative of any patron . . .").

¹²⁴ RESTATEMENT (SECOND) OF AGENCY, *supra* note 116, § 13 cmt. a. *See also* Hoekstra, *supra* note 28, at 28 (case law interpretation of the duty of a cooperative agent: 1) act fairly in all transactions with member-principals in day to day operation; 2) fully disclose all pertinent information to member-principals in all transactions with members; 3) treat all member principals equally).

¹²⁵ RESTATEMENT (SECOND) OF AGENCY, *supra* note 116, § 385 (agent has duty to turn over profits to principal in connection with transactions conducted on principal's

and to deal fairly with the principal in all transactions between them, and the duty not to act as an adverse party without the principal's consent.¹²⁶ In addition, "[a]n agent must act solely for the benefit of the principal, unless it is otherwise agreed, in all matters connected with his agency."¹²⁷ An agent may take no unfair advantage of the principal¹²⁸ and must account for profits arising out of the employment contract unless otherwise agreed.

In *Rhodes v. Little Falls Dairy*,¹²⁹ the New York Supreme Court defined the milk marketing cooperative's duty to its principal. The court said that the cooperative had the duty to get the best price possible for the milk, give the member his proportionate share, make deductions allowed by contract, and return to the member his share of the profits remaining, if any, based on patronage.¹³⁰

Statutes and cooperative documents often authorize marketing cooperatives to enter into contracts of sale with members in which the title passes directly to the cooperative for resale.¹³¹ The "buy-sell" contract may create a relationship in which the cooperative as trustee administers the corpus (produce and its proceeds) for the producer, who is both settlor and beneficiary.¹³² Even if no trustee-beneficiary or agent-principal relationship is recognized in the buy-sell contract,¹³³ the law

behalf).

¹²⁶ RESTATEMENT (SECOND) OF AGENCY, *supra* note 116, § 13 cmt. a.

¹²⁷ RESTATEMENT (SECOND) OF AGENCY, *supra* note 116, § 387 cmt. a (relation created for any other purpose is not an agency).

¹²⁸ RESTATEMENT (SECOND) OF AGENCY, *supra* note 116, § 387 cmt. b.

¹²⁹ *Rhodes v. Little Falls Dairy*, 245 N.Y.S. 432 (N.Y. App. Div. 1930), *aff'd* 177 N.E. 140 (N.Y. 1930).

¹³⁰ *Id.* at 435.

¹³¹ *E.g.*, *Phases*, *supra* note 16, at 183.

¹³² *Bogardus v. Santa Ana Walnut Growers Ass'n*, 108 P.2d 52, 57 (Cal. Ct. App. 1941) (cooperatives are agents or trustees of members with regard to money returned to local cooperative from federated cooperative for patronage). See *California & Hawaiian Sugar Ref. Corp. v. Comm'r of Internal Revenue Service*, 163 F.2d 531, 533 (9th Cir. 1947). The cooperative may operate in one of at least three capacities. "As ordinary purchaser by an ordinary sale," as an agent that holds title and processes and sells for its members, "as trustee of the raw sugar, the corpus of the trust, and proceeds of which, after refinement and sale, it holds in trust for the transferring members as beneficiaries." *Id.* But cf. *HARL*, *supra* note 26, § 133.02(2)(a) (in fact courts disregard characterization as purely principal and agent or seller and buyer because relationship has elements of both statuses).

¹³³ RESTATEMENT (SECOND) OF AGENCY, *supra* note 116, § 14J (mere transaction of receiving goods from another for resale does not create agency—determinative fact on issue of whether party is an agent or a buyer for self is whether parties agree that the purchaser's duty is to act primarily for the benefit of the one who delivered the

could impose an implied covenant of good faith and fair dealing because of the special nature of the agreement.¹³⁴ According to one commentator,

Courts may become more inclined than in previous times to impose an implied duty of fair dealing between the cooperative and its members. Several cases have been brought by members or former members of cooperatives based on breach of an implied duty of fair dealing or a closely related theory. Courts may find this theory appealing if they find that cooperatives have not dealt with their members in a fair and equitable manner.¹³⁵

Thus, even where the contract does not create a formal fiduciary relationship, with its attendant duties, courts may impose equivalent obligations.

Whether a court determines that a cooperative acted as an agent or as a buyer in a contract of purchase with its members, fiduciary duties imposed by law control cooperative behavior. Duties defined and imposed by operation of law subject one who breaches those duties to liability for harm to all persons within a legally found range of harm created by the tortfeasor's conduct.¹³⁶ The cooperative therefore may be tortiously liable to members for violation of those duties imposed by law to members. In marketing cooperatives, the deferred patronage refunds are the proceeds of this fiduciary relationship and, arguably, cooperatives have a fiduciary obligation imposed by law with respect to redemption of these funds.

2. Laws Governing Redemption of Deferred Patronage Refunds

State statutes generally allow cooperatives to exercise substantial discretion in the redemption of deferred patronage refunds of former members. Three different types of state statutes direct cooperatives in

goods).

¹³⁴ Pittman v. Groveowners Coop. of Loxahatchee, 534 So. 2d 1207 (Fla. 1988). The former member of a marketing cooperative sued the cooperative for breach of fiduciary duty in handling and distribution of profits not in accordance with the contract. The court said that the member and cooperative were in a contractual relationship. The court found the contract in the bylaws because there was no separate marketing contract. *Id.* at 1210. Nothing in the contract required more than good faith duty in absence of a higher duty and the court directed a verdict for the cooperative. The member had failed to object for the seven years as a member. The member did not claim that there was an agency relationship.

¹³⁵ James B. Dean, *Agricultural Cooperatives: An Update*, 73 NEB. L. REV. 228, 236 (1994) (citing Quick Appliance Parts v. Johnstone Supply, No. 91-C5204, 1991 U.S. Dist. LEXIS 14709 (N.D. Ill. Oct. 16, 1991)).

¹³⁶ Cavico, *supra* note 77, at 362, 398.

such redemption decisions. In each statute the key issue is the point in time the payment must be made. The discretionary type of statute either allows the board of directors to exercise its discretion, enables a cooperative to adopt a bylaw provision to fix a time for payment, or requires redemption "within a reasonable time."¹³⁷ These statutes have no definite requirements and cooperatives governed by them often fail to return former members' deferred patronage refunds in a timely manner.¹³⁸ A second group of statutes requires redemption of former member interests within a specific time, usually one or two years. Finally, a third group of statutes exists which are neither entirely mandatory nor discretionary. Some of the statutes in this third group further differentiate between expelled former members and other former members.¹³⁹

The vice president and chief financial officer of Dairymen, Inc., a regional marketing dairy cooperative, wrote, in 1992, about the problems Dairymen, Inc., had in administering its special program allowing early redemption of the deferred patronage refunds of former members in hardship cases. The cooperative discontinued the program because it could not be administered fairly. The difficulty was in evaluation of the hardship justifying early redemption.¹⁴⁰ This example shows the problem of deciding fairly when the board's discretion is very broad.

3. The Fiduciary Relationship and Deferred Patronage Refunds

Unlike their recognition of the fiduciary nature of the marketing functions, courts do not always recognize the decisions of a cooperative in the context of redemption of deferred patronage refunds as decisions by a fiduciary.¹⁴¹ Deferred patronage refunds do proceed from the marketing activity of the cooperative,¹⁴² and the cooperative, there-

¹³⁷ HARL, *supra* note 26, § 131.04(2)(e)(ii).

¹³⁸ HARL, *supra* note 26, § 131.04(2)(e)(ii).

¹³⁹ HARL, *supra* note 26, § 131.04(2)(e)(ii).

¹⁴⁰ Mueller, *supra* note 95, at 249-50.

¹⁴¹ See Tipton, *supra* note 75, § 5 citing Loomis Fruit Growers' Ass'n v. California Fruit Exchange, 16 P.2d 1040 (Cal. App. 1932) and Ozona Citrus Growers Ass'n v. McLean, 165 So. 625 (Fla. 1935) (debtor-creditor relationship in connection with retained money).

¹⁴² Farmers Coop. v. Birmingham, 86 F. Supp. 201 (Ct. Cl. 1949), "net effect of payment of equity credits in case of marketing cooperative is to increase the amount received for products marketed for members." Reinert v. California Almond Growers, 70 P.2d 1 (Cal. 1937) (court treated the cooperative's obligation with respect to the reserve fund as a fiduciary obligation).

fore, should be regarded as a fiduciary in its handling of those funds it holds for the benefit of members.¹⁴³

In several cases courts have identified as fiduciary the relationship between a cooperative and its members in connection with deferred patronage refunds.¹⁴⁴ In *Bogardus v. Santa Ana Walnut Growers Ass'n*,¹⁴⁵ for example, current members of a cooperative sued to enjoin the cooperative from paying to former members certain patronage refunds which had been returned to the cooperative by a federated cooperative of which it was a member. The court refused the plaintiffs' request to declare the money was the property of the local association, and former members had no interest in the money.¹⁴⁶ The court indicated that allowing the cooperative to retain the money for the benefit of the cooperative or for its present members would only contravene the purpose for which it was organized.¹⁴⁷

[T]he moneys in contention constitute the balance of the net proceeds received from the sale of walnuts contributed to the local association for market during the years [in which the former members were active members] and as such are the property of, and belong to, those persons who contributed their walnuts for market during that period.¹⁴⁸

This court acknowledged that the relationship between the member-producers and the cooperative at all times was that of principal and agent, or trustee and beneficiary, and that the fiduciary relationship required accounting by the cooperative to producers for all proceeds from the sale of the crop.¹⁴⁹

In *Burley Tobacco Growers' Co-op Ass'n v. Brown*,¹⁵⁰ the marketing contract allowed for two standard deductions from the proceeds of sale of the crop. If the entire funds were used each year, as permitted by

¹⁴³ *Phases*, *supra* note 16, at 472 (deferred patronage refunds are not "dividends" but refunds because of savings and surplus to be distributed according to patronage). See also *HOBERG ET AL*, *supra* note 60, at 26 (citing *Southeastern Colorado Cooperative v. Ebright*, 563 P.2d 30 (Colo. Ct. App. 1977)); *Tipton*, *supra* note 75, § 4.

¹⁴⁴ Perhaps one could argue that no trustee/beneficiary relationship is created, for example because the agent complied with all that was required by reinvesting part of proceeds into cooperative. In that case the implied covenant of good faith and fair dealing would require the cooperative's behavior to meet a certain standard and would subject the cooperative to liability when the conduct fell below that standard.

¹⁴⁵ *Bogardus v. Santa Ana Walnut Growers Ass'n*, 108 P.2d 52 (Cal. App. 1941).

¹⁴⁶ *Id.* at 53.

¹⁴⁷ *Id.* at 56-57.

¹⁴⁸ *Id.* at 59.

¹⁴⁹ *Id.* at 57.

¹⁵⁰ *Burley Tobacco Growers' Co-op Ass'n v. Brown*, 17 S.W.2d 1002 (Ky. Ct. App. 1929).

the contract, no surplus arose from the deductions and no distribution could be compelled. The Kentucky Court of Appeals stated that calling the deduction a trust fund might not be proper, but that it “partakes of the nature of a trust fund in that any balance unexpended for the purposes mentioned in the contract will be distributed at some time” to members.¹⁵¹

In *Mt. View Walnut Growers Ass’n v. California Walnut Growers Ass’n*,¹⁵² the defendant cooperative acted as a marketing agency for its members. It retained part of the net from its sale of members’ crops for use as a reserve fund to carry on future operations.¹⁵³ The parties agreed that the reserve fund was a trust fund for the benefit of all the members of the cooperative.¹⁵⁴ These cases illustrate the different standard to which courts hold cooperatives when a cooperative acts as an agent, a fiduciary, and not just in its capacity as a corporation.

4. Consequences of the Recognition of a Fiduciary Relationship in Redemption Decisions

One of the consequences of recognizing a fiduciary obligation by the cooperative, whether it is couched as agency, trustee, or implied covenant, is the choice created between contract and tort causes of action in case of breach.¹⁵⁵ This makes a difference because the remedies provided by law in tort and contract actions differ in purpose.¹⁵⁶ Tort

¹⁵¹ *Id.* at 1006.

¹⁵² *Mountain View Walnut Growers’ Ass’n v. California Walnut Growers Ass’n*, 65 P.2d 80 (Cal. Ct. App. 1937).

¹⁵³ *Id.* at 81.

¹⁵⁴ *Id.*

¹⁵⁵ RESTATEMENT (SECOND) OF AGENCY, *supra* note 116, § 401 (possible for an agent to be liable only in contract; for example if the agent agrees to act for one year and quits sooner. But if agent knowingly or negligently breaches a fiduciary duty, for example subjects the principal to liability to a third party, then agent may be liable in either tort or contract and is responsible for the loss). *See also* HARL, *supra* note 26, § 133.04(3)(a),(d) (member may seek a variety of remedies against cooperative that breaches its duty to a member, including damages for: breach of contract, fraudulent inducement to join, and wrongful expulsion; rescission of contract and termination of membership; injunction and specific performance, and for an accounting).

¹⁵⁶ Eileen A. Scallen, *Promises Broken vs. Promises Betrayed: Metaphor, Analogy, and the New Fiduciary Principle*, 93 ILL. L. REV. 897, 899 n.6 (1993) (though similar in many respects, the distinction between tort and contract is well-grounded in common law and divergent objectives underlie remedies). *See also* Cavico, *supra* note 77, at 360 (contract and tort have a common source but are different because the objectives are different).

remedies generally protect broader social interests,¹⁵⁷ while contract remedies are intended to accomplish economic rather than social goals.¹⁵⁸ Contract actions are essentially "strict liability" suits - if the party does not perform the contract the party is liable for contract damages.¹⁵⁹ On the other hand, tort liability is generally premised on negligence.¹⁶⁰

The underlying theory of contract damages is that the parties bargained for certain duties which they imposed upon themselves.¹⁶¹ Breach of contract remedies are intended to compensate the non-breaching party for losses resulting from the breach.¹⁶² The non-breaching party may recover for consequential damages that were reasonably foreseeable at the time of the contract.¹⁶³

In contrast, a tort cause of action rests upon a duty of care toward other persons imposed by law.¹⁶⁴ Remedies are intended to both restore the innocent party and to punish and deter culpable conduct.¹⁶⁵ The party who breaches a duty may be liable for compensatory damages and for consequential damages reasonably foreseeable at the time of the breach.¹⁶⁶ Damages awards may also be punitive.¹⁶⁷

¹⁵⁷ Cavico, *supra* note 77, at 362.

¹⁵⁸ Cavico, *supra* note 77, at 361.

¹⁵⁹ Cavico, *supra* note 77, at 366, [(citing Holmes) contracts are a set of alternate promises, to perform or pay damages for non performance].

¹⁶⁰ See Cavico, *supra* note 77, at 389.

¹⁶¹ Cavico, *supra* note 77, at 362. Contract duties are created by the will of the contracting parties and not the state; parties theoretically can and have safeguarded their interests. By contrast, tort remedies protect broader social interests, while contract actions endeavor to protect expectation, reliance, and/or restitution interests.

¹⁶² Cavico, *supra* note 77, at 361, stating:

The primary purpose of contract remedies is compensation. This is not understood to provoke public policy concerns but does give security in economic relationships by assuring contracting parties that promises will be kept. Contract law serves society by promoting standardized conduct in performance of promises and produces certain, uniform, stable, and efficient business transactions. Traditional goals of contract law stress economic principles not social justice.

¹⁶³ Scallen, *supra* note 156, at 899 (reasonably foreseeable consequential damages, standard of proof is reasonable certainty of damages and no punitive damages are allowed).

¹⁶⁴ Cavico, *supra* note 77, at 362 (tort duties are defined and imposed by operation of law and are general so that they apply to all persons within legally found range of harm created by a tortfeasor's conduct).

¹⁶⁵ Cavico, *supra* note 77, at 362 (tort remedies protect interest in security of person, property, and relationships from unauthorized harm, violation, or misappropriation).

¹⁶⁶ Cavico, *supra* note 77, at 370. See also Scallen, *supra* note 156, at 899, n.4

The distinction between remedies in contract and tort sometimes blurs when a contract creates special relationships. The general rule is that punitive damages are not available in contractual relations. Exceptions exist to the general rule, however.¹⁶⁸ One commentator identifies the focal point of the exception as the determination of whether or not the contract creates an independent fiduciary relationship between the parties.¹⁶⁹ Bare contract principles, he states, presuppose: 1) the agreement is between parties of relatively equal bargaining power and occurs in a functioning market; 2) the parties have the same degree of risk aversion; 3) the aggrieved party detects the breach and sues for damages; 4) monetary remedies exist for every type of damage; 5) the victim recovers compensation in speedy and costless litigation; 6) orthodox measures of the Restatement (Second) of Contracts supply full and true redress for all harm; and 7) parties attain an efficient agreement before or after the breach.¹⁷⁰ He concludes that the presuppositions of contract law, encompassing the theory of efficient breach of contract, do not account for "take it or leave it" contracts where parties' aversion to risk is different, and that in such cases punitive damages are necessary to make suits economical.¹⁷¹

Insurance contracts are an example of contracts¹⁷² in which failure to perform is not only a private breach but also a contravention of social norms.¹⁷³ A fiduciary relationship exists where one party is particularly vulnerable because she or he is dependant upon and relies on the skill and judgment of another.¹⁷⁴ Frank J. Cavico, Jr., writes that "The dependency aspect inherent in the insurance association and the potentially dire economic position of an emotionally distraught insured, leave the insured especially exposed to bad faith or outrageous conduct by the economically powerful entity."¹⁷⁵

Cooperative contracts between members and cooperatives for marketing of products resemble insurance contracts in their "quasi-public

(foreseeability and certainty standards lower in tort causes of action than in contract).

¹⁶⁷ Scallen, *supra* note 156, at 899, n.4.

¹⁶⁸ Cavico, *supra* note 77, at 377.

¹⁶⁹ Cavico, *supra* note 77, at 378.

¹⁷⁰ Cavico, *supra* note 77, at 372.

¹⁷¹ Cavico, *supra* note 77, at 365 (punitive damages allow private individuals to enforce the rules of law and recover their expenses).

¹⁷² Cavico, *supra* note 77, at 372.

¹⁷³ Cavico, *supra* note 77, at 368.

¹⁷⁴ Cavico, *supra* note 77, at 405.

¹⁷⁵ Cavico, *supra* note 77, at 405.

contract” nature.¹⁷⁶ Producer-members of cooperatives depend upon cooperatives as agents to act in good faith in acceptance and handling of members’ produce, in finding the best markets available, and in remitting the proceeds to the producer.¹⁷⁷ Because of this dependency, even in buy-sell contracts between cooperatives and members, the law should impose in the agreement an implied covenant of good faith and fair dealing that rises to a fiduciary level.¹⁷⁸ Members then should have a choice of remedies where the cooperative breaches its fiduciary obligation.

However, both contract and tort remedies pose significant public policy problems in the cooperative framework. Tort remedies can be inefficient and may also threaten the survival of a cooperative, and thus damage its producer members, while contract remedies are often insufficient.

First, tort remedies are economically inefficient.¹⁷⁹ The cost of litigation makes it likely that only a minority of injured parties will ever be compensated.¹⁸⁰ These parties undertake the burden of litigation and are overcompensated while most injured parties are undercompensated.¹⁸¹

Second, contract remedies may be insufficient. Contract law serves society by promoting standardized conduct in performance of promises and produces certain, uniform, stable, and efficient business transactions.¹⁸² Traditional remedies do not always fully compensate non-breaching parties for breach of contract. For example, one fundamental concept of contract law is the encouragement of “efficient breach” of contract.¹⁸³ For the sake of economic efficiency a breaching party is

¹⁷⁶ See Cavico, *supra* note 77, at 404.

¹⁷⁷ But see Cavico, *supra* note 77, at 421 (some courts, citing U.C.C. § 4, refuse to recognize the extension of punitive damages in contracts beyond the insurance scope, saying they fear spawning punitive damages for every purposeful breach).

¹⁷⁸ See Cavico, *supra* note 77, at 377 stating: “Punitive damages are applicable where a breach of contract comprises a breach of fiduciary duty. Even though the relationship may arise from the contract, recovery is granted upon breach of implied-in-law duty created by the relationship rather than from the contract itself.”

¹⁷⁹ Cavico, *supra* note 77, at 377.

¹⁸⁰ Cavico, *supra* note 77, at 377.

¹⁸¹ Cf. Scallen, *supra* note 156, at 925. See also HARL, *supra* note 26, § 131.05.

¹⁸² Cavico, *supra* note 77, at 361.

¹⁸³ Cavico, *supra* note 77, at 366 (awards of punitive damages victimize breaching party by compelling payment of more than compensable damages; courts don’t want to deter “efficient breach” because it is wealth-producing and they don’t want to encourage performance of economically unsound contracts). But see Scallen, *supra* note 156, at 925 (definition of efficient breach concept is not applicable to “betrayed

allowed to pay damages, without punishment, to the non-breaching party when to do so is less expensive than performance.¹⁸⁴ Traditional contract remedies, however, do not fully compensate some parties for efficient breach.¹⁸⁵

Because of the problems presented by both remedies the best solution may be legislative. A legislative solution would guide cooperatives, clarify the issues for courts, and would also meet the needs of producers in advancing certainty in their relationships with one another and their cooperative. Legislation could satisfy the interests of the public in nurturing a strong agricultural sector. Before turning to a discussion of such legislation, however, this article will examine one remaining problem with the consequence of the fiduciary relationship between cooperative and former member.

As previously discussed, the existence of a fiduciary relationship between a cooperative and its former members exposes the cooperative to tort liability for breach. Ordinarily, the cooperative board may raise the business judgment rule as a defense to its decisions. Because the cooperative has a conflict of interest with the former members, however, the use of the business judgment rule may be inappropriate in some cases.

C. Effect of Recognition of a Fiduciary Relationship and Application of the Business Judgment Rule

Directors of cooperatives, like those of corporations, have three duties: obedience, loyalty, and care.¹⁸⁶ Directors must comply with the cooperative agreements with members and applicable laws.¹⁸⁷ Directors must act in good faith and must also be loyal to the cooperative, avoiding conflicts of interest.¹⁸⁸ Directors also must act with the requisite diligence, care, and skill.¹⁸⁹

promises," or promises in which there is a special relationship).

¹⁸⁴ For example, if A agrees to buy local wheat and haul it to B, and A's truck becomes inoperable so that A cannot afford to perform, it makes economic sense to allow B to cover at the least cost and allow A to compensate B for the extra cost, if any.

¹⁸⁵ For example, when the one party to a contract has trusted the other party, and the other party, in order to favor her own position, breaches with the knowledge that consequential damages, unforeseeable at the time of contracting, will occur, traditional contract remedies may not make the non-breaching-party whole.

¹⁸⁶ *E.g.*, HARL, *supra* note 26, § 131.05.

¹⁸⁷ HARL, *supra* note 26, § 131.05.

¹⁸⁸ HARL, *supra* note 26, § 131.05.

¹⁸⁹ HARL, *supra* note 26, § 131.05.

A cooperative director is also a fiduciary and owes a fiduciary duty to the cooperative and to its members. Allen C. Hoberg identifies the significance of the distinctive relationship between director and cooperative.

The status of fiduciary signifies a special relationship between a director and the cooperative, characterized by trust and confidence reposed in the director, and by the director's integrity and candor with the cooperative. In his fiduciary capacity, a director is obliged to act prudently and primarily for the benefit of the cooperative Whether the duty is attributed to the director's role as agent for the cooperative or as trustee for its assets, a director has, by virtue of his position, assumed the fiduciary duty to act for the cooperative's benefit¹⁹⁰

Directors owe the cooperative (and its composite members) the duty to act for its benefit. Indeed, the director may be liable for not acting primarily for the cooperative's benefit. However, situations occur which require directors to choose whether to make decisions benefitting the cooperative at the expense of former members. These decisions present directors with a dilemma. Deferred patronage refund redemption decisions which discriminate against former members are examples of decisions which benefit the cooperative. Such decisions by boards fulfill the board's duty to the cooperative and its current members. But because the actions of the board are the actions of the cooperative, and because the cooperative has a fiduciary duty toward former as well as current members, such decisions may cause the cooperative to breach its duty to former members.

As discussed earlier, the board of directors is potentially subject to liability in a suit brought either by the cooperative or its members. The cooperative, through actions of the board of directors, officers, or other agents, may breach its fiduciary duty to a member so that the member suffers individualized harm. In that case the member may sue both the cooperative and the board of directors and officers directly.¹⁹¹

The business judgment rule is a defense from personal liability if the board of directors' conduct satisfies the standard of care.¹⁹² Directors are not liable in derivative suits unless the decision-making process deviated from acceptable practices.¹⁹³ When the business judgment rule applies, courts will not intervene in the management of the cooperative. In this indirect manner the business judgment rule also

¹⁹⁰ HOBERG ET AL, *supra* note 60, at 3.

¹⁹¹ HARL, *supra* note 26, § 131.04(4)(j).

¹⁹² HARL, *supra* note 26, § 131.05(3)(d).

¹⁹³ HARL, *supra* note 26, § 131.04(3)(d) (business judgment rule protects directors just as tort law protects doctors and lawyers from malpractice).

protects the cooperative from liability to members due to the actions of the board.

The business judgment rule protects boards of directors from being "second-guessed" by courts, but courts do recognize its use as improper in some cases.¹⁹⁴ One commentator notes that three types of conduct not protected by the business judgment rule are: self-dealing, lack of knowledge, and personal bias.¹⁹⁵ On the issue of bias he states:

The requirement that directors make their business decisions in good faith without personal bias or favoritism may be in issue where directors of a cooperative have discretionary power to redeem the retained equities of former patrons. Most cooperative directors have an interest in the retained equities of former patrons because the equities constitute an interest-free investment in the cooperative. This investment operates to increase the net earnings of the cooperative and the funds available for patronage dividends. By declining to redeem the retained equities of former patrons, the directors, as current patrons, are able to increase their own patronage refunds. Thus, directors have a personal interest in any decision concerning the redemption of retained equities of nonpatrons and it follows that the business judgment rule does not apply.

In the same way, the interest of a cooperative in interest-free capital obviously may conflict with the interest of the individual former member in equity redemption.¹⁹⁶ This article began with a particularly egregious example of the effect of bias on the decision not to redeem equity. In that case the jury assessed both compensatory and punitive damages against the cooperative, House of Raeford Farms, Inc., because it abused its discretion and violated its fiduciary duty.¹⁹⁷

The situation in House of Raeford Farms, Inc., illustrates that the problem of redemption decisions for former members results from the circumstances in which cooperatives operate.¹⁹⁸ The problem is created by the combination of zero-interest capitalization by members and the board's broad discretion to redeem that capital. Directors cannot be expected to balance their fiduciary duty to the cooperative with the cooperative's fiduciary duty to its former members. Therefore, where directors have discretion to discriminate against former members, courts must be willing to review the decisions themselves for fairness and to intervene in the cooperative's management when appropriate.

¹⁹⁴ HARL, *supra* note 26, § 131.05(3)(d).

¹⁹⁵ HARL, *supra* note 26, § 131.05(3)(d).

¹⁹⁶ Baarda, *supra* note 55, at 704.

¹⁹⁷ HAJMM Co. v. House of Raeford Farms, 379 S.E.2d 868, 875 (N.C. 1989).

¹⁹⁸ Baarda, *supra* note 55, at 699.

This Article does not argue that all decisions to redeem deferred patronage refunds should be denied the business judgment rule protection, but rather that the conflict of interest between former members and the cooperative should make use of the business judgment rule as a defense inappropriate in some cases. Redemption decisions concerning former members deserve closer scrutiny by the courts. Generally, however, courts instead apply the business judgment rule defense and review the decision-making process. If the process appears reasonable, the court declines to review the substantive decision for fairness.¹⁹⁹

In the case of *Dyvig v. Farmers Cooperative Ass'n*,²⁰⁰ a member sued a cooperative for redemption of deferred patronage refunds. The applicable state statute gave discretion to the directors in redemption decisions regarding former members, including members who had died. The Humboldt County District Court of Iowa decided that the directors' refusal to redeem was an abuse of discretion. The court defined discretion as implying the "absence of arbitrary determination and exercise of discriminatory judgment within bounds of reason."²⁰¹ The court found an abuse of discretion because redemption would not have caused hardship to the cooperative and the cooperative had and was receiving the benefit of the former member's equity funds.²⁰²

This case illustrates the type of analysis this Article advocates. The benefit the cooperative gained from the use of the former member's equity compromised the board's ability to properly exercise discretion, or independent judgment. Further, if the cooperative could redeem without hardship, the court said it must.

The *Dyvig* court could have explicitly recognized that a conflict of interest existed, cited the board's lack of independent judgment, and concluded that an abuse of discretion was therefore inherent. The court then could have refused to apply the business judgment rule to the de-

¹⁹⁹ Baarda, *supra* note 55, at 710 (director discretion the key element in most equity redemption litigation). See also *Parish v. Maryland & Virginia Milk Producers Ass'n*, 277 A.2d 19, 48 (Md. 1971). See generally *Atwood Grain & Supply Co. v. Growmark, Inc.*, 712 F. Supp. 1360 (N.D. Ill. 1989); *Hanson v. Ontario Milk Producers Coop*, 294 N.Y.S.2d 936 (1968); *Lake Region Packing Ass'n v. Furze*, 327 So. 2d 212 (Fla. 1976).

²⁰⁰ HOBURG ET AL, *supra* note 60, at 26, *citing* *Dyvig v. Farmers Coop. Ass'n*, Civil No. 13730 (Ia. D.Ct., Humboldt Co. 1973).

²⁰¹ HOBURG ET AL, *supra* note 60, at 26, *citing* *Dyvig v. Farmers Coop. Ass'n*, Civil No. 13730 (Ia. D.Ct., Humboldt Co. 1973).

²⁰² HOBURG ET AL, *supra* note 60, at 26, *citing* *Dyvig v. Farmers Cooperative Ass'n*, Civil No. 13730 (Ia. D.Ct., Humboldt Co. 1973).

cision. The court would have scrutinized the decision for fairness and resolved the issues in the same manner that it did.

In another case, *Lake Region Packing Ass'n v. Furze*,²⁰³ the Florida Supreme Court refused to intervene in the board's decision about distribution of deferred patronage refunds to former members. Cooperative documents allowed the distribution at the discretion of the board. The court decided the decision was protected by the business judgment of the board unless there was fraud, breach of trust, illegality, or abuse of discretion by directors.²⁰⁴

The court said a member could challenge the board's refusal to redeem in this situation if the member could prove that the director abused her or his discretion or committed a breach of trust by establishing unreasonably low charges to current members, or by permitting accumulation of an unreasonably high reserve account.²⁰⁵ Allen C. Hoberg and his co-authors write that this court seemed to leave open the possibility of challenging the refusal to redeem on an economic basis. These authors believe, however, that the business judgment rule *should* preclude such a basis for challenge.²⁰⁶ Therefore, the *Furze* decision could be perceived as holding implicitly that the court would scrutinize the decision for fairness *if* the member could show both the existence of a conflict of interest and preference by the board for the cooperative. The cooperative in this case, however, was not treating the former member any differently than current members. Therefore, the former members were not entitled to review of the substantive decision by the court.²⁰⁷

Courts reviewing redemption decisions should first identify the character of the cooperative's function. That is, whether it is acting in its capacity as a corporation or as a fiduciary. If the board of directors is making a decision as part of the cooperative's operation as a corporation, courts should apply the business judgment rule and review the decision-making process for fairness. If, however, the board's decision is part of the fiduciary function of the cooperative, the court should search for the existence of any conflict of interest.²⁰⁸

²⁰³ *Lake Region Packing Ass'n v. Furze*, 327 So. 2d 212 (Fla. 1976).

²⁰⁴ *Id.* at 215.

²⁰⁵ *Id.* at 217.

²⁰⁶ HOBBERG ET AL, *supra* note 60, at 27, *citing* *Lake Region Packing Ass'n*, 327 So. 2d at 217.

²⁰⁷ *See* *Lake Region Packing Ass'n*, 327 So. 2d at 215 (cooperative changed redemption method because of 1963 changes to the tax code).

²⁰⁸ *See generally* Hamilton, *supra* note 19, at 626 (the "worrisome tendency" of some cooperatives to fail to distinguish between opportunities for cooperatives and for

Where there is no conflict of interest, the business judgment rule standard adequately protects members' interests.²⁰⁹ However, the existence of a conflict of interest, such as that between former members and the cooperative, should cause the court to hold that there can be no absence of abuse of discretion because there is no independent judgment. The court should then reject the use of the business judgment rule defense and should examine the decision itself for fairness and reasonableness.

The cooperative and its members have a fiduciary relationship in connection with the marketing contract and its proceeds. The cooperative has a fiduciary obligation to its members in its decisions in connection with those funds. Therefore, the decision about redemption of deferred patronage refunds is an action by the cooperative as a fiduciary and not as a corporation. Since the cooperative and former members have conflicting interests the application of the business judgment rule standard is inappropriate in those cases.²¹⁰

Without the business judgment rule shield, the operation of a cooperative is vulnerable to intervention by the court, which may substitute its judgment for the business judgment of the board in deferred patronage redemption decisions.²¹¹ Though removal of director discretion would solve the problem by allowing use of the business judgment rule standard, removal of discretion could threaten the board's ability to protect the cooperative's economic viability.²¹² As the senior vice president and chief financial officer of Dairymen, Inc., wrote in 1992: "One of the most difficult messages to get across to members is that retirement of equity must be at the discretion of the board of directors . . . [W]ho knows what kind of financial condition you may face down the road?"²¹³

members, as exemplified in the controversial decision of a large cooperative to become an integrated hog producer in direct competition with its hog-producer members).

²⁰⁹ See Scott, *supra* note 74, at 541. Not all fiduciary responsibilities are the same and some are more intense. "The greater the independent authority to be exercised by the fiduciary, the greater the scope of his fiduciary duty." A fiduciary can procure consent before acting in a way which would breach the duty.

²¹⁰ HARL, *supra* note 26, § 131.05(3)(d).

²¹¹ See HARL, *supra* note 26, § 131.05(3)(d).

²¹² Sanchez v. Grain Growers Ass'n of California, 176 Cal. Rptr. 655, 659 (1981). See also Baarda, *supra* note 55, at 704-05, 732.

²¹³ Mueller, *supra* note 95, at 249.

D. *The Legislative Solution*

Cooperatives are worth protecting. Small and medium-sized farming operations are good for society both because of their contributions to production and because of the social value of the family farm. Cooperatives are helpful to those operations and therefore good for society. Such protection, however, should not come at the expense of individual producers.²¹⁴ A solution requires balancing the interests of the cooperatives and the individual producers.

Cooperative programs for redemption of deferred patronage refunds must be drafted carefully in order to achieve this balance.²¹⁵ According to one authority, few cooperatives try to harmonize redemption programs with the cooperative's need for capital or with members' use-patterns and demographics, or to do any long-term planning.²¹⁶ This lack of long-range planning accounts for the concentration of equity in the hands of older and retired members,²¹⁷ and is a reason these issues are likely to be increasingly litigated in the future.

According to experts, one of the best equity redemption plans is the "base capital" plan. Though seldom used because of its complexity, experts consider it to be the most equitable means of keeping investment in the hands of current users.²¹⁸ The base capital plan tries to balance patrons' equity with their *use* of the cooperative. The cooperative redeems no member's equity until that equity is balanced with the member's use. As patronage declines (for example as may result from the slow-down associated with approaching retirement), redemption increases.²¹⁹ Though cooperative programs such as the base capital plan best balance the competing interests of current and former members, simpler solutions that provide equitable treatment of former members exist.

Generally, deferred patronage refunds decisions are governed by by-

²¹⁴ See generally Joan R. Fulton & Wilctor L. Adamowicz, *Factors That Influence the Commitment of Members to Their Cooperative Organizations*, 8 J. AGRIC. COOPERATION 39 (1993) (survival of cooperative depends on commitment of members to patronage).

²¹⁵ Ginder, *supra* note 14, at 89. See also Mueller, *supra* note 95, at 247 (capital base plan explained as ensuring cooperatives are capitalized in proportion to use by current users).

²¹⁶ Ginder, *supra* note 14, at 89.

²¹⁷ Ginder, *supra* note 14, at 89.

²¹⁸ Rathbone, *supra* note 1, at 110.

²¹⁹ Ginder, *supra* note 14, at 90. See also Mueller *supra* note 95, at 247. There are plans which try to take into account the financial difficulties of beginning farmers, which this plan does not.

law provisions and not statutes.²²⁰ Statutes, however, sometimes influence the way in which cooperative bylaws are drafted. The volume of redemption litigation is evidence that a statute is needed to ensure cooperative redemption programs are fair and equitable to former members. Federal legislation, which would remove director discretion to discriminate against former members in redemption decisions, would help to end the problems raised in this article by eliminating any possible role for bias. An example of a cooperative program epitomizing the role that bias may play in redemption of former member equity is that of Dairymen, Inc. This regional milk marketing cooperative extends the redemption cycle of members who leave the cooperative but continue production. Those producers must wait at least twice as long as current members to receive their deferred patronage refunds. The vice president and chief financial officer wrote, in 1992, "If we didn't use this approach, we would have to ask our *loyal*, active members to increase their equity investment in order to pay back a former member who is now competing in the marketplace. Obviously this is not fair and cannot be supported from an economic standpoint."²²¹ This position, however, seems to defy one fundamental principle of cooperation — ownership, control, and financing by member-users.²²² The Dairymen, Inc., program allows the cooperative to operate at a lower cost to current members at the expense of former members. While one could argue that former members agreed to these provisions when they joined the cooperative, often the cooperative is the only game in town. Producers may have had little choice but to join in order to obtain a market for their produce. Nevertheless, this program illustrates the attitude which cooperatives sometimes have toward former members.²²³

This article advocates federal legislation that would encourage cooperatives to enact bylaws eliminating the role of bias against former members. These bylaws would remove boards' discretion to discriminate, thus eliminating the possibility that conflicting interests will drive redemption decisions. Removal of a role for bias would ensure independent judgment in decisions and, therefore, make the business judgment rule standard appropriate.

²²⁰ HOBERG ET AL, *supra* note 60, at 25.

²²¹ Mueller, *supra* note 95, at 251 (emphasis added).

²²² John R. Dunn, *Basic Cooperative Principals and their Relationship to Selected Practices*, 3 J. AGRIC. COOPERATION 83, 85 (1988).

²²³ See Mueller, *supra* note 95, at 249, to compare the Dairymen, Inc., program with the base capital plan.

Some state cooperative statutes limit discretion in connection with redemption of former members' deferred patronage refunds. For example, some state statutes require redemption of former members' interests within a specific time, generally one or two years after termination of membership.²²⁴ The problem with this limitation of discretion, however, is that the cooperative might be forced to redeem equity at a time when redemption would threaten the cooperative's financial health.²²⁵

*Sanchez v. Grain Growers Association of California*²²⁶ is an example of both the problem with mandatory redemption statutes and the solution. A California cooperative statute required cooperatives to redeem expelled members' deferred patronage refunds within one year, unless the bylaws provided for a different method.²²⁷ The former members sued to have their deferred patronage refunds redeemed according to the statute. Former members prevailed at the trial on the theory that the cooperative had not adopted a different method. The cooperative appealed, asserting the trial court's incorrect interpretation of the statute "resulted in an improper order of immediate payment . . . threatening the association's fiscal stability."²²⁸ The appellate court reversed, deciding that the cooperative did have a plan. The cooperative's plan, though purporting to allow unlimited discretion to the directors, gave former members the right to receive deferred patronage refunds "in the same manner as continuing members."²²⁹ The court said "[t]he actions of the board are subject to good faith and reasonable business judgment."²³⁰ In this case the court applied the business judgment rule standard as this article advocates. Where the board, bound to obey the cooperative bylaws, had no discretion to discriminate against former members in favor of the cooperative and current members, the business judgment rule offered sufficient protection of the former members' interests. Federal legislation requiring cooperatives to draft by-

²²⁴ HARL, *supra* note 26, § 131.04(2)(e)(ii) (citing Baarda, *supra* note 55, at 704-05); U.S. DEP'T. OF AGRIC., AGRIC. COOPERATIVE SERVICE, ACS RESEARCH REPORT NO. 30, STATE INCORPORATION STATUTES FOR FARMERS COOPERATIVES n.10 at 410-11 (Oct. 1982); ILL. REV. STAT. ch. 32, para. 449(I) (now cited (after 1/1/93) as 805 ILCS 315/10 (1996)).

²²⁵ Baarda, *supra* note 55, at 704-05.

²²⁶ See generally *Sanchez v. Grain Growers Ass'n of California*, 176 Cal. Rptr. 655, 659 (1981).

²²⁷ CAL. FOOD & AGRIC. CODE § 54122 (West 1986 & Supp. 1997).

²²⁸ *Sanchez v. Grain Growers Ass'n of California*, 176 Cal. Rptr. 655 (1981).

²²⁹ *Id.* at 658 (emphasis added).

²³⁰ *Id.* at 659.

laws so that they treated the deferred patronage refunds of former members no differently than those of the current members would solve the problem presented by discretion in a fiduciary function where a conflict of interest exists.²³¹ Federal legislation mandating non-discriminatory redemption would also accomplish the goals of fair treatment of former members and improve relationships between cooperatives, their current members, and former members.

IV. AMENDMENT OF THE CAPPER-VOLSTEAD ACT

Federal statutes regulate agricultural cooperatives in many areas.²³² Federal legislation, authorized through the commerce clause,²³³ could eliminate discretion to discriminate against former members in redemption of their deferred patronage refunds. The Capper-Volstead Act²³⁴ is often referred to as the Magna Carta for cooperatives because it is from the Capper-Volstead Act that cooperatives receive their special dispensation from most anti-trust regulation, without which cooperatives could not operate. In order to be treated as a cooperative under the Act, however, a cooperative must meet several requirements that are consistent with the four fundamental principals of cooperatives

²³¹ See generally *Sanchez v. Grain Growers Ass'n of California*, 176 Cal.Rptr. 655 (1981) (example of bylaws that did not allow exercise of discretion in connection with redemption of former members equity).

²³² HARL, *supra* note 26, § 135.01 (federal income taxation); § 136.01 (federal securities regulations); § 137.01 (federal antitrust laws).

²³³ U.S. CONST. art. I, § 8, cl. 3.

²³⁴ Capper-Volstead Act ch. 57, § 1, 42 Stat. 388 (1922) (current version at 7 U.S.C. § 291 (1980). Authorization and powers of associations:

Persons engaged in the production of agricultural products as farmers, planters, ranchmen, dairymen, nut or fruit growers may act together in associations, corporate or otherwise, with or without capital stock, in 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 conform to one or both of the following requirements: *First*. 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, *Second*. That the association does not pay dividends on stock or membership capital in excess of 8 percent per annum. *And in any case to the following*: *Third*. That the association shall not deal in the products of nonmembers to an amount greater in value than such as are handled by it for members." (emphasis added)

mentioned at the beginning of this Article.²³⁵ For example, one of the essential cooperative principles is control by members. The Capper-Volstead Act requires that cooperative bylaws, in most cases, allow only one vote per member.²³⁶ In addition, cooperatives may not do more business with non-members than with members.²³⁷

The Capper-Volstead Act could be amended with language requiring cooperatives to adhere to one of the other cooperative principles, that is, the principle that cooperatives are funded by users. The Capper-Volstead Act reads as follows:

Persons engaged in the production of agricultural products as farmers, planters, ranchmen, dairymen, nut or fruit growers may act together in associations, corporate or otherwise, with or without capital stock, in 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 conform to one or both of the following requirements: First. 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, Second. That the association does not pay dividends on stock or membership capital in excess of 8 percent per annum. And in any case to the following: Third. That the association shall not deal in the products of nonmembers to an amount greater in value than such as are handled by it for members.

An amendment could add a fourth clause:

Fourth. That the association shall be funded primarily by member-users and shall not discriminate against former members in redemption of equity.

Cooperatives could meet the requirements of an amended Capper-Volstead Act by establishing revolving programs which revolve in exactly the same way the equity of current members and former members. *Sanchez*, discussed previously, is an example of such a program.²³⁸

The amended Capper-Volstead Act would achieve two goals. First, because the business judgment rule standard would be appropriate in all cases of deferred patronage refund decisions, cooperatives would face less liability. Cooperatives and their boards of directors would be

²³⁵ RASMUSSEN, *supra* note 17, at 3.

²³⁶ Capper-Volstead Act, ch. 57, § 1, 42 Stat. 388 (1922) (current version at 7 U.S.C. § 291 (1980)).

²³⁷ *Id.*

²³⁸ *Sanchez v. Grain Growers Ass'n of California*, 176 Cal. Rptr. 655, 659 (1981).

able to operate with more certainty. Relationships would improve and litigation by former members would decrease. Second, the former-members of cooperatives would be treated more fairly - they wouldn't have to die for their equity.²³⁹

CONCLUSION

The opening paragraphs of this article described the redemption problem faced by a member of the cooperative, House of Raeford Farms, Inc. This problem originated in the conflict of interest between the cooperative and the member. The cooperative bylaws clothed the decision-makers with complete discretion and the business judgment rule protected the decision. HAJMM won, probably because of the egregious circumstances of the case and the outrageous conduct of the president. The correct analysis of this case should have begun with the identification of the decision as one being made in a fiduciary capac-

²³⁹ Although beyond the scope of the problems highlighted by this article, mandatory redemption of deferred patronage refunds would benefit former patrons and overinvested current patrons. More equitable treatment of members might also benefit the cooperative by increasing its patronage. However, mandatory redemption would make it more difficult for cooperatives to adjust to changes in operation. U.S. DEP'T OF AGRIC., AGRIC. COOPERATIVE SERVICE, ACS RESEARCH REPORT No. 23, EQUITY REDEMPTION: ISSUES AND ALTERNATIVES FOR FARMER COOPERATIVES 158 (1982).

In 1991, the average revolving cycle was 16 years, with some cooperatives redeeming only upon death. In California the same year, the average revolving cycle was 6 years. Robert C. Rathbone, *Aging Members and Equity Redemption Issues*, AMERICAN COOPERATION, 1995 at 95, 99. Sixteen years, beginning at death or retirement, can be too long a period of time for former members.

One way in which cooperatives could comply with mandatory redemption would be to adopt a redemption program along the lines of that suggested by Rathbone: when considered in context of the user-benefit principle of cooperatives, lack of timely redemption violates the cooperative principles. *Id.* at 96. Member equity would not be revolved until the occurrence of one of the following events: 1) the member reaches the age of 60 (or 65); 2) the member retires; 3) the member dies; 4) the member ceases to patronize the cooperative. Upon the occurrence of the first of these events, the cooperative would revolve equity on a ten-year cycle. A program such as this would provide a pension-type plan for farmers or their families. This program would also ensure that the cooperative is funded primarily by active users and not by former members.

Special programs for revolving equity for deceased or retired members should have standards that provide guidelines that limit director discretion in order to avoid unfair dissimilar treatment. Programs which allow redemption only on death violate the cooperative principle that cooperatives are funded-by-users. Cooperatives may borrow money commercially from special cooperative banks. If necessary, money should be borrowed in order to ensure that the cooperative is funded by its member users instead of by those no longer active.

ity. Second, once the function was identified as fiduciary in nature, the court should have determined the nature and strength of any conflict of interest. At that point the court should have closely scrutinized the decision itself for fairness. The court should not have allowed the business judgment rule to shield the directors' actions. The reader comes away from the court's decision with the impression that, had Johnson been a more sympathetic witness, the cooperative might have prevailed, or at least not been assessed punitive damages.²⁴⁰

The dual functioning of incorporated agricultural cooperatives provides a good reason why cooperatives' activities should be separated into the activities of a corporation and activities of a fiduciary. An agricultural cooperative, in connection with activity that is indistinguishable from that of a corporation, should be treated the same as a corporation. However, in connection with discretionary decisions about deferred patronage redemption, the cooperative's conduct should be categorized as that of a fiduciary and a different standard should apply.

Since cooperatives have a conflict of interest with former members, the business judgment rule should not protect the refusal by cooperatives to redeem deferred patronage refunds of former members. Unfair refusal should subject the cooperative to tort liability. Federal legislation addressing these issues is necessary to provide certainty for cooperatives and their members. An amendment of the Capper-Volstead Act is one way to accomplish this end.

²⁴⁰ House of Raeford Farms is no longer a cooperative but is the 16th largest privately held company in North Carolina, with a fifth processing plant under construction. Kathryn Quigley, *He Gobbles a Big Share of Bird Sales*, FAYETTEVILLE OBSERVER-TIMES, May 7, 1995, at A1. As the local newspaper recently reported, Johnson lives life on his own terms now. "He doesn't have to answer to anyone, not even the board of directors, which is composed of Johnson, his son and his two sons-in-law." *Id.* In 1995, however, when Raeford's employees voted to go union, Johnson said, "My feelings were a little hurt by it." *Id.*