Farmworker Production Cooperatives: The Property Interests of Members

In recent years, some of California's former farmworkers and sharecroppers have increased their incomes and gained access to land and tools through forming incorporated agricultural production cooperatives. This article examines the ways these cooperatives can structure their property relationships to best serve long term corporate goals and immediate individual needs.

Membership in a farmworker production cooperative[1] has made positive changes in the lives of Manuel and his family.[2] Prior to joining the cooperative they worked in the growers' fields for fixed wages. They did not have a great deal to say about when, how or even if they worked. They simply took what was available and did what the field supervisor told them to do. Now they have year-round employment; access to land and tools; training in farming and business methods; increased political clout;[3] greater control over their working conditions; and increased family income.[4]

---

1. The Watsonville-Salinas region was the first major area for farmworker production cooperatives. A small group of farmworkers and the Central Coast Counties Development Corporation, a community development agency, incorporated the first of the cooperatives, the Cooperativa Campesina, in the Watsonville area in 1970. The Cooperativa Central, the largest and most successful of the cooperatives, began operations in the Salinas area in 1971. Today there are cooperatives in agricultural areas throughout the state. Cooperatives are starting near Santa Maria, Santa Rosa and Davis. Interview with E. Phillip Leveen, Professor of Agricultural Economics at the University of California, Berkeley, in Berkeley, California (June 30, 1977).

2. Manuel is not an actual person. He is a composite constructed from the membership of the successful cooperatives.

3. Former farmworkers and sharecroppers who are now members of cooperatives are "growers" for many purposes. For instance, the members of the Cooperativa Central can now vote as growers in the affairs of the Strawberry Advisory Board. Interview in Salinas, California with Steven C. Huffstutlar while he served as business manager of the Cooperativa Central (September 3, 1977).

4. In 1976 the Cooperativa Central paid an average of about $25,000 to member-families. The member-families paid the portion of harvest and cultivation costs not covered by the cooperative out of this money. This figure included the return of about $3,000 earned in 1974, which had been retained by the cooperative, plus 8 percent interest on the retained funds. Cooperativa Central, Progress Report (February 1, 1977) (unpublished memorandum).

Manuel's farmworker production cooperative is a type of agricultural cooperative. The Farmer Cooperative Service of the United States Department of Agriculture defines a cooperative as follows:

> A cooperative is a voluntary contractual organization of persons having a mutual ownership interest in providing themselves a needed service on a nonprofit basis. It is usually organized as a legal entity to accomplish an economic objective through the joint participation of its members.[5] In a cooperative the investment and operational risks, benefits gained, or losses incurred are shared equitably by its members in proportion to their use of the cooperative's services. A cooperative is democratically controlled by its members on the basis of their status as member-users and not as investors in the capital structure of the cooperative.[6]

The members of Manuel's production cooperative are all former farmworkers or sharecroppers. Their cooperative furnishes them with the land and the tools to produce crops. The members and their families farm parcels leased or owned by the cooperative.[7] They use cooperative owned equipment to plant, cultivate and harvest the crop. Once the crop is harvested, they deliver it to the cooperative for marketing.

The property rights and interests which Manuel and others have acquired through cooperative membership are important to them and their families. As in other California cooperatives, the members and the cooperative decide what those rights and interests are through the articles, bylaws and other member-cooperative contracts.[8] This article will explore the structures for deciding those interests and what those interests can and, in some instances, should be.

The article is divided into three sections. The first section outlines some fundamental problems and conflicts which shape the property decisions. The second section discusses the decision-making structures both during the organizational process and later as the cooperative and its members adjust their property interests to meet new requirements as the cooperative evolves. The final section deals with the substantive as-

5. Small cooperatives sometimes operate as partnerships. Most California cooperatives prefer the limited liability and continuity of life provided by incorporation as an agricultural nonprofit cooperative association. CAL. FOOD & AGRIC. CODE §§ 54000-54294 (West 1968). (The Legislature renamed the California Agriculture Code the California Food and Agriculture Code, 1972 Cal. Stats. 225). *See generally* R. SHULMAN & G. GOLDMAN, THE LEGAL SIDE OF MULTI-OWNER FARM BUSINESSES: DOING BUSINESS AS A PRODUCTION COOPERATIVE CORPORATION 3-8 (1977).

6. J. SAVAGE & D. VOLKIN, COOPERATIVE CRITERIA, Farmer Cooperative Service Report 71, Farmer Cooperative Service, U.S. Department of Agriculture (1965).

7. The members use the parcels under license, lease or sublease agreements with the cooperative. Interview in Sacramento, California with David Kirkpatrick, original attorney for the Cooperativa Campesina (May 18, 1977).

8. *See, e.g.*, Driscoll v. East-West Dairymen's Ass'n, 52 Cal. App. 2d 468, 470-73, 126 P.2d 467, 468-69 (3d Dist. 1942); Bogardus v. Santa Ana Walnut Growers Ass'n, 41 Cal. App. 2d 939, 946-51, 108 P.2d 52, 56-58 (4th Dist. 1940).

pects of the members' property interests. It uses criteria related to the cooperative's development to evaluate the ways members contribute property and remove property from the cooperative.

I. Fundamental Problems and Conflicts Which Shape Property Decisions

Many of the problems which farmworker production cooperatives face are common to all types of cooperatives. All cooperatives strive to be equitable. Equitability, however, has two distinct and conflicting meanings in the cooperative setting. The cooperative's democratic and egalitarian traditions seem to define equitability as equal access to land and tools. However, cooperatives also seek to be viable economic enterprises in which members reap returns proportionate to their contributions. Equitable, therefore, may also mean that a member's contribution of capital, labor or produce determines access to the cooperative's benefits.

All cooperatives must also reconcile conflicts pertaining to the nature and time frame of their objectives. Cooperatives have traditionally sought goals of a non-economic nature alongside, and occasionally in lieu of, economic goals. Sometimes the cooperative must sacrifice gross returns for such non-economic goals as increased status, working together with one's family, and increased control over working conditions. The members and the cooperative also usually differ on their economic time perspectives. The cooperative wants to retain and reinvest present earnings in order to ensure the cooperative's long term growth and survival. The members, on the other hand, are more concerned with the short range well-being of their families than with profits for future members.

Finally, all cooperatives must address the conflict between the cooperative's need to retain and build its capital and the former members' demands to withdraw their investments. The cooperative cannot keep a member's property indefinitely, yet a block of members should not have the power to ruin the cooperative by withdrawing property at will.

Farmworker production cooperatives also have problems that are not common to all cooperatives. The cooperative's desire for autonomy has conflicted with its need for start-up capital. Because most members did not have large amounts of money to invest originally, farmworker production cooperatives have had to rely heavily on outside lenders for initial capital.[9] The cooperatives have been forced to give up some of their

9. Both the Cooperativa Central and the Cooperativa Campesina began on leased land with large bank loans. Cooperativa Central, Progress Report (February 1, 1977) (unpublished memorandum); Cooperativa Campesina, Association Synopsis (1977) (unpublished memorandum).

autonomy because lenders wanted to secure their investment through some control over the cooperatives' operations. For instance, the Bank of America conditioned its initial loan to the Cooperativa Central on the cooperative retaining the previous farm's general manager for the life of the loan.[10]

Another problem in farmworker production cooperatives is devising property schemes which members with little formal education can use and understand. The experience of the Cooperativa Central illustrates this conflict.[11] The Central hired an accountant who specialized in cooperative financing to devise a formula to determine the value of each member's patronage to the cooperative. The accountant devised an equitable, economically-sound formula which combined factors of gross output, crop characteristic,[12] and yield per acre.[13] The record keeping, however, was difficult and the members did not have the educational backgrounds needed to understand the merits of the formula. After two years they voted to implement a simple gross output formula. This system was less equitable because it failed to account for differences in crop characteristics and plot size, yet the members preferred it because of its simplicity.

Thus problems and conflicts involving equitability, economic time perspective, non-economic goals, rights of departing members, initial member wealth and member educational backgrounds influence property decision-making. It is important that the cooperative develop decision-making procedures and structures during the cooperative's organizational period that can effectively meet these challenges throughout the life of the cooperative.

II. Structures for Making Effective Property Decisions

Prospective members acting as an independent committee or in conjunction with a community development agency usually make the initial property decisions as they organize the cooperative. They draft an organization agreement to show prospective lenders the organizational

---

10. Interview with Steven C. Huffstutlar, while he served as business manager of the Cooperativa Central, in Salinas, California (September 3, 1977).

The Central Coast Counties Development Corporation arranged for the Cooperativa Campesina's initial financing. As a condition for the financing, it controlled a Governing Board which monitored the cooperative's finances. Letter from David H. Kirkpatrick, former attorney for the Cooperativa Campesina, to author (January 4, 1978).

11. Interview in Salinas, California with Steven C. Huffstutlar while he was serving as business manager of the Cooperativa Central (September 3, 1977).

12. The principal crop of the Cooperativa Central has been strawberries. The berries produce on three-year cycles. First, second and third-year plants have different characteristics and productivity.

13. The success of a production cooperative is measured by the per capita income of participating members. Per capita income correlates most closely with efficiency, *i.e.* "net earnings" per acre, and not gross profits.

structure and members' commitment.[14] Once the organizing committee obtains a desired level of financial and membership support, it files articles of incorporation with the Secretary of State.[15] Although the articles usually are a generally worded document, the California Food and Agriculture Code requires that the articles specifically set forth the general measure of the members' property interests.[16] The organizing committee selects the initial directors.[17] These directors must call a membership meeting to adopt the cooperative's most important document, the bylaws, within thirty days of incorporation.[18] Besides approving the bylaws, the members usually sign their marketing contracts[19] and elect new directors[20] at their first meeting.

The cooperative is not bound forever by the property decisions embodied in these initial documents. It can alter them as the cooperative's situation changes. The board of directors, on its own initiative or at the request of the members, can offer new marketing agreements to supersede former ones. Through a simple majority of their voting power, members can amend or repeal the bylaws or delegate this authority to the board of directors.[21]

The most important factor in decision-making is the identity of the decision-makers. The decision-makers parallel those of a corporation: the managers, board of directors and members. Managers supervise the daily business operations of the cooperative.[22] Although managers do

14. The organization agreement typically includes a promise to join the cooperative; a provision for payment of membership fees in advance; a promise to invest in the cooperative's capital; an outline of the organizing process; projections about the anticipated operations; and a provision imposing penalties for breaking the agreement. *See generally* R. SHULMAN & G. GOLDMAN, THE LEGAL SIDE OF MULTI-OWNER FARM BUSINESSES: DOING BUSINESS AS A PRODUCTION COOPERATIVE 9-11 (1977).

15. CAL. FOOD & AGRIC. CODE § 54082 (West 1968).

16. CAL. FOOD & AGRIC. CODE § 54081(f) (West 1968).

17. The names of the initial directors must appear in the articles. CAL. FOOD & AGRIC. CODE §54081(d) (West 1968).

18. CAL. FOOD & AGRIC. CODE § 54111 (West 1968).

19. The Code authorizes marketing agreements: "The association and its members may make and execute marketing contracts which require the members to sell for any period of time, but not over 15 years, all or any specified part of any product or specified commodity exclusively to or through the association. . . ." CAL. FOOD & AGRIC. CODE § 54261 (West 1968).

A typical marketing agreement contains the obligations of the member-farmer, the obligations of the association, the powers of the association, and the remedies for breach of agreement. Cooperativa Central, Membership Contract and Marketing Agreement (as of September 3, 1977).

20. "The affairs of the association shall be managed by a board of not less than three directors who are elected by the members or stockholders." CAL. FOOD & AGRIC. CODE § 54141 (West 1968).

21. CAL. FOOD & AGRIC. CODE § 54111 (West 1968).

22. A manager of a farmworker production cooperative fills a difficult role. Cooperatives prefer to appoint or hire their own members as managers but often must hire outside the cooperative to get persons with sufficient training and expertise. Managers

not have direct, formal control over major property decisions, they are important because their access to information and their expertise give them considerable influence over the board of directors. The board of directors dominates decision-making over property interests in most traditional cooperatives.[23] In farmworker production cooperatives, on the other hand, the members have a relatively greater role.[24]

The members make property choices directly through bylaw provisions giving them the power to initiate or ratify decisions, and indirectly through their power to recall the other decision-makers. Membership initiation and ratification can be slow and guided by short-sighted goals, therefore the scope and nature of this power should be specifically defined and limited in the bylaws.[25] The bylaws should include what issues may be acted on, the person or persons who may call special meetings, any supermajority voting requirements, and whether the members' powers are exclusive or concurrent with the board's. Members can also influence decision-making through their power of removal.

must delicately balance economic efficiency against the cooperative's non-economic goals, such as member control and participation. The manager's relationship to the members is also complicated by the fact that the manager must be simultaneously the boss and employee of the members. Interview in Salinas, California with Steven C. Huffstutlar, who was then business manager of the Cooperativa Central (September 3, 1977).

The Cooperativa Central has sought to minimize these conflicts through a multiple manager system. The general manager is not a single individual, but an executive committee composed of three directors who meet daily. Immediately below the general manager are a production manager and a business manager. The production manager is a member of the cooperative with considerable farming experience. The original business manager was a non-member hired for his greater experience in business. He has trained a member to take his place. Through this division of management responsibilities, the cooperative has provided for maximum member control without taking risks on inexperienced management. R. Magary, Cooperativa Central: Opportunity through Ownership: Proposed Loan (March 8, 1977) (unpublished memorandum).

23. Directors may be elected for multi-year and staggered terms. CAL. FOOD & AGRIC. CODE § 54081(d) (West 1968). The basic principle in electing directors is one vote per member, although weighted voting is possible. CAL. FOOD & AGRIC. CODE § 54081(e),(f) (West 1968). The bylaws may authorize the election of directors representing the public interest. CAL. FOOD & AGRIC. CODE § 54145 (West 1968). However, only members are usually eligible to become directors.

24. Besides the cooperatives' strong democratic and egalitarian impetus, there are other factors which underlie the trend towards member rather than board decision-making. These are the small size of the cooperatives; the frequent daily contacts among members; the physical interdependency inherent in a production-oriented enterprise; the memories of village politics; and the lack of mutual trust that results from joining on the basis of economic necessity rather than affinity between members. Letter from Steven C. Huffstutlar, former business manager of the Cooperativa Central, to author (December 23, 1977).

25. Some issues concerning or affecting property which might be considered for member initiation and ratification are: 1) expansion of facilities; 2) changes in capital structure; 3) major marketing decisions; 4) major cooperative expenses, i.e. items above $500 or $1,000; 5) increase or decrease in membership; 6) major hiring decisions; 7) dissolution; 8) reorganizations; 9) adoption of a marketing contract; 10) investment decisions; 11) basic changes in the kinds of service performed; 12) major capital expenditures; and 13) long-range goals and objectives.

They can exert powerful informal pressure to force resignations. If informal pressure does not succeed, the members have the right to remove their directors and officers for cause.[26] The bylaws can also provide for the members' removal of the cooperative's manager.

It is important for the cooperative to balance decision-making responsibilities between the members and the board of directors. If it is successful, it will have proceeded significantly towards developing structures which can adapt the substantive aspects of the members' property interests to the cooperative's needs. These substantive aspects include the ways members put money and property into the cooperative and the rights the members have to withdraw their money and property.

III. MEMBERS' PROPERTY INTERESTS

A. *Types of member contributions to the cooperative's property*

Direct financial contributions from members have played only a minor role in the past. The cooperatives have not imposed large membership fees or weighty stock ownership requirements.[27] They have felt that wealth related entrance barriers might exclude some of the people who could benefit most from the cooperative's economic opportunities. This trend, however, might be changing. Farmworkers have greater income now due to unionization and they are willing to pay more for cooperative memberships as the cooperatives become more economically attractive.[28] These factors make the entrance barriers less formidable, especially if financing is available.

This increased willingness and ability of members to make direct contributions may make contributions a more important means of building the cooperative's capital or reimbursing its operating losses in the future.[29] These contributions may take the forms of member loans to the cooperative, voluntary contributions to its capital or mandatory assess-

26. The California Food and Agricultural Code mandates procedures for the removal of directors and officers. CAL. FOOD & AGRIC. CODE § 54150 (West 1968).

27. California law permits nonprofit cooperative associations to issue stock. CAL. FOOD & AGRIC. CODE § 54081(f) (West 1968). However, farmworker production cooperatives generally do not issue stock. Issuing common stock to members has the drawbacks of imposing wealth related entrance barriers, of creating unequal voting rights, and of creating property interests unrelated to the members' contribution to the cooperative's production. Preferred stock is not offered because outside investors hesitate to purchase stock which offers high risks but no voting control.

28. Letter form Steven C. Huffstular, former business manager of the Cooperativa Central, to author (December 23, 1977).

29. Letter from Robert Shulman, co-author of THE LEGAL SIDE OF MULTI-OWNER FARM BUSINESSES: DOING BUSINESS AS A PRODUCTION COOPERATIVE CORPORATION, to author (December 23, 1977); and letter from Steven C. Huffstutlar, former business manager of the Cooperativa Central, to author (December 23, 1977).

ments. Of the three, the cooperative should be most cautious about exercising any contractual authority to levy assessments on its members.[30] Since assessments are compulsory and potentially burdensome, the cooperative should require contributions from its members only when absolutely necessary and when chances of repayment are reasonably good.

The principal way members contribute to the capital of farmworker production cooperatives is through capital retains. The Cooperativa Central's use of capital retain financing illustrates the concept.[31] The members, pursuant to their marketing agreement, deliver their crops to the cooperative. The cooperative takes title to the produce on delivery.[32] The cooperative sorts the produce into pools according to type and quality[33] and then markets it through brokers.[34] Members receive weekly vouchers of the sale of their produce. The vouchers show the division of the gross sales between fixed deductions,[35] the cooperative's percentage share, and the member's percentage share.[36] The cooperative uses its share to pay its expenses and obligations. Whatever the coopera-

30. "An association may levy assessments in the manner and in the amount as may be provided in its bylaws." CAL. FOOD & AGRIC. CODE § 54177 (West 1968).

Assessments cannot be levied without contractual authority or in a manner which "will result in unjust discrimination." Alfalfa Growers of California, Inc. v. Icardo, 82 Cal. App. 641, 643, 647, 256 P. 287, 288, 290 (2d Dist. 1927).

31. The discussion of Cooperativa Central operations is from several sources. Interview in Salinas, California with Steven C. Huffstutlar, who was then business manager of the Cooperativa Central (September 3, 1977); R. Magary, Cooperativa Central: Opportunity Through Ownership: Proposed Loan (March 8, 1977) (unpublished memorandum); Cooperativa Central, Membership Contract and Marketing Agreememt (as of September 3, 1977); Cooperativa Central, Financial Planning Model 1977-1978-1979 (January 1977) (unpublished Memorandum).

32. "The marketing contract may provide that the association may sell or resell any product which is delivered by its members, with or without taking titles to such product . . ." CAL. FOOD & AGRIC. CODE § 54262 (West 1968). If title to the produce does not pass to the cooperative, the marketing contract should provide that the cooperative acts as the member's agent for marketing purposes.

33. The marketing agreement gives the cooperative the right to pool the member's products. Cooperativa Central, Membership Contract and Marketing Agreement (as of September 3, 1977).

34. Incorporated cooperatives can become members of other cooperatives. CAL. FOOD & AGRIC. CODE § 54233 (West 1968). Production cooperatives can increase their market power by becoming members of marketing cooperatives.

35. The fixed deductions are primarily for marketing commissions, and for the harvest crates, which the cooperative supplies to the members at cost. These deductions are less than one-quarter of the sales price. Cooperativa Central, Financial Planning Model 1977-1978-1979 (January 1977) (unpublished memorandum).

36. The Board and the membership have the concurrent right to change the proportions going to the cooperative and members according to the cooperative's needs and market conditions. As of September 3, 1977, the Central first deducted marketing and packaging costs and then kept 45% and gave the members 55%. Cooperativa Central Membership Contract and Marketing Agreement (as of September 3, 1977); letter from Steven C. Huffstutlar, former business manager of the Cooperativa Central, to author (February 28, 1978).

tive has left at the end of the year is its "net proceeds" or "net margin." These net proceeds are roughly analogous to corporate profits.

At the end of the year, the cooperative calculates the amount each member contributed to this net margin through his or her business, that is "patronage," with the cooperative. The cooperative obligates this portion of the net margin to each member as a "patronage refund." There are many ways to calculate patronage refunds.[37] A patronage formula which includes both gross output and yield per acre factors is most equitable. The Central, however, allocates solely on the gross value of produce each member delivers because that formula is easier for the cooperative to use and for the members to understand.[38]

The cooperative can temporarily retain and use a portion of the patronage refund rather than distribute all of it in the year allocated. The income tax structure for cooperatives makes these retentions possible.[39] If the members consent in writing to include their entire patronage refund in their taxable income in the year allocated, the cooperative can temporarily keep up to eighty percent without having to pay income taxes on any of the patronage refund monies.[40] The portion of the patronage refund which the cooperative retains is the cooperative's capital retains.[41] Capital retains, therefore, are those portions of the profits

37. The primary factor shaping the patronage formula in an agricultural production cooperative is whether the land is farmed in common or each member farms a separate parcel. If the land is farmed in common, the easiest measure is hours worked. The easiest measure in the parcel system is the amount produced. For an excellent discussion of this and related issues, *see* R. SHULMAN & G. GOLDMAN, THE LEGAL SIDE OF MULTI-OWNER FARM BUSINESSES: DOING BUSINESS AS A PRODUCTION COOPERATIVE CORPORATION 21-23 (1977).

38. The combination of a percentage split on weekly vouchers and an allocation of net proceeds according to amount produced can lead to an anamalous situation. Suppose Growers A and B each grow berries on identical one acre parcels. Neither is plagued by ill health or bad luck. Grower A produces 5,000 crates of berries. After fixed deductions the gross is $4.00 per crate, or $20,000. Using a 45:55 split, the cooperative gets $9,000 and A gets $11,000. The cooperative's expenses are fairly uniform at $6,000 per acre. The net proceeds attributable to Grower A's actual production are $3,000. Grower B, on the other hand, produces only 2,500 crates of berries for a gross of $10,000. The cooperative gets $4,500 and B gets $5,500. After subtracting the cooperative's expenses, $6,000, the net proceeds attributable to Grower B's actual production are a minus $1,500. However, since the patronage refunds are based on the gross value of what each member delivers, and not how much the cooperative netted from that production, both Growers A and B will be receiving patronage refunds—A's being twice as large as B's. In effect, Grower A is subsidizing Grower B. Letters from Steven C. Huffstutlar, former business manager of the Cooperativa Central, to author (December 23, 1977 and February 28, 1978).

39. I.R.C. §§ 1382, 1385, 1388; CAL. REV. & TAX CODE § 24404 (West 1970).

40. I.R.C. § 521 offers cooperatives an even broader exemption. Under § 521, a cooperative does not have to pay income taxes on non-patronage income, such as capital gains income. This section, however, has onerous reporting and qualification requirements. The Cooperativa Central concluded that the burdens outweighed the benefits and relinquished its exempt status under § 521. Interview with Steven C. Huffstutlar, then business manager of the Cooperativa Central, in Salinas, California (September 3, 1977).

41. The cooperative can also accumulate capital retains through per unit capital re-

traceable to individual members which the cooperative retains beyond the year allocated rather than distributing to the members.

B. Members' property rights and interests

Members who put money and property into the cooperative through membership fees, stock purchases, contributions to capital, loans, assessments or capital retains expect something in return. The property rights and interests they can create fall into four categories: fixed obligations, capital retains without definite repayment dates, unallocated assets and membership interests. Of the four, fixed obligations are usually the least important.

1. Fixed obligations

Fixed obligations obligate the cooperative to pay members a specified amount on a specific date. Loans from members to the cooperative and capital retain certificates[42] with definite repayment dates are examples of fixed obligations. Cooperatives hesitate to use these inflexible internal commitments as they set the stage for conflicts with the superior claims of external creditors.[43]

2. Capital retains without definite repayment dates

Capital retains without definite repayment dates are usually the members, most important form of property interest. The articles or bylaws give the board of directors the power to determine the time of redemption. These retains combine characteristics of both equity and "soft" debt. Like equity, the obligation has no payment date and is inferior to the rights of outside creditors.[44] Like debt, the obligation is for a specified sum.

The members and the cooperative's management often differ on the timing of the cash payment of retain obligations to members. Members favor short repayment cycles and easy accessibility to the retained money. Managers want long repayment cycles so the cooperative can accumulate maximum capital resources to ensure its survival and busi-

---

tains. I.R.C. §§ 1382, 1385, 1388. The cooperative keeps proceeds based on either the dollar value or amount of the produce the member delivers to the cooperative, for example 25¢ per crate of strawberries. Since per unit retains are not based on net margins, the cooperative does not need to wait until the end of the accounting period to allocate them.

42. When the cooperative retains the refund money, it must give the members "qualified written notices of allocation" or "qualified per-unit retain certificates" as evidence of the cooperative's obligation to them. I.R.C. § 1388(c). Both of these are referred to as "retain certificates" in the text.

43. Letter form David Kirkpatrick, original attorney for the Cooperativa Campesina, to author (December 23, 1977).

44. These characteristics, along with specific tax reporting instructions to the members, should be stated clearly in the articles or bylaws and on the certificate.

ness success. The board of directors, with proper bylaw authority, can hold retains until dissolution.[45] However, the board usually exercises its dual fiduciary duties to the cooperative and the members by using systematic and special redemption programs to distribute retains prior to dissolution in a manner which does not seriously undermine the cooperative's strength.

a. Systematic redemption programs

Most agricultural cooperatives provide in their bylaws for a systematic program to distribute capital retains to members.[46] Cooperatives often have a program in which the board "revolves out" the oldest retains once the capital of the cooperative reaches an adequate level.[47] The reserve[48] of all retains in this program is known as a "revolving fund." The Cooperativa Central's program illustrates a revolving fund method.[49] Before beginning its operations, the Central estimated that it would need an operating reserve of at least $250,000. It began full operations in 1973. It built a fund of about $120,000 that year. The next year the fund reached about $230,000. The Board realized that the fund would surpass the cooperative's reasonable capital needs in the following year. Therefore, in 1975 the cooperative kept the current retains and distributed, "revolved out," the $120,000 retained in 1973, plus interest. The revolving fund reached $260,000 that year. In 1976, the cooperative kept the current retains and revolved out the money retained in 1974. The fund reached about $300,000. Thus the Central has developed a pattern of revolving out funds on a two year cycle. That is an exceptionally short cycle. A 1976 survey showed that the average revolving cycle for all types of agricultural cooperatives was over ten years.[50] The Central, however, is not bound by its present cycle. It can adjust its cycle according to its business needs. For instance, the Central recently negotiated the purchase of some Monterey County farmland. The members passed a resolution to forego redemption of their retain certificates until

45. *See* Driscoll v. East-West Dairymen's Ass'n, 52 Cal. App. 2d 468, 473, 126 P.2d 467, 469 (3d Dist. 1942).

46. P. Brown & D. Volkin, Equity Redemption Practices of Agricultural Cooperatives 5, Farmer Cooperative Research Report 41, Farmer Cooperative Service, U.S. Department of Agriculture (1977).

47. *Id.* at 9.

48. "An association may establish reserves . . . as may be provided in the bylaws." Cal. Food & Agric. Code § 54175 (West 1968).

49. The description of the Cooperativa Central's revolving fund is taken from Cooperativa Central, Progress Report (February 1, 1977) (unpublished memorandum), and an interview in Salinas, California with Steven C. Huffstutlar, who was then business manager of the Cooperativa Central (September 3, 1977).

50. P. Brown & D. Volkin, Equity Redemption Practices in Agricultural Cooperatives 9, Farmer Cooperative Research Report 41, Farmer Cooperative Service, U.S. Department of Agriculture (1977).

the loans are repaid.[51] Generally, then, a cooperative will choose a shorter cycle when it has accumulated satisfactory capital and a longer one when it is planning significant capital expansion.

Another form of revolving program is redemption of a pro rata percentage of all outstanding retain certificates regardless of the year issued. In the percentage method, all members, and not just those who were in the cooperative at the beginning of the revolving cycle, share in the distribution. A problem with the percentage method is that it is difficult to compute interest because the year of issuance varies from member to member.[52]

Both revolving methods function satisfactorily under most circumstances. Neither system, however, makes allowances for exceptional situations when members should have the right to withdraw their retains early. For example, persons who must leave the cooperative or who face large, unexpected medical bills should not have to wait until dissolution or until the end of a ten year revolding cycle to redeem their interests. A base capital plan is a complex, but potentially viable alternative which addresses part of this problem. It provides accelerated redemptions to those who are no longer patronizing the cooperative due to retirement, death, expulsion or resignation. To use the base capital method, the cooperative first determines the total accumulated reserves it will need during the coming year. Next the cooperative uses a formula which compares each member's patronage during the last several years plus expected future patronage against the similar patronage of other members to arrive at the equitable percentage each member should contribute to those reserves. The cooperative multiplies the desired reserves by that percentage to arrive at each member's base capital figure. If the member's total accumulated retains at the end of the year exceed the member's base capital figure, the member will receive the excess back in the form of a cash patronage refund. If the member's accumulated retains fall short of his or her base capital figure, the cooperative will retain a high percentage of that member's patronage refund in order to move that member quickly towards his or her base capital goal.[53] Under

51. Cooperativa Central, Financial Planning Model 1977-1978-1979 (January 1977) (unpublished memorandum).

52. Cooperative bylaws may prescribe up to eight percent interest on membership capital. CAL. FOOD & AGRIC. CODE § 54120 (West 1968). Although the payment of interest might reduce member pressure for quick redemptions, a young or struggling cooperative may not want the extra financial burden of paying interest.

53. Example: A cooperative has 50 members and each member farms two acres. The cooperative determines it needs $200,000 in capital reserves. This cooperative's base capital formula compares each member's last two years' patronage, plus current and next year's expected future patronage to arrive at each member's fair share of those reserves. An active member's expected future patronage is calculated at a rate of $5,000 per acre. The total patronage figure for all members from the formula years is $2,000,000. If the total patronage figure of an individual member from the formula years is $40,000 or 2%,

this plan, departing members will be able to receive their retains back faster than active members. A departing member's capital figure is partly based on expected future patronage. Since a departing member has no expected future patronage, the base capital figure will be lower and the cooperative will redeem the departing member's retains sooner.[54]

If the cooperative's members can understand and use a base capital plan,[55] they will realize other advantages as well. A base capital system maximizes both a new member's rate of contribution and an established member's rate of redemption. New members and established members often have identical base capital figures because their recent rates of patronage are the same. However, the established members are more likely to have already reached their base capital figures due to retains accumulated in years prior to the ones taken into account by the base capital formula. Thus, established members will be more likely to re-

---

that member's base capital figure would be $4000 which would be 2% of the cooperative's needed capital reserves.

The consequences of exceeding or not exceeding a base capital figure are illustrated below:

	Patronage				Base Capital Figure
	2 yrs. ago	1 yr. ago	current yr. (expected)	next year (expected)	beginning of current year
Member A	10,000	10,000	10,000	10,000	4,000
Member B	10,000	10,000	10,000	10,000	4,000

	Past accum. retains held by coop	Net proceeds attributable to each at end of current year	Net proceeds retained by cooperative	Net proceeds refunded in cash
Member A	2,000	5,000	2,000	3,000
Member B	2,000	2,000	1,600*	400*

* I.R.C. § 1388(c) requires that at least 20% of each year's patronage refund must be made in cash at the end of the year allocated. See text accompanying notes 39-41, *supra*.

54. *See* note 53 *supra*, for illustrative situation.

The departing members receive accelerated redemptions in situations similar to the following:

	Patronage				Base Capital Figure
	2 yrs. ago	1 yr. ago	current yr. (expected)	next year (expected)	beginning of current year
Active member	10,000	10,000	10,000	10,000	4,000
Departing member	10,000	10,000	0	0	2,000

	Past accum. retains held by cooperative	Net proceeds alloc. to each accord. to their current yrs. prod.	Net proceeds retained by cooperative	Net proceeds refunded in cash	Past accum. retains refunded
Active member	4,000	5,000	0	5,000	0
Departing member	4,000	0	0	0	2,000

55. *See* text accompanying notes 11-13 *supra*, for a discussion of the problems of property schemes which are too complex to be understood by members.

ceive their entire patronage refund in cash that year.[56]

b. *Special redemption programs*

Although systematic redemption plans, such as a base capital plan, can provide early redemptions to departing members, these plans do not provide for medical emergencies and other exceptional situations when members should be able to tap their interests. A cooperative can design special equity redemption programs to meet these situations.[57] These programs should be outlined in the cooperative's bylaws along with the cooperative's systematic redemption program. These plans must be well-conceived and uniformly administered or they might undermine the systematic plan, impair the cooperative's morale through favoritism, or unnecessarily deplete the cooperative's reserves. The bylaws should set specific standards and require board approval in each case.

Good programs can perform savings and insurance functions for members. If the bylaws provide for complete or accelerated redemption to a member's family or designated beneficiaries upon a member's death, the retains serve as life insurance. The retains constitute a retirement fund if they guarantee members a certain percentage of their credits every year after age sixty or on their sixty-fifth birthday. The retains can even serve as medical insurance by allowing the members to draw on their retains to meet medical emergencies.

c. *Other methods of redemption upon termination or expulsion*

There are other methods besides special redemption programs and systematic base capital plans which resolve the conflict between the rights of departing members to withdraw their property upon leaving the cooperative and the cooperative's need to retain the funds for its

---

56. *See* note 53 supra, for illustrative situation.

Established members receive larger redemptions in situations similar to the following:

	Patronage				Base Capital Figure
	2 yrs. ago	1 yr. ago	current year (expected)	next year (expected)	beginning of current year
Established member	10,000	10,000	10,000	10,000	4,000
New member	0	0	10,000	10,000	2,000

	Past accum. retains held by cooperative	Net proceeds alloc. to each accord to current yr. prod. at end of current year	Net proceeds retained by cooperative	Net proceeds refunded in cash
Established member	4,000	5,000	0	5,000
New member	0	5,000	2,000	3,000

57. *See generally* P. BROWN & D. VOLKIN, EQUITY REDEMPTION PRACTICES OF AGRICULTURAL COOPERATIVES 10-12, Farmer Cooperative Research Report 41, Farmer Cooperative Service, U.S. Department of Agriculture (1977).

business purposes. Like special redemption and systematic base capital programs, these methods neither force members to leave empty-handed, nor do they allow members immediate, full redemption.

Members could conceivably get cash for their retain certificates by selling or assigning them or by using them as security for loans. These alternatives, however, have not generally been available in the past. Most cooperatives severely restrict the transferability of their certificates to prevent speculation and concentrations of wealth or control. Most lenders have not accepted the members' certificates as security for loans due to the restrictions on transferability, their subordination to outside creditors' claims, the lack of definite repayment date or the generally tenuous chances of cooperative survival. There are signs of change, however. Members of the Cooperativa Central have recently been able to borrow on their retain certificates.[58] Perhaps borrowing will become more widespread as other cooperatives achieve comparable success and stability.

Settlement and compromise, limiting the maximum redemption period, and redemption in proportion to the cooperative's liquid assets can be fruitful avenues for balancing the pressures for retention and withdrawal. The bylaws can give the board the power to settle and compromise through purchasing departing members' retain certificates at a discount. The board may either bargain with the members on an ad hoc basis or set a uniform rate that is low enough not to encourage termination.[59] The cooperative can also require itself to redeem departing members' certificates within a set period of time. This limitation gives the cooperative some flexibility while affording the outgoing members the security of a time limit. Finally, the cooperative can adjust its redemption periods according to the liquidity of its assets. This approach aims at preventing the cooperative from having to sell fixed assets when members leave. There are two basic measures. The cooperative can assure the outgoing members that their retain certificates may be immediately redeemed in the proportion that the cooperative's reasonably liquid assets bear either to the total value of outstanding retain certificates or to the total value of the cooperative's assets.[60] Although this

58. Interview in Salinas, California with Steven C. Huffstutlar, who was then business manager of the Cooperativa Central (September 3, 1977).

59. As of September 1977, the outgoing members of the Cooperativa Central could demand immediate redemption of their certificates at 65% of face value, forfeiting all interest. Interview in Salinas, California with Steven C. Huffstutlar, who was then business manager of the Cooperativa Central (September 3, 1977).

60. An example can clarify the mechanics of using these two measures. A cooperative has $400,000 total assets. Three hundred thousand dollars is tied-up in buildings, land and equipment. One hundred thousand dollars is reasonably liquid. The total value of outstanding retain certificates is $200,000. An outgoing member has $4,000 of retain certificates. Using the total asset measure, the cooperative would redeem $1,000 of the

practice has a strong economic basis, its complexity and accounting requirements might make it impractical for some farmworker production cooperatives.

3. Unallocated assets

The cooperative's total assets usually are not completely obligated to specific creditors or members. Wealth derived from such sources as investment, property appreciation and business with nonmembers can be unallocated. The cooperative is free to determine the members' rights and interests in this property.[61]

Cooperatives usually limit these rights to members active at dissolution.[62] There are many reasons why the bylaws or articles should not allow the cooperative to distribute these assets until dissolution. If members were allowed to withdraw their share of the cooperative's assets at will, they might become more concerned with the cooperative's balance sheet than farming cooperatively.[63] The assets of a going concern are difficult to appraise and distribute. Also, the withdrawal of assets by a sizable block of departing members can impair a cooperative's morale and productivity if it requires liquidation of fixed assets.

In addition, important reasons exist for requiring members who leave the cooperative prior to dissolution to forfeit all rights in the cooperative's unallocated assets. Forfeiture provides an incentive for members to stay in the cooperative. The cooperative avoids the difficult and expensive task of tracing former members to distribute assets to them.

---

certificates within a short time, perhaps a year, and the remaining $3,000 within an extended but limited period, perhaps five years. The ratio of the member's quickly redeemed certificates to his total certificates, $1,000: $4,000, is the same as the cooperative's reasonably liquid assets to the total assets, $100,000: $400,000. Using total outstanding retain certificates instead of total assets as a measure, $2,000 could be quickly redeemed as the respective ratios are $2,000: $4,000 and $100,000: $200,000.

Phillip F. Brown and David Volkin endorse the total assets measure in *Equity Redemption Practices of Agricultural Cooperatives*. Farmer Cooperative Service Report 41, Farmer Cooperative Service, U.S. Department of Agriculture at 25-28 (1977). The other measure, the ratio of the reasonably liquid assets to outstanding retain certificates, however, has two advantages. Expensive appraisals of the cooperative's nonliquid assets are not required and only reasonably liquid assets are vulnerable to quick redemption, even when the amount of outstanding certificates exceeds the total assets of the cooperative.

61. CAL. FOOD & AGRIC. CODE § 54122 (West 1968).

62. The Cooperativa Campesina is currently involved in a suit for involuntary dissolution brought by a minority faction seeking liquidation and distribution of assets. Estrada v. Cooperativa Campesina, Civ. No. 64264 (Super. Ct. Santa Cruz Co., filed Dec. 6, 1977).

63. A California appellate court held valid a bylaw provision declaring members' interests in the cooperative's property not payable until the dissolution of the cooperative. It based its decision on the rationale that the principal purpose of the cooperative is to serve its members, for example to market its member's products, and not to increase the members' property. Driscoll v. East-West Dairymen's Ass'n, 52 Cal. App. 2d 468, 474, 126 P.2d 467, 469 (3d Dist. 1942).

Upon dissolution, the assets first go to satisfy the cooperative's creditors, including retain certificate holders, in their order of priority.[64] Then the members divide the remaining, unallocated assets. The general measure of a member's interest in this property must be in the articles.[65] Cooperatives use either of two measures. Cooperatives can measure the interests according to each member's share of the outstanding retain certificates or according to each members' share of the total past patronage.[66] Accounting is simpler using the retain certificates method and it works equitably in cooperatives where all retains are redeemed in a systematic manner, as in a revolving or base capital plan.[67] If the cooperative provides special redemption programs for such contingencies as medical emergencies or approaching retirement, however, measuring by outstanding retain certificates penalizes members for taking advantage of these provisions by reducing their relative portions. Thus, the outstanding retain certificate measure is less equitable than the patronage measure for cooperatives with special redemption programs.

4. Membership interests

Unallocated assets, like assets subject to fixed obligations and to capital retains without definite repayment dates, represent interests in tangible assets held by the cooperative. Membership interests,[68] on the other hand, represent the value of a cooperative membership to persons outside the cooperative. The Cooperativa Central has recently begun to allow members to sell their membership interests.[69] The Central believes transferability will correct former inequities caused by prohibiting

64. *See* prior CAL. CORP. CODE § 5000 (1947 California Stats., ch. 1038, § 5000). The general corporation laws govern where there is no applicable section in the Food and Agriculture Code. CAL. FOOD & AGRIC. CODE § 54040 (West 1968). The new General Corporation Law, effective Jan. 1, 1977, however, does not seem to reach these cooperatives. CAL. CORP. CODE § 102(a) (West 1977). Therefore, the prior law should still be effective as to these cooperatives.

65. CAL. FOOD & AGRIC. CODE § 54081(e),(f) (West 1968).

66. The Cooperativa Central measures the members' interests by their accumulated patronage. Cooperativa Central, Articles of Incorporation § 14.01 (filed May 10, 1972).

67. For discussion of systematic redemption plans, *see* text accompanying notes 46-56 *supra*.

68. These membership interests generally are exempt from California and federal securities regulation. 15 U.S.C. § 77c(a)(5) (1976); CAL. FOOD & AGRIC. CODE § 54201 (West Cum. Supp. 1977).

69. The description of the "Central Plan" for transferability of membership interests is taken from a letter from Steven C. Huffstutlar, as Assistant to the Executive Committee of the Cooperativa Central, to Brad Dewan, Bill Greenwood, Valeriano Sencedo and Michael Smith (December 26, 1976).

A group sponsored by the Central has started a cooperative in the Santa Maria area. This new cooperative implemented a plan for making its memberships transferable. The future success or failure of this plan will give an indication whether transferability is viable for new, as well as established farmworker production cooperatives. Letter from original members from sharing completely in the cooperative's assets when they withdrew from the cooperative prior to dissolution. Without transferability, the original members received only the value of their retain certificates. Nothing compensated them for the extra labor they contributed or the outside income possibilities they sacrificed to build the cooperative's equity and to make it a viable income-producing entity. New members received a windfall by inheriting the former members' share for the nominal entrance fee.[70] By making memberships transferable, the Central is aiming at a fair exchange of values.

Outgoing members can sell directly to prospective members, if they find buyers satisfactory to the cooperative.[71] If the outgoing member fails to find a satisfactory replacement, the cooperative arranges the sale. If the outgoing member was expelled for not fulfilling his or her obligations to the cooperative, the cooperative arranges the sale and then deducts its costs to maintain the crop. The board determines the price of the memberships by using a formula it devised with the aid of its accountant.[72] Typical memberships, excluding retain certificates, will cost from $8,000 to $12,000.[73] The new member pays one-third down in cash and the rest in two equal, annual installments.

Financing is the major obstacle to the sale of memberships. The Central does not want to create wealth barriers. Low-income people usually cannot make the cash down payment without financing. The Central is investigating the possibility of financing through the Farmers Home Administration, the Small Business Administration or private banks.[74]

Steven C. Huffstutlar, former business manager of the Cooperativa Central, to author (December 23, 1977).

70. As of September 3, 1977, the entrance fee was $50.00. Cooperativa Central, Bylaws §2.05.

71. The Central's board reserves the right to reject a prospective member's application. The cooperative wants members who work well together and share common goals. The board looks at personal recommendations; financial need; the size, ages and farming experience of the prospective member's family; and the willingness of the family to work hard while keeping outside hired labor to a minimum. The latter two criteria are especially important because the functional economic unit is the family. Gross income depends on total labor output. If there are enough able-bodied workers in the family, a member can avoid the expense of hiring outside workers. Interview in Salinas, California with Steven C. Huffstutlar, who was then business manager of the Cooperativa Central (September 3, 1977).

72. The formula for determining the price of memberships is as follows:

1st year berries	$1,000 per acre
2nd year berries	$800 per acre
3rd year berries	$500 per acre
Plus $1,000 for each year of membership	

Letter from Steven C. Huffstutlar, former business manager of the Cooperativa Central, to author (December 23, 1977).

73. Letter from Steven C. Huffstutlar, former business manager of the Cooperativa Central, to author (February 28, 1978).

74. Letter from Steven C. Huffstutlar, former business manager of the Cooperativa Central, to author (December 23, 1977).

If these sources of financing are not available, the Central might have to take the risk of financing the sales itself, either through an internal loan fund or perhaps even by establishing a credit union. If the Central can solve the financing problem, other cooperatives will probably emulate its example and membership interests will play a much larger role in farmworker production cooperatives.

CONCLUSION

No single scheme of property interests will be best for all farmworker production cooperatives. Each cooperative has different economic and noneconomic goals. Needs within a cooperative change as the cooperative meets new situations. Each cooperative must accommodate conflicting interests somewhat differently.

Conflicting views of equitability, tensions between long and short term economic perspectives, and the problem of the rights of departing members challenge every agricultural cooperative. Farmworker production cooperatives have traditionally adhered to equality in access to land and tools and member voting, but have divided economic rewards unequally according to the member-family's production. The board of directors is charged with balancing the long term economic needs of the cooperative against the members' immediate financial needs when distributing patronage refunds or redeeming capital retains. Farmworker production cooperative boards have helped the members by redeeming retains on a shorter cycle than have the boards of other agricultural cooperatives.[75] The demands of departing members for their property has been a thorny issue. The cooperatives have many ways, ranging from base capital plans to aiding in procurement of loans, to provide accelerated redemption of capital retains. In addition, the departing members' burden of having to forfeit their interests in the cooperative's unallocated assets might be relieved in the future by greater transferability of membership interests.

The composition of farmworker production cooperative membership creates some problems and tensions not common to every type of agricultural cooperative. The members have generally come from lower income strata and thus have not been able to contribute to the cooperative's property except through retains withheld from their agricultural incomes. This has meant that cooperatives have relied heavily on outside financing, especially during the initial stages. This situation is slowly changing, however, as outside farmworker income increases and as the members of successful cooperatives have more income to reinvest. Due to this trend, membership fees, member loans to the coop-

75. *See* text accompanying note 52 *supra*.

erative, mandatory assessments and transferable membership interests are more viable alternatives than they were in the past.

Members also generally have not had enough formal education to equip them to appreciate and trust the more complex property formulas. The cooperatives will be able to utilize sophisticated, economically sound systems, such as combined production and efficiency patronage formulas,[76] base capital plans[77] and adjustment of redemptions to liquid assets[78] only if the cooperatives can thoroughly educate the members as to the mechanics and merits of the systems.

In sum, California's farmworkers have embarked on a promising experiment. However, there are still unresolved problems. The way farmworker production cooperatives handle these problems will determine the future viability of these cooperatives and will provide valuable guidance in structuring other much needed, self-run business enterprises for low-income persons.

Duncan E. Falls

---

76. *See* text accompanying note 13 *supra*.
77. *See* text accompanying notes 53-56 *supra*.
78. *See* text accompanying note 60 *supra*.