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The Organization of Consumer Cooperatives in the Ghetto

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THE ORGANIZATION OF CONSUMER COOPERATIVES IN THE GHETTO

The principles of the modern-day cooperative can be traced to those first adopted by the Rochdale Society of Equitable Pioneers:[1] economic power through collective, democratic effort, with emphasis on equality of control, political neutrality, and a non-discriminatory membership policy.[2] These principles were followed at an early date in this country by farmers' marketing and purchasing cooperatives.[3] More recently they have been utilized by groups of consumers seeking to maximize purchasing power.[4]

In 1968 approximately 500,000 American families were owners or members of some 430 consumer cooperatives.[5] Total assets that year approached $200 million and gross sales were approximately $450 million.[6] Thus far, consumer cooperative enterprise has been largely a middle-class phenomenon[7] and the establishment of these associations in ghetto areas is only a relatively recent development.[8] From an economic standpoint, however, the cooperative method of distribution is particularly suitable for urban low-income areas.[9] Therefore, it is likely that the utilization of consumer cooperatives by ghetto residents will increase substantially during the next few years.[10]

The thrust of many current congressional[11] and administrative[12] urban

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1. E. ROY, COOPERATIVES: TODAY AND TOMORROW 53-55 (1964).

2. L. KERCHER, V. KEBKER, & W. LELAND, JR., CONSUMER COOPERATIVES IN THE NORTH CENTRAL STATES 4-7 (1951) [hereinafter cited as KERCHER].

3. The peculiar status of farmer cooperatives has been recognized and protected by farmer's cooperative statutes in all states. E. ROY, COOPERATIVES: TODAY AND TOMORROW 255 (1964).

4. For an interesting discussion of the application of cooperative principles to the consumer and others, see Miller, *Increasing Low-Income Consumer Buying and Borrowing Power by Cooperative Action*, 29 OHIO ST. L.J. 709 (1968); Satterfield, *The Cooperative in Our Free Enterprise System*, 33 MISS. L.J. 14 (1961). *See also* 12 U.S.C. §1752 (1964), which permits the organization of federal credit unions "for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes" on a cooperative basis. Another widespread use of cooperative principles has been by groups of small retail merchants seeking to compete in purchasing power with chain stores. By 1964 retail food store cooperatives accounted for 44% of all grocery sales. NATIONAL COMMISSION ON FOOD MARKETING, FOOD FROM FARMER TO CONSUMER 70 (1966).

5. Danforth, *Needed: Strong Multi-Unit Co-ops*, CO-OP REPORT, Aug.-Sept. 1969, at 30-31.

6. *Id.* at 30.

7. *Id.*

8. Silverstein, *Cooperative Retail Business—A Route to Self-Help, Pride and Profit in Economically Blighted Communities*, 23 TAX LAW. 315 (1970).

9. *Id.* at 315.

10. *Id.* at 315-17.

11. *See, e.g.*, Economic Opportunity Act, 42 U.S.C. §§2701, 2902, 2906(b) (1964). *See also* Baum, *The Federal Trade Commission and the War on Poverty*, 14 U.C.L.A.L. REV. 1071 (1967).

12. 34 Fed. Reg. §6703 (Supp. 1969); *see* Vazquez, *The Role of the Department of Commerce in the Development of Minority Business Enterprise*, 25 BUS. LAW. 55 (Special Issue 1969).

redevelopment programs, as well as those initiated by business and industry[13] and by private foundations,[14] has been toward injecting credit and investment capital into the inner cities. The long-range goal of these programs is to create a sound economic base that will support viable, competitive economic entities in the blighted urban areas.[15]

Yet the climate for establishing retail businesses in urban core areas is less than inviting. Although the urban poor are in desperate need of quality goods and services at competitive prices,[16] ghetto consumers do not represent a suitable market for most retail businesses.[17] This problem is compounded by a lack of adequate support facilities, such as store space, lighting, parking, and sewers, and by the unavailability of adequate insurance protection.[18]

Consumer cooperatives are better able to survive the adverse ghetto economic conditions than are traditional retail businesses.[19] Moreover, the cooperative form of distribution is uniquely suited to provide ghetto consumers with quality goods at competitive prices.[20] In emphasizing economic power through collective, democratic effort, the consumer cooperative provides a realistic model for urban economic redevelopment as well as the nucleus for creative social development.

The purpose of the present note is to inform the practicing attorney and potential cooperative organizer of some of the legal problems and implications encountered in organizing consumers' purchasing cooperatives in underdeveloped urban areas. Particular emphasis is placed upon the practical aspects of financing, selection of the proper business entity, and federal in-

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13. Clark, *The Crisis: Attitudes and Behavior*, in BUSINESS LEADERSHIP AND THE NEGRO CRISIS 21, 31-32 (E. Ginsberg ed. 1968).

14. Atterbury, *Experiments in Making Foundation Credit Available to the Poor*, 25 BUS. LAW. 21 (Special Issue 1969).

15. *See, e.g.*, Economic Opportunity Act, 42 U.S.C. §2701 (1964) (declaration of purpose).

16. D. CAPLOVITZ, THE POOR PAY MORE 18-20 (1967) [hereinafter cited as D. CAPLOVITZ].

17. Purchasing power of ghetto consumers is limited not only because of low incomes but also because of unsophisticated buying habits, *id.* at 14. In order to cater to installment buying habits, ghetto retailers must often double or triple the total price of goods in order to realize the same profit margin as their non-ghetto counterparts. FEDERAL TRADE COMMISSION, THE ECONOMIC REPORT ON INSTALLMENT CREDIT AND RETAIL SALES PRACTICES IN THE DISTRICT OF COLUMBIA (1968), *cited in* White, *Consumer Credit in the Ghetto: UCCC Entry Provisions and the Federal Trade Commission Study*, 25 BUS. LAW. 143, 146 (Special Issue 1969). This increase in the purchase price of goods sold to low-income consumers is necessitated by the fact that merchants often must go to considerable expense in order to recover the debt or may have to write the purchase off as uncollectible. The extent of increase generally will depend on the percentage of "high risk" clientele ordinarily buying from the merchant and the particular profit margin the merchant has determined to recover. *See generally* D. CAPLOVITZ, *supra* note 16, ch. 2.

18. *See* Griffin, *Office of Economic Opportunity Programs*, 25 BUS. LAW. 43, 45 (Special Issue 1969).

19. The cooperative is eminently more flexible than traditional modes of enterprise and can be organized with a minimum of capital. *See* text accompanying notes 33-36 *infra*.

20. Consumer cooperatives provide three sources for consumer savings: elimination of net profits, reduction of operating costs, and reduction or elimination of the federal income tax. *See* text accompanying notes 31-36 *infra*.

come tax implications since these problems are likely to be most often presented to organizers and counsel. The scope of this discussion will be that of a general overview rather than a detailed analysis of any one particular problem area.

Economic Advantages of Cooperative Distribution

In retail accounting practice, there are three components that make up the selling price of an item: cost of goods sold, operational costs (sales, real estate and rent costs, utilities, insurance and taxes); and net margin (net profit).[21] Therefore, in order to lower selling prices a retailer must purchase goods for less, lower his operational costs, or realize less net profit. It is unlikely that an independent ghetto retailer will be able to purchase goods at lower than market wholesale prices. On the contrary, a newly formed retail business will probably pay more for its goods than its competitors because initial purchasing volume will not be sufficient to realize quantity discounts.[22] Operational costs are generally fixed in character and provide little latitude for the realization of savings.[23] Finally, nationwide surveys indicate that net margins of retail businesses are characteristically small[24] and it is, consequently, unlikely that consumer savings can be realized through reducing profit margins.

Another factor renders the traditional retail business unsatisfactory as a functional mode for reduction of low-income consumer costs. Buying habits of low-income consumers are characterized by a very low level of sophistication in the pricing of items.[25] In addition, these habits are generally oriented toward installment purchases, which often result in net retail markups of as much as 300 per cent of original suggested cash prices.[26] Therefore, even if it were possible for an independent ghetto retailer to reduce prices on a cash basis, because of inability to buy on a cash basis or a predisposition to installment purchasing, ghetto consumers probably would not patronize the business. It is apparent that in order to provide a suitable market for the support of local businesses, ghetto consumers not only must be provided with goods at lower costs, they also

21. L. Weiss, Case Studies in American Industry 214, 215 (1967) [hereinafter cited as L. Weiss].

22. For example, it has been estimated that the "optimal" annual sales volume for a supermarket is about $1 million per year. National Commission on Food Marketing, Food from Farmer to Consumer 72 (1966), *cited in* L. Weiss, *supra* note 21, at 213.

23. L. Weiss, *supra* note 21, at 214-15.

24. For example, the following average retail net margins have been estimated: 1.6% for supermarkets, 2.5% for department stores, 1.2% for variety stores, 1.1% for service stations, and 5.2% for drug stores. L. Weiss, *supra* note 21, at 219.

25. D. Caplovitz, *supra* note 16, at 19, in which the author states: "These merchants have a 'captive' market because their customers do not meet the economic requirements of consumers in the larger, bureaucratic marketplace. But also, they can sell inferior goods at high prices because, in their own words, the customers are not 'price and quality conscious.'"

26. D. Caplovitz, *supra* note 16, at 16. The author notes that merchants bypass maximum credit charges by not marking their merchandise and use a numbering system to indicate whether the item was sold at 100, 200, or 300% of its hypothetical wholesale price.

must be educated in pricing and buying techniques so as to maximize their limited purchasing power.

It has been suggested that the lack of sophistication in buying habits stems from the inability of the urban poor to fully understand or influence the day-to-day economic decisions that affect their lives.[27] This sense of futility is intensified by the fact that urban dwellers generally lack organized, effective means through which they can channel their interest and combat prevailing economic conditions.[28] Consequently, the creation of a sound economic base in the ghetto will, to a great degree, be dependent upon the extent ghetto residents become participants in local enterprises. Stimulation and continuous maintenance of stable commercial activity requires that dollars locally spent inure to the benefit of local ghetto residents[29] and that the frustrations of residents be satisfied by allowing them an effective role in their society. Without substantial control and participation in the ghetto economy it is unlikely that the urban poor will actively support local enterprise.[30]

When compared with traditional forms of retail enterprise, the cooperative system of distribution offers several distinct advantages to the ghetto consumer and to the urban economy as a whole. Through use of the cooperative form, substantial savings can be achieved that can be allocated to meet future capital needs or distributed to member-consumers,[31] or both.

A small, but significant, source of savings occurs through elimination of the net margin.[32] Savings can also be realized through reduced costs of operation. For example, in the early stages of development, members may help to offset labor costs (which account for approximately one-half of all operating expenses).[33] In addition, capital improvement can be financed

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27. D. CAPLOVITZ, *supra* note 16, at 14. In reference to the low income consumer, the author states: "They tend to lack the information and training needed to be effective consumers in a bureaucratic society. Partly because of their limited education and partly because as migrants from more traditional societies they are unfamiliar with urban culture, they are not apt to follow the announcements of sales in newspapers, to engage in comparative shopping, to know their way around the major department stores and bargain centers, to know how to evaluate the advice of salesmen — practices necessary for some degree of sophistication in the realm of consumption." *Id.*

28. T. CROSS, BLACK CAPITALISM 90 (1969).

29. *See* Weston, *Economic Development of Corporations*, 25 BUS. LAW. 219, 224 (Special Issue 1969).

30. DeLorean, *The Problem*, in BLACK ECONOMIC DEVELOPMENT 7, 14 (W. Haddad & G. Pugh eds. 1969): "If black people don't own and control it [ghetto enterprise] the most important factor is lost. There are some gains but not the ones we need most of all at this time — to make our own decisions and control our own lives!" *See also* Shadden, A Model Consumer Action Program for Low Income Neighborhoods, 1-4 (Department of Church Planning, Church Federation of Greater Chicago, May 1966); Eichelbaum, *Economic Development in Poverty Areas*, 75 CASE & COM., March-April 1970, at 3.

31. *See* text accompanying notes 164-167 *infra*.

32. KERCHER, *supra* note 2, at 8.

33. L. WEISS, *supra* note 21, at 214.

through savings on a gradual basis[34] since consumers will probably be willing to accept lower standards in physical appearance and space than they would from independent retailers with whom they would otherwise do business. Moreover, the capital investment necessary to reach "optimal volume" (the volume at which cost of goods sold is reduced to a competitive level)[35] is likely to be less in cooperatives than in similar retail establishments. Favorable tax treatment also gives the cooperative an additional advantage over similar retail businesses and provides another source of savings for the consumer members.[36]

The ghetto-based consumer cooperatives may provide a significant service to consumer-members by teaching them the advantages of cash purchasing and the pitfalls of installment purchasing.[37] In addition, since control of the cooperative is apportioned equally on a one-man one-vote basis,[38] the cooperative can uniquely provide its member-consumers with the opportunity to participate in the decisions that govern the operation of the business. Such participation may extend to decisions concerning the prices charged for items, as well as their quantity and quality. The locally owned and operated cooperative may also provide a valuable source of jobs, and the opportunity for some community members to learn new skills.[39] The participatory role of residents not only aids the individuals, but identification of members and patrons with the business entity through which they obtain their goods and services fosters the continued patronage essential to the survival of any business enterprise.

FINANCING

Preorganization Activities

The initial step in organizing a consumer cooperative usually involves the procurement of financial commitments from prospective members or shareholders. The preincorporation subscription agreement may be called a "share" in the case of a stock cooperative or a "membership agreement" in the case of a nonstock cooperative.[40] It may embody provisions for the purchase of a facility or entire enterprise, for employment contracts, for eventual limited return on part or all of the capital, for a very limited interest return, or for the eventual payment of patronage refunds.[41] If the agreements

34. Silverstein, *supra* note 8, at 318.

35. L. WEISS, *supra* note 21, at 214. *See* Walker, *The Role of the Attorney in a Community Owned and Operated Cooperative*, 25 BUS. LAW. 195 (Special Issue 1969).

36. *See* text accompanying notes 253-261 *infra*.

37. Miller, *Organizing the Consumer Cooperative*, in THE LAW AND THE LOW INCOME CONSUMER 393-94 (C. Katz ed. 1968).

38. KERCHER, *supra* note 2, at 4-7.

39. Walker, *The Role of the Attorney in a Community Owned and Operated Cooperative*, 25 BUS. LAW. 195, 197 (Special Issue 1969).

40. I. PACKEL, THE ORGANIZATION AND OPERATION OF COOPERATIVES 31 (1970) [hereinafter cited as PACKEL].

41. *Id.* at 49-50.

are properly drafted and approved by the cooperative, they will be binding upon the members and enforceable at law.[42] Although subscription agreements do not bind the cooperative unless it assents to them,[43] the courts may use a variety of theories to enforce the agreements against the cooperative.[44]

Even in the absence of paid-in-capital requirements, which may be imposed by particular statutes,[45] it is of primary importance that organizers and counsel assure the existence of adequate capital for day-to-day operation of the business and for the repayment of debt obligations. Undercapitalization[46] and "thin" capitalization[47] have frequently been important factors in cases denying corporate shareholders their defense of limited liability. However, one authority has suggested that traditional notions concerning equity-debt relationship[48] cannot be strictly applied to cooperatives since statutes or bylaws often limit the return of capital to fixed rates of interest, and involving loan certificates often provide for no fixed rate of return.[49]

If equity capital is to be obtained from the sale of memberships or shares, and if the size and scope of the prospective cooperative is sufficiently large, counsel for the promoters or organizers should also carefully consider the possible applicability of federal and state statutes regulating the sale and distribution of securities.

Federal Security Laws

The Securities Act of 1933[50] was enacted to insure full, public disclosure of all information that might be material to prospective investors and to pre-

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42. *See, e.g.*, Burley Tobacco Growers' Co-op. Ass'n v. Rogers, 88 Ind. App. 469, 150 N.E. 384 (1926); Warren County Cooperative Ass'n v. Boyd, 171 N.C. 184, 88 S.E. 153 (1916).

43. *See, e.g.*, Chapman v. Sky L'Onda Mut. Water Co., 69 Cal. App. 2d 667, 159 P.2d 988 (1945); Zalewski v. Pennsylvania Rabbit Breeders Cooperative Ass'n, 76 Pa. D. & C. 225 (C.P. Adams County 1950).

44. Hart Potato Growers' Ass'n v. Greiner, 236 Mich. 638, 641, 211 N.W. 45, 46 (1926); McCloskey v. Charleroi Mountain Club, 390 Pa. 212, 134 A.2d 873 (1957). As in the case of general business corporations, courts may utilize theories such as ratification, adoption, continuing offer, or third party beneficiary to bind the cooperative. *See, e.g.*, Hackbarth v. Wilson Lumber Co., 36 Idaho 628, 212 P. 969 (1923) (continuing offer was called "the most logical theory of liability to fit the case"); McArthur v. Times Printing Co., 48 Minn. 319, 51 N.W. 216 (1892) (adoption).

45. *Compare* D.C. CODE ANN. §29-804 (1968), *with* FLA. STAT. §608.03(2)(d) (1969).

46. Anderson v. Abbot, 321 U.S. 349, 362 (1944). *See also* Minton v. Cavaney, 56 Cal. 2d 576, 364 P.2d 473, 15 Cal. Rptr. 641 (1961).

47. *See, e.g.*, Costello v. Fazio, 256 F.2d 903 (9th Cir. 1958). Contributors are often given a substantial amount of debt as well as preferred stock and junior securities in return for their capital in a deliberate attempt to avoid "double taxation" from payment of dividends and to provide deductions for interest for the corporation. Tomlinson v. The 1661 Corp., 377 F.2d 291 (5th Cir. 1967), *aff'g* 247 F. Supp. 936 (M.D. Fla. 1965); Nassau Lens Co. v. Commissioner, 308 F.2d 39 (2d Cir. 1962).

48. Normally, equity capital does not represent an indebtedness of a corporation to its shareholders. *See, e.g.*, Arnold v. Phillips, 117 F.2d 497 (5th Cir.), *cert. denied*, 313 U.S. 583 (1941); Sternbergh v. Brock, 225 Pa. 279, 284, 74 A. 166, 168 (1909).

49. PACKEL, *supra* note 40, at 170-71.

50. 15 U.S.C. §§77a-bbb (1964).

vent fraud in the sale of securities.[51] The Act makes it unlawful for any person to use interstate facilities or the mails for the purpose of offering to sell any security prior to filing a registration statement with the Securities and Exchange Commission.[52]

The Act expressly exempts farmers' cooperative associations, as defined in paragraphs (12), (13), and (14) of section 103 of the Revenue Act of 1932.[53] Presumably, this express exemption does not extend to other than farmers' cooperatives. Therefore, any claim of nonapplicability of registration requirements to consumer cooperatives would have to be grounded upon either a showing that the provisions of the Act do not contemplate consumer cooperative shares or memberships within the definition of "securities,"[54] or, alternatively, upon a showing that the particular cooperative issue in question falls within the scope of one of the express exemptive provisions. These include the "private offering"[55] exemption, the "intrastate offering"[56] exemption, and the section 3 exemption relating to small offerings.[57]

There are very few federal security cases in which the question of the security character of cooperative shares or membership agreements has been in issue. In *United States v. Davis*[58] it was held that certificates in a cooperative association that entitled the holders to a profit-sharing arrangement were securities within the meaning of section 2(1) of the Act.[59] Similarly, in *Tcherepnin v. Knight*[60] the Supreme Court was faced with construing the term "security" as used in the Securities Exchange Act of 1934,[61] in reference to withdrawable shares in a savings and loan association. The Court noted that the provisions in the 1933 Act relating to the term "security" are almost identical to those of the 1934 Act,[62] and stated that both acts embody:[63]

> [A] flexible rather than static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek to use the money of others on the promise of profits.

Viewing section 2 of the Act in the abstract, it is apparent that Congress intended the regulations to apply to a wide range of financial arrange-

51. *See* Landis, *The Legislative History of the Securities Act*, 28 GEO. WASH. L. REV. 29 (1959).
52. Securities Act of 1933, §5(a), 15 U.S.C. §77e(a) (1964).
53. Securities Act of 1933, §3(5), 15 U.S.C. §77c(a)(5) (1964).
54. Securities Act of 1933, §2(1), 15 U.S.C. §77(b)(1) (1964).
55. Securities Act of 1933, §4(1), 15 U.S.C. §77d(2) (1964).
56. Securities Act of 1933, §3(a)(11), 15 U.S.C. §77c(a)(11) (1964).
57. Securities Act of 1933, §3(b), 15 U.S.C. §77c(d) (1964).
58. 40 F. Supp. 246 (N.D. Ill. 1941).
59. Securities Act of 1933, §2(1), 15 U.S.C. §77(b)(1) (1964).
60. 389 U.S. 332 (1967)
61. 15 U.S.C. §78c(a)(10) (1964).
62. 389 U.S. at 336.
63. *Id.* at 338. Since "profit-sharing," in the traditional sense, is the antithesis of consumer cooperative operation and practice the precedent value of *Davis* and *Tcherepnin* for determining the "security" nature of consumer and cooperative shares or membership is questionable.

ments.[64] In addition, the decisions construing this section have given a very liberal interpretation to its provisions.[65] Therefore, it would probably be most prudent for cooperative managers or organizers to assume that the Act does encompass cooperative shares and attempt to ground non-applicability of the registration regulations upon one of the express exemptive provisions.[66]

The Private Offering Exemption. The Securities Exchange Commission (SEC) has stated that the number of persons to whom an offering is extended is relevant only in determining whether the offerees have sufficient knowledge of the offeror's operations and purpose of the issue in order for them to make an informed investment decision.[67] Another important factor is whether the securities are purchased for investment or for resale.[68]

The Intrastate Exemption. The Commission has stated that no part of an issue can be offered or sold to a nonresident if the issue is to retain its "intrastate" character.[69] This rule applies to all securities forming a part of the issue, including those sold to residents of the state of issue. In other words, if part of the issue is "interstate" in character, the intrastate exemption will not apply to any other part of the issue.[70] Moreover, the proceeds of

64. Securities Act of 1933, §2(1), 15 U.S.C. §77(b)(1) (1964) provides in part: "The term 'security' means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral trust certificate, preorganization certificate or subscription . . . ."

65. *E.g.*, SEC v. Howey Co., 328 U.S. 293, 298 (1946); SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344 (1943).

66. This might be more likely when the contracts between a cooperative and its members are shares of business corporation stock than when they are membership certificates, as in the case of cooperatives incorporated under nonprofit or special purpose statutes. *See* text accompanying notes 221-223 *infra*. These statutes generally make it clear that members are not entitled to share in the profits of the corporation. *See, e.g.*, D.C. CODE ANN. §29-831(4)(a)-(d) (1968); FLA. STAT. §617.011 (1969). However, members may receive a prorata share based on patronage of those funds in excess of cost of goods and expenses. *See* D.C. CODE ANN. §29-831 (1968). Whether these patronage refunds should be treated as a share in the "profits" of the cooperative is a matter of much discussion among cooperative experts. *Compare* Note, *Non-Profit Corporations—Definition*, 17 VAND. L. REV. 336 (1963), *with* R. PATTERSON, THE TAX EXEMPTION OF COOPERATIVES 13-15 (1961).

67. SEC Securities Act Release No. 4552 (Nov. 6, 1962). This interpretation was first enunciated by the Supreme Court in dictum in SEC v. Ralston Purina Co., 346 U.S. 119, 125 (1953).

68. SEC Securities Act Release No. 4552 (Nov. 6, 1952); *cf.* SEC Securities Act Release No. 3825 (Aug. 12, 1957). Statements by the purchasers of securities to the effect that the securities are purchased for investment and not for resale are not conclusive as to intent; however, it would seem that restrictions placed upon the transferability of cooperative shares might be conclusive as limiting their purchase to purposes of "investment" rather than "resale." *Cf.* SEC Securities Act Release No. 4552 (Nov. 6, 1952). For a discussion of the operation of the private offering exemption *see* Orrick, *Non-Public Offerings of Corporate Securities—Limitations on the Exemption Under the Federal Securities Act*, 21 U. PITT. L. REV. 1, 10-11 (1959).

69. SEC Securities Act Release No. 201 (July 30, 1934).

70. *Id. See, e.g.*, Hillsborough Inv. Corp. v. SEC, 276 F.2d 665 (1st Cir. 1960); SEC v. Los Angeles Trust Deed & Mortgage Exch., 186 F. Supp. 830, 871 (S.D. Cal.), *aff'd*, 285 F.2d 162 (9th Cir. 1960).

the offering must be used for business conducted primarily within the state of issue.[71]

Regulation A. Section 3 of the 1933 Act confers upon the Commission the power to exempt certain securities that by reason of their small amount and limited character do not require regulation in order to protect the public interest.[72] Generally, if the securities constitute in the aggreggate less than 300,000 dollars, and if they are not within special classes excluded by the Commission,[73] they will be held exempt.[74] The applicability of this exemption to a proposed cooperative issue could be easily determined in advance of the offering. Nevertheless, it is important to consult the Commission well in advance of any proposed issue in order to insure full compliance with appropriate rules and regulations.[75]

Blue Sky Laws

In addition to the federal security laws, it is important that organizers of consumer cooperatives be cognizant of the possible applicability of state blue sky laws. Most states provide for some form of regulation of the issue, sale, and trading of securities.[76] The Florida act [77] provides for registration by notification, by qualification, and by announcement.[78] Thus, it ranks among the most extensive of state blue sky laws.[79] Most of the definitive Florida provisions are identical to those of the Federal Securities Act of 1933 and, as in the federal act, these provisions are generally applicable to cooperatives unless a specific exemption is granted.[80]

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71. SEC v. Truckee Showboat, Inc., 157 F. Supp. 824 (S.D. Cal. 1957); *see* SEC Securities Act Release No. 201 (July 30, 1934).

72. Securities Act of 1933, §3, 15 U.S.C. §77c(b) (1964). This the Commission has done by promulgating Regulation A. SEC Reg. A, 17 C.F.R. §230.252 (1970).

73. SEC Regulation A, 17 C.F.R. §§230.252(b), (c), (d) (1970).

74. 17 C.F.R. §230.254 (1970). *See generally* Glavin & Purcell, *Securities Offerings and Regulation A—Requirements and Risks*, 13 BUS. LAW. 303, 313-34 (1958).

75. The Commission will give informal interpretative advice concerning the applicability of exemptive provisions to specific offers. 17 C.F.R. §200.2 (1970). In certain cases it will even state as a matter of public record that no action will be taken concerning a proposed offer that it deems to be exempt from registration. 17 C.F.R. §200.81, *as amended* by 35 Fed. Reg. 17779, 17780 (1970). Inquiries requesting a "no-action" letter should state in an identifying caption the specific relevant provisions of the Securities Act. *Id.* Extreme caution should be exercised in making any public statement concerning the proposed offering until such time as the exempt status of the offering is positively determined. *See* SEC Securities Act Release No. 3844 (Oct. 8, 1957).

76. *See* Draftsman's Commentary to Section 402(a) of the Uniform Securities Act, *cited in* L. LOSS & E. COWETT, BLUE SKY LAW 352 (1958). For example, New York requires the filing of certain rather basic information, N.Y. BUS. CORP. LAW §§352 *et seq.* (McKinney 1947), whereas California has created a complex and comprehensive scheme of regulation, CAL. CORP. ANN. CODE, §§25000 *et seq.* (West 1955).

77. FLA. STAT. ch. 517 (1969).

78. FLA. STAT. §§517.08, .09, .091 (1969).

79. *See* L. LOSS & E. COWETT, BLUE SKY LAW (1958).

80. *See* [1949-1950] FLA. ATT'Y GEN. BIENNIAL REP. 476-78.

The exemptive provisions of the state blue sky laws are varied,[81] and most are so elaborate that it is impossible to formulate a general statement with regard to the exemption of cooperatives from state security regulations.[82] This difference in exemptive provisions apparently reflects varying attitudes of state legislatures toward different types of cooperatives.[83] For example, Florida does not uniformly exempt cooperatives as a class from compliance with its security regulations;[84] however, it does expressly exempt agricultural cooperatives[85] and apartment cooperatives.[86] The absence of similar exemptive provisions for consumer cooperatives is probably due to the infrequency with which these entities have been organized in Florida. If consumer cooperatives can be successfully utilized in the economic rehabilitation of the blighted urban areas in Miami, Jacksonville, or Tampa then, hopefully, the legislature may provide statutory machinery that will encourage the organization and operation of these enterprises.

Potential Sources of Capital for Ghetto Consumer Cooperatives

The underlying differences in economic purpose and structure between cooperatives and general business corporations will likely give rise to different problems in meeting initial capital requirements. These problems may become more acute when attempting to organize consumer cooperatives in urban low-income areas. Organizers may find that ghetto residents cannot afford membership – even at a cost of a few dollars per share. Yet, the consumer cooperative seems to be ideally suited to ghetto environments.[87] Existing federal urban redevelopment programs may provide a valuable source of capital to launch consumer cooperatives in depressed urban areas. The Small Business Administration (SBA) is authorized under the Economic Opportunity Act[88] to provide technical and financial assistance for the establish-

81. Because of the disparate treatment accorded cooperatives by state legislation, the framers of the Uniform Securities Act deferred to the various legislatures rather than attempt to provide a specifically worded exemptive provision that would extend to the many types of cooperatives. *See* UNIFORM SECURITIES ACT, *Official Comment to Title* (1956), *cited in* L. LOSS & E. COWETT, BLUE SKY LAW 249, 362 (1958).

82. *See* L. LOSS & E. COWETT, BLUE SKY LAW (1958). At least 14 state statutes contain exemptions for securities issued by certain types of cooperatives: FLA. STAT. §517.05 (1969); IDAHO CODE ANN. §§30-1434, -1435 (1967); ILL. ANN. STAT. ch. 121½, §§137.3, .4 (Supp. 1971); IND. ANN. STAT. §25-855 (Burns 1967); IOWA CODE ANN. §§502.4, .5 (Supp. 1970); KAN. STAT. ANN. §§17-1252 to -1270 *et seq.* (Supp. 1970); MASS. GEN. LAWS ANN. ch. 110A, §§3, 4 (1967); MINN. STAT. ANN. §§80.05-.07 (1968); MONT. REV. CODES ANN. §§15-2013 to -2014 (1967); N.D. CENT. CODE §§10-04-05 to -06 (Supp. 1969); OHIO REV. CODE ANN. §§1707.02, .03 (Page Supp. 1970); S.D. COMPILED LAWS ANN. §§47-31-67 to -31-92 (1967); TEX. REV. CIV. STAT. §581-6 (Vernon 1964); WIS. STAT. ANN. §551.22 (1970).

83. L. LOSS & E. COWETT, BLUE SKY LAW 362 (1958).

84. *See* FLA. STAT. §§517.05, .06 (1969).

85. FLA. STAT. §517.05 (10) (1969).

86. FLA. STAT. §517.06 (15) (1969).

87. *Cf.* D. CAPLOVITZ, *supra* note 16, at 182-88.

88. 42 U.S.C. §§2902, 2906 (b) (1964).

ment of cooperatives in urban areas with high concentrations of unemployed or low-income individuals.[89] An examination of the legislative history of the Act reveals a clear intent on part of Congress to make Economic Opportunity loans available to organizations like consumer cooperatives, which would aid in strengthening the economy of the ghetto and in providing jobs and vocational training to the urban poor.[90] However, in apparent contravention of this congressional intent, the SBA has excluded consumer cooperatives from eligibility for Economic Opportunity loans.[91]

Apart from the Economic Opporunity program, the SBA might nevertheless provide an indirect source for cooperative funding. Generally, the SBA will not lend to nonprofit organizations.[92] The agency has made an exception, however, in the case of Local Development Corporations.[93] These pooling vehicles help obtain capital and managerial expertise for disadvantaged small business concerns.[94] The agency neither expressly nor impliedly excludes consumer cooperatives from the category of independent small businesses that may be established by local development corporations.[95] Therefore, consumer cooperatives might be eligible for loan funds from the SBA through such an intermediary device.[96]

The Economic Development Administration,[97] established in 1965 and administered by the Department of Commerce,[97] is another source of direct or

89. 42 U.S.C. §2906 (b) (1964).

90. *See* 2 U.S. CODE CONG. & AD. NEWS 2455 (1967). The House Education and Labor Committee Report on the 1967 amendment to title IV of the Act (H.R. REP. No. 866, 90th Cong., 1st Sess. (1967)) makes it clear that a major focus of the economic opportunity loan program should be on small business concerns: "(1) located in urban or rural areas having high proportions of unemployed or low-income individuals or (2) owned by low-income individuals." 2 U.S. CODE CONG. & AD. NEWS 2455 (1967). The committee placed considerable emphasis on "[p]lanning and research, identification and development of new business opportunities, stimulation of new private capital resources . . . establishment . . . of business service agencies . . . [and establishing] management training and counseling programs of sufficient content to adequately prepare participants for the rigors of business competition." *Id.*

91. 13 C.F.R. §119.21 (d) (1968).

92. 13 C.F.R. §120.2 (d) (4) (1968). However, cooperatives comprised of groups of private profit-centered businesses, seeking to increase purchasing power, are expressly made eligible for Small Business Administration funds. *Id.*

93. 13 C.F.R. §108.2 (d) (1968).

94. Economic Development Corporations are nonprofit corporations, eligible to receive grants and gifts under §501 (c) (3) of the Internal Revenue Code of 1954, deductible to the donors under §170 (b) (1) (A) (vi) of the Code. *See* Treas. Reg. §1.501 (c) (3)-1 (d) (2) (1970). *See also* Weston, *Economic Development Corporations*, 25 BUS. LAW. 219 (Special Issue 1969).

95. *See* 13 C.F.R. §§108.1-.502-1 (1968).

96. *Id.* §108.2 requires only that eligible small business concerns qualify as small businesses under §§121.3-10 or .3-11 relating to economic standards. Minority Enterprise Small Business Investment Companies (MESBIC) may also offer an avenue for funding of consumer cooperatives. *See* 13 C.F.R. §107 (1967), *as revised in* 34 Fed. Reg. 1234 (1968) *and* 35 Fed. Reg. 4596, 8673 (1970). A MESBIC must operate within SBA regulations, but its transactions with small businesses are private arrangements and have no connection with the SBA. *Id.*

97. Economic Opportunity Act, 42 U.S.C. 3121 (Supp. V, 1969); 13 C.F.R. §§301.1-.63 (1970).

guaranteed loans for low-income urban businesses, including, presumably, consumer cooperatives.[98] This agency also provides skill and expertise to prospective low-income businessmen.[99] In addition, the Office of Minority Business Enterprise (OMBE) was created in 1969 to provide a center for leadership and coordination of the 116 related governmental aid programs administered by different departments and agencies.[100] The OMBE may be able to provide considerable information on obtaining financial and technical assistance from the federal government.

If the prospective cooperative will have a sufficiently large economic and social impact in an urban depressed area, organizers may be able to qualify for aid from one of the many large private foundations. For example, the Ford Foundation has recently been engaged in several depressed area redevelopment research projects.[101] An innovative application of the cooperative entity as a vehicle through which investment and credit capital could be generated and recycled within a low-income urban area might be quite consistent with the goals of the Ford Foundation[102] or other similar institutions.

Although the financing of a consumer cooperative in a depressed inner city area will be more difficult without outside assistance from governmental or private sources, the unavailability of such assistance should not completely discourage prospective cooperative organizers. Since organization and motivation of key personnel are likely to present the biggest problem, co-op promoters should seek the aid of functioning community organizations such as churches, OEO community action groups,[103] and legal services offices. With a sufficiently large number of prospective participants, it may be possible to obtain the entire initial capital needs directly from the member-consumers.[104]

Selection of The Form of Entity

Possibly the most important consideration in the organizational process is the selection of the appropriate entity under which the cooperative will do business. The cooperative form appears to be adaptable to most currently recognized business entities in the absence of express statutory limitations.

98. *Id.* In order to be eligible for assistance, prospective applicants must reside in an urban area designated by the Economic Development Administration as a target area for their aid. Designation is based on unemployment and median family income levels. *Id.*

99. *See* Vazquez, *The Role of the Department of Commerce in the Development of Minority Business Enterprises*, 25 Bus. Law. 55 (Special Issue 1969).

100. Exec. Order No. 11,458 (March 5, 1969), 34 Fed. Reg. 4937 (1969).

101. Atterbury, *Experiments in Making Foundation Credit Available to the Poor*, 25 Bus. Law. 21 (Special Issue 1969).

102. *Id.* at 22.

103. *See* 45 C.F.R. §1060.1-2 (1971). Consumer cooperatives, if organized to improve living standards of the poor, are within the goals specified by the OEO for Community Action Program grantees. 45 C.F.R. §1078.1-7 (1971).

104. For example, the Harlem River Consumer's Cooperative obtained $270,000 in equity capital from fewer than 100 Harlem residents. Walker, *The Role of the Attorney in a Community-Owned and Operated Cooperative*, 25 Bus. Law. 195 (Special Issue 1969).

Cooperatives are generally considered to embody a number of common characteristics, including: substantially equal control and ownership by each member, limited membership on the basis of patronage, limited return on members' invested capital, limited (or prohibited) transfer of ownership interest, economic benefits to patrons, limited personal liability of obligations of the association in the absence of a direct undertaking or authorization by members, and emphasis on cash-basis transaction.[105] However, there is no absolute test to determine whether a particular organization is truly cooperative in character.[106] At least one court has determined that the cooperative enjoys a hybrid existence sharing some qualities of a corporation, partnership, and a joint stock association.[107] This hybrid existence permits the cooperative to operate within the legal framework of an unincorporated association, a non-profit corporation, a regular corporation or a corporation organized under special cooperative incorporation statutes.[108] One of these entities is likely to prove more suitable within a particular jurisdiction.

Retail-charge Versus Direct-charge Method

One important determination to be made in choosing the proper form is whether the cooperative will be operated on a retail-charge or direct-charge basis. Traditionally, consumer cooperatives have utilized the retail-charge method, purchasing goods at wholesale costs and reselling them to member-patrons at prevailing market retail prices.[109] After deducting operating costs and retaining a small sum for expenses and contingencies, net savings are returned to the member patrons.[110] Transactions with member patrons are generally on a cash basis.[111]

In contrast, there are two methods of dealing on a direct-charge basis. In the first method the cooperative acts merely as an agent for its members, making purchasing arrangements with wholesalers and manufacturers;[112] this method has proved to be successful in marketing durable goods such as furniture. In the second method, which is more suitable in marketing perishable goods, the cooperative purchases and then resells items at wholesale costs.[113] Operating costs such as salaries, rent, and utilities are usually assessed through small service charges that are added to wholesale costs.[114] This sys-

105. PACKEL, *supra* note 40, at 4-5. *See* Rose, *Direct Charge Cooperatives: Legal Aspects of a New Strategy in the War on Poverty*, 38 GEO. WASH. L. REV. 958 (1970).

106. Keystone Auto. Club Cas. Co. v. Commissioner, 122 F.2d 886, 889, 891 (3d Cir. 1941), *cert. denied*, 315 U.S. 814 (1942).

107. School Dist. of Philadelphia v. Frankford Grocery Co., 376 Pa. 542, 551, 103 A.2d 738, 742 (1954).

108. *See generally* PACKEL, *supra* note 40, at 52-62.

109. Rose, *supra* note 105, at 958.

110. *Id.* at 959.

111. *Id.*

112. Shadden, A Model Consumer Action Program for Low Income Neighborhoods 6 (Department of Church Planning, Church Federation of Greater Chicago, May 1966).

113. Rose, *supra* note 105, at 960.

114. *Id.*

tem makes no allowance for the accumulation of capital, but rather passes savings directly to member patrons in the form of lower prices for goods. Any excess of collected service charges over and above actual expenses may be returned at the end of the year.[115]

The Unincorporated Cooperative Association

In its early stages of growth, a consumer cooperative may take the form of a voluntary, unincorporated association, which is merely a body of persons united in a common purpose and acting in concert.[116] In the absence of special statutes, cooperative associations are usually governed by the same legal principles as are other associations and clubs.[117]

The powers of the unincorporated association are determined by the constitution or articles of association, and bylaws[118] that constitute a contract between members and the association.[119] The scope of the association's rights and liabilities may be determined by the constitution and bylaws and is limited only to matters reasonably consonant with the purposes for which the cooperative was formed, subject to the laws of the appropriate jurisdiction.[120] These documents may include provisions for such matters as voting rights,[121] disposition of interests of members upon expulsion or withdrawal,[122] and methods of raising funds.[123] In addition, the association agreement may be combined with another agreement, such as a purchasing contract, in which case both agreements will be construed together.[124]

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115. Annual rebates are still possible over assessments on a weekly or monthly basis. *Cf. id.*

116. H. OLECK, NON-PROFIT CORPORATIONS, ORGANIZATIONS AND ASSOCIATIONS 6 (2d ed. 1969) [hereinafter cited as H. OLECK].

117. *Cf.* PACKEL, *supra* note 40, at 28-29.

118. *See, e.g.*, Kelsey v. Early Grain & Elevator Co., 206 S.W. 849 (Tex. Civ. App. 1918).

119. *See, e.g.*, Lawson v. Hewell, 118 Cal. 613, 618-19, 50 P. 763, 764 (1897); Taite v. Bradley, 151 So. 2d 474, 475 (1st D.C.A. Fla. 1963); American Live-Stock Comm'n Co. v. Chicago Live-Stock Exch., 143 Ill. 210, 228, N.E. 274, 278 (1892).

120. *See, e.g.*, Rogers v. Boston Club, 205 Mass. 261, 269-70, 91 N.E. 321, 325 (1910); Weinstock v. Ladisky, 197 Misc. 859, 871, 98 N.Y.S.2d 85, 97 (Sup. Ct. 1950). Ordinarily, courts will not interfere with the enforcement of rules or bylaws of the association unless the methods of enforcement or the laws by themselves are unreasonable, immoral, or contrary to public policy. Even in these instances, however, courts will intervene only after members have exhausted their internal remedies. Harper v. Hoecherl, 153 Fla. 29, 33, 14 So. 2d 179, 181 (1943).

121. *See* Detwiler v. Commonwealth *ex rel.* Dickinson, 131 Pa. 614, 18 A. 990 (1890).

122. When adequate notice and hearing have been given, and in the absence of fraud or bad faith, courts will not generally review the sufficiency of the cause for the expulsion of a member by his association. State v. Florida Yacht Club, 106 So. 2d 207, 211 (1st D.C.A. Fla. (1958). Courts have upheld bylaws providing for the retention of a member's property following expulsion. *See* Driscoll v. East-West Dairymen's Ass'n, 52 Cal. App. 2d 468, 126 P.2d 467 (1942); *cf.* Clearwater Citrus Growers' Ass'n v. Andrews, 81 Fla. 299, 87 So. 903 (1921).

123. Reno Lodge No. 99, I.O.O.F., Hutchinson v. Grand Lodge, I.O.O.F., 54 Kan. 73, 37 P. 1003 (1894).

124. *Cf.* Brame v. Dark Tobacco Growers' Co-op. Ass'n, 212 Ky. 185, 278 S.W. 597 (1925).

The voluntary association form may offer a distinct advantage to small or embryonic cooperatives, in that there are few statutory guidelines with which they must comply. On the other hand, there are certain inherent disadvantages in doing business as a voluntary unincorporated association. Most of these liabilities stem from the well-established principle that, absent special statutory provisions, this form does not represent a legal entity distinct from that of its individual members.[125] The lack of legal recognition of an unincorporated cooperative may severely hamper the organization in its day-to-day business operations and may also serve to render the individual members liable for wrongful actions taken by officers or by other members.

Power to Contract. The legal problems affecting contractual relations are likely to be of most significant importance to the unincorporated association since the consumer cooperative will be continually engaging in contractual arrangements. In at least one jurisdiction an association may, by statute, be given the power to contract.[126] In the absence of such a statutory provision, however, an association has no legal power to contract[127] and cannot ratify a contract.[128] However, members of the association may incur liability under general agency principles. The liability of individual members for contracts executed by officers or other members of the voluntary cooperative association will, in the absence of applicable statutory authority, be determined by principles of express, implied, or apparent authority.[129]

Ordinarily, a member of an unincorporated association has no general authority to contract for the association.[130] However, such authority may be granted expressly by an association or it may be implied from the customary duties of the member.[131] Likelihood of a determination of member liability, of course, becomes more acute with respect to contracts executed by the officers of the cooperative.[132]

Florida does not grant statutory power to voluntary associations or their officers or members to enter into contractual arrangements. It was established at an early date in this state that a member or officer of an association who purports to bind the association as principal, binds himself.[133] This rule was

125. H. OLECK, *supra* note 116, at 93.

126. N.J. STAT. ANN. §2A:64-1 (2) (Supp. 1970).

127. *E.g.*, Hunt v. Adams, 111 Fla. 164, 149 So. 24 (1933).

128. *E.g.*, Amalgamated Clothing Workers of America v. Kaiser, 174 Va. 229, 6 S.E.2d 562 (1939).

129. Reese v. Levin, 124 Fla. 96, 168 So. 851 (1936).

130. *See, e.g.*, McConnell v. Denver, 35 Cal. 365 (1868); Cousin v. Taylor, 115 Ore. 472, 239 P. 96 (1925).

131. *See, e.g.*, Cherry v. Chicago & A.R. Co., 191 Mo. 489, 90 S.W. 381 (1905).

132. *See* Boyce v. Hart, 8 App. Div. 2d 916, 187 N.Y.S.2d 41 (3d Dep't 1959), where members of an association were held liable on a contract made by an officer without original authority after the contract had been ratified by the members with full knowledge of the facts.

133. Henry Pilcher & Sons, Inc. v. Martin, 102 Fla. 672, 136 So. 386 (1931); I.W. Phillips & Co. v. Hall, 99 Fla. 1206, 128 So. 635 (1930).

first stated in *I. W. Phillips & Co. v. Hall.*[134] A group of trustees were held individually liable on a note purportedly executed on behalf of its church.[135] The principle was later modified to the effect that outside creditors, who have knowledge of the legal nonexistence of a principal or who consent not to bind the agent with whom they are dealing, will be left entirely without legal remedy.[136] Because of this rule, outside parties may understandably be quite reluctant to extend credit to consumer cooperatives operating as voluntary, unincorporated associations.[137]

Tort Liability. Unincorporated associations are under the same duties and liabilities as other principals with respect to torts committed by their members.[138] In general, a principal is liable for torts committed by its agents while acting within the scope of their employment.[139] However, since the association has no separate legal identity, liability for tortious acts committed by officers or members within the scope of their authority may be imputed to all the members of the association.[140] It would therefore be wise for officers and members of unincorporated cooperatives to attempt to insulate themselves from possible tort liability through insurance and bonding.[141]

Power To Acquire and To Hold Property. In some jurisdictions, including Florida, an association cannot convey or receive property in its own name.[142] However, property may, in most instances, be conveyed by deed of trust to the cooperative officers or other representatives as trustees.[143]

Power To Sue or To Be Sued. In the absence of an enabling or permissive statute,[144] an unincorporated association cannot sue or be sued in its own

134. 99 Fla. 1206, 128 So. 635 (1930).

135. *Id.*

136. Hunt v. Adams, 111 Fla. 164, 149 So. 24 (1933); Bryce v. Bull, 106 Fla. 336, 143 So. 409 (1932).

137. A similar problem faces emerging tenant unions. Because of their nonrecognition as legal entities, it is often difficult to persuade landlords to enter into bargaining agreements. Note, *Tenant Unions: Their Law and Operation in the State and Nation*, 23 U. FLA. L. REV. 79, 87 (1971). *See also*, Note, *Hazards of Enforcing Claims Against Unincorporated Associations in Florida*, 17 U. FLA. L. REV. 211, 212 (1964).

138. *See, e.g.*, Baird v. National Health Foundation, 235 Mo. App. 594, 144 S.W.2d 850 (1940).

139. *See, e.g.*, Ketcher v. Sheet Metal Workers Int'l Ass'n, 115 F. Supp. 802 (E.D. Ark. 1953); Kelly v. Wallace, 6 Fla. 690 (1856).

140. *See* PACKEL, *supra* note 40, at 196-200.

141. Rose, *supra* note 105, at 963. The Peabody Store, an unincorporated cooperative association, attempted to limit its liability by having each member agree not to sue the other members. The members agreed that if the organization were sued its liability should not exceed its assets. Similar agreements were sought with wholesalers and others frequenting the store. The author pointed out that insurance should nevertheless be obtained for injuries to outsiders. *Id.*

142. *See, e.g.*, Kain v. Gibboney, 101 U.S. 362 (1879); Full Gospel Temple v. Redd, 82 So. 2d 589 (Fla. 1955).

143. Full Gospel Temple v. Redd, 82 So. 2d 589 (Fla. 1955).

144. *See, e.g.*, ALA. CODE tit. 7, §142 (1958); McNulty v. Higginbothom, 252 Ala. 218, 40 So. 2d 414 (1949).

name.[145] This rule is well established in Florida and except in cases in which associations are treated as partnerships,[146] no actions will lie unless all members are joined and served individually.[147] The practical impact of this procedural rule on the day-to-day operations of the cooperative association is that the organization may be severely restricted in business dealings in which legal rights and duties may be of ultimate concern. For example, it may be difficult for unincorporated cooperatives to obtain credit from outsiders who are apprehensive of the procedural difficulties in recovering from the association should foreclosure become necessary.

Treatment of Unincorporated Cooperative as a Partnership. Another possible problem in many jurisdictions, including Florida, is that an unincorporated association that is organized for profit may be legally deemed to be a partnership.[148] Although there may be persuasive arguments that consumer purchasing cooperatives, especially those organized partially for purposes of urban economic redevelopment, should be deemed to be nonprofit in character,[149] the possible consequences of being determined to be a partnership could be most detrimental and should not be overlooked.[150]

The element of intent is the most significant criterion the courts apply when deciding whether an organization is or is not a partnership.[151] Consequently, perhaps the best argument with which to rebut an assertion of partnership is that the members, in joining the cooperative, did not have the requisite intent to become partners since they did not intend to participate actively in the management of the business or to undertake the fiduciary responsibilities consonant with partnership status. This argument should be

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145. *See, e.g.*, Brown v. United States, 276 U.S. 134 (1927); Montgomery Ward & Co. v. Langer, 168 F.2d 182 (8th Cir. 1948); Florio v. State, 119 So. 2d 305 (2d D.C.A. Fla. 1960).

146. *Cf.* Johnston v. Albritton, 101 Fla. 1285, 1288-91, 134 So. 563, 565 (1931).

147. *See, e.g.*, Santa Rosa Medical Soc'y v. Spires, 153 So. 2d 325 (1st D.C.A. Fla. 1963); Florio v. State, 119 So. 2d 305 (2d D.C.A. Fla. 1960). However, action may be maintained against an unincorporated association for purposes of subjecting its property to an equitable lien where no personal judgment is sought against the association. Ross v. Gerung, 69 So. 2d 650 (Fla. 1954).

148. F.J. Dubos & Co. v. Hoover, Jones & Bowden, 25 Fla. 720, 6 So. 788 (1889).

149. Rose, *supra* note 105, at 972.

150. It is well established that death, bankruptcy, or other legal incapacity of a partner dissolves a partnership. *See, e.g.*, UNIFORM PARTNERSHIP ACT §§31(4), (5) [hereinafter cited as U.P.A.]; Fillyau v. Laverty, 3 Fla. 72 (1856). In addition, in Florida a partnership may be dissolved at the will of any partner when no definite terms or particular undertaking are specified in the partnership agreement. Hirsch v. Bartels, 49 So. 2d 531 (Fla. 1950). Under the Uniform Partnership Act and under Florida law, each partner has equal rights in the management and conduct of the partnership business, and the acts of each partner within the scope of the partnership objectives bind all other partners. U.P.A. §18(a); Proctor v. Hearne, 100 Fla. 1180, 131 So. 173 (1930). Obviously, the consequences of a determination that a cooperative is legally a partnership and a concomitant application of these legal principles to a consumers' purchasing organization with several hundred members could be catastrophic.

151. *See, e.g.*, UNIFORM LAWS ANN., UNIFORM PARTNERSHIP ACT §7 n.34. *See also* Nelson v. Seaboard Sur. Co., 269 F.2d 882 (8th Cir. 1959); Stephens v. Orman, 10 Fla. 9 (1862).

especially persuasive in the case of direct-charge cooperatives, since these organizations act as mere conduits, procuring for their members requested goods and services.[152]

Incorporated Cooperatives

Because of the many hazards inherent in operating a cooperative under the voluntary, unincorporated association form, organizers should carefully consider three alternative forms of incorporation—either under a special purpose cooperative statute, under nonprofit corporation laws, or under the general business corporation laws. Incorporation would almost certainly be advisable for the large retail-charge cooperatives because of the advantages of limited liability for officers and members. The corporate form also affords additional convenience of operation and facilitation of credit for the cooperative organization.

Special Purpose Cooperative Statutes. Several states have enacted statutes specifically for the incorporation of consumer cooperatives.[153] These statutes do not restrict the cooperative to operation within traditional "corporate norms" and usually embody provisions particularly compatible with cooperative principles and methods of operation.[154] The Cooperative League of America and other authorities recommend that, in the absence of a special purpose cooperative statute in the resident state, it may often be advantageous for cooperative organizers to incorporate under a special cooperative statute of a foreign state.[155]

The District of Columbia statute on consumer cooperatives[156] has been characterized as the most ideally suited for incorporation.[157] This statute requires only nominal filing and incorporation fees[158] and permits organization on either a stock or nonstock basis, membership certificates serving in lieu of shares in the latter case.[159] The one-man, one-vote principle is expressly recognized by the District of Columbia statute.[160] Moreover, voting agreements and proxy arrangements are prohibited so as to prevent circumvention of cooperative principles of operation.[161] In addition, the Act permits a referendum on acts of directors upon petition of ten per cent of the members or

152. Rose, *supra* note 105, at 960.

153. *See, e.g.*, CAL. ANN. CORP. CODE §§12200 *et seq.* (West 1964); D.C. CODE ANN. §§29-801 *et seq.* (1968); ILL. STAT. ANN. §§305 *et seq.* (1969); WIS. STAT. §§185 *et seq.* (1969).

154. *See, e.g.*, D.C. CODE ANN. §§29-801 to -847 (1968).

155. PACKEL, *supra* note 40, at 62; TIME TO ORGANIZE? 1 (The Cooperative League of the USA (1969)).

156. D.C. CODE ANN. §29-806 (1968).

157. PACKEL, *supra* note 40, at 61; Miller, *Increasing Low-Income Consumer Buying and Borrowing Power by Cooperative Action*, 29 OHIO ST. L.J. 709, 715 (1968); TIME TO ORGANIZE?, *supra* note 155, at 1, 2.

158. D.C. CODE ANN. §29-806 (1968).

159. D.C. CODE ANN. §§29-805(7), -825 (1968).

160. D.C. CODE ANN. §29-813 (1968).

161. D.C. CODE ANN. §29-813 (1968).

a majority of the directors so long as third-party creditors are not prejudiced.[162]

Contrary to normal corporate practice,[163] provision is made by the District of Columbia statute for mandatory payment of patronage dividends.[164] Ten per cent of the net savings of the cooperative are required to be placed annually in a reserve fund until such time as the reserve fund equals fifty per cent of paid-in capital.[165] This fund, used for general conduct of the business, provides creditors with some assurance of cooperative liquidity. A portion of the remainder of the net savings must be allocated to a fund for cooperative education;[166] some may also be allocated for the general welfare of the members; and the remaining net savings are allocated at a uniform rate to all patrons in proportion to their patronage.[167] A Florida-based cooperative desiring to incorporate under the District of Columbia cooperative incorporation statute would simply register with the Secretary of State as a foreign corporation.[168]

Nonprofit Statutes. In some states nonprofit statutes may provide a suitable alternative to selection of a foreign, special-purpose cooperative statute.[169]Usually the articles of incorporation are relatively simple to prepare[170] and filing fees are nominal.[171] In addition, there is generally no minimum capital requirement before incorporation is permitted.[172] These statutes provide the advantages of incorporation (limited liability, the right to contract, to hold and acquire property, and to sue and be sued in the corporate

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162. D.C. CODE ANN. §29-821 (1968).

163. *See, e.g.*, FLA. STAT. §608.09 (Supp. 1970).

164. D.C. CODE ANN. §29-831 (4) (1968).

165. D.C. CODE ANN. §29-831 (1) (1968).

166. D.C. CODE ANN. §29-831 (3) (1968). This educational purpose lends support to the argument that the consumer cooperative serves a social purpose beyond pecuniary benefit to its members. *See also* Mississippi Valley Portland Cement Co. v. United States, 408 F.2d 827, 833-34 (5th Cir. 1969), *cert. denied*, 395 U.S. 944 (1969), wherein the court implies that the cooperative patrons must possess some degree of horizontal similitude beyond being investors. *See* text accompanying notes 239-241 *infra*.

167. D.C. CODE ANN. §§29-831 (4) (a)-(d) (1968). Savings returns are equivalent to the patron's proportionate share of the cooperative's gross income minus taxes, cost of goods sold, and operational and business expenses.

168. *E.g.*, as a general foreign corporation under FLA. STAT. §613.01 (1969) or as a foreign nonprofit corporation under FLA. STAT. §617.11 (1969). The latter provision may afford foreign nonprofit corporations broader powers than resident nonprofit corporations. In [1959-1960] FLA. ATT'Y GEN. BIENNIAL REP. 769 a nonprofit corporation, organized under the nonprofit corporation statutes of another state for the purpose of operating and managing a cooperative apartment house on a cooperative basis without capital stock, was permitted to do business in Florida as a nonprofit corporation. This was permitted despite the fact that one writer has suggested that a cooperative apartment house could not be incorporated under Florida's Nonprofit Corporation Statute. Anderson, *Cooperative Apartments in Florida: A Legal Analysis*, 12 U. MIAMI L. REV. 13, 17 (1957).

169. PACKEL, *supra* note 40, at 57-59.

170. *E.g.*, FLA. STAT. §617.013 (1) (1969).

171. *E.g.*, FLA. STAT. §617.015 (1) (1969).

172. *E.g.*, FLA. STAT. §617.013 (1969).

name)[173] without subjecting the cooperative to restrictive compliance with traditional corporate norms.[174] Thus, application under a nonprofit statute usually presents few mechanical or procedural difficulties.

The primary obstacle to adoption of this business form is the basic problem of qualification as a nonprofit corporation. In the abstract, the term "nonprofit" is of limited utility and has given rise to considerable conflict and confusion. A corporation may in reference to certain matters, such as capital stock[175] or license taxes,[176] be deemed a corporation-for-profit. Yet such a determination may have little relevance to whether the organization is considered to be nonprofit within the meaning of nonprofit corporation statutes.[177]

For example, in *School District of Philadephia v. Frankford Grocery Co.*,[178] a school district sought to recover a tax on the gross receipts of a grocery cooperative incorporated under a general business corporation statute. The statute in question required a tax from "every person engaging in any business in any school district."[179] The term "business" was defined by the statute as "carrying on or exercising for gain or profit . . . any trade [or] business."[180] In holding the cooperative exempt from taxation the court reviewed the origin and economic purpose of cooperative enterprises, and distinguished them from normal business entities, stating:[181]

> When a group of individuals enter into an agreement to pool their resources for a common purpose and state therein that their contributions to the extent not required for that purpose shall be repaid to them, it is hard to conceive how the contributions returned to them should be regarded as a gain or profit to the entity acting as their mutual agent.[182]

When determining the scope of operations permissible under a nonprofit statute, the courts appear to be concerned not so much with whether a cor-

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173. *E.g.*, FLA. STAT. §617.021 (1969).

174. *See* text accompanying notes 207-220 *infra*.

175. [1957-1958] FLA. ATT'Y GEN. BIENNIAL REP. 722.

176. [1959-1960] FLA. ATT'Y GEN. BIENNIAL REP. 769.

177. The Florida attorney general has stated that the capital stock and real and personal property of agricultural marketing associations, organized under FLA. STAT. ch. 618 (1969), are subject to taxation. *See* [1959-1960] FLA. ATT'Y GEN. BIENNIAL REP. 769; [1945-1946] FLA. ATT'Y GEN. BIENNIAL REP. 662. Yet, FLA. STAT. §618.01 (4) (1969), states that such associations "shall be deemed non-profit, inasmuch as they are not organized to make profit for themselves, as such, or for their members, as such."

178. 376 Pa. 542, 103 A.2d 738 (1954).

179. *Id.* at 546, 103 A.2d at 740.

180. *Id.*

181. *Id.* at 551, 103 A.2d at 742.

182. *But see* Miami Beach College Corp. v. Tomlinson, 143 Fla. 57, 59, 196 So. 608, 609 (1940). In that case the City of Miami Beach sought to enforce the imposition of a business license tax on a private college incorporated under the Florida Not-for-Profit Corporation Statute, FLA. STAT, ch. 617 (1969). In holding the college liable for the profits tax, the court did not concern itself with the question of whether the corporation was operating on a nonprofit basis within the meaning of the statute under which it was chartered. 143 Fla. 61, 63, 196 So. 608, 609 (1940).

poration had made or plans to make a profit, but whether the money will be used in a manner consistent with the purposes for which the statute was enacted.[183] As an example, the Ohio supreme court in *Ohio* ex rel. *Russell v. Sweeney*[184] upheld a decision by the secretary of state denying incorporation of a purportedly nonprofit corporation. The promoters had planned to acquire an existing corporation for profit and to use corporate earnings for community development purposes.[185] The holding was based on two conclusions: first, the charter provisions vested unduly broad authority in the directors, empowering them to act in a manner that might conceivably exceed the stated purposes of the charter.[186] Second, even if the directors acted in a manner wholly consistent with the stated corporate objectives, those corporate purposes would be outside the scope of activities contemplated by the relevant nonprofit statute.[187] The court conceded that direct pecuniary benefit would not be conferred upon the shareholders under the charter provisions. However, most of the shareholders, as beneficiaries of the community development program, would receive an indirect economic benefit from the corporation. The court found this element of indirect pecuniary gain to shareholders to contravene the purposes for which the governing nonprofit statute was enacted.[188] Following a similar rationale in sustaining a *quo warranto* attack on a chartered nonprofit corporation, the Washington supreme court in *State v. Lumbermen's Clinic* stated:[189]

> Profit does not necessarily mean a direct return by way of dividends, interest, capital account or salaries. A saving of expense which would otherwise necessarily be incurred is also a profit to the person benefited.

Consequently, the utility of nonprofit statutes for incorporation of consumer cooperatives may depend upon whether the indirect economic benefits, which inure to members as a result of their participation in the cooperative, are deemed to constitute a distribution of corporate "profits" to the members, incidental to corporate activities.[190] One authority, conceding that the economic benefit accruing to cooperative members might be considered a "profit," nevertheless argues in favor of a nonprofit status for cooperatives and distinguishes these entities from normal business corporations on yet another

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183. The Florida supreme court has stated that the fact that profits result from a nonprofit corporation is entirely consistent with the not-for-profit character of the corporation, as long as profits are used for purposes intended by the not-for-profit statute and are not diverted to shareholders. Miami Retreat Foundation, Inc. v. Ervin, 62 So. 2d 748 (1952), *construing* Fla. Stat. §617.01 (1951), *cf.* State v. State Racing Comm'n, 116 Fla. 144, 156 So. 343 (1934), in which a not-for-profit corporation was denied a permit to operate a dog racing club although the charter specified that profits would be devoted to charitable purposes.

184. 153 Ohio St. 66, 91 N.E.2d 13 (1950).

185. *Id.* at 68, 91 N.E.2d at 14.

186. *Id.* at 70-72, 91 N.E.2d at 16.

187. *Id.*

188. *Id.*

189. 186 Wash. 384, 394-95, 58 P.2d 812, 816 (1936).

190. *Cf.* H. OLECK, *supra* note 116, at 1.

basis.[191] The ordinary business corporation deals primarily with third persons. When profits are derived through corporate dealings with these third persons and are in turn distributed to shareholders, there is no question as to the characterization of such corporations as "for-profit."[192] The true cooperative, however, enables members to obtain "profits" resulting from the activities of the members themselves; therefore, the cooperative should not be considered as carrying on "for-profit" activities.[193]

This argument may be somewhat tenuous in the case of consumer cooperatives since members are not really dealing with themselves except in pooling their buying power. They are instead dealing with third persons and utilizing the cooperative as a conduit. The issue remains whether savings resulting from membership are to be deemed "a profit."[194] Perhaps a better basis on which to ground an argument of nonprofit status would be that of the purpose behind organizing and operating the cooperative.[195] It could be argued that social and educational objectives outweigh possible individual economic benefits in a consumer cooperative organized to facilitate economic development of a low-income community.[196]

Courts in several states have upheld the incorporation and operation of cooperatives under nonprofit statutes.[197] However, the Model Nonprofit Corporation Act[198] specifically precludes the organization of cooperatives under its provisions.

The Florida Not-For-Profit Corporation Statute. The availability of Florida's not-for-profit corporation act[199] for cooperative incorporation and operation is somewhat questionable. The statute specifies that a corporation "for lawful purposes" but "not for pecuniary profit" may be organized thereunder.[200] "Profit" is not specifically defined; however, no dividends or other corporate income may be distributed to members, directors, or officers.[201]

Whether cooperatives can utilize the not-for-profit statute will most likely turn on a determination of whether the indirect economic benefit derived as an incident to membership (savings on purchasing of goods and services)

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191. PACKEL, *supra* note 40, at 59.

192. *Id.*

193. *Id.*

194. For an interesting discussion in which an affirmative answer to this question is given, *see* Note, *Non-Profit Corporations — Definition*, 17 VAND. L. REV. 336 (1963).

195. H. OLECK, *supra* note 116, at 1-2. The author suggests that when the dominant motives of an organization are ethical, moral, or social the organization should be considered nonprofit for purposes of incorporation under the usual nonprofit statute.

196. *See* text accompanying notes 37-39 *supra*.

197. *See, e.g.*, Milk Producers' Marketing Co. v. Bell, 234 Ill. App. 222 (1924); Burley Tobacco Growers' Co-op. Ass'n v. Rogers, 88 Ind. App. 469, 150 N.E. 384 (1926).

198. ABA-ALI MODEL NONPROFIT CORPORATION ACT §4 (1957). *But see* R. BOYER, NONPROFIT CORPORATION STATUTES: A CRITIQUE AND PROPOSAL 129-34 (1957).

199. FLA. STAT. ch. 617 (1969).

200. FLA. STAT. §617.01 (1969).

201. *Id.* §617.011.

constitutes a "pecuniary profit."[202] This question has never been decided by the Florida courts; however, an opinion by the Florida attorney general appears to indicate that indirect economic benefit is not tantamount to "pecuniary profit" within the meaning of the statute.[203] This opinion stated that a corporation organized for the purpose of securing benefits for members under the federal housing program could probably be incorporated under the not-for-profit corporation statute.[204] This opinion adds validity to the earlier suggestions that educational and social purposes of the proposed cooperative may be determinative in applying for incorporation under the not-for-profit act.[205]

General Corporation Statutes. As a third alternative, consumer cooperative organizers may wish to consider incorporating under general business corporation statutes. However, compliance with federal security registration requirements may be more difficult for the cooperative organized as a general business corporation.[206]

General corporation statutes may pose other difficulties, especially in jurisdictions that strictly adhere to traditional "corporate norms."[207] Broad discre-

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202. *Compare* PACKEL, *supra* note 40, at 57-59, *with* Note, *Non-Profit Corporations—Definition*, 17 VAND. L. REV. 336 (1963). *See also* R. PATTERSON, THE TAX EXEMPTION OF COOPERATIVES 13-15 (1961) where it is argued that patronage dividends do not represent earnings on profits from corporate activities but are mere refunds of overcharges on goods and services.

203. [1959-1960] FLA. ATT'Y GEN. BIENNIAL REP. 769.

204. *Id.*

205. In view of the lack of case law concerning cooperative organization under Florida's not-for-profit corporation statute, it is recommended that organizers and counsel consult the offices of the secretary of state or attorney general prior to attempting to incorporate under this statute. In the absence of a more persuasive authority, it may be noted that the Fraternity Purchasing Association of Gainesville, Florida was granted a not-for-profit charter in 1961. This organization operates under traditional cooperative principles, providing food commodities and certain services to member fraternity organizations on a direct-charge basis. Fraternity Purchasing Association of Gainesville, Florida Charter and Bylaws. There is another problem posed by the Florida not-for-profit statute. FLA. STAT. §617.01 (1969) provides that if a not-for-profit corporation can incorporate under any other law of this state, it may not be incorporated under the not-for-profit statute. FLA. STAT. §§608.03 (1) (b), .13 (12) (Supp. 1970) expressly provides for the incorporation of cooperatives as general business corporations. These provisions construed together would therefore seem to preclude the incorporation of cooperatives as not-for-profit corporations. It might be argued, however, that a cooperative that issues membership certificates rather than shares of stock should be entitled to incorporate under the not-for-profit act since the general corporation act seemingly contemplates only corporations in which shares of stock are issued. *See* FLA. STAT. §608.03 (2) (c) (Supp. 1970).

206. *See* text accompanying notes 50-75 *supra*.

207. PACKEL, *supra* note 40, at 60. In each state the statutory and relevant case law should be carefully scrutinized by counsel to insure that restrictions and limitations upon centralization of power and discretion in the board of directors, maximum amount of share ownership, voting power, and return on capital investment can be effected in keeping with traditional principles of cooperative operation. Transfer of shares will not ordinarily pose a problem for the cooperative. Cooperatives organized under general corporation laws can normally limit the transferability of shares, State v. Sho-me Power Coop., 356 Mo. 832, 204 S.W.2d 276 (1947); *cf.* Elliot v. Lindquist, 356 Pa. 385, 52 A.2d 180 (1947). Where

tionary powers are generally accorded the board of directors in the management of corporate business.[208] For example, payment of dividends is traditionally within the province of board discretion.[209] The only manner in which stockholders can object to a board decision regarding the withholding of dividends, short of discharging directors for valid cause, is to bring a derivative action;[210] and courts will not override a decision by a board of directors without a showing of an abuse of discretion.[211]

Proxy voting, allowed in most jurisdictions[212] and mandatory in some,[213] provides another means by which cooperative aims could be frustrated. This is the traditional method used by corporate management to effectuate long-range control and stability and, in many cases, to stifle shareholder dissent.[214] Such procedures are incompatible with the purposes of cooperatives since democracy in voting and equality in control represent the cornerstone of cooperative principles of operation.[215] Finally, substantial paid-in capital requirements, initial filing fees, and periodic extensive reporting requirements may prove to be cumbersome and unrealistic to cooperatives incorporated under general business corporation statutes.

The Florida General Corporation Statute. The Florida general corporation statute[216] expressly provides for the incorporation of cooperatives.[217] Many of the characteristics of the cooperative form of operation are recognized in special provisions.[218] Therefore, it would appear that the Florida

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there are obstacles in placing restraint on the alienation of shares, the desired result can often be accomplished by the establishment of voting trusts. *E.g.*, CAL. ANN. CORP. CODE §§2230, 2231 (West 1955); DEL. CODE ANN. §218 (1953). Strict compliance with statutory terms may be mandatory, *e.g.*, Abercrombie v. Davies, 36 Del. Ch. 371, 130 A.2d 338 (Sup. Ct. 1957).

208. *E.g.*, Citizens Nat'l Bank v. Peters, 175 So. 2d 54 (2d D.C.A. Fla. 1965); *see* H. BALLANTINE, CORPORATIONS 550-54 (rev. ed. 1946).

209. *E.g.*, Reid v. Long Island Bond & Mortgage Guarantee Co., 198 Misc. 460, 98 N.Y.S.2d 739 (Sup. Ct. 1949), *aff'd*, 277 App. Div. 888, 98 N.Y.S.2d 389 (2d Dep't 1950); FLA. STAT. §608.131 (1969). *See* H. BALLANTINE, CORPORATIONS 550-54 (rev. ed. 1946). Patronage refunds should not be considered excess corporate profits but may be said to be at least equitably owned by the members. As previously discussed, this distinction is recognized by the District of Columbia cooperative statute, D.C. CODE ANN. §29-831 (4) (1968). *See* text accompanying notes 163-167 *supra*.

210. *E.g.*, FLA. STAT. §608.131 (1969).

211. *E.g.*, Williams v. Green Bay & Western R.R., 326 U.S. 549 (1946). As a practical matter, however, the deduction from income tax given cooperatives upon the payment of certain patronage dividends might minimize this problem. *See* text accompanying notes 253-261 *infra*.

212. H. BALLANTINE, CORPORATIONS 407-09 (rev'd. ed. 1946).

213. *E.g.*, FLA. STAT. §608.10 (5) (Supp. 1970).

214. J. GALBRAITH, THE NEW INDUSTRIAL STATE 61 (Signet ed. 1967).

215. J. MARTIN & G. SMITH, THE CONSUMER INTEREST 21-22 (1968).

216. FLA. STAT. ch. 608 (1969), *as amended*, (Supp. 1970).

217. FLA. STAT. §§608.03 (1) (b), .13 (12) (Supp. 1970).

218. FLA. STAT. §608.13 (12) (Supp. 1970) provides, in part, that a cooperative may: "(a) Limit and regulate the right of stockholders to transfer their stock and provide terms and limitations of stock; (b) Provide for the government of the association by the purely

general corporation statute is more suitable for cooperative incorporation than many business corporation statutes.

This recognition by the Florida Legislature of traditional cooperative characteristics and modes of operation is salutary. Yet, these provisions may not be of sufficient scope to preclude the necessity for Florida-based cooperatives to incorporate under foreign special-purpose cooperative statutes. For instance, there are no special provisions preventing proxy voting or limiting the amount of required initial paid-in capital.[219] Perhaps the main drawback of these provisions is that they have not yet been subjected to the test of judicial construction. Section 608.13 (12) (b) of the Florida Statutes, 1970 supplement, provides for government according to "the purely cooperative custom of one-man, one-vote." It might be argued that this provision virtually vitiates the traditional corporate norm embodied in section 608.09:[220]

> The business of every corporation shall be managed and its corporate powers exercised by a board of one or more directors . . . .

Whether the Florida courts will adopt this interpretation, however, cannot be predicted at this time.

Summary. Because of the advantages of limited liability, the power to contract, to buy and sell property, to sue and be sued as a legal entity, and the concomitant benefit of more favorable treatment by commercial creditors it is probably advisable for most consumer cooperatives to incorporate. Special purpose cooperative statutes are generally more suitable than general business corporation statutes.[221]

Cooperatives doing business as general corporations are probably more likely to be required to register offerings of membership shares with the Securties and Exchange Commission than are cooperatives with nonprofit or special purpose charters since the latter generally place strict limitations upon sharing of net earnings with members.[222]

In states in which the availability of nonprofit statutes is in doubt, counsel might consider incorporating under a foreign special purpose statute, such as the District of Columbia cooperative statute, and registering in the member's state as a foreign nonprofit corporation.[223]

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cooperative custom of one man, one vote; and (c) Distribute earnings, wholly or in part, on the basis of or in proportion to the amount of property bought from or sold to its members or other customers or of labor performed for or services rendered to the association."

219. FLA. STAT. §608.13 (12) (Supp. 1970).

220. FLA. STAT. §608.09 (1) (Supp. 1970).

221. *See* text accompanying notes 156-168 *supra.*

222. *See, e.g.,* D.C. CODE ANN. §29-822 (1968); FLA. STAT. §617.011 (1969). *See also* note 66 *supra.* Although cooperatives chartered as business corporations could be similarly limited through their articles of incorporation from sharing profits with members, the legality of such provisions might be doubtful in states that adhere strictly to the corporate norm. *E.g.,* FLA. STAT. §608.09 (1) (Supp. 1970). *See* text accompanying note 220 *supra.*

223. *See* note 168 *supra.*

Taxation of Consumer Cooperatives

The Internal Revenue Code of 1954 expressly exempts farmer's cooperatives from income taxation.[224] Although consumer cooperatives do not fall within any express exemptive provisions they may nevertheless receive favorable tax treatment if they operate within certain specified guidelines.[225] This favorable treatment includes a deduction to the cooperative upon payment of certain types of patronage dividends[226] and a delayed filing date of up to eight and one-half months after the close of the taxable year.[227] Patrons of consumer cooperatives are also accorded special treatment. Patronage dividends that would ordinarily be taxable to the patrons are not includable in their gross income, provided these dividends are attributable to purchases of personal, living, or family items.[228]

Patronage Dividends

A "patronage dividend" is expressly defined in the Code as "an amount paid to patron by an organization . . . on the basis of quantity or value of business done with or for such patron . . . ."[229] The business done with the cooperative must be under a preexisting obligation to make the payment, and the payment is determined by reference to the net earnings of the organization from business done with or for its patrons.[230]

The requirement of an obligation to make payment may be satisfied if payments are required by state law or are paid pursuant to provisions of the bylaws, articles of incorporation, or other written contract whereby the organization is obligated to make such payment.[231] While the Code does not state that the obligation to make patronage dividends must be in writing,[232] the

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224. Int. Rev. Code of 1954, §521 (a) [hereinafter cited as Code].

225. For an exhaustive treatment of the history of the taxation of cooperatives and of the application of Subchapter T to nonexempt cooperatives, *see* Logan, *Federal Income Taxation of Farmers and Other Cooperatives*, 44 Texas L. Rev. 250, 1269 (pts 1-2) (1965-1966).

226. Code §1382 (b). *See* text accompanying 253-261 *infra*.

227. Code §6072 (d). *See* text accompanying notes 269-270 *infra*.

228. Code §1385 (b). *See* text accompanying notes 253-261 *infra*.

229. Code §1388 (a) (1).

230. Code §§1388 (a) (2), (3). Subchapter T was inserted into the 1954 Code in 1962 to plug the loophole created by the decision in Long Poultry Farms, Inc. v. Commissioner, 249 F.2d 726 (4th Cir. 1967). In *Long Poultry* the cooperative deducted the face amounts of certificates issued as patronage dividends. The certificates were considered of such contingent value that the recipient was not required to consider it as gross income. Subchapter T was enacted to insure that the earnings of the cooperative will be taxed at either the cooperative level or at the patron level. *See* H.R. Rep. No. 1447, 87th Cong., 2d Sess. 78-79 (1962); S. Rep. No. 1881, 87th Cong., 2d Sess. 111-12 (1962).

231. Treas. Reg. §1.1388-1 (a). The Regulations provide that there can exist no power to divert the profits from the patron to the benefit of others. Any such power, regardless of whether it is exercised or not, will result in a loss of deduction. *See, e.g.*, Fountain City Coop. Creamery Ass'n v. Commissioner, 172 F.2d 666 (5th Cir. 1949).

232. Code §1388 (a) (2).

Treasury Regulations specifically require that in order to obtain the deduction there must be a "valid enforceable written obligation."[233]

Source of Patronage Dividends. In order to qualify as a patronage dividend the payment must be derived from profits or margins earned from the patrons' business; the dividend cannot derive from business with others to whom a smaller amount (or nothing) is paid with respect to substantially identical transactions.[234] In addition, proceeds from business done with the Government from the lease of property or from sales of capital assets are not patronage.[235]

In *Mississippi Valley Portland Cement Co. v. United States*[236] the court refused to allow a patronage deduction for dividends paid to patrons from the proceeds of sales to nonmember patrons. In that case each shareholder patron holding five shares of stock in the cooperative cement company was entitled to purchase one barrel of cement at market price. Patronage dividends were made to the extent the market price per barrel exceeded its cost of production and sales.[237] Failure by the patron to purchase the cement by a certain date resulted in an assignment of the patron's purchasing rights to a sales corporation. During the relevant year none of the patrons' purchase rights were exercised. All cement produced by the cooperative was delivered to the sales corporation for sale to the general public. The issue before the court was whether the distribution to shareholders of the net profit of Portland Cement could be characterized as patronage dividends and therefore deductible. The court held that such dividends were not deductible since they were not distinguishable from dividends paid by a traditional corporate entity to its shareholders.[238]

In holding that the dividends were not deductible, the court provided some guidelines that reveal the nature of patronage dividends as contemplated

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233. Treas. Reg. §1.1388-1 (a) (ii). Some courts have held that an informal understanding with patrons, even if carried out in practice, will not permit a deduction. *See, e.g.*, American Box Shook Export Ass'n v. Commissioner, 156 F.2d 629 (9th Cir. 1946); Beaver Valley Canning Co., 9 CCH TAX CT. MEM. 1120 (1950). However, oral contracts for patronage dividends have been effective for a deduction. *See, e.g.*, Southwest Hardware Co., 24 T.C. 75 (1955), *acquiesced in* 1955-2 CUM. BULL. 9. With this conflict it is clear that to avoid problems in claiming the patronage deduction the cooperative should take the precaution of having a "valid enforceable written obligation" with its patrons as prescribed by the Treasury Regulations.

234. CODE §1388 (a).

235. Logan, *supra* note 225, at 1272.

236. 408 F.2d 827 (5th Cir. 1969). This case is one of the few decisions in the area of taxation of nonexempt consumer cooperatives.

237. *Id.* at 829.

238. *Id.* at 834. The court stated: "We have lifted the cooperative veil and have unmasked the economic realities of these transactions. Our conclusion is that the taxpayer's shareholders were no more than paper patrons, and 'that the distribution to stockholders was nothing more than a dividend paid out of profits of the corporation.' Peoples Gin Co., Inc. v. Commissioner of Internal Revenue, 5 Cir. 1941, 118 F.2d 72, 73. . . . [S]hareholders were merely investors and non-essential links in a conduit to the outside, not consumers of the corporate product." *Id.* at 833-34.

by the Code. First, because the cooperative provided for "prepackaged semi-automatic assignments"[239] of its entire production, it was apparent that the cooperative's purpose was not to supply its shareholders with cement at reduced cost. Its purpose was to supply them with a return on their investment. Second, there was no "horizontal similitude among the stockholder-patrons" because the shareholders were a "variegated and disparate conglomerate."[240] The only thing the shareholders held in common was an investment that they hoped would be a profitable venture. Their relationship to each other and to the cooperative was no different from that of shareholders in any other publicly held corporation.[241]

It is apparent from this case that the form of the transaction will not govern. Had the individual patrons purchased the cement and then sold to the sales corporation, any preexisting arrangement between Portland and the sales corporation for purchase from patrons would have tainted the transaction, and a patronage dividend would have been denied a deduction. Permeating this decision is the court's requirement of some horizontal similitude, or common interest among the patrons, other than the profit motive, which would distinguish them from investors in corporate enterprise.

Form of Patronage Dividends. Under the current law the cooperative may deduct amounts paid during the payment period for the taxable year as patronage dividends, whether distributed in money, qualified written notices of allocation, or other property.[242] A deduction is also allowed for the redemption of nonqualified written notices of allocation whether redeemed in money or property.[243]

Payment in money is the simplest form of patronage dividend. Such a payment includes payment by check but does not include "a credit against amounts owed by the patron to the cooperative organization, a credit against the purchase price of a share of stock, or of membership in such organization."[244] Nor does it include a payment made in the form of a document redeemable in money by the cooperative.[245] In lieu of paying its patrons wholly in cash a cooperative may wish to make at least part of the patronage dividends in certificates that are redeemable at some later period of time. This

239. *Id.* at 834.

240. *Id.* at 835. The court also stated: "In economic substance the taxpayer's distributions were the same as ordinary corporate dividends, and consequently they could not be excluded from the taxpayer's gross income." *Id.* at 834.

241. *Id.* at 833-34. Of compelling importance in the court's reasoning was the fact that the patron never actually used the product. This contravened the language of the CODE, §1388 (a) (1) (A), precluding as patronage dividends amounts paid to a patron out of earnings other than from business done "with or for patrons."

242. CODE §1382 (b) (1) (last sentence of §1382 (b) permits deduction).

243. *Id.* §1382 (b) (2). In addition, per-unit retain allocations, which relate to marketing agreements as opposed to purchasing agreements, are also deductible under certain circumstances but will not be discussed further since they generally are not used in consumer cooperatives. *Id.* §§1382 (b) (3), (4).

244. Treas. Reg. §1.1388 (1) (c) (ii) (1963).

245. Logan, *supra* note 225, at 1283. The author explores the possibility of satisfying the payment of patronage dividends with negotiable notes.

would allow the organization the use of these funds in the interim period. The Code permits the cooperative to do this and refers to such redeemable certificates as written notices of allocation, defining them as:[246]

> [A]ny capital stock, revolving fund certificate, retain certificate, certificate of indebtedness, letter of advice, or other written notice, which discloses to the recipient the stated dollar amount allocated to him by the organization and the portion thereof, if any, which constitutes a patronage dividend.

A written notice of allocation is qualified[247] if it may be redeemed in cash at its stated dollar amount within a period of at least ninety days from the date of payment[248] or if the patron consents to declare as gross income the stated dollar amount of the qualified notice.[249] The written consent required need not take any specified form. Consent may be made by a signed invoice, sales slip, delivery ticket, or other document that contains language informing the member of his agreement to include the patronage dividend on his tax return.[250] A patron may also consent to take the stated dollar amount of written notices of allocation into account by obtaining or retaining membership in the cooperative organization.[251] Consent may also be effectuated by the cooperative adopting a valid bylaw providing that membership in the cooperative organization constitutes consent.[252]

Qualified written notices of allocation are deductible by the coopera-

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246. CODE §1388 (b).

247. CODE §1388 (c). An over-all requirement is that at least 20% of the allocation must be paid in money or by "qualified check." *Id.* §1388 (c) (1). The latter may be used when consent of the patron is a requisite qualification of a written notice of allocation and consent has not been obtained by any of the other methods prescribed by the Internal Revenue Service. *Id.* §1388 (c) (4). The patron merely endorses a check on which is imprinted a statement to the effect that the patron agrees to include the stated dollar amount as gross income. *Id.* §§1388 (c) (2) (C), (c) (4). The check must be cashed before the ninetieth day after the close of the payment period for the taxable year. *Id.* §1388 (c) (4).

248. *Id.* §1388 (c) (1) (A).

249. *Id.* §1388 (c) (1) (B). Section 1388 (c) (2) provides that such consent may be made only by: "(A) making such consent in writing, (B) obtaining or retaining membership in the organization after (i) such organization has adopted . . . a bylaw providing that membership in the organization constitutes such consent, and (ii) he has received a written notification and copy of such bylaw, or (C) endorsing and cashing a qualified check, paid as part of the patronage dividend or payment of which such written notice of allocation is also a part, on or before the 90th day after the close of the payment period for the taxable year of the organization for which such patronage dividend or payment is paid."

250. Treas. Reg. §1.1388-1 (c) (3) (i) (1963). However, CODE §1388 (c) (3) provides that no consent can be irrevocable but consent is effective during the taxable year of the cooperative in which the patronage dividend is received and for all subsequent years until revoked.

251. CODE §1388 (c) (2) (B).

252. CODE §1388 (c) (2) (B). Treas. Reg. §1.1388-1 (c) (3) (ii) (b) (1963) offers a suggested form of bylaw that if adopted would constitute consent. Treas. Reg. §1.1388-1 (c) (3) (ii) (a) (1963) provides that this consent shall take effect only after the distributee has received a copy of the bylaw informing him of its adoption and significance. Such notice must be given separately to each member.

tive.[253] Ordinarily, they are includable in the gross income of the patron.[254] However, when these qualified written notices of allocation are attributable to purchases of personal, living, or family items they may be excluded from the gross income of the patron.[255]

Nonqualified written notices of allocation are defined as any other written notices of allocation than those that are qualified.[256] For example, if a cooperative declares a patronage dividend but states to its members that the dividend will be issued in the form of a note payable in one year, the note constitutes a nonqualified written notice of allocation.[257] Nonqualified written notices of allocation are not deductible by the cooperative when issued.[258] However, the amount of money or the value of other property subsequently paid in redemption of nonqualified written notices of allocation is deductible at the time of such redemption.[259] Ordinarily, cooperative patrons must include amounts received in redemption of nonqualified written notices of allocation in their gross income.[260] However, if the amounts are attributable to personal, living, or family items they need not be included in the patrons' gross income.[261]

Computing the Amount of the Patronage Dividend. In order to compute the amount of the patronage dividend a cooperative must make an allocation of total profits attributable to each member and available for distribution as patronage.[262] Records of each transaction with individual patrons must be

253. CODE §1382 (b) (1).
254. CODE §1385 (a) (1).
255. CODE §1385 (b) (2).
256. CODE §1388 (d).
257. In this hypothetical situation 20% of the dividend is not paid in money or by qualified check. *Id.* §1388 (c). The note is not redeemable *within* a period extending at least ninety days. *Id.* §1388 (c) (1) (A). Nor did the patron (s) consent to take into account as gross income the stated dollar amount of the note. *Id.* §1388 (c) (1) (B). Therefore, the note is a nonqualified written notice of allocation. *Id.* §§1388 (b), (d). For a discussion of a possible accounting problem concerning nonqualified written notices of allocation, *see* Logan, *supra* note 225, at 1286, 1287.
258. CODE §1382 (b) (1).
259. CODE §1382 (b) (2).
260. *Cf.* CODE §1385 (b).
261. CODE §1385 (b) (2).
262. Logan, *supra* note 225, at 1277. For example, assume the cooperative sells couches and chairs. Assume further that the profit margin on chairs is $5 and on couches is $7. When computing patronage dividends it is assumed by the cooperative that all transactions result in equal profit. Consequently, the average profit would be $6. *X* buys couches worth $200; *Y* buys chairs worth $50. Total profit on *X* and *Y* purchase of $250 is $20. Patronage dividends will be computed as follows:

$$\frac{200}{250} \times 20 = \$16 \text{ to } X$$

$$\frac{50}{250} \times 20 = \$4 \text{ to } Y$$

The patronage dividends distributed to *X* and *Y* would be deductible to the cooperative and nontaxable to *X* and *Y* respectively.

kept accurately in order to provide a reference at the end of the year for a basis of allocation. If such records are not available through carelessness or loss, an allocation may still be permitted under the *Cohan* rule.[263]

The method most often used for computation of patronage dividends is to assume that the business with patrons entitled to patronage is equally profitable.[264] The total net income from all business is ascertained prior to deduction of federal taxes and after ordinary business deductions,[265] and if there have been dividends on capital stock the cooperative is not allowed a deduction for them.[266] Capital stock dividends of a nonexempt cooperative must be ratably charged against all net earnings, from both members and nonmembers, before deductible patronage dividends can be computed.[267] If otherwise qualified, the prorata portion of the remaining balance computed in accordance with the fractional share of business done with those entitled to patronage is considered available for patronage allocations and is deductible.[268]

Filing the Return

One possible problem area for the cooperative is the determination of the most advantageous time for patronage dividends and the date on which the cooperative is obligated to file its tax return. The Commissioner has ruled that a nonexempt cooperative is required to file an ordinary corporate return on the fifteenth day of the third month after the close of the taxable year.[269] The Code was amended in 1962 to authorize certain nonexempt cooperatives to have an eight and one-half month period following the close of the taxable year for filing the return. To qualify for this extension, the particular organization must be under an obligation to pay patronage dividends in an amount equal to fifty per cent of its net earnings from business done with or for its patrons.[270]

All cooperatives subject to Subchapter T, that make payments in the

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263. Producers Gin, Inc. v. Commissioner, 18 CCH TAX CT. MEM. (1959). Under the *Cohan* rule, Cohan v. Commissioner, 39 F.2d 540 (2d Cir. 1930) where records are not accurately kept itemizing permissible deductions, a deduction may nevertheless be permitted on a showing of other evidence by the taxpayer of his expenses. This same rule is applicable to cooperatives for the purpose of showing that patronage dividends were paid although the cooperative cannot itemize to whom or how much of a dividend was paid. However, any discrepancy will bear heavily against the taxpayer since the inexactitude of the computations are his own making.

264. Logan, *supra* note 225, at 1277.

265. CODE §§62, 162.

266. Rev. Rul. 68-228, 1968-1 CUM. BULL. 385.

267. *Id.*

268. Logan, *supra* note 225, at 1278. In Farmer's Cooperative Co., 22 CCH TAX CT. MEM. 183, 185 (1963), nonpatronage income was used to pay dividends on capital stock, which resulted in a corresponding proportionate increase in the total amount available as patronage income from shareholder business. The Service has continued to dissent from this position. Rev. Rul. 68-228, 1968-1 CUM. BULL. 385.

269. Rev. Rul. 59-322, 1959-2 CUM. BULL. 154.

270. CODE §6072 (d).

form of patronage dividends aggregating ten dollars or more to any person during the calendar year, are also required to submit an information return giving the aggregate amount of such payments and the name and address of each person to whom paid.[271] However, consumer cooperatives engaged primarily in distributing items of a type generally for personal, living, or family use are exempted from filling the reports.[272] In order for a cooperative to qualify for this exemption from reporting, eighty-five per cent of its gross receipts for the preceding taxable year, or eighty-five per cent of its aggregate gross receipts for the preceding three taxable years, must have been derived from the sale at retail of goods or services of a type that is generally for personal, living, or family use.[273]

Summary. The cooperative has the ability to "price-out"[274] and thereby avoid much, if not all, of any tax that might be imposed at the cooperative level. The purpose of Subchapter T is to assure that a tax is levied on either the cooperative or patron.[275] Congress has chosen not to enforce this policy, however, when the patron receives a dividend from transactions involving personal, family, and living expense items.[276] If close attention is given to the federal tax laws applicable to cooperatives it may be possible to avoid tax at the cooperative or consumer level and insure a maximum potential for growth and development of the consumer cooperative.

CONCLUSION

The cooperative form of distribution with its emphasis on economic power through collective, democratic effort can uniquely provide the urban poor with quality goods at reduced prices. When compared with independent, ghetto-based retail businesses, cooperatives provide three sources for additional consumer savings: elimination of net profits, reduction of operating costs, and reduction or elimination of the federal income tax.

From the standpoint of its ability to survive the adverse economic conditions of the ghetto, the consumer cooperative is also at a distinct advantage over the traditional retail business. Ghetto consumers are more likely to pa-

271. CODE §6044 (a) (1).

272. CODE §6044 (c). A cooperative is not exempt from the reporting requirements merely because it is an organization of a type that is described as entitled to the exemption. Treas. Reg. §1.6044-4 (a) (1).

273. Treas. Reg. §1.6044-4 (a) (2). The period of the exemption extends until the first taxable year in which gross receipts for permissible items fall below 70%. Treas. Reg. §1.6044-4 (a) (3).

274. R. PATTERSON, THE TAX EXEMPTION OF COOPERATIVES (1961). Pricing-out is the ability of a cooperative to pay patronage dividends to member patrons so that the cooperative does not retain any income on which to be taxed.

275. *See* H.R. REP. No. 1447, 87th Cong., 2d Sess. 78-79 (1962); S. REP. No. 1881, 87th Cong., 2d Sess. 111-12 (1962).

276. *Id.*