



# Starting an Agricultural Marketing Cooperative

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## Contents

<b>Introduction</b> .....	4
<b>Acknowledgements</b> .....	5
<b>Understanding the Nature of Cooperatives</b> .....	7
<b>When Cooperatives are Needed</b> .....	10
<b>Determining the Need for a Cooperative</b> .....	12
<b>Market Survey</b> .....	13
<b>Choosing a Strategy</b> .....	14
<b>Making a Preliminary Feasibility Estimate</b> .....	15
<b>Taking the Next Steps</b> .....	17
<b>Drafting the Articles of Incorporation</b> .....	19
<b>Drafting the Bylaws</b> .....	20
<b>Drafting a Marketing Agreement</b> .....	22
<b>Cooperative Finance/Equity Capital</b> .....	23
<b>Allocated Equity</b> .....	24
<b>Unallocated Equity</b> .....	25
<b>Cooperative Marketing</b> .....	26
<b>Comparing Pooling and Buy-Sell Transactions</b> .....	27
<b>Call Marketing Pools</b> .....	29
<b>Keys to Success</b> .....	30
<b>Other Considerations</b> .....	31
<b>Resources</b> .....	34
<b>Appendix I</b> — Excerpts from California Food and Agriculture Code .....	35
<b>Appendix II</b> — Sample Articles of Incorporation .....	39
<b>Appendix III</b> — Tables for Estimated Cash Flow Analysis .....	42
<b>Appendix IV</b> — Organization Agreement, Bylaws, Marketing Agreement, Membership Application, Election of Directors by Districts .....	44



## Introduction

**"N**ever doubt that a small group of concerned people can create a change; indeed, it's the only thing that ever has," noted Margaret Mead, the distinguished anthropologist and student of the human condition.

By forming cooperative businesses to address their own economic needs, citrus fruit growers in Southern California created their own nationally-recognized brand name and dominant market share, hardware store owners across the country now own their own wholesale supply company, farmers in the Midwest own and operate their own fertilizer manufacturing plants, residents of the isolated towns and ranches in west Texas operate their own electrical power network, college students in Wisconsin operate their own dormitories, homeowners in Ohio insure their houses and cars through their own insurance company, residents of Seattle have their own health care system and a chain of stores selling outdoor recreational equipment, and state employees in California have built their own banking system; cooperatives process and market cheese in Wisconsin, pork in Iowa, sugar beets in North Dakota, soybeans in Arkansas, cattle in Kansas, apples in Washington, cranberries in Connecticut, butter in Minnesota, cotton in Texas, and everything from avocados to prunes in California.

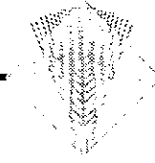
While some of these cooperatives are large business enterprises today, listed by *Fortune* magazine as among the 500 largest corporations in the country, most cooperatives are relatively small to middle-sized and will stay that way because they are effectively meeting the economic needs of their member owner-users.

In the following pages, we will study three distinct steps in starting a cooperative:

The first is to determine the need for a cooperative. This involves asking a number of carefully considered questions designed to help define the community's economic circumstances and to determine how forming a cooperative business can meet the community's economic needs.

The second is to organize the cooperative, bringing together member owner-users, financing, management and staff, governance, and physical assets. Key activities in this step include writing a statement of purpose, a business plan, articles of incorporation, bylaws, and policies.

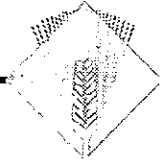
The final step is to begin business operations.



## Acknowledgments

The Center for Cooperatives wishes to thank the Agricultural Cooperative Service, U. S. Department of Agriculture, for their assistance in the preparation of this handbook. This handbook draws heavily upon various reports and materials made available by the Agricultural Cooperative Service. A partial list is as follows:

- *How To Start a Cooperative*, Gene Ingalsbe and James Goff, Cooperative Information Report No. 7, 1991. USDA, Economics, Statistics, & Cooperatives Services.
- *Sample Legal Documents for Cooperatives*, Donald A. Frederick, Agricultural Cooperative Service, USDA, 1991.
- *Some Answers to Questions About Commodity Market Pools*, John R. Dunn, Stanley K. Thurston, and William S. Farris, Agricultural Cooperative Service, USDA, 1980.
- Cooperative Information Report 40, 1994. Available from: USDA, RDA/Cooperative Services, Ag Box 3250, Washington, D. C. 20250-3250.





# Understanding the Nature of Cooperatives

Cooperatives are one of four basic types of business organizations which also include single or sole proprietorships, partnerships, and corporations. A cooperative is a business owned and controlled by the people who use its services. They finance and operate the business for their mutual benefit. Working together, they are able to achieve personal economic goals that would otherwise remain beyond their reach. Cooperatives are remarkably flexible and adaptable to a broad range of business and personal needs.

Cooperatives are particularly well-suited for helping people who lack sufficient resources of time, money, and expertise to expand or extend their business enterprises into new markets or for creating reliable sources at reasonable prices for the services and products that people want for their homes and families.

Cooperatives have also been organized to provide electricity or telephone service in remote rural regions, to provide affordable housing in inner-city areas, and to provide personal and business financing at reasonable costs.

A cooperative is any business owned and controlled by the people who use its services. They finance and operate the business for their mutual benefit. Working together, they are able to achieve personal economic goals that would otherwise remain beyond their reach.

Cooperatives give individuals the power to control their economic destinies through group action. This power flows from the willingness of each member-owner to pool his or her resources with those of all other participants in the venture. When the limited resources of individuals are combined, the economic well-being of each member of the group is improved.

Before organizing a cooperative business, however, the characteristic advantages and disadvantages of all four types of business organizations should be carefully considered. The form that best suits the long-term needs

and personalities of the members should be adopted. Keep in mind that one of the strongest characteristics of cooperatives seems to contradict common sense: cooperatives serve individual economic needs through group action.

The significant differences between cooperatives, sole proprietorships, partnerships, and corporations are seen in aspects of finance, distributing of benefits, control, taxation, risk and ownership.

## 1. Financing a Business

All businesses require capital to get started, to finance ongoing operations, and to acquire the resources needed to establish, maintain, and expand processing and distribution capabilities and to reach markets in response to the needs of member owner-users.

Long experience suggests that cooperatives are best financed by their member owner-users on an equitable basis. Members usually contribute financing in proportion to the amount of business they do through the cooperative. Such financing may come from direct infusions of cash at the time the cooperative is organized, through additional assessments after operations are under way, or through payment of membership fees as each new participant joins the association. Many cooperatives also require member owner-users to contribute additional financing each year in the form of retained earnings, which are funds withheld from the distribution of benefits to members.

Financing cooperatives with retained earnings is a popular method of "bootstrapping" the growth of a cooperative business when members have few financial resources to invest. Many cooperatives issue certificates of retained earnings (often referred to as common stock) as evidence of members' investments. Some cooperatives "revolve," "retire," or "redeem" investments of retained earnings within a specified period of time or at specified intervals. Others retain such earnings as permanent capital investments.

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Usually cooperatives do not pay interest to member owner-users on earnings retained as a source of financing. Under circumstances defined in the Capper-Volstead Act, farmer-owned cooperatives are allowed to pay limited dividends of up to eight percent annually on retained earnings. Consumer cooperatives such as cooperative grocery stores operating under different regulations are free of such restrictions.

The more usual practice of not paying interest on retained earnings grew out of the failures of a number of farmer-owned and consumer cooperatives organized in the second half of the 19th century, all of which tried to borrow their way to prosperity. Repeated analyses of those failures demonstrate that the costs of interest payments on borrowed funds undermined the financial strength of those cooperatives.

All other factors being equal, the cooperative that borrows the least and pays the least amount of interest stands the best chance of long-term survival and of successfully meeting the economic objectives of its member owner-users.

The owners of single proprietorships and partnerships are directly responsible for providing capital to their firms, and corporations acquire their capital through the sale of corporate bonds, common stock, or preferred stock to investors. All are subject to the same constraints of operating on borrowed funds.

### **2. Distributing the Benefits of Owning a Business**

All cooperatives return to their member-owners the difference between the income earned and the cost of doing business. That difference is paid back to member owner-users in proportion to their use of the cooperative's services. Because of this feature, cooperatives hold the legal status of nonprofit organizations. Note that while many cooperatives are organized to provide such direct economic benefits to their members, others are organized to assure access to markets or sources of supply essential to the success of the economic activities of individual members. The value of such cooperatives is realized through reliable access to markets or sources of supplies rather than in the earnings distributed after operating costs are paid.

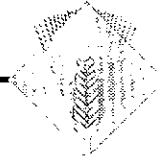
In corporations, profits may be reinvested in the corporation or distributed to investors in proportion to their investment in the firm. Partners most often divide the profits of their partnership in proportion to their capital investment or other contributions to their firms. Owners of single proprietorships receive all profits (and bear all risks) resulting from their business ventures.

### **3. Controlling a Business**

Cooperatives are democratically controlled by their member owner-users. The form of control involves one of two principles expressed in the "one-member, one-vote" model and/or by voting in proportion to the degree each member-owner uses the services of the cooperative. Control is normally expressed by member owner-users through the election of a board of directors. Directors are elected to represent the general membership in establishing the overall goals and policies of the cooperative, and to select management to develop and implement a business plan designed to achieve their cooperative's overall goals. Directors are also responsible for evaluating management's performance and adjusting the cooperative's goals and policies to meet the needs of member owner-users and in response to changes in the business environment. Representation can be apportioned on a geographic basis and/or in proportion to the volume of business each member owner-user does through the cooperative. The issue of control and representation is an important consideration in every form of business organization, because it is through control and representation that the owners assure that their business is meeting their individual economic needs.

In cooperatives, the central issue of control focuses on determining the nature of services provided to member owner-users. In corporations, control is normally held by owners of common stock who are usually concerned about the returns to their investments in the firm compared to other current investment opportunities. Control and representation issues such as the elimination of "outside interference" very often motivate the formation of single proprietorships and partnerships.





#### 4. How Businesses are Taxed

There are many potential variations on the tax treatment of agricultural cooperatives, but cooperative taxation is a complex subject and individual cases should always be discussed with a tax attorney knowledgeable about cooperative law. However, it is generally true that cooperatives, under provisions of the Internal Revenue Code, enjoy "single-tax treatment." This means that the earnings of a cooperative are not taxed when first earned by the cooperative, but are instead taxed as personal income only after they have been distributed to the co-op members. In some cases, member or co-op earnings are not taxed until distributed in cash; in general, earnings retained by the co-op as permanent capital or earnings from nonmember business are taxed.

Thus, the tax treatment of a cooperative is more like a sole proprietorship or a partnership than it is like an investor owned corporation. Corporate income is taxed when it is first earned by the corporation, and it is taxed again at the personal level when shareholders receive dividends derived from the corporation.

#### 5. Risk

Where liability for financial loss is concerned, the cooperative is more like an investor-owned corporation. While sole proprietors and some partners have unlimited financial liability, the member-owner of a

cooperative, like owners of other incorporated firms, has limited financial liability. The owner of the cooperative, like the stockholder in another corporation, can lose no more than the value of the stock he holds in the cooperative.

#### 6. Ownership

Of the four forms of business, only cooperatives are defined in terms of whom the business serves. Only the producers of agricultural commodities are eligible to own and be members of agricultural marketing cooperatives. Only the patrons of a cooperative grocery store are eligible to be member-owners of such a firm.

Anyone with capital to invest may become an investor in a corporation. The laws of the United States and of California are indifferent to the identity of investors as consumers of the services and products manufactured and marketed by corporations. By the same token, anyone may establish a sole proprietorship or participate in partnerships. However, an agricultural producer can become a member of a particular agricultural marketing cooperative *only* if he produces one or more of the particular commodities marketed by that co-op.

The following table compares the major forms of business organization with respect to the issues of financial liability, taxation, and control:

#### Comparison of Four Forms of Business Organization

<u>Form</u>	<u>Control</u>	<u>Tax</u>	<u>Financial Liability</u>
Proprietorship	Proprietor	Individual rate	Unlimited
Partnership	Partners, based on equity contributions	Individual rate	Unlimited
Corporation	One vote per share	At corporate rate, plus dividends at individual rate	Limited to initial contribution
Cooperative (incorporated)	"One-member, one-vote," and/or in proportion to patronage	Individual rate (patronage business); corporate rate (non-patronage business)	Limited to initial contribution and retained earnings



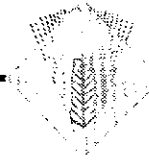
## When Cooperatives are Needed

People form cooperatives for economic reasons, some of which reflect the failure of existing businesses to serve the changing needs of buyers and/or sellers.

As mentioned above, cooperative business structures are highly flexible and can serve many purposes. People form cooperatives for economic reasons, some of which reflect the failure of existing businesses to serve the changing needs of buyers and/or sellers.

Historically, cooperatives have been started to address one or more of the following situations:

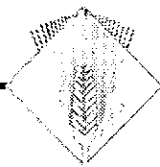
1. One or more processors use their market power to depress prices paid to farmers for the commodities they grow. In such cases, the processors retain for their exclusive use important information about current market demand for their products and the value of the commodities they process into those products. Such processors typically negotiate the purchase of commodities from individual growers one by one. Similarly, consumers often question the prices they pay for vital supplies and services such as groceries and electricity. Growers and consumers are motivated to form cooperatives to gather information about the demand for the commodities and to share that information with their members, thereby providing the group with marketing power more comparable to that held by the processors.
2. Often there are so few buyers or sellers in a market area that it is difficult for either side to negotiate satisfactory pricing. A group of buyers may establish a cooperative capable of attracting sellers to a single, central location. In a similar way, sellers may pool their production to establish a cooperative to market members' produce to all buyers.
3. It is often possible to capture large economies of scale in processing and marketing commodities by combining or pooling the production of a number of growers for processing in a single plant for sale through a single marketing group. Such concentration of production and marketing often requires larger capital investments than any one individual can afford, making it advantageous for a number of individual producers to pool their capital resources to build and operate the business cooperatively.
4. Optimum savings can be realized by growers who build processing plants if they are careful to match the volume of their commodity production to the processing capacity of their cooperative plant and to the effective market demand for the products produced. This is the argument for owning and managing processing plants cooperatively, and it works equally well for both marketing and consumer cooperatives. Maximum manufacturing efficiency can be achieved only if the plant's total capacity is constantly utilized, placing added emphasis on maintaining member loyalty and commitment.
5. Vertical integration allows cooperative member owner-users to capture additional profits from engaging in business activities related to the production, processing, and marketing of commodities they grow or consume. For example, a farmer may invest in a fertilizer manufacturing cooperative and, through that cooperative, in natural gas production and rock phosphate mines.



Dairymen often vertically integrate through the formation of breeding cooperatives which make genetically superior cattle available through artificial insemination. They also form milk processing and marketing cooperatives which convert milk into butter, ice cream, and other dairy products for sale under their cooperatives' own brand names.

Land O'Lakes, a dairy marketing cooperative; Sunkist, a citrus marketing cooperative; and Ocean Spray, a cranberry marketing cooperative, have each vertically integrated their member owner-users' production to develop brand names which now earn added royalty income from marketing products unrelated to their members' production. Thus the brand names developed and owned by farmers through their cooperatives provide added income streams to their farming operations.

6. In addition to vertical integration, growers have horizontally integrated their cooperative enterprises by using their combined marketing power and earnings to buy out competitors, thus further increasing their market power.
7. In some situations, cooperatives are formed to coordinate the timing of the delivery of commodities to markets. This coordination function becomes desirable for growers of highly perishable seasonal commodities, who often find their markets unable to absorb all their potential production in the relatively short period of time their produce is marketable.
8. The pricing of many commodities can be highly volatile, varying widely from a low to high level over the course of a year in reaction to changes in supply and demand. Farmers often find that they fare better economically by pooling their production with other farmers and taking the average price earned by selling a small amount every day through a cooperative. The alternative is for each individual to attempt to guess when pricing is most favorable, then find a buyer willing to pay that price, and then arrange delivery in a timely manner to capture that price. Forming a cooperative that is in the market every day, and taking the average price resulting from pooling, minimizes price and market risks. The same principles apply to the operation of consumer cooperatives.
9. Often consumers and producers require certain services or products in regions where the potential sales volume is so small that privately owned companies are reluctant to make their products or services available. Such consumers or producers may join together to form cooperatives to assure the availability of vital products and services on an economically feasible basis. Through such actions, farmers have become owners and operators of petroleum product refining plants, grocery stores, electrical generating and distribution networks, and local telephone exchanges.



## Determining the Need for a Cooperative

**Because cooperatives are self-help organizations, they are most effectively organized at the grass roots level by those who will directly benefit from the services their cooperative will offer.**

To someone starting a cooperative for the first time, the process appears circular—another form of the riddle, “Which came first, the chicken or the egg?” A little further thought on the nature of cooperatives will suggest where one can begin the organizing process.

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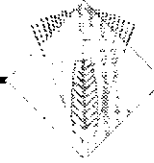
Leaders in any community establish and nurture their identities through their ability to identify problems and possible solutions. They are also able to mobilize to action those who would benefit from such solutions. Community leaders who sense that their economic well-being can be improved by organizing a cooperative should first understand how cooperatives might function in improving their situation and then explore that possibility with other members of the community who might also benefit.

This first exploration should be kept informal and open to as many possibilities as feasible. It should focus on establishing a consensus opinion in the community concerning the potential improvement in economic circumstances which could result from owning and operating their own business cooperatively and on their willingness to share personal resources and commit to using the cooperative on a long-term basis.

Above all, leaders of the movement must be aware that they set the example—good or bad—that other potential participants will follow. The success of the cooperative will be a function of the willingness of the leadership group to see the formation of their cooperative through to fruition. They must be willing to share personal resources. They must be willing to commit to using the cooperative on a long-term basis. And they must be willing to honor those commitments by acting for the benefit of all members of the cooperative rather than in their own interests.

Should the leadership conclude that the larger community shares their vision of the role a cooperative business could play in improving the larger group's economic well-being, the time has come for serious, in-depth studies of the economic role the cooperative would serve and how it would achieve those goals.

This stage is a good time for the leaders to write out a simple statement of what they believe the proposed cooperative can accomplish, who its activities would benefit, and in what forms those benefits would be realized. This statement of purpose will serve to focus additional discussion within the community and to provide the key benchmarks in the studies that contribute to the remainder of the process.



## Market Survey

Should the leaders and their community agree that the group action of a cooperative will improve their economic well-being, it is time to take the next steps of studying the potential markets the cooperative would serve.

At this point, the Center for Cooperatives at the University of California, Davis, can provide substantial technical assistance in designing studies that would point to the aspects of structure, financing, management, and marketing which would best help the proposed cooperative achieve the community's objectives. It is also at this point that the leadership group should establish a steering committee to conduct and evaluate these studies and to establish contacts with other cooperatives which can be sources of advice and moral support.

Markets in capitalistic systems such as those found in the industrialized nations of North America and Europe are driven by the needs of consumers of products and services. In such markets, economic success comes from learning what consumers want and providing those products and services in the desired form, when and where consumers want them. Customer service has become increasingly important as the competitive environment has intensified.

Such consumer demand typically has two components: a desire for a product or service and the purchasing power to pay for them. Both components must be present to complete an economic transaction. The challenge to a cooperative's steering committee at this stage is to determine the desire for the products or services it plans to offer and the prices consumers are willing and able to pay. If the product or service is new, a market study should also identify those consumers who will purchase it.

If the product or service is already available in the market, the steering committee must identify potential competitors and potential barriers to entry, and evaluate the likelihood that the cooperative can compete effectively for an acceptable share of the market. Barriers to entry can take many forms, from government regulations, to consumers' loyalty to an

established brand name, to the cost of acquiring market information or processing technologies needed to compete effectively. Each represents a challenge to a new business entering competition in established markets.

The key to making a useful market study is to start with the final consumer and work back through the market to the operations of the proposed cooperative. At each step in the process, it is critical to identify and challenge each assumption about what consumers want and how potential competitors are performing.

The steps to follow are:

1. Survey current buyers of products or services similar to those the proposed cooperative would offer in each market where they are offered. Initially, this would involve interviewing potential buyers in person or by phone. This should be done in each market segment handling the product or service as it moves to the final consumer by talking to manufacturers, suppliers, distributors, brokers, retailers, and to those who actually consume the products or services offered.
2. Ask buyers at each level:
  - a. Quantities purchased annually?
  - b. Prices paid at each level of distribution for these quantities?
  - c. Pricing variations for differences in quality such as size, grade, color, and ripeness?
  - d. At what discount would the buyer switch to a different product (yours) of the same quality?
  - e. What are their normal order sizes?
  - f. Maximum lead times required for delivery?
  - g. Is there seasonal demand for the product or service?
  - h. Do prices vary by season, and if so, by how much?
  - i. What are the markets for or methods of disposing of by-products resulting from processing the commodities into finished products?

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## Choosing a Strategy

**W**ith the collection of data from this set of questions, a major issue of market strategy now can be addressed: How is the cooperative going to gain and defend market share?

The answer to this question is crucial to the economic success of the cooperative.

All businesses pursue one of two basic marketing strategies, whether they are organized as a cooperative, an investor-owned corporation, a partnership, or a proprietorship:

- Sell the product or service at a lower price than offered by any competitor (a function of cost leadership); or,
- Invest in creating a product or service with qualities not offered by any competitor (a function of differentiation).

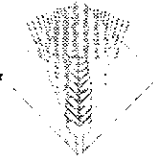
Offering to sell a product or service at a lower price than any competitor is the most effective approach to gaining and defending market share. This strategy demands that costs be held to levels lower than those achieved by any other competitor in the industry.

In many instances, cooperatives deliberately follow a strategy of marketing their products at the going market rates established by competitors and counting on efficient operations to create profits for distribution to member owner-users.

Investing in creating unique products or services will likely increase costs. It can be an effective strategy if competitors have difficulty in offering similar products or services at lower costs. In most cases, this strategy of differentiation requires continuous investment in research and development to stay ahead of competitors attempting to copy the products or services. This strategy involves higher risk of failure, but at the same time, it forces the cooperative to keep its business practices current with the industry's "state of the art." Such a strategy will also allow the business to capture a greater market share if none of its competitors are in the market with truly differentiated products.

In pursuing either approach, a cooperative business should be organized to operate at a lower cost than can be achieved by any competitor. This requires being extremely conscious of all costs and the technologies that can be applied to minimize costs or improve productivity. This also requires maximizing the use of plant capacities and of closely evaluating the productivity of labor employed.

This is relatively easy to achieve when starting a new business, by coordinating member inputs with plant capacity based on market demand. Because it is more difficult to adjust or coordinate plant capacity, market demand, and member production at a later date, the cooperative should plan from the beginning to coordinate changes in these factors on a continuous basis.



# Making a Preliminary Feasibility Estimate

Once the market survey is in hand, it is possible to make a first rough preliminary estimate of the economic feasibility of the proposed cooperative. This preliminary estimate is based on the findings of the market survey and the anticipated commitments of potential members to support the cooperative enterprise.

From these studies, it is possible to have a general understanding of the products and services the cooperative might offer. It should be possible to estimate the market demand for these products and services, the costs of doing business, the potential income, the strategies of possible competitors, the size and capacities of available processing facilities, and the demands of various markets regarding quality, size, seasonal volume movements, and discounts.

In addition, it will be necessary to develop a cost budget for building and operating processing facilities scaled to closely match anticipated market volume. This budget should include the following costs for processing, administration, and marketing based on assumptions of seasonal volume movements and qualitative considerations:

## Processing Costs

- Labor, including payroll taxes and benefits
- Depreciation
- Interest on loans
- Lease payments
- Utilities
- Transportation
- Operation and maintenance expenses
- Materials and other expenses
- Rent on plant, property, and equipment

## General and Administration

- Salaries, including payroll taxes and benefits
- Accounting and finance costs
- Insurance, taxes, and licenses
- Travel, telephone, postage, and supplies

## Marketing

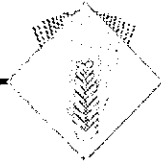
- Salaries, including payroll taxes and benefits
- Promotional, advertising, and entertainment expenses
- Discounts and brokerage commissions

## Distribution

- Packaging, boxing, and palletizing
- Warehousing
- Transportation

## Revenues

- Gross sales by each quality grade and commodity (including by-products) minus costs of goods sold, or
- Gross sales by service provided minus the costs of goods sold or services provided, and
- Net sales by each quality grade and commodity (including by-products) minus pro-rated administrative costs, or
- Net sales by service provided minus pro-rated administrative costs.



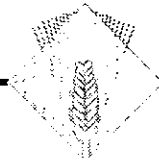
### **Net Returns to Members**

Some net earnings are returned to members as a cash patronage refund and some may be retained in the business. Retained earnings may be assigned to members as shares of ownership (equity) in the cooperative.

- In a marketing cooperative, cash refunds are defined by total earnings and earnings per unit of raw commodity delivered to the cooperative for processing and marketing, minus retained earnings.
- In service and supply cooperatives, cash refunds to members are net earnings from services or supplies provided, minus current earnings retained in the business.

This first-round estimate of the feasibility of the cooperative's business activities should be the subject of a meeting of all potential member owner-users. The agenda at this meeting could include a step-by-step review of the findings of the marketing survey and the projected feasibility of the cooperative presented by members of the steering committee. Participants in the meeting should leave with a feeling of confidence in the reasonableness of these studies and the cooperative's statement of purpose. The steering committee should make sure that their objectives are the same as those of others involved.





# Taking the Next Steps

At this time a vote should be taken among the potential members of the proposed cooperative on whether to proceed. If the vote is positive, subcommittees should be formed to act on the following steps:

1. Reviewing and adjusting the statement of purpose in light of what was learned through the completed studies

2. Recruiting members, and

a. Conducting a grower survey seeking commitments of commodity volume to be delivered to the cooperative or of patronage based on the projected economic benefits to member owner-users

b. Collecting details on expected varieties, quality levels, and timing of commodity deliveries or specific needs of active members for products and services to be delivered by the cooperative

c. Securing commitments from potential member owner-users to share in financing start-up costs and future operating costs

3. Developing a Business Plan

Prepare a detailed business plan, based on the results of the completed surveys and containing the following information:

a. Estimated cash income and expenses by month for the first year of the cooperative's operation

b. Cash needs by month for the first year for projected capital item outlays such as plant and equipment which will have a useful life of more than one year

c. Estimated net sales by month for the first year, projecting payments based on commercial credit terms and bad debt allowances

d. Net cash flows and cash balances by month for the first year and annually for the following two years. Negative cash balances in a given month will demonstrate the extent and timing of financing needed to conduct operations.

e. Projected profit-and-loss statements and balance sheets for the first three years of operations

f. A statement describing:

- Sources of raw commodities for processing and marketing or of inputs for supplying member owner-users

- Size and location of each customer for member-produced commodities (by significant quality category) or of suppliers of inputs

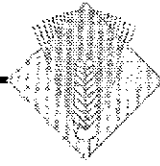
- Key characteristics, capabilities, and responsibilities of senior management staff and directors

4. Finding Sources of Financing

Begin the search for possible sources of financing of capital equipment as well as operating loans and grants. Most lenders will require a business plan before considering loan applications.

5. Incorporating the Business and Drafting Membership Agreements

A lawyer with a strong background in cooperative law and the commercial codes governing operations of the cooperative should be retained to assist in drafting the Articles of Incorporation and the Bylaws and preparing filings for incorporation, which are the basic documents underlying membership agreements. The Center for Cooperatives at the University of California does not provide legal advice; however, the Center has sample forms which can be adapted by an attorney to meet the specific needs of almost any cooperative business.



6. Hiring Key Management and Staff

The important element of this task is to carefully identify the key characteristics of the management staff in terms of the core needs and expectations of the cooperative's member owner-users. These can include a knowledge of the industry in which the cooperative intends to compete, an ability to communicate effectively to key stakeholders (including member owner-users), detailed knowledge of specific processing or marketing technologies, or understanding of complex government regulations affecting the cooperative.

7. Determining the Cooperative's Needs for Physical Facilities

Depending on the activities of the cooperative, this committee's task may range from locating and equipping simple office space to retaining engineers and architects to design new processing plants and specialized warehouses.

When the work of these subcommittees is completed, another general meeting should be called to review the results. This is a time to exercise special attention to detail and to allow full discussion of every issue of concern.

If the business plan appears to be sound and a sufficient volume of business and start-up capital has been committed, the leadership should call for a vote on whether or not to proceed. In most American communities, political considerations dictate that this vote be conducted by secret ballot on a "one-member, one-vote" basis, with the decision being determined by a simple majority.

This suggested model should not rule out other approaches, such as conducting a public vote by show of hands or requiring a greater majority. One of the responsibilities of leadership is to determine what form of voting will best assure the long-term commitment of potential members.

If those participating in this meeting vote to proceed, the group should elect a group of representatives called *incorporators* to represent the general membership in the process of incorporating their cooperative. In California, a minimum of three natural persons are required to be elected as incorporators to complete the establishment of a cooperative business.

After the cooperative is incorporated, the process of formally recruiting members should begin. A membership recruitment committee should ask potential members to sign the membership agreement and to provide start-up capital contributions according to the terms developed by the steering committee.

It would be helpful at this point to look more closely at the basic legal documents supporting the cooperative: the articles of incorporation, the bylaws, and the membership agreement. It may also be desirable to hire legal counsel specializing in the law regarding incorporation of cooperative businesses.



## Drafting the Articles of Incorporation

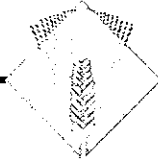
The articles of incorporation establish the core characteristics of the cooperative corporation. (An example can be found in Appendix II.) In California, the articles of incorporation are filed with the Secretary of State in order to establish the cooperative as a specific legal entity under the laws of the state; and to

- Register the name of the cooperative and keep it from being used by any other business;
- Name the principal place of business (usually the headquarters) of the cooperative;
- Give the cooperative's basic statement of purpose;
- State briefly the powers of the cooperative corporation, usually including the right to:
  - Borrow money and to give liens against assets to secure loans;
  - Make advance payments to members against deliveries of commodities for processing and marketing;
  - Buy, sell, or lease property;
  - Cooperate with other similar cooperative businesses;
  - Exercise all powers, privileges, and rights conferred on ordinary business corporations;
- Authorize the cooperative to exist forever;
- Designate the original incorporators and the initial board of directors;
- Set forth procedures for amending the articles;
- Specify the voting rights of the members; and
- Declare whether the cooperative will be a stock or non-stock corporation.

The capital structure of the cooperative must be defined in detail, beginning with the issue of whether it will be a stock or non-stock corporation.

A cooperative choosing to be a non-stock company must specify in its articles of incorporation the qualifications for membership and the basis for allocating voting rights to members.

A cooperative electing to conduct business as a stock corporation must state the number and par value of any shares of common stock and the number and par value of shares of preferred stock it is authorized to issue and who is eligible to hold stock in the cooperative. Usually this right is reserved to members; however, some cooperatives further require that common stock may be bought or sold only with the consent of the board of directors.



# Drafting the Bylaws

**B**ylaws for the cooperative provide a more detailed description of the structure and method of operating the cooperative. Bylaws are a working plan or blueprint for how the association will function. (See Appendix I, p. 35 and Appendix IV, p. 47.)

Major topics covered by a cooperative's bylaws should include:

**Membership**—Defines the requirements for membership and procedures for joining the cooperative, the benefits and obligations of membership, and how membership in the cooperative may be ended either voluntarily or involuntarily.

**Membership Meetings**—Specifies the date of the annual meeting of the membership, notices required prior to holding other membership meetings, procedures for determining whether a quorum is required and exists, and procedures for conducting votes among the owner-users at membership meetings.

**Election of Directors and Officers**—Covers the number of directors to be elected to the cooperative's board of directors, their appointment and length of terms, the method of electing board officers, the scheduling of board meetings, and provisions for removing directors and for filling the unexpired terms of directors who resign before completing their current term.

**Duties of Directors**—The scope of the board's authority is set in the articles of incorporation, the bylaws, and applicable state and federal laws and regulations. Because of the legal implications of being a director of a cooperative, the responsibilities of directors are spelled out in considerable detail in the bylaws. In keeping with their title, directors are charged with establishing the basic direction of the cooperative. They are responsible for defining the cooperative manager's responsibilities and authority, for regularly reviewing the manager's performance, and for taking appropriate action if performance is unsatisfactory. The board is also responsible for hiring an independent audit firm to audit the cooperative's accounts. The independent audit firm is responsible for reporting its findings to the board as an aid in evaluating management's performance. Directors are also responsible for periodically reviewing the cooperative's objectives and strategies and adjusting them to reflect changes in members' expectations and the competitive environment.

**Duties of Officers**—The bylaws should name and describe the functions of all board officers and specify the manner of their election, the length of their terms, and the procedures for their removal and replacement.

**Determining Operating Margins and Members' Capital Contributions**—The bylaws should specifically state that the cooperative is to be a nonprofit organization. The bylaws should also detail how operating margins are to be determined and allocated based on each member's use of the cooperative. This section should also indicate the method of collecting equity capital contributions from member owner-users.

**Equity Redemption**—The membership has several options to consider which will determine whether equity capital contributed by members will be repaid or redeemed. If the equity capital contributed by members is to be redeemed, the bylaws should precisely state the timing and method to be followed, as well as the conditions under which the timing of redemptions might be changed or suspended.

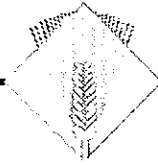
**Nonmember Business and Income**—Cooperatives are allowed to do business with nonmembers so long as the volume of business conducted with members is greater than the volume of nonmember business. The bylaws should reflect this relationship and state how the cooperative will account for and distribute the benefits resulting from nonmember business.

**Accounting for Losses**—As with any other business, the cooperative will likely suffer losses from time to time. A section of the bylaws should address the method of allocating these losses across the membership.

**Dissolution**—Any business should provide a procedure for dissolution of the business and distribution of any remaining assets. Including these provisions in the bylaws eliminates disputes that might otherwise arise at the time of dissolution. A simple and direct method is to distribute the assets remaining after all creditors' claims are paid to current equity holders, on the basis of their share of the business' net worth.

**Indemnification**—The bylaws should state that the cooperative will indemnify (protect or insure) directors to the fullest extent possible, against possible damage through legal suit or other costs which result from conducting the cooperative's business.

**Amendments to the Bylaws**—A procedure for amending the bylaws should be provided that identifies who has the right to make such amendments and the nature of the vote required.



# Drafting a Marketing Agreement

**M**arketing contracts benefit both individual grower-members and their cooperatives. Growers benefit from knowing they have a "home" for their crop, a particularly valuable asset when selling perishable commodities in markets where there are few buyers. For the cooperative, member marketing agreements provide management the means to coordinate the volume of business with the size of processing facilities, allowing the cooperative to achieve the lowest possible operating costs. Marketing agreements may also enable management to pre-sell members' produce on the basis of timing considerations included in these contracts.

Marketing agreements are contracts between the cooperative and its member owner-users and should include the following:

1. A description of the commodity or commodities to be produced, packed, processed, and marketed, specifying the quantity to be delivered to the cooperative. Depending on the particular circumstances, the quantity to be delivered can be stated in terms of weight or the production of a specific acreage. If the contract is on an acreage basis, the cooperative assumes the yield risk. If the contract is based on a delivered weight basis, the grower has the risk of being unable to deliver the specified yield.
2. A statement concerning the disposition of produce grown in excess of the contracted commitment. Some cooperatives require that all crop produced in excess of the marketing agreement be destroyed to prevent it from flooding the market and depressing prices. Other cooperatives require member-growers to deliver all the commodity they produce, while still others allow members to market excess production at their own discretion.
3. The time and place where legal title of ownership is transferred from the grower to the cooperative.
4. A description of how and when the producer will be paid and the method of determining the value of the commodity. Several of the possible options are discussed later in this publication in the section on cooperative marketing pools.
5. A provision obligating the grower-member to notify the cooperative if a lien (such as a claim securing a bank loan) has been placed against the crop covered by the marketing agreement.
6. A statement of the rights and obligations of the cooperative and the grower-member in the event that the member fails or refuses to deliver the commodity specified. This section specifically defines those actions that breach the contract and the remedies to be applied.
7. The life span of the agreement and the time period during which the contract may be extended or during which either party may withdraw.
8. The agreement should contain an "Act-of-God" clause which holds each party harmless in the event of natural disasters or events beyond human control.

Cooperative committees charged with drafting Articles of Incorporation, Bylaws, and Membership Agreements should work with attorneys experienced in both corporate and cooperative law to ensure that all three documents are consistent with each other and also with the cooperative's statement of purpose and its business plan. This approach allows representatives of the cooperative and their counsel to mutually test whether a good working relationship is likely in the future.



## Cooperative Finance/ Equity Capital

Equity capital—funds invested by member owner-users—is the fuel that powers cooperatives. The commitment of member owner-users to invest their capital is an important consideration by commercial lenders asked to lend operating or term lines of credit. This is particularly important for new cooperatives which may not have yet acquired assets—either physical property or cash reserves—which can be pledged as collateral for loans.

One of the unique characteristics of cooperative businesses is the way they handle equity capital. Since the users of a cooperative are also its owners, they stand to benefit most from investments of equity or risk capital. It is reasonable then that member owner-users of cooperatives should be obliged to provide needed capital investments.

When a group of member owner-users start a new cooperative, they determine the amount of money needed to cover the initial expenses of their business, for example, the costs of incorporation, paying professional fees, and the reserves needed to obtain financing from commercial sources. Equity or risk capital is normally pledged by member owner-users in proportion to the estimated volume of deliveries committed through marketing agreements. Equity investments plus capital and operating loans must see the cooperative through the beginning phases of its operations until a positive cash flow can be achieved and sustained.

Once operations are under way, the current equity position or net worth of the firm will be found in the liability and equity section of the cooperative's balance sheet.

The balance sheet of a cooperative business will display a simple structure. The cooperative's assets are listed on the left side. The cooperative's liabilities and members' equity is shown on the right side. The sum total of the assets listed on the left should equal the sum total of the liabilities and members' equity listed on the right and thus be "balanced."

Members' equity or the firm's net worth is figured by subtracting the cooperative's liabilities from its assets. It represents the amount of money contributed to the cooperative by its member owner-users either through direct contributions, such as those solicited when the cooperative is being formed, or as the portion of earnings which are retained from the operating results of the cooperative.

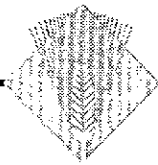
Retained earnings and the out-of-pocket contributions paid in when the cooperative is formed are shown on the cooperative's balance sheet as allocated equity (or general reserves in many consumer cooperatives).

Equity capital initially contributed by the cooperative's member owner-users or retained from earnings is used to capitalize the cooperative—to make those long-term investments in buildings, equipment, market development, and research that will contribute to the long-term development of the cooperative.

Every dollar of equity capital is considered to be risk capital in that it can be lost should the cooperative's capital investments fail to generate sufficient earnings. Every dollar of equity capital contributed by member owner-users or retained from earnings reduces the amount of money the cooperative will have to borrow and pay interest charges on, regardless of the success or failure of the business.

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## Allocated Equity

There are two common methods of accumulating and accounting for allocated equity.

In the first case, a simple revolving fund is created. Members may be assessed a small commission or fixed charge per unit of commodity delivered or inputs purchased from the cooperative. This form of equity is also referred to as *per-unit retains* because they represent the portion of net margins retained from each member as equity capital in direct proportion to each member's use of the cooperative in a given accounting period.

Equity capital deposited in revolving fund accounts is held for a period of years determined by the board of directors, most often between 7 and 10 years. Accounts are maintained by the cooperative recording each member's contribution of retained earnings. Stock cooperatives issue shares of common stock as tangible evidence of the amount of the earnings retained as allocated equity.

When the cooperative's board of directors determine that the time has come to revolve these funds, these shares of common stock are redeemed at their par value. Normally the oldest stock is redeemed first.

Under certain conditions, farmer-owned cooperatives can pay an annual dividend of up to eight percent on the outstanding retained earnings held as allocated equity. There is no such limitation on the dividends paid member owner-users of consumer cooperatives.

A second approach to accumulating equity capital is to establish a base capital plan under which member owner-users contribute equity capital in proportion to their use of the cooperative's capital investments. Cooperatives using this approach first determine the capital required to build and equip processing facilities scaled to members' deliveries of commodity and to develop the markets to consume the cooperative's output.

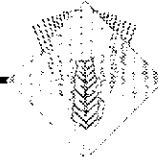
In some circumstances, it is desirable to limit members' ability to deliver commodities for processing and marketing to some set amount established in proportion to each member's contribution of equity capital. Such a system of base delivery rights can be incorporated into the member agreement and be directly related to members' contributions of equity capital under the cooperative's base capital plan.

This can be done by estimating the capacity to be allocated to each member owner-user based on volume commitments in member agreements. Each member is then assessed his or her share of the total capital needed to build and equip the processing plant and supply the markets developed through the investment of members' capital contributions.

Payment of these capital assessments can be paid through direct out-of-pocket contributions or over a period of years through deductions from earnings distributed to members. A combination of the two approaches may also be used in which an initial contribution is followed by annual deductions from the distribution of earnings.

An allocated equity account is established for each member by recording contributions of capital and adjusting the contributions required according to each member's use of the cooperative. Redemption of investments in the cooperative's base capital plan at the time a member chooses to leave the cooperative due to retirement or other reasons is usually made in a series of annual payments established by the board of directors. Some cooperatives allow retiring or resigning members to sell or transfer their equity investments to current or new members.





## Unallocated Equity

Many cooperatives carry a second entry on the members' equity portion of their balance sheets. Unallocated equity accounts usually reflect income generated from nonmember or nonpatronage activities of the cooperative.

There are structural considerations to take into account when cooperatives decide to do substantial amounts of nonmember business. These should be addressed by legal and tax experts.

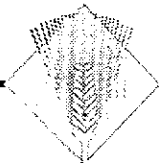
In general however, when cooperatives engage in nonmember business activities, they must pay income taxes on any profits earned from nonmember business. A cooperative may establish a subsidiary to conduct its nonmember business. The profits earned by such a subsidiary will be subject to income taxes. The after-tax net income from nonmember business activities conducted by the subsidiary flows to the cooperative.

The board of directors has two choices in managing such sources of income. The nonpatronage earnings can be distributed directly to the membership based on their use of the cooperative. Alternatively, such income can be credited to the equity portion of the balance sheet as unallocated equity. This second option can be used to reduce the equity contributions required of the membership to capitalize current and future operations of the cooperative.

When such income streams are treated as unallocated equity, they are normally retained by the cooperative as permanent equity and held until such time as the cooperative business might be dissolved. Creating such a pool of unallocated equity not only reduces the equity contributions required of members; it also provides funds which can be leveraged to obtain increased borrowing and can function as a reserve insurance account to be applied against the loss of uninsured property.

Cooperative accounting has some characteristics that are different from those followed by other business firms. These result from the requirements to track each member-owner's use of the cooperative's services and the purchase of its inputs and to account for each member owner-user's contributions of equity capital. In this regard, it is as important to hire an accountant experienced in cooperative accounting procedures as it is to hire an attorney to oversee the writing of the articles of incorporation, the bylaws, and the membership agreements.

Because each cooperative has many member owner-users, it is important that the board of directors hire an independent audit firm with no direct ties to the cooperative to conduct annual audits and to make the results of such audits available to members and lenders. Such actions assure both groups of stakeholders of the integrity of the cooperative and help to maintain the credibility of both the cooperative's board of directors and its management.



## Cooperative Marketing

Having commodities marketed as processed products by professional specialists is one of the major advantages of being a member owner-user of a processing and marketing cooperative. It illustrates the unique advantages of pooling resources to achieve individual benefits through group action.

Marketing specialists achieve important economies of scale by gathering greater volumes of more accurate and useful information about both domestic and international markets. They also achieve scale economies by handling larger volumes of commodities and products, thus reducing the per-unit costs of their activities to the minimum level possible.

Cooperatives use many methods of accounting for and tracking the marketing of raw commodities delivered by member owner-users and nonmembers. The most typical method involves making an advance payment to the grower-member at the time the raw commodity is delivered that is based on quality standards defined by the cooperative, the industry, or state and federal government agencies. The initial payment is usually based on the going market rate for the commodity in the given producing region.

In some cases, no reliable market value can be determined because most of the commodity grown in a region is produced under contract. The delivery price may be based on an estimate of the cash costs of growing, harvesting, and delivering the commodity.

Additional payments, commonly known as *progress payments*, can be made as the commodity is marketed and income flows to the cooperative. For certain perishable fruits and vegetables, California law requires that the initial payment be made within 28 days of delivery.



## Comparing Pooling and Buy-Sell Transactions

A buy-sell transaction is one in which the seller does not give up ownership of the commodity or product until a final price has been agreed upon. Such a price may be part of an oral or written agreement, a price posted on delivery, or a future price committed to through a forward contract.

Alternatively, a marketing contract can be written specifying the quantity to be delivered but leaving the price unresolved and to be settled on the day the commodity is sold.

In either case, member owner-users may receive additional payments based on their cooperative's earnings for the marketing season. Such additional payments can only be made after all operating costs have been accounted for and deducted from all income earned to determine the net margins resulting from the cooperative's marketing activities.

In cooperative marketing pools, all growers of a specific commodity jointly pool their harvests to be marketed by their cooperative. Under this practice, ownership of the harvested commodity is transferred to the cooperative and the cooperative's management determines the best time to sell, where to sell, and whether to subject the raw commodity to further processing.

In return, growers participating in the marketing pool agree to accept the average return earned by the pool during the marketing season. The final return paid to participants in such pools is adjusted according to the relative quality of the delivered commodity. In a typical cooperative marketing pool, growers receive advance payments at the time their harvests are delivered to the cooperative which then makes a series of progress payments as the crop is marketed. A final settlement payment is made when all costs and revenues for the marketing season have been established.

Depending on the commodity, the length of a seasonal pool may be as short as a few weeks or as long as two or three years. For example, a rice marketing pool is established when the

first deliveries are received after harvest begins in September. Ownership is transferred to the cooperative as the rice leaves the field. Different types of rice—long grain, medium grain, and short grain—are segregated into separate pools when they are placed in warehouses after drying.

Unmilled rice is shipped to the cooperative for processing as orders are received. It may be sold to many types of buyers: some may go to retail stores in 2-pound polyfilm bags, some to hotels or restaurant kitchens in 25-pound kraft paper bags, some to industrial food and beer processors in rail cars, and some may be shipped overseas in vessels carrying up to 30,000 metric tons of bulk cargo.

Net returns—calculated on the basis of 100-pound units of unmilled rice dried to a uniform moisture content—will be different in each of these markets. Members participating in a rice marketing pool will receive returns that reflect the weighted average net return earned in each market by each type of rice delivered.

The pool may be closed at the end of the rice marketing season, traditionally 12 months after it opened, and any rice remaining unsold is transferred to the next year's pool at a price reflecting the average value of transactions taking place at the time the old pool is closed.

Alternatively, each year's pool can be held open until all the rice delivered to that pool is sold, regardless of how long it takes. The final settlement of earnings is distributed after the pool is closed and all revenues and costs are determined. Pools such as those for rice or processing tomatoes may be kept open for several years, because those commodities are easily stored without substantial loss of quality.

Seasonal pools provide real advantages by placing the commodity in the hands of marketing specialists to be sold for the highest price available on any given day. Being in the market every day reduces the risks of failing to sell at the highest price offered by the market

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or selling all production at the market's low point for the year. Risk is further reduced by spreading it over a group of members instead of concentrating it in the production of one grower. No one participating in the marketing pool receives the highest price offered for a given commodity in a given year, but on an individual basis, each one is protected from selling at the bottom of the market.

If the cooperative has a significant market share, pool managers are better able to coordinate the flows of commodities produced by members with market demand, and this in turn reduces the volatility of market pricing and enhances the opportunity for improved average returns.

One significant issue to keep in mind is whether membership in the cooperative is to be open to all producers or closed to a limited number of growers. In certain circumstances, legal considerations dictate whether cooperative membership can be closed or limited.

Closing or limiting membership in processing and marketing cooperatives offers several distinct advantages:

- The cooperative's board and management are able to coordinate deliveries of raw commodities with processing plant capacities, thus allowing the cooperative to maximize plant utilization while reducing costs to practical minimums per unit of commodity volume delivered.
- Coordination can be extended to the market to preserve maximum returns by matching supply with demand.
- Closing membership *and* limiting deliveries of crops through contracts allows cooperatives to effectively deal with individual members who would seek to increase their deliveries to the cooperative to the detriment of per-unit returns to other member owner-users. This becomes particularly important as cooperatives enter into value-added processing and marketing activities.

Participating in seasonal pools carries some disadvantages. Because the pool cannot be closed until the end of the marketing season, there are some delays in making the final settlement or equalization payments. These

payments are normally a small portion of the total payments to growers participating in cooperative marketing pools and can be managed to prevent significant disruptions of cash flows to growers' individual business operations.

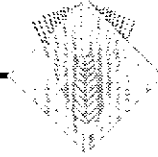
Some growers feel real discomfort when they surrender control of the decisions regarding when to sell their production. They are willing to sacrifice the relative security of weighted average prices for the opportunity to control the sales of their crops according to their understanding of market conditions.

Lastly, some pools may be too small to fill orders for large customers, making it difficult for them to achieve the desirable scale economies that minimize per-unit costs. In addition to matching the size of processing and handling capacities to member production and market demand, cooperative boards and managers also need to pay attention to such per-unit administrative costs as management salaries and marketing promotion costs spread over small marketing pools.

More than one commodity can be included in a single pool. To cite one example, a California processing and marketing cooperative combines all of the crops it processes into a single pool. When each crop is harvested, growers receive an advance called a *field payment*, which is based on the estimated field price in the current market; this price varies from crop to crop.

Combining several different crops into a single marketing pool becomes possible in part because a large portion of the processing and canning equipment operated by a cooperative is used to process all the crops in the pool. Similarly, most of the marketing and administrative costs are generated by a single staff of marketing specialists.

Only direct, separable, fixed costs such as depreciation, interest, and taxes attributable to handling specific crops are charged to those crops. The remaining overhead is spread over all crops on the basis of a formula approved by the board of directors. Net returns are determined for each crop and final settlement payments are made according to procedures that are acceptable to the general membership.



## Call Marketing Pools

Some cooperatives (for example, a California cotton marketing cooperative) use a "call" pool, which is a variation of the concept of a true marketing pool. In a call pool, ownership of each bale of cotton remains with the cooperative member who produced it. At any time during the marketing season, the member decides when to sell each bale that he has produced and delivered to the cooperative.

After the member orders the cooperative to sell his production, the sale is completed and a small portion of the proceeds is withheld to cover the cooperative's operating costs and to provide an appropriate contribution to equity capital. The remaining funds are paid to the member.

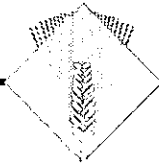
In addition to giving members the right to determine the time of sale through the call pool, the cooperative may also allow members to set a minimum or reservation price at which the commodity may be sold.

Similar pools were operated by a number of California cooperatives as "exchanges" in the early decades of the twentieth century. The cooperative functioned first to provide a marketplace where transactions between buyers and sellers were conducted in public, and, secondly, to provide information on the most recent transactions to all members of the cooperative, thus giving them increased market power in the form of information about supply and demand, as well as the impact of the market situation on the prices being offered to growers for their commodities.

In another form of cooperative marketing, one California fresh fruit marketing cooperative functions as a simple broker between buyer and seller. In marketing fresh table grapes, the cooperative does not take ownership of the fruit, which is packed by the cooperative's grower-members under their own private labels. The cooperative's only function is to sell its members' grapes and to guarantee the collection of proceeds for the members. In exchange for these services, the cooperative deducts a fee similar to a brokerage fee from the proceeds collected, to cover its costs of operations and each member's contribution to a revolving equity fund.

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**In a call pool, such ownership of each bale of cotton remains with the cooperative member who produced it. At any time during the marketing season, the member decides when to sell each bale that he has produced and delivered to the cooperative.**



## Keys to Success\*

**S**tep 1: Analyze market conditions with a firm understanding of what cooperatives can and cannot do. Do not waste time and money organizing a cooperative when existing markets already perform reasonably well.

Step 2: If a determination is made that a cooperative could potentially make members economically better off, conduct a feasibility study questioning whether sufficient membership, business volume, and equity capital can be obtained.

Step 3: If the answers to the questions asked in Step 2 are positive, organize the cooperative to optimize membership size and build commitment among the member owner-users. Be flexible in financing arrangements and voting procedures in order to achieve a structure that is both acceptable to potential members and viable in the long term. Plan carefully to avoid the need to change the terms of organization and structure. Getting it right the first time helps avoid distracting procedural arguments among members in the future.

Step 4: Carefully estimate the new cooperative's potential business volume and plan capital facilities that will efficiently handle that volume; draft membership agreements that optimize the use of the cooperative's assets.

Step 5: If at all possible, hire a full-time professional manager to run the operation, basing the criteria for selection on carefully considered qualities that meet the cooperative's greatest needs.

Step 6: Finance initial capital outlays and generate a sufficient equity base by using flexible membership fees and possibly grants. Obtain debt capital through the Banks for Cooperatives or Industrial Development Bonds.

Step 7: Develop a plan and a timetable to refund retained equity contributions to

members on a basis consistent with maintaining the financial stability and well-being of the cooperative.

Step 8: Establish pricing policies that take advantage of the built-in pricing flexibility of cooperatives. In many cases, new cooperative businesses will have little control over the prices they charge for their output. Market prices will be determined by industry supply and demand factors. In order to remain economically viable, cooperatives should aim to be the lowest-cost suppliers in their markets.

Step 9: Carefully consider membership policies. Because they are both owners and users of the business, all members must be willing to act together to achieve objectives that are both beneficial to and accepted by all member owner-users. Careful attention should be given to the prospective advantages and disadvantages of open versus closed membership and to accepting or refusing to accept nonmember business.

Step 10: Always keep in mind the relative strengths and weaknesses of cooperatives as a form of business organization. The strengths include harmonization of trade, ease of communication, pricing flexibility, and government policies that are beneficial to cooperatives. The main weaknesses of cooperatives are their difficulty in obtaining equity capital and their failure to reward entrepreneurial activity. Cooperatives may also be less flexible than other business organizations because of their democratic nature. Take advantage of the strengths and take steps to overcome the weaknesses.

In addition to all of the above recommendations, it is beneficial to network with other cooperatives (their members, managers, and directors), with representatives of associations of cooperatives, with government agencies serving cooperatives, and with the cooperative-oriented professional organizations.

\* Adapted from "Conclusions and Recommendations" (p. 46), in Richard Sexton and Julie Iskow, *Factors Critical to the Success or Failure of Emerging Agricultural Cooperatives*, Giannini Foundation Information Series No. 88-3, Division of Agriculture and Natural Resources, University of California, June 1988. Single copies of this report may be ordered free of charge from Agriculture and Natural Resources Publications, 6701 San Pablo Avenue, Oakland, CA 94608. Order by report number (Information Series 88-3).



## Other Considerations

There are two sides to any human activity, including the formation of user-owned cooperative businesses. One aspect is objective, meaning that it can be quantified. Numbers are assigned to such factors as income, costs, volumes, market shares, plant capacities, and units of time. Those numbers are used to determine the progress of the business.

However, experience has shown that in the operation of cooperatives, as in life, numbers alone cannot tell everything needed to understand the conduct of a business.

The other side of business is subjective. It is the art of business, those intangible qualities that cannot be quantified. This is the arena of feelings rather than facts. In this category are the character traits and global vision of directors and management, relationships with key stakeholders (including members and lenders), the motives and expectations of members and employees, shifts in the behavior of competitors and customers, and the tendency of many people to attempt to address economic challenges with political solutions.

As is the case with any human enterprise, the success or failure of a cooperative enterprise is largely determined by the motivation and the integrity of its leaders as expressed through communications with key stakeholder groups.

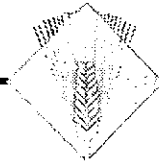
Because the cooperative form of business has been applied to a wide spectrum of circumstances throughout the world, it is possible to suggest that certain characteristics of structure, leadership, and expectations lead to a greater probability of success.

In this guide, we have suggested that cooperatives are uniquely grass-roots organizations; that is, they succeed when broad support exists at the primary level for applying group action to the tasks of meeting individual economic needs. While it is possible to impose a cooperative structure on a group of individuals, the experiences of the past century show that individuals participating in such enterprises have a relatively low level of organizational commitment. When organized from the top down rather than from the bottom up, cooperatives usually have a correspondingly low level of fulfillment of the organizers' goals.

It is important in this regard to be clear in stating the cooperative's goals and objectives and in understanding what the cooperative form of business can and cannot achieve. It is also a reminder to check with all stakeholders in the cooperative enterprise in order to be certain that there exists a uniformity in understanding both the purposes for which the cooperative is being organized and the expectations held by each stakeholder.

In the absence of forthright leadership combined with a responsive and concerned membership, it is quite possible for an established cooperative to drift into difficult circumstances. It is for this reason that directors and senior managers are advised to periodically undertake thorough reviews of the cooperative's statement of purpose, its progress toward achieving its core goals and objectives, and changes in the behavior of the key stakeholder groups.

A cooperative's group of key stakeholders is usually broad. Stakeholders include any of a number of interests that are either affected by a cooperative enterprise or can influence its success.



A short list of a cooperative's stakeholders would include:

- Members
- Members' sources of financing
- Directors
- Managers
- Employees
- Vendors
- Brokers
- Customers
- Competitors
- Sources of financing
- Independent audit firm
- Government legislative and regulatory agencies influencing the cooperative's operations
- General media and other sources of information influencing the cooperative's stakeholders

All of these activities can be gathered under the acronym S.W.O.T.—assessments of the cooperative's Strengths and Weaknesses and its Opportunities and Threats—which encompass the planning and budgeting functions. Included in these assessments should be an objective evaluation of the performance of the cooperative's management.

This needs to be grounded in a clear understanding of the separate authority and responsibilities of directors and of management.

It is the responsibility of the board to set the cooperative's strategy, goals, and objectives, and to hire the manager.

The manager, in turn, is responsible for hiring all other employees and guiding their performance in the implementation of the activities carried out to achieve the goals and objectives of the cooperative.

Management is responsible for reporting results to the board. The board and management have a collective responsibility to report to the membership. The board hires an independent auditor to confirm management's report on business activities.

From this audit comes the opportunity for the directors to evaluate management's performance and to consider the course of events and business conditions influencing the cooperative's ability to achieve its long-term goals and objectives.

It is the board's responsibility to replace the manager when appropriate, and it is the manager's responsibility to evaluate the performance of employees and make the adjustments necessary to achieve the cooperative's goals and objectives. Sometimes, given the nature of changes in the business environment, it is necessary to adjust the cooperative's goals. While this is ultimately the board's responsibility, it should be done with the senior managers participating in the annual planning and budgeting exercises.

One of the more difficult experiences in serving as a cooperative director is understanding the nature of the cooperative's business apart from its direct contact with member owner-users. Managers and the board's leadership should arrange continuing education for directors that informs them of all aspects of the cooperative's business practices, as well as those of the industry and the business environment in which the cooperative competes.



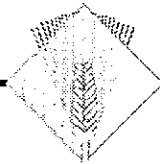
All of the above implies continuous communication between directors and managers.

Both sides need to keep in mind the general membership of owner-users, and these people need to be involved in the dialogue about the performance of the cooperative. Including the general membership in this ongoing dialogue honors their role as the owners and users of the cooperative and as the beneficiaries of the cooperative's business activities.

One of the particular challenges in operating a cooperative is meeting the diversity of needs of member owner-users, which increases as time passes. Most member owner-users participating in the formation of a cooperative share very similar goals at the beginning. Over the years, however, the relative success of their individual enterprises creates new needs. Additionally, new members join, sometimes bringing with them expectations that are different from those of the founding members.

These differences intensify as some members reach retirement and look to the cooperative to return equity capital investments, at the same time that other, younger members seek to expand the operations of the cooperative, which requires additional investments of equity capital. Successfully sorting through these competing needs is in large measure a function of the structure adopted when the cooperative was established.

In the final analysis, the ongoing success of any cooperative is directly related to the confidence the general membership places in its elected representatives and the management they oversee and, in turn, on the ability of leadership to deal effectively with real business and market challenges. Cooperative members should expect to be treated equitably, not equally. They expect to be told of any significant changes in the environment. Member commitment flows directly from the credibility of the cooperative's leadership.



## Resources

Agricultural Council of California  
P.O. Box 1712  
Sacramento CA 95812-1712  
Phone (916) 443-4887

California Association of Cooperatives  
420 9th Street  
Davis, CA 95616  
Phone (916) 753-8857

Center for Cooperatives  
University of California  
Davis, CA 95616  
Phone (916) 752-2408

Credit Union National Association  
Box 432  
Madison, WI 53701  
Phone (608) 231-4000

National Association of Accountants for  
Cooperatives  
6320 Augusta Drive - Suite 8026  
Springfield, VA 22150  
Phone (703) 569-3088

National Business Cooperative Association  
1401 New York Ave., NW - Suite 1100  
Washington, D.C. 20005-2160  
Phone (202) 638-6222

National Council of Farmer Cooperatives  
50 F Street, N.W. - Suite 900  
Washington, D.C. 20001  
Phone (202) 626-8700



# Appendix I

## Excerpts from the California Food and Agriculture Code, Division 20

### Chapter 1.

### Nonprofit Cooperative Associations

#### Article 1. Definitions

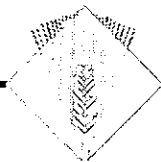
54001. Unless the context otherwise requires, the definitions in this article govern the construction of this chapter.
54002. "Association" means any corporation which is organized pursuant to this chapter. An association shall be deemed incorporated pursuant to this chapter, or organized pursuant to this chapter, and shall be deemed a producer of a product within the meaning of this chapter, if it is functioning under, or is subject to, the provisions of this chapter, irrespective of whether it was originally incorporated pursuant to such provisions or was incorporated under other provisions.
54003. "Member" includes members of associations without stock and holders of common stock in organizations with shares of stock.
54004. "Product" includes any horticultural, viticultural, forestry, dairy, livestock, poultry, bee, or farm product.

#### Article 3. Purposes

54061. Three or more natural persons, a majority of whom are residents of this state, who are engaged in the production of any product, may form an association pursuant to this chapter for the purpose of engaging in any activity in connection with any of the following:
- (a) The production, marketing, or selling of the products of its members.
  - (b) The harvesting, preserving, drying, processing, canning, packing, grading, storing, handling, shipping, or utilization of any product of its members.
  - (c) The manufacturing, selling, or supplying to its members of machinery, equipment, or supplies.
  - (d) The financing of the activities which are specified in this section.
  - (e) Any one or more of the activities which are specified in this section.

#### Article 4. Articles of Incorporation

54081. The articles of incorporation of the association shall show that the signers of the articles of incorporation are engaged in the production of products, and that they propose to incorporate an association pursuant to this chapter, and shall state the following:
- (a) The name of the association.
  - (b) The purpose for which it is formed.
  - (c) The county where the principal office for the transaction of business of the association is to be located.
  - (d) The number of directors of the association, which shall not be less than three, and the names and addresses of the persons who are to serve as first directors.



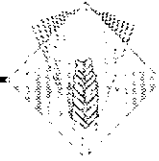
- 54082. Articles of incorporation shall be signed, acknowledged, and filed in the manner which is prescribed by the general laws of this state for domestic corporations.
- 54083. The articles of incorporation of any association may be amended in the manner and for the purposes which are authorized by the General Corporation Law.

**Article 5. Bylaws**

- 54111. Each association shall within 30 days after incorporation, adopt for its government and management, a code of bylaws, not inconsistent with this chapter. The vote or written assent of shareholders or members that hold at least a majority of the voting power is necessary to adopt such bylaws. The power to repeal and amend the bylaws, and adopt new bylaws may, by a similar vote or similar written assent, be delegated to the board of directors, which authority may, by a similar vote, or similar written assent, be revoked.
- 54112. The bylaws may prescribe the time, place and manner of calling and conducting its meetings. Meetings of members shall be held at the place provided in the bylaws.
- 54113. The bylaws may prescribe the number of members which constitutes a quorum.
- 54115. The bylaws may prescribe the number of directors which constitutes a quorum.
- 54116. (a) The bylaws may prescribe the qualifications, compensation, duties, and term of office of directors and officers and the time of their election.  
(b) The number of directors set fourth in the articles of incorporation shall be either a fixed number or a variable number. If a fixed number, it shall not be less than three, and if a variable number, the stated minimum shall not be less than three and the stated maximum shall not be greater than two times the stated minimum minus one.
- 54117. The bylaws may prescribe penalties for violations of the bylaws.
- 54118. The bylaws may prescribe the amount of entrance, organization, and membership fees, if any; the manner and method of collection such fees; and the purpose for which they may be used.
- 54119. The bylaws may prescribe the amount which each member or stockholder shall be required to pay annually, or from time to time, if at all, to carry on the business of the association; the charge, if any, to be paid each member or stockholder for services rendered by the association to him and the time of payment and manner of collection; and the marketing contract between the association and its members.
- 54120. The bylaws may prescribe the amount of any dividends which may be declared on the stock or membership capital, which shall not exceed eight percent per annum, shall be in the nature of interest, and shall not affect the nonprofit character of any association which is organized pursuant to this chapter.
- 54121. The bylaws may prescribe the number and qualifications of members or stockholders of the association and the conditions precedent to membership or ownership of common stock; the method, time and manner of permitting members to withdraw or the holders of common stock to transfer their stock; the manner of assignment and transfer of the interest of members; and of the shares of common stock; the conditions upon which, and time when, membership of any member shall cease; the automatic suspension of the rights of a member when he ceases to be eligible to membership in the association; and mode, manner, and effect of the expulsion of a member.
- 54122. The bylaws may prescribe the manner of determining the value of a member's interest and provision for its purchase by the association upon the death or withdrawal of a member or the expulsion of a member or forfeiture of membership.

**Article 6. Directors and Management**

- 54141. The affairs of the association shall be managed by a board of not less than three directors who are elected by the members.



- 54142. The bylaws may provide that the territory in which the association has members shall be divided into districts and that directors shall be elected from the several districts. In any such case, the bylaws shall specify the number of directors to be elected by each district, the manner and method of reapportioning the directors and of redistricting the territory.
- 54143. The bylaws may provide that primary elections shall be held to nominate directors.
- 54147. An association may provide a fair remuneration for the time which is actually spent by its officers and directors in its service and for the service of the members of the executive committee.
- 54148. If a vacancy on the board of directors occurs except by expiration of term, the remaining members of the board, by majority vote, shall fill the vacancy unless otherwise provided for in the bylaws.
- 54149. The directors shall elect a president, one or more vice presidents, a secretary, a treasurer, and any other such officers as may be prescribed by the bylaws. Any two or more offices except those of president and secretary may be held by the same person.
- 54150. Any member may bring charges against any officer or director by filing them in writing with the secretary of the association together with a petition which is signed by five percent of the members.

**Article 7. Powers of the Cooperative**

- 54171. An association may engage in any activity in connection with the marketing, selling, preserving, harvesting, drying, processing, manufacturing, canning, packing, grading, storing, handling, or utilizing of any product which is produced or delivered to it by its members; or the manufacturing or marketing of the byproducts of any such product; or any activity in connection with the purchase, hiring, or use by its members of supplies, machinery, or equipment or in the financing of any such activities; or in any one or more of the activities which are specified in this section.
- 54172. An association may borrow without limitation as to amount of corporate indebtedness or liability and may make advances to members.
- 54173. An association may act as the agent or representative of any member or members in any of the activities which are mentioned in section 54171 or 54172.
- 54175. An association may establish reserves and invest the funds of the reserves in bonds or in such other property as may be provided in the bylaws.
- 54176. An association may buy, hold, and exercise all privileges of ownership over such real or personal property as may be necessary or convenient for the conduct and operation of, or incidental to, any of the business of the association.
- 54177. An association may levy assessments in the manner and in the amount as may be provided in its bylaws.
- 54179. An association may use or employ any of its facilities for any purpose, provided the proceeds which arise from such use and employment shall go to reduce the cost of operations for its members. The products which are handled for, or the services, machinery, equipment, or supplies or facilities which are furnished to, nonmembers shall not, however, exceed in value the products which are handled for, or the services, merchandise, or facilities which are supplied to, members during the same period.
- 54180. An association may organize, form, operate, own, control, have an interest in, own stock, or be a member of any other corporation, with or without capital stock, which is engaged in preserving, drying, processing, canning, packing, storing, handling, shipping, utilizing, manufacturing, marketing, or selling of any product which is handled by the association, or the byproducts of any such product.
- 54181. Any two or more associations may, by agreement between them, unite in employing and using, or may separately employ and use the same personnel, methods, means, and agencies for carrying on and conducting their respective business.



**Article 8. Financial Provisions**

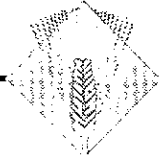
- 54201. An association is not subject in any manner to the terms of the Corporate Securities Law, Division 1, Title 4 of the Corporations Code, and any association may issue its membership certificates or stock or other securities as provided in this chapter without the necessity of any qualification under the law.
- 54204. The board of directors of every association shall cause to be sent to the members of the association not later than 120 days after the close of the fiscal or calendar year an annual report of the operations of the association, unless such report is expressly dispensed with in the bylaws.  
  
Such annual report and any interim reports shall include a balance sheet as of such closing date. Such financial statement shall be prepared in a form which is sanctioned by sound accounting practice.

**Article 9. Members**

- 54231. Under the terms and conditions which are prescribed in the bylaws adopted by it, an association may admit as members or issue common stock to only such persons as are engaged in the production of any product which is to be handled by or through the association. This includes lessees and tenants of land which is used for the production of such products and any lessors and landlords that receive as rent all or part of the crop which is raised on the leased premises.
- 54233. Any association may become a member or stockholder of any other association.
- 54234. If a member of an association which is established without shares of stock has paid his membership fee in full, he shall receive a certificate of membership.
- 54235. An association shall not issue a certificate for stock to a member until it has been fully paid for. The promissory notes of the members may be accepted by the association as full or partial payment. Retention of the stock as security does not affect the member's right to vote.
- 54237. The bylaws shall prohibit the transfer of the common stock or membership certificates of the association to any person that is not qualified to be a shareholder or member.
- 54239. A member or stockholder is not liable for the debts of the association to an amount which exceeds the sum which remains unpaid on his membership fee or his subscription to the capital stock, including any unpaid balance on any promissory note which is given in payment of the membership fee.

**Article 10. Marketing Contracts**

- 54261. The association and its members may make and execute marketing contracts which require the members to sell, for any period of time, but not over 15 years, all or any part of any product or specified commodity exclusively to or through the association. If they contract a sale to the association, title to the product passes absolutely and unreservedly, except for recorded liens, to the association upon delivery or at any other specified time which is expressly and definitely agreed to in the contract.
- 54262. The contract may provide that the association may sell or resell any product which is delivered by its members, with or without taking title to such product, and pay over to its members the resale price, after deducting all of the following:
  - (a) Necessary selling, overhead, and other expenses, including reserves for retiring stock, if any.
  - (b) Other proper reserves.
  - (c) Interest not exceeding eight percent per annum upon common stock.
- 54263. Notwithstanding any provisions of the Civil Code, a contract which is entered into by a member or stockholder of an association which provides for the delivery to such associations of any product which is produced or acquired by the member or stockholder may be specifically enforced by the association to secure the delivery to it of such product.
- 54264. The bylaws or the marketing contract may fix, as liquidated damages, specific sums to be paid by the member or stockholder to the association upon the breach by him of any provision of the marketing contract.



# Appendix II

## Simplified Sample Articles of Incorporation

We, the undersigned, a majority of whom are residents of the State of California, all of whom are engaged in the production of agricultural products, have associated together for the purpose of forming a nonprofit cooperative association (with or without capital stock), under the provisions of the Food and Agricultural Code of the State of California (Food and Agricultural Code), Chapter 1 of Division 20, Sections 54001-54294.

### ARTICLE I. NAME

The name of the association shall be \_\_\_\_\_.

### ARTICLE II. PRINCIPAL PLACE OF BUSINESS

The association shall have its principal place of business in the city of \_\_\_\_\_, County of \_\_\_\_\_, State of California.

### ARTICLE III. PURPOSES

The association is formed for the following purposes: To produce, process, market, and sell agricultural products as defined by Section 54004 of the Food and Agricultural Code for its members and other producers of any and all agricultural products derived therefrom; to engage in any activity in connection with the picking, gathering, harvesting, receiving, assembly, handling, grading, cleaning, shelling, standardizing, packing, preserving, drying, processing, transporting, storing, financing, advertising, selling, or distribution of any such agricultural products or any products derived therefrom; to manufacture, process, store, handle, ship, distribute, furnish, supply, and procure any and all such farm supplies and equipment; and to exercise all such powers in any capacity and on any cooperative basis that may be agreed upon.

### ARTICLE IV. INITIAL AGENT FOR SERVICE OF PROCESS

The name of the association's initial agent for service of process is \_\_\_\_\_. The agent's business address is \_\_\_\_\_ (street, road), \_\_\_\_\_ (city) \_\_\_\_\_ California, (zip) \_\_\_\_\_.

### ARTICLE V. POWERS

In order to carry out the purposes for which it was formed, the association shall have and may exercise each and every power, privilege, right, and immunity now or hereafter authorized for a corporation organized and existing pursuant to Chapter 1 of Division 20 of California's Food and Agricultural Code.

### ARTICLE VI. PERIOD OF DURATION

This association shall have perpetual existence.



**ARTICLE VII. DIRECTORS**

This association shall have at least \_\_\_\_\_ Directors, but no more than \_\_\_\_\_ directors, in accordance with California Food and Agricultural Code Section 54116 (b).

The names and addresses of those who are to serve as the initial directors are:

NAME	ADDRESS
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____
_____	_____

There shall be \_\_\_\_\_ directors for each district, \_\_\_\_\_ director(s) to be elected by the members (of each, at large) of each district.

Any questions as to the effect of any changes made in district boundaries, or the number or identity or districts, shall be conclusively determined by the board of directors.

Nominations for directors shall be made by petition addressed to the secretary of the association, requesting placement on the ballot of the name of the person so nominated. Such a petition nominating a district director shall be signed by not fewer than \_\_\_\_\_ members of that district.

**ARTICLE VII. REVOLVING FUND**

To provide funds for effecting corporate purposes, the association may collect or retain from members for its own use, sums to be determined from time to time by the board of directors of the association, in accordance with any applicable provisions contained in the bylaws. Pursuant to those provisions, retained funds shall be placed in one or more association funds called "Revolving Funds," to the credit of the respective members from whom collected or retained, and each member shall be entitled to a credit called "Revolving Fund Credit," for the amount collected or retained from that member. Revolving Fund Credits shall be repayable out of moneys in any revolving Fund not required for the use of the association at that time, with the priorities and on the conditions provided in the bylaws of the association.

Revolving Fund Credits may also be set up on the books of the association and admitted by the association in payment for property purchased by the association or as consideration for moneys loaned or advanced to the association, the principal of which shall be payable solely and exclusively out of the moneys in the Revolving Fund to which credited in the same manner as Revolving Fund Credits for retained funds.

The matter of payment of interest (which in no event may exceed eight percent per annum) on Revolving Fund Credits shall be appropriately provided for in the bylaws.





**ARTICLE VIII. CAPITAL STRUCTURE AND VOTING RIGHTS**

(Non stock option)

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

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

The property rights and interests of each member in the association shall be unequal and shall be determined and fixed on a patronage basis, and the net proceeds from the business of the association shall be allocated to member-patrons in the proportion that the patronage of each member bears to the total patronage of all the members of the association.

**ARTICLE IX. INDEMNIFICATION**

The liability of the directors of the association for monetary damages shall be eliminated to the fullest extent permitted under California law. The association is authorized to indemnify the directors, officers, and agents of the association to the fullest extent permissible under California law.

**ARTICLE X. AMENDMENT**

These articles may be amended upon the affirmative vote of a majority of the members actually voting on the proposed amendment.

**Signatures**

Signed this \_\_\_\_ day of \_\_\_\_\_, 19\_\_\_\_, by the undersigned incorporators, all of whom are engaged in agriculture as bona fide producers of agricultural products.

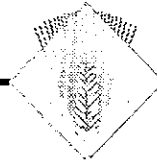
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

**DECLARATION**

The undersigned declare that they are the incorporators and the directors named therein who have executed these Articles of Incorporation and hereby declare that this instrument is the act and deed of the undersigned.

Executed \_\_\_\_\_, 19\_\_\_\_.

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_



# Appendix III

## Estimated Cash Flow Analysis

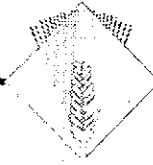
Table 1. Estimated Cash Income 19\_\_\_\_\_.

	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec
<b>Cash Received:</b>												
Product sales												
Capital retains												
Supply sales												
Other sales												
Interest income												
Operating loan												
Long-term loan												
Grants received												
Other												
<b>Total Cash In</b>												



**Table 2. Estimated Cash Expense 19\_\_\_\_\_.**

Cash Disbursed	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec
Equipment												
Land purchase												
Buildings												
Raw product												
Supplies												
Wages												
Payroll taxes												
Packaging material												
Insurance												
Trucking												
Utilities												
Electric												
Gas												
Telephone												
Water												
Repairs												
Office expenses												
Travel												
Supplies												
Rent												
Bad debt allowance												
Legal & audit fees												
Tax & license												
Loan payments												
Operating												
Long-term												
<b>Total Cash Out</b>												
Net Cash Flow												
Begin Cash Balance	0	0	0 0	0	0 0	0	0 0	0	0 0	0	0 0	0
End Cash Balance												



# Appendix IV

## SAMPLE LEGAL DOCUMENTS FOR A CALIFORNIA MARKETING COOPERATIVE

Donald A. Frederick, Attorney-Advisor  
Agricultural Cooperative Service / USDA  
for  
Center for Cooperatives  
University of California, Davis

One of the axioms of business planning is that a strong foundation is essential if an organization is to have a strong structure. An important component of a strong cooperative foundation is a set of basic legal documents that conforms to Federal, State, and local law and facilitates conducting the business affairs of the association to enhance the mutual well-being of the members.

This paper presents sample language as an aid in preparing initial documents, or in revising existing ones, to make sure they promote the objectives of the cooperative venture.

Most of the sample language in this report is suitable for virtually any type of cooperative. Where the language must be tailored to reflect specific functions of the association, wording appropriate for an agricultural marketing cooperative is used. Counsel can help make the necessary modifications to cover supply and related service organizations and nonagricultural activities.

**One point cannot be stressed too much! Cooperative organizers, advisers, and leaders should not just sit down and copy these, or any other set, of legal documents and declare them as their own. These foundation documents should only be adopted after review by a competent attorney, one who understands the unique characteristics of cooperatives and the industry in which the association does business. This will maximize the likelihood that the documents will conform to applicable law and meet the specific needs of the association and its members.**

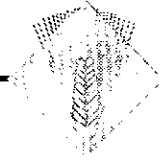
One problem in drafting organizational papers is that they can be thorough or simple, but not both. This paper contains many compromises between these two objectives. This only reemphasizes the need for cooperative founders and leaders, and their professional advisers, to avoid adopting any sample set of documents verbatim and to review existing documents on a regular basis.

This paper presents sample language for four key cooperative documents:

- a. The **organization agreement** secures both a patronage and a financial commitment from prospective members. It is also a vehicle for educating prospective members about the cooperative form of business and the objectives of the proposed association.
- b. The **bylaws** provide a detailed description of the structure and method of operation of the cooperative. Bylaws are a working plan for how the association should function.
- c. The **marketing agreement** is a contract between each individual member of the cooperative and the membership as a whole. This contract establishes the obligations of the member and the cooperative for terms of sale, payment, delivery, and other items important to a commercial transaction.
- d. The **membership agreement** serves as official notice that an applicant has been accepted into membership status by other members of the cooperative.

Drafting cues are enclosed in parentheses ( ); they should be deleted when actual documents are prepared. Also, when drafting options are presented in the text of a sample document, they are separated by a line of stars ( \* \* \* ); discarded options and the stars should likewise be deleted.

These drafting aids are only a place to start in preparing and revising cooperative legal documents. Users must make changes to bring the documents into conformity with the incorporation statute and other legal requirements on the cooperative, and to make sure the documents reflect the manner in which the members want their cooperative to operate.



**APPENDIX IV**

**ORGANIZATION AGREEMENT ..... 45**  
**BYLAWS ..... 47**  
**MARKETING AGREEMENT ..... 53**  
**MEMBERSHIP APPLICATION ..... 55**  
**ELECTION OF DIRECTORS BY DISTRICTS ..... 56**

**ORGANIZATION AGREEMENT**

Section 1. Purpose The undersigned, a producer of agricultural products, hereinafter referred to as "Producer," together with other signers of agreements similar hereto, proposes to organize a cooperative association as defined by Section 54004 of the Food and Agricultural Code of the State of California for the purpose of the production, processing, marketing, and selling of agricultural products for its members and other producers.

Section 2. Organization Committee The association shall be organized with suitable articles of incorporation and bylaws as determined by an organizational committee consisting of the following persons:

Name	Address
_____	_____
_____	_____
_____	_____

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

Section 3. Patronage Commitment [3 possible options are presented]

[1] Full Production

Producer agrees to sign a marketing agreement to commit all \_\_\_ (product) produced by Producer, on land owned or leased by Producer, to the cooperative for direct marketing, processing, or other disposition as the cooperative sees fit. Producer estimates such production will total \_\_\_ (units) in \_\_\_ (year).

\*\*\*\*\*

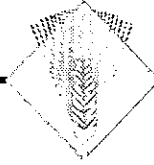
[2] Defined Volume

Producer agrees to sign a marketing agreement to commit \_\_\_ (units) of \_\_\_ (product), produced by Producer, on land owned or leased by producer, to the cooperative for direct marketing, processing, or other disposition as the cooperative sees fit.

\*\*\*\*\*

[3] Set Acreage

Producer agrees to sign a marketing agreement to commit all \_\_\_ (product) produced by Producer on \_\_\_ acres of land, owned or leased by Producer, to the cooperative for direct marketing, processing, or other disposition as the cooperative sees fit. Producer estimates such production will total \_\_\_ (units) in \_\_\_ (year). [If the cooperative is likely to have a minimum quality standard that must be met before product will be accepted, that standard should also be explained and the person or entity judging quality should be named.]



**Section 4. Financial Commitment** [Stock cooperative option] Producer agrees to purchase one share of voting common stock of the association, par value \$ \_\_\_\_\_, payable on demand following a favorable vote by the signees of agreements similar hereto to incorporate the association.

Producer further agrees to purchase \_\_\_\_\_ shares of nonvoting preferred stock of the association, par value \$ \_\_\_\_\_ each, and agrees to pay for same as follows:

- \$ \_\_\_\_\_ cash on demand following incorporation of the association,
- \$ \_\_\_\_\_ on or before \_\_\_\_\_, 19 \_\_\_\_, and
- \$ \_\_\_\_\_ on or before \_\_\_\_\_, 19 \_\_\_\_.

Producer expressly understands that this stock subscription agreement is an irrevocable legally binding obligation which will be relied upon by the association, other producers who subscribe to its stock, and lending institutions from which the association will seek financing to implement its cooperative purposes.

[If a cooperative is organized as a nonstock corporation, the sample language can be altered to call for payment of a membership fee, rather than purchase of a share of common stock, and payment of an additional sum into an equity account, rather than purchase of nonvoting preferred stock.]

**Section 5. Calling of Membership Meeting** [two options presented]

**[1] Committee Discretion**

If, on or before \_\_\_\_\_, 19 \_\_\_\_, the organization committee is of the opinion that sufficient sign up has been obtained to enable the association to operate efficiently, the committee shall set a time and place for a meeting of those persons who have signed this agreement to determine, by majority vote, whether to proceed with the formation and operation of the association, and to consider such other business as may be deemed appropriate.

Not less than ten days before the meeting, notice of the time and place of the meeting shall be sent to all signees by first-class mail, and an appropriate notice shall be published in one or more newspapers of general circulation in the area in which those who signed agreements like this one reside.

\*\*\*\*\*

**[2] Minimum Required Sign-up**

If, on or before \_\_\_\_\_, 19 \_\_\_\_, bona fide producers of agricultural products otherwise eligible to become members in the association agree to execute marketing agreements covering \_\_\_\_\_ (units) of \_\_\_\_\_ (product) and subscribe to provide equity to the association equal to the sum of at least dollars (\$ \_\_\_\_\_), the organization committee shall set a time and place for a meeting ... [continue as above].

\*\*\*\*\*

**Section 6. Accounting** The organization committee shall keep detailed, accurate accounts of all receipts and of all expenditures of every kind. It shall have such accounts audited and render a written report thereof to the board of directors of the association when organized. And it shall thereupon turn over to the association any balance remaining in its hands, free of obligation. If the association is not organized, such unexpended balance shall be prorated among, and returned to, those who contributed to the organization fund.

Date \_\_\_\_\_, 19 \_\_\_\_

Producer's name \_\_\_\_\_

Address \_\_\_\_\_

Telephone \_\_\_\_\_

Social number \_\_\_\_\_

Producer's signature \_\_\_\_\_

Signature \_\_\_\_\_

Chairman, Association Organization Committee



## BYLAWS

### ARTICLE I. MEMBERSHIP

**Section 1. Qualifications** Any person, firm, partnership, corporation, or association, including both landlord and tenant in share tenancies, who is a bona fide producer of agricultural products in the State of California, and who agrees to be a patron of the association, signs a marketing agreement with the association, purchases one share of common stock or pays the initial assessment, and meets such other conditions as may be prescribed by the board of directors, may become a member of the association.

All applications for membership must be approved by the board of directors. Member status is effective as of the time the board approves the application for membership.

**Section 2. Suspension or Termination** In the event the board of directors of the association shall find, following a hearing, that any of the common stock of this association has come into the hands of any person who is not eligible for membership, or that the holder thereof has ceased to be an eligible member, or that such holder has not marketed through the association the products covered by a marketing agreement with the association or has not otherwise patronized the association for a period of \_\_\_\_\_ ( \_\_\_\_\_ ) year(s), or has otherwise violated the articles of incorporation, bylaws, or other agreements made with the association, the association may suspend such holder's rights as a member and terminate the membership.

When a membership is terminated, the association shall repurchase the member's share of common stock for par value or refund the initial assessment. The holder shall return to the association the certificate evidencing the holder's share of stock. If such holder fails to deliver the certificate, the association may cancel such certificate on its books and records, and the certificate is then null and void.

A suspended or terminated member shall have no rights or privileges on account of any stock held, nor vote or voice in the management or affairs of the association other than the right to participate in accordance with law in case of dissolution.

### ARTICLE II. MEETINGS OF MEMBERS

**Section 1. Annual Meeting** The annual meeting of the members of this association shall be held in the State of \_\_\_\_\_, during the month of \_\_\_\_\_, at such time and in such place as the board of directors shall designate.

**Section 2. Special Meetings** Special meetings of the members of the association may be called at any time by order of the board of directors and shall be called upon written request of at least \_\_\_\_\_ members, or at least \_\_\_\_\_ percent ( \_\_\_\_\_ %) of the membership, whichever is a greater number.

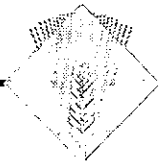
**Section 3. Notice of Meetings** Written notice of every regular and special meeting of members shall be prepared and mailed to the last known post office address of each member not less than \_\_\_\_\_ ( \_\_\_\_\_ ) days before such meeting. Such notice shall state the nature of the business expected to be conducted and the time and place of the meeting. No business shall be transacted at any special meeting other than that referred to in the notice.

**Section 4. Voting** Unless otherwise stated in the articles of incorporation, or these bylaws, or required by applicable law, all questions shall be decided by a vote of a majority of the members voting thereon.

Each member shall be entitled to only one vote. Voting by mail shall not be permitted. Proxy voting shall be allowed. Each proxy shall be in writing, and no member shall vote more than one proxy. Cumulative voting is not permitted.

If a membership is held by a partnership, corporation, or other legal entity, the member shall designate in writing the person who shall vote on behalf of the member. That designation shall remain in effect until written notice of a properly authorized change in the designated voter shall be received by the association.

**Section 5. Quorum** \_\_\_\_\_ ( \_\_\_\_\_ ) members or \_\_\_\_\_ percent ( \_\_\_\_\_ %) of the membership, whichever is a larger number, shall constitute a quorum at any properly called annual or special membership meeting.



## ARTICLE III. DIRECTORS AND OFFICERS

Section 1. Number and Qualification of Directors The association shall have a board of directors of \_\_\_\_\_ ( \_\_\_\_\_ ) members. Each director elected shall be a member of this association in good standing.

No person shall be eligible to be a director if that person is in competition with, or is affiliated with any enterprise that is in competition with, the association. If a majority of the board of directors of the association finds at any time following a hearing that any director is so engaged or affiliated that person shall thereupon cease to be a director.

No director after having served for \_\_\_\_\_ ( \_\_\_\_\_ ) consecutive full term(s) shall be eligible to succeed himself or herself, but after a lapse of \_\_\_\_\_ ( \_\_\_\_\_ ) year(s) he or she shall again be eligible.

Section 2. Election of Directors At the first annual meeting of the members of this association, directors shall be elected to succeed the incorporating directors. \_\_\_\_\_ director(s) shall be elected for one (1) year; \_\_\_\_\_ directors for two (2) years \_\_\_\_\_ and directors for three (3) years. At each annual meeting thereafter, new directors shall be elected, for a term of three (3) years each, to succeed those directors whose terms are expiring. [See Appendix IV, p. 56.]

All directors shall be elected by secret ballot, and the nominee(s) receiving the greatest number of votes shall be elected.

Section 3. Election of Officers The board of directors shall meet within seven (7) days after the first election and within seven (7) days after each annual election and shall elect by ballot a president, vice president, secretary, and treasurer, each of whom shall hold office until the election and qualification of a successor, unless earlier removed by death, resignation, or for cause.

The president and vice president shall be members of the board of directors. The secretary and treasurer need not be directors or members of the association.

Section 4. Vacancies Whenever a vacancy occurs in the board of directors, other than from the expiration of a term of office, the remaining directors shall appoint a member to fill the vacancy until the next regular meeting of the members. If the term of the vacating director does not expire at that regular member meeting, a special election shall be held to select a director to fill the year or years remaining in that term.

If one or more officer positions become vacant, such offices shall be filled by the board of directors, through election by ballot, at either a regular or special meeting of the board.

Section 5. Regular Board Meetings In addition to the meetings mentioned above, regular meetings of the board of directors shall be held monthly, or at such other times and at such places as the board may determine.

Section 6. Special Board Meetings A special meeting of the board of directors shall be held whenever called by the president or by a majority of the directors. Only the business specified in the written notice shall be transacted at a special meeting. Each call for a special meeting shall be in writing, shall be signed by the person or persons calling the meeting, shall be addressed and delivered to the secretary, and shall state the time and place of such meeting.

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

Section 8. Quorum A majority of the board of directors shall constitute a quorum at any meeting of the board.

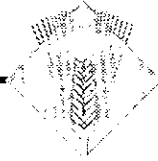
Section 9. Reimbursement and Compensation The association shall reimburse directors for all reasonable expenses incurred in carrying out their duties and responsibilities.

The compensation, if any, of the members of the board of directors shall be determined by the members of the association at any annual or special meeting of the association.

No member of the board of directors, or member of the immediate family of any board member, shall occupy any position in the association on regular salary.

Section 10. Removal of Directors Whenever any director shall fail to meet the qualifications as described in Section 1 of this Article, or fails to attend three (3) consecutive board meetings, either regular or special, without just cause and provided that notice of such meetings has been given in accordance with these bylaws, then it shall be the duty of the board to remove said director and to fill the vacancy in accordance with Section 4 of this Article.





Members, through petition noting the charges and signed by at least \_\_\_\_\_ ( \_\_\_\_\_ ) members or \_\_\_\_\_ percent ( \_\_\_\_ %) of the membership, whichever is a greater number, may request the removal of any member of the board. Such director shall be notified in writing of the charges and given an opportunity to be heard at a membership meeting of the association. Removal of a director shall require a vote of ( \_\_\_\_ %) of members voting. Any vacancy resulting from such action shall be filled by nomination and vote of members at such meeting.

#### **ARTICLE IV. DUTIES OF DIRECTORS**

Section 1. Management of Business The board of directors shall have general supervision and control of the business and the affairs of the association and shall make all rules and regulations not inconsistent with law, the articles of incorporation, or bylaws for the management of the business and the guidance of the members, officers, employees, and agents of the association.

Section 2. Employment of Manager The board of directors shall have power to employ, define duties, fix compensation, and dismiss a manager with or without cause at any time. The board shall authorize the employment of such other employees, agents, and counsel as it from time to time deems necessary or advisable in the interest of the association. The manager shall have charge of the business of the association under the direction of the board of directors.

Section 3. Bonds and Insurance The board of directors shall require the manager and all other officers, agents, and employees charged by the association with responsibility for the custody of any of its funds or negotiable instruments to give adequate bonds. Such bonds, unless cash security is given, shall be furnished by a responsible bonding company and approved by the board of directors, and the cost thereof shall be paid by the association.

The board of directors shall provide for the adequate insurance of the property of the association, or property which may be in the possession of the association, or stored by it, and not otherwise adequately insured, and, in addition, adequate insurance covering liability for accidents to all employees and the public.

Section 4. Accounting System and Audits The board of directors shall have installed an accounting system which shall be adequate to meet the requirements of the business and shall require proper records to be kept of all business transactions.

At least once in each year the board of directors shall secure the services of a competent and disinterested public auditor or accountant, who shall make a careful audit of the books and accounts of the association and render a report in writing thereon, which report shall be submitted to the directors and the manager of the association and made available to the members of the association.

This report shall include at least a balance sheet showing the true assets and liabilities of the association, and an operating statement for the fiscal period under review.

Section 5. Depository The board of directors shall select one or more banks to act as depositories of the funds of the association and shall determine the manner of receiving, depositing, and disbursing the funds of the association and the form of checks and the person or persons by whom they shall be signed, with the power to change such banks and the person or persons signing such checks and the form thereof at will.

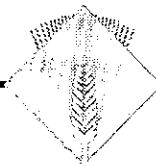
Section 6. Committees The board may, at its discretion, appoint from its own membership an executive committee of \_\_\_\_ members, and determine their tenure of office and their powers and duties. The board may delegate to the executive committee all or any stated portion of the functions and powers of the board, subject to the general direction, approval, and control of the board. Copies of the minutes of any meeting of the executive committee shall be mailed to all directors within seven (7) days following such meeting.

The board of directors may, at its discretion, appoint such other committees as it deems appropriate.

#### **ARTICLE V. DUTIES OF OFFICERS**

Section 1. Duties of President The president shall (1) preside over all meetings of the association and of the board of directors; (2) call special meetings of the board of directors; (3) appoint such committees as the board of directors may deem advisable for the proper conduct of the cooperative; and (4) perform all acts and duties usually performed by a presiding officer.

Section 2. Duties of Vice President In the absence or disability of the president, the vice president shall perform the duties of the president, provided, however, that in case of death, resignation, or disability of the president, the board of directors may declare the office vacant and elect any eligible person president.



**Section 3. Duties of Secretary** The secretary shall keep a complete record of all meetings of the association and of the board of directors and shall have general charge and supervision of the books and records of the association. The secretary shall sign papers pertaining to the association as authorized or directed by the board of directors. The secretary shall serve all notices required by law and by these bylaws and shall make a full report of all matters and business pertaining to the office to the members at the annual meeting. The secretary shall keep the corporate seal and all books of blank certificates, complete and countersign all certificates issued, and affix the corporate seal to all papers requiring a seal; shall keep complete stock ownership records; shall make all reports required by law; and shall perform such other duties as may be required by the association or the board of directors. Upon the election of a successor, the secretary shall turn over all books and other property belonging to the association.

**Section 4. Duties of Treasurer** The treasurer shall be responsible for the keeping and disbursing of all moneys of the association, and shall keep accurate books of accounts of all transactions of the association. The treasurer shall perform such duties with respect to the finances of the association as may be prescribed by the board of directors. At the expiration of his term of office, the treasurer shall promptly turn over to his successor all moneys, property, books, records, and documents pertaining to his office or belonging to the association.

## ARTICLE VI. OPERATION AT COST AND MEMBERS' CAPITAL

**Section 1. Operation at Cost** The association shall at all times be operated on a cooperative service-at-cost basis for the mutual benefit of its member patrons.

**Section 2. Margin Allocation** In order to induce patronage and to assure that this association will operate on a service-at-cost basis in all its transactions with its members, the association is obligated to account on a patronage basis to all member patrons on an annual basis for all amounts received from business conducted with members on a patronage basis, over and above the cost of providing such services and of making reasonable additions to reserves. Such allocation shall be on the basis on the volume (or dollar value) of product marketed through (and/or purchased from) the association.

The association is hereby obligated to pay all such amounts to the patrons in cash or by credits to a capital account of each member patron.

**Section 3. Per-Unit Retains** Each member also agrees to provide capital in such amounts as shall be determined by the board of directors based on physical units of product marketed through the association. Such per-unit retains shall be allocated to the member's capital credit account.

**Section 4. Dividends** No dividends shall be paid on any capital credits.

**Section 5. Records and Documentation** The books and records of the association shall be set up and kept in such a manner that at the end of each fiscal year, the amount of capital, if any, so furnished by each member is clearly reflected and credited in an appropriate record to the capital account of each member.

The association shall, within 8-1/2 months after the close of each fiscal year, notify each member of the capital so credited to the member's account. The notice shall be in the form of a written notice of allocation or per-unit retain certificate (as those terms are used in Subchapter T of the Internal Revenue Code) or other appropriate written document. The board shall have discretion to issue such notices and certificates in either "qualified" or "non-qualified" form as permitted by the Internal Revenue Code and other applicable law.

**Section 6. Fiscal Year** The fiscal year of this association shall commence on the first day of \_\_\_\_\_ (month) and end on the last day of \_\_\_\_\_ (preceding month).

## ARTICLE VII. EQUITY REDEMPTION

**Section 1. Regular Redemption** [Two options presented]

[1] **Revolving Fund**

If at any time the board of directors determines that the financial condition of the association will not be impaired thereby, capital credited to members' accounts may be redeemed in full or in part. Any such redemption of capital shall be made in order of priority according to the year in which the capital was furnished and credited, the capital first received by the association being the first redeemed.



\*\*\*\*\*

[2] Percent of All Equities

It shall be the policy of the association, when other redemption priorities set forth herein have been met, and when funds are available, to redeem in cash a percentage of each member patron's capital credits, rather than ratably by year. The time and method of any such redemption shall be determined by the board of directors.

\*\*\*\*\*

Section 2. Discretionary Special Redemptions Notwithstanding any other provision of these bylaws, the board, at its absolute discretion, shall have the power to retire any capital credited to members' accounts on such terms and conditions as may be agreed upon by the parties in any instance in which the interests of the association and its members are deemed to be furthered thereby and funds are determined by the board to be available for such purposes.

Section 3. Specified Special Redemptions The association shall give priority to redemption of members' capital credits held by deceased persons for the settlement of their estate. The association shall thereafter grant priority redemption to capital credits of former members who have attained their 65th birthday and are no longer actively engaged in agricultural production as actual producers or landlords in share tenancy. The time and method of such redemption shall be determined solely by the board of directors, dependent upon the financial condition of the association. In the case of redemption of the equities of those persons who have attained age 65 and retired from farming, preference may be given to the oldest retirees in establishing the order of priority among those eligible.

In the case of a corporation or partnership holder of members' capital credits, such corporation or partnership shall be considered eligible for priority treatment to the same extent as the individual stockholders of such corporation or partners of the partnership would have qualified, if each individual stockholder or partner were an individual member-patron of this association. Any redemption shall be made to the corporation or partnership, and not to the individual stockholder or partner thereof.

Each corporation or partnership shall report to the association the percentage of ownership interest in the corporation or partnership of each of its stockholders or partners. Failure to report accurately the percentage of individual ownership interest shall disqualify any allocations made to the corporation or partnership by this association from redemption priority. If a corporation or partnership should dissolve, its capital credits in this association shall be prorated among, and transferred to, the individual stockholders or partners and considered for redemption on an individual ownership basis. The amount of any redemption or prorate related to a corporation or partnership member shall be determined by the percentage of ownership interest as reported by the corporation or partnership.

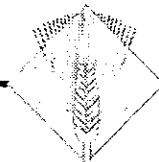
When two or more persons are holders of capital credits as tenants in common, without a designation of rights of survivorship, they shall be deemed by this association to be acting as partners and shall be subject to the same requirements as a partnership.

Capital credits held in joint tenancy with rights of survivorship shall be considered for priority of redemption according to the qualifying status of the youngest member of the joint tenancy or, in the event of death of one of the joint tenants, of the survivor.

**ARTICLE VIII. CONSENT**

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

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



### **ARTICLE IX. NON MEMBER BUSINESS**

This association may conduct business with non members on either a patronage or non patronage basis. However, this association shall not market the products of non members in an amount the value of which exceeds the value of the products marketed for members. It shall not purchase supplies and equipment for non members in an amount the value of which exceeds the value of the supplies and equipment purchased for members. It shall not purchase supplies and equipment for persons who are neither members nor producers of agricultural products in an amount the value of which exceeds fifteen percent (15%) of all its purchases. Business done for the United States or any of its agencies shall be disregarded in determining the limitations imposed by this section.

### **ARTICLE X. NONPATRONAGE INCOME**

The non patronage income of the association shall be its gross receipts derived from all sources which under law do not qualify as patronage income, less all expenses properly attributable to the production of such non patronage sourced income and all income taxes payable on such receipts by the association. Non patronage income shall be used on behalf of the association and its members in accordance with such lawful purposes, including assignment to an unallocated reserve account and allocation in whole or in part to members, as may be determined by the board of directors.

### **ARTICLE XI. LOSSES**

Section 1. Patronage Losses In the event the association suffers a loss during any year on business conducted with or for patrons, such loss may be apportioned among the patrons during the year of loss so that such loss will, to the extent practicable, be borne by the patrons of the loss year on an equitable basis. The board shall have full authority to prescribe the basis on which capital furnished by patrons may be reduced or such loss otherwise equitably apportioned among the patrons. In the event of a patronage loss in one or more departments or divisions of the operation of this association, but not so much as to cause an overall loss for the fiscal year, such loss or losses may be prorated against each of the remaining profitable departments on the basis of their respective percentage of the net margins during such fiscal year.

Section 2. Non patronage Losses If in any fiscal year the association shall incur a loss other than on patronage operations, such loss may be charged against any reserve accumulated from non patronage earnings in prior years.

Section 3. General Provisions The board shall have no authority to make assessments against members.

This section shall not be construed to deprive the association of the right to carry backward or forward losses from any source whatsoever in accordance with the Internal Revenue Code or state taxing statutes:

### **ARTICLE XII. DISSOLUTION AND PROPERTY INTEREST OF MEMBERS**

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

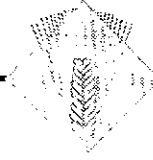
### **ARTICLE XIII. INDEMNIFICATION**

The association shall indemnify its officers, directors, employees, and agents to the fullest extent possible under the provisions of the California Corporation Code, as it may be amended from time to time.

The association may purchase liability insurance coverage for any person serving as an officer, director, employee, or agent to the extent permitted by applicable California law.

### **ARTICLE XIV. AMENDMENT**

If notice of the character of the amendment proposed has been given in the notice of the meeting, these bylaws may be altered or amended at any regular or special meeting of the members by the affirmative vote of \_\_\_\_\_ ( \_\_\_\_\_ ) of the members present or voting by proxy.



## MARKETING AGREEMENT

THIS AGREEMENT, made as of this \_\_\_\_\_ day of \_\_\_\_\_ 19\_\_\_\_ by and between \_\_\_\_\_, herein referred to as Producer, and \_\_\_\_\_ an agricultural cooperative having an office at \_\_\_\_\_, herein referred to as Association.

### RECITALS

A. Association is an agricultural cooperative organized under the laws of the State of California.

B. Producer is a member of the Association who produces \_\_\_\_\_.

C. Producer has purchased one share of common voting stock and paid to Association the sum of \_\_\_\_\_ dollars (\$ \_\_\_\_\_) calculated at the rate of \$ \_\_\_\_\_ per \_\_\_\_\_ (unit) of \_\_\_\_\_ (product), as specified in Producer's membership application, receipt of which is acknowledged as an equity investment in the Association. This entitles Producer to all the benefits of membership in the Association as long as Producer complies with the articles of incorporation and bylaws of the Association and the provisions of this agreement.

In consideration of the mutual covenants and obligations contained herein, the parties agree as follows:

Section 1. Sale of \_\_\_\_\_ (product). Association agrees to buy and Producer agrees to sell to Association \_\_\_\_\_ (number) \_\_\_\_\_ (units) of \_\_\_\_\_ (product) as defined by USDA standards and grown by Producer. This agreement is intended by the parties to pass an absolute title to \_\_\_\_\_ (number) \_\_\_\_\_ (units) of \_\_\_\_\_ (product) grown by Producer as soon as they have a potential existence but such \_\_\_\_\_ (product) shall be at the risk of Producer until delivery.

#### Section 2. Payment to Producer [two options presented]

##### [1] Gross margin operation

Association shall market Producer's \_\_\_\_\_ (product) and Producer shall accept as payment for Producer's \_\_\_\_\_ (product) a price based on the current market price in the area for \_\_\_\_\_ (product) of like grade and quality.

Association shall pay the amount due Producer, less deductions authorized in Section 6 of this agreement, not more than \_\_\_\_\_ days after delivery of \_\_\_\_\_ (product) to Association or Association's prescribed buying location.

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##### [2] Pooling operation

The Association may at any time pool any or all \_\_\_\_\_ (product) of Producer with any other \_\_\_\_\_ (product) of a similar kind and grade. Producer shall receive, for \_\_\_\_\_ (product) pooled, a unit price equal to the average net unit price obtained for the pooled \_\_\_\_\_ (product), less deductions authorized in Section 6 of this agreement.

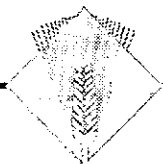
Association shall make an advance payment to Producer of \_\_\_\_\_ percent of the current market price in the area for \_\_\_\_\_ (product) of like grade and quality not more than \_\_\_\_\_ days after delivery of \_\_\_\_\_ (product) to Association or Association's prescribed buying location.

\*\*\*\*\*

Section 3. Delivery All \_\_\_\_\_ (product) shall be delivered by Producer at Producer's expense at the earliest reasonable time after harvesting, or at such time as called for by Association, to Association's principal place of business or to one of Association's authorized buying locations as prescribed by Association. The Association will use its best efforts to locate buying locations within a reasonable distance from Producer's farm.

Section 4. Inspection and Grading Prior to acceptance by Association, all \_\_\_\_\_ (product) shall be inspected and graded by the USDA in accordance with USDA standard rules and regulations.

All purchases and/or marketings of \_\_\_\_\_ (product) received by Association from Producer shall be based upon USDA grade, and Producer agrees to accept the grading established by USDA.



**Section 5. Loans and Security** Association shall have the power to borrow money for any purpose on the security of the \_\_\_\_\_ (product) delivered to Association, the products derived thereupon, and evidence of such products or by-products, or cash or accounts arising from the sale thereof, and to give a lien, either legal or equitable, thereon as the absolute owner and/or marketing agent thereof. Association may commingle such products and by-products with other products and by-products of like grade and variety and shall exercise all other rights of ownership without limitation.

**Section 6. Deductions** Association agrees to purchase from and/or market for Producer the \_\_\_\_\_ (product) set forth in Section 1 and to pay to Producer for said \_\_\_\_\_ (product) the price set forth in Section 1, less the following deductions authorized by Producer:

- a. An amount to be determined annually by the board of directors, in the sole discretion of the board, to meet the general contingencies of the business of the Association including operating expenses.
- b. A \$ \_\_\_\_\_ per \_\_\_\_\_ (unit) capital retain deduction by the Association on the purchase price of each \_\_\_\_\_ (unit) of \_\_\_\_\_ (product) received from Producer.

**Section 7. Liens** Producer shall notify the Association of any lien on any \_\_\_\_\_ (product) covered by this agreement. Producer shall obtain permission from the lien holder for Association to market such \_\_\_\_\_ (product) and to retain any deductions from the payments to Producer authorized hereunder and under the articles of incorporation and bylaws of the Association. After any such deductions, Producer authorizes the Association to apply the balance of the sale proceeds, or so much thereof as is necessary, for payment of the lien.

**Section 8. Liquidated Damages** The remedy at law would be inadequate and it would be impracticable and difficult to determine the actual damages to the Association should Producer fail to deliver the \_\_\_\_\_ (product) covered by this agreement. Therefore, regardless of the cause of such failure, Producer agrees to pay to the Association for all such \_\_\_\_\_ (product) delivered or disposed of by Producer, other than in accordance with the terms of this agreement, a sum equal to \_\_\_\_\_ % of the fair market value of the product at the close of business on the day the product should have been delivered to the Association, as liquidated damages for the breach of this agreement.

All parties agree that this agreement is one of a series dependent for its true value on the adherence of all the contracting parties to all of the agreements, but the cancellation of any other similar agreement or the failure of any of the parties thereto to comply therewith shall not affect the validity of this agreement.

Failure to deliver the \_\_\_\_\_ (product) committed herein due to act of God shall not constitute a breach of this agreement.

**Section 9. Specific Performance** Producer agrees that in the event of a breach or threatened breach by Producer of any provisions of this marketing agreement regarding delivery of \_\_\_\_\_ (product), the Association shall be entitled to a preliminary restraining order and an injunction to prevent breach or further breach hereof and to a decree of specific performance hereof. The parties agree that this is a contract for the purchase and sale of personal property under special circumstances and conditions and that the Association may, but shall not be obligated to, go into the open markets and buy \_\_\_\_\_ (product) to replace any that Producer may fail to deliver.

**Section 10. Legal Costs and Expenses** If the Association brings any action whatsoever by reason of a breach or threatened breach of this agreement, Producer shall pay to the Association all court costs, costs for bonds, travel expenses, and all other expenses arising out of or caused by the litigation, including reasonable attorney's fees expended or incurred by Association in such proceedings, and all such costs and expenses shall be included in the judgment.

**Section 11. Termination and Renewal** After this agreement has been in effect one year from the date of execution, either party may terminate it in any year by notifying the other party in writing between \_\_\_\_\_ (date) and \_\_\_\_\_ (date). It is mutually agreed that failure to so terminate in any year shall constitute conclusive evidence that the parties have renewed this agreement for another year.

**Section 12. Non conforming Agreements** Association may enter into agreements with other growers differing in terms from those contained herein, consistent with the bylaws of the Association, without invalidating this agreement, provided that Producer at Producer's request may sign a similar agreement as a substitute for this agreement.

**Section 13. No Contrary Agreements** Producer warrants that Producer has not contracted to sell, market, consign, or deliver and will not contract to sell, market, consign, or deliver any \_\_\_\_\_ (product) during the term of this agreement to any person, firm or corporation, contrary to this agreement.



Section 14. Forfeiture of Membership Violation of this agreement in any material respect by Producer shall be grounds for the board of directors to terminate Producer's membership in the Association.

Section 15. Articles and Bylaws Producer agrees to conform to and observe the articles of incorporation and bylaws of the Association now in force and as they may be amended hereafter.

Section 16. Assignment This agreement may be assigned by the Association in its sole discretion. Producer may assign this agreement, but only upon written authorization granted by the board of directors of the Association.

Section 17. Entire Agreement It is agreed that the articles of incorporation and the bylaws of the Association, now or hereafter in effect, and this marketing agreement constitute the entire agreement between the Association and Producer, and that there are no oral or other conditions, promises, covenants, representations, or inducements in addition to, or at variance with, any terms of this agreement.

Section 18. Governing Law This agreement shall be governed by the laws of the State of \_\_\_\_\_.

IN WITNESS WHEREOF, these parties have executed this agreement as of the day, month and year first above written:

Producer's name \_\_\_\_\_

Cooperative's name \_\_\_\_\_

By \_\_\_\_\_  
President

ATTEST: \_\_\_\_\_

Secretary: \_\_\_\_\_

### MEMBERSHIP APPLICATION

Applicant's Statement I hereby apply for membership in \_\_\_\_\_ and agree to abide by the articles of incorporation and bylaws of the association, now and hereafter in effect, copies of which have been presented to me for inspection. I certify that I am a producer of \_\_\_\_\_, have tendered the purchase price of one share of common voting stock, have signed a marketing agreement, and have met such other qualifications for membership as have been explained to me.

After my membership shall have been in effect for one year from the date of its acceptance by the association, either party may terminate it by notifying the other party in writing of this intention between \_\_\_\_\_ (date) and \_\_\_\_\_ (date) of any year. If neither of the parties to this agreement so notifies the other, it is mutually agreed that this shall constitute conclusive evidence that the parties have renewed this agreement for another year.

Date \_\_\_\_\_ 19 \_\_\_\_\_.

Applicant's name \_\_\_\_\_

Address \_\_\_\_\_

Telephone \_\_\_\_\_

Social Security number \_\_\_\_\_

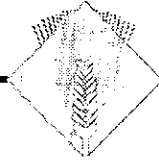
Applicant's signature \_\_\_\_\_

Acceptance This certifies that \_\_\_\_\_ is a member of and is entitled to all of the rights, benefits, and privileges of membership in the association.

Date \_\_\_\_\_ 19 \_\_\_\_\_.

President: \_\_\_\_\_

Secretary: \_\_\_\_\_



**APPENDIX A. ELECTION OF DIRECTORS BY DISTRICTS  
(BY LAW PROVISION)**

**ARTICLE III. DIRECTORS AND OFFICERS**

Section 2. Election of Directors by Districts [Insert this text between the two paragraphs of Section 2 located on page 48.]

The territory in which the association has members shall be divided into \_\_\_\_\_ (same number as number of directors) districts. The respective districts and their boundaries shall be established by resolution of the board of directors.

The board of directors may from time to time change the boundaries of one or more districts by adding territory not included within any district, by adding to one district territory previously included in another district, or by excluding from a district a part of its territory.

There shall be as many directors as there are districts, one director to be elected by the members of each district. However, when the number of districts is an even number there shall be one additional director, to be known as a director-at-large and to be elected by all members of the association. A district director must be a resident of, or be a producer of agricultural products in, the district for which such director is elected or appointed.

Any questions as to the effect of any changes made in district boundaries, or the number or identity of districts, shall be conclusively determined by the board of directors.

Nominations for directors, either for a district or at large, shall be made by petition addressed to the secretary of the association requesting placement on the ballot of the name of the person so nominated. Such a petition nominating a district director shall be signed by not less than \_\_\_\_\_ members of that district. Such a petition nominating a director-at-large shall be signed by not less than \_\_\_\_\_ members of the association.