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An Agricultural Law Research Article

## **Expulsion of Members of Agricultural Cooperatives**

by

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# Expulsion of Members by Agricultural Cooperatives

*John D. Copeland*

The relationship between farmer members and their cooperatives is unique, a combination of contract, business, and membership interests. Cooperatives may have occasion to terminate the relationship by expelling a member. This article explores legal authority of cooperatives to expel members, conditions under which expulsion is an acceptable action by cooperatives, and legal consequences to the cooperative when expulsion occurs. Adverse consequences of improper expulsion are described, and procedures are suggested to protect member and cooperative interests when expulsion is necessary.

Agricultural cooperatives are voluntary democratic organizations with unique marketing and financial structures.<sup>1</sup> Whether incorporated or unincorporated, they operate to enhance the competitive market advantages of their members. Cooperative members obtain more market outlets for their products than normally would be practical and are able to obtain quality supplies and services at the lowest possible cost.<sup>2</sup> Such benefits are extremely important to agricultural producers who are subject to the whims of nature, are unable to adjust production to meet demand, find it difficult to pass operating costs on to consumers, and tend to be price takers both in the buying and selling of products.<sup>3</sup>

Because of the special nature of the relationship between agricultural cooperatives and their members, the involuntary termination of an individual's membership can have serious economic repercussions for the member. This article examines the power of cooperatives to expel members, as well as some of the legal issues that arise out of such expulsions. This article does not explore those situations where a member voluntarily withdraws from cooperative membership, or where membership automatically terminates as a result of a member's death.

## **Right to Expel Members**

### **Source of Expulsion Power**

Voluntary organizations cannot function and survive without being able to discipline recalcitrant members. The power of cooperatives to expel members usually is found in the state enabling statute that provides for the creation of cooperatives, as well as in the charter and bylaws of each cooperative. The majority of state statutes grant cooperatives the right to expel

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members, but do not specify the mode, manner, nor effect of expulsion. Such permissive statutes grant individual agricultural cooperatives great freedom in determining for what reasons, and under what conditions, members will be expelled.<sup>4</sup>

A minority of state statutes specify the grounds upon which a cooperative may expel a member. For example, a state statute might provide for the expulsion of a member who willfully violates any article or bylaw that makes expulsion a penalty.<sup>5</sup> A question arises, of course, as to the power of a cooperative to expel members where the state statute is silent concerning expulsion, or where the specific conduct complained of is not enumerated as a basis for expulsion in the pertinent statute. There is common law authority that nonstock cooperatives possess an inherent right to expel members upon a showing of good cause.<sup>6</sup> In contrast, common law does not provide for the expulsion of a member of an incorporated association.<sup>7</sup>

The power of an incorporated cooperative to expel a member where the state statute is silent was questioned in *Frezzo v. Delaware Mushroom Cooperative Association*.<sup>8</sup> The cooperative expelled a member who failed to provide mushrooms in accordance with a marketing agreement. The member successfully challenged the expulsion on the theory that the Delaware cooperative statute did not contain provisions for the expulsion of cooperative members, nor did the statute affirmatively grant cooperatives the right to formulate articles or bylaws providing for expulsion.<sup>9</sup>

The cooperative argued that the right to formulate such bylaws was implicit in the Delaware statute allowing cooperatives to formulate bylaws to regulate conduct and manage its affairs.<sup>10</sup> The court in *Frezzo*, however, noted that although the Delaware legislature explicitly provided for the removal of cooperative directors and officers, it had not made provision for the expulsion of members.<sup>11</sup> The court reasoned that if the legislature had intended for cooperative members to be expelled, it would have explicitly provided for expulsion in the statute.<sup>12</sup>

## Grounds for Expulsion

Where the right to expel a member is established by state statute, the cooperative's own bylaws and articles, or a common law right of self-preservation, the courts have repeatedly upheld expulsion actions in appropriate circumstances.

## Failure to Do Business with the Cooperative

The economic viability of any agricultural cooperative is dependent upon the patronage of its members. A number of state statutes specify that a member may be expelled for failure to patronize a cooperative for a particular period of time, such as 12 months.<sup>13</sup> In a similar vein, state statutes also sanction the expulsion of members who cease to be producers of agricultural products.<sup>14</sup> Agricultural cooperatives receive significant tax benefits<sup>15</sup> and antitrust exemptions<sup>16</sup> so long as the cooperative is primarily composed of members involved in production of agricultural products. Because it is essential that cooperative members be producers of agricultural products, state statutes and cooperative bylaws may provide that such associations be composed only of bona fide producers of agricultural prod-

ucts.<sup>17</sup> Once a member ceases to belong to the eligible membership class, he is subject to being expelled from the cooperative.<sup>18</sup>

### ***Breach of Marketing Contracts***

Generally, membership in a nonstock cooperative is not automatically terminated when a member's marketing contract with the cooperative is terminated. Nor does a stockholder in an incorporated cooperative automatically cease to be a stockholder in the same circumstances.<sup>19</sup> However, cooperative bylaws may provide for the expulsion of a member upon breach of a marketing agreement.<sup>20</sup> Marketing agreements are essential to the operation of most marketing cooperatives, and the threat of expulsion is one means of seeing that they are honored. Although a cooperative member can be expelled for failing to deliver contracted products to the cooperative, a member cannot automatically terminate his membership through such a failure unless the association consents.<sup>21</sup>

### ***Financial Insolvency***

Given the need of cooperatives to preserve and protect their financial integrity, a question arises as to whether cooperatives can expel members who become insolvent. The issue becomes particularly complex if the member has filed a bankruptcy petition.

In *Schlossmans, Inc. v. Associated Furniture Dealers of New York, Inc.*,<sup>22</sup> a member of a retail furniture trade organization was expelled for filing a Chapter 11 bankruptcy reorganization petition. The organization's bylaws provided for the expulsion of any member who filed a bankruptcy petition, or for whom a receiver was appointed, or who sought to take advantage of any insolvency statute.<sup>23</sup>

The expelled member sought a revocation of the expulsion and a restoration to full membership privileges. The court, however, held that New York corporation law gave organizations the right to suspend and expel members in appropriate circumstances. The bylaw enacted by the trade organization was essential to the mutual protection of its members. The financial impairment of a single member posed a threat to the organization to the extent that the member would no longer be able to make essential contributions and meet obligations. Such a failure placed added burdens on remaining members by increasing operational costs and by tightening credit given by suppliers.<sup>24</sup>

The court in *Schlossmans* also held that the expulsion did not violate the spirit or intent of the then extant Bankruptcy Act of 1898. The court ruled that a distinction existed between actions of parties dealing with the bankrupt that interfere with the provisions of the bankruptcy law and those measures taken for financial protection. Creditors and other persons have the right to take necessary steps to protect themselves from the practical and financial consequences of a bankruptcy proceeding.<sup>25</sup>

It would be easy to assume that the court's logic in *Schlossmans* would be equally applicable to agricultural cooperatives. To preserve the financial integrity of the cooperative, it might appear to be necessary to expel a member who gets into financial difficulties. It is doubtful, however, that the *Schlossmans* decision is still good law. The holding was supported by

cases decided under the now repealed Bankruptcy Act of 1898.<sup>26</sup> These cases upheld the validity of contract clauses that provided for the termination of the contracts upon the filing of bankruptcy petitions by the debtor. In one case, a court upheld a lease provision to the effect that the adjudication of the lessee as a bankrupt ipso facto terminated the lease agreement and all the rights thereunder.<sup>27</sup>

In another case, the debtor sought relief under Chapter 11 of the Bankruptcy Act of 1898 as amended by the Chandler Act of 1938, 11 U.S.C. sections 701 et seq.<sup>28</sup> The Court held that the lessor had the option to terminate the lease, in accordance with the contract terms, even though the lessee was a debtor-in-possession of the leased premises.<sup>29</sup>

Under the 1978 Bankruptcy Code the debtor's estate comprises all property in which the debtor has a legal or equitable interest as of the commencement of the case.<sup>30</sup> This includes a debtor's property interests in and contract rights with a cooperative. Any entity in possession of the debtor's property must deliver it to the trustee and account for the property or its value, unless the property is of inconsequential value or of no benefit to the estate.<sup>31</sup> Notwithstanding any bankruptcy or ipso facto clauses that terminate, forfeit, or modify a debtor's interest in the property, the trustee is permitted to use, sell, or lease the property.<sup>32</sup> A debtor-in-possession under a Chapter 11 reorganization plan has substantially the same rights and powers as a trustee.<sup>33</sup>

It is conceivable that a trustee or debtor-in-possession could manage the estate in such a manner that the cooperative would not be placed at a financial disadvantage. If so, there would be no need for the cooperative to take expulsion action against the member, and any decision as to membership could be postponed until the bankruptcy proceeding was completed. Just as important, and contrary to the opinion of the New York court in *Schlossmans*, expulsion may not be in accordance with the financial rehabilitative spirit and intent of the Bankruptcy Code. This would be especially true as to Chapter 11 proceedings where an attempt is being made to rehabilitate and continue the member's business. Expulsion of a cooperative member who has filed a Chapter 11 proceeding could conceivably make rehabilitation an impossibility if the member is cut off from needed markets or low cost supplies. The same reasoning would hold true for an individual involved in a Chapter 13 wage earner's plan, which is now available under limited circumstances to individual farmers.

The *Schlossmans* reasoning might continue to apply in a Chapter 7 liquidation, which typically marks the end of the debtor's career as an agricultural producer. However, there is still the question of whether expulsion is appropriate if the trustee, pending final liquidation, chooses to honor the debtor's marketing agreements, or other contracts, with the cooperative.

Even if expulsion is sustainable in any of the described bankruptcy actions, there also is the additional problem of what to do if the debtor, following discharge by the bankruptcy court, seeks to rejoin the cooperative. The Bankruptcy Code of 1978 prohibits governmental bodies from taking discriminatory action against persons who have been involved in bankruptcy proceedings, but such nondiscriminatory provisions have not yet been extended to nongovernmental organizations, except as to acts by employers against employees.<sup>34</sup>

## ***Undesirable Conduct and Other Actions***

Just as the financial integrity of a cooperative is important, so also is its reputation for observing ethical business practices. Courts have upheld expulsions where members have engaged in undesirable conduct. In *Gottlieb v. Economy Stores*<sup>35</sup> a Virginia cooperative composed of retail grocery dealers was permitted to expel a member for opening his business on Christmas Day, contrary to an association agreement that no business would be conducted on Christmas. Also, the member falsely advertised the availability of green stamps at the member's stores. Although the cooperative's charter did not contain an expulsion clause, the cooperative's bylaws provided that the board of directors could expel any member deemed undesirable.<sup>36</sup>

The Virginia Supreme Court upheld a trial court ruling that the association had the right to expel members for failing to comply with the association's bylaws. The Court ruled that bylaws of a voluntary association constitute a contract between the members that will be enforced by the courts so long as the contract is not immoral, nor contrary to public policy. The court found that the defendant organization was organized to assist responsible retail grocers of good moral character in conducting their businesses. As a result, the association had the right to require that its members conform to association policies and possessed the power to expel those members who conducted themselves to the contrary.<sup>37</sup>

In addition, association members may be expelled for such diverse reasons as attempts to make unauthorized transfers of memberships or cooperative stock,<sup>38</sup> or the failure to pay annual financial assessments.<sup>39</sup> In short, expulsion is appropriate where the acts of an individual member threaten the cooperative's business reputation, orderly operation, or economic viability. In addition to statutory grounds for expulsion, cooperatives have an inherent power to expel members for offenses of an infamous character indictable at common law, offenses against a member's duty as a coprator, and a combination of such offenses.<sup>40</sup>

## **Due Process Requirements**

### ***Fundamental Principles of Justice***

Although it is possible for cooperatives to expel members for a substantial number of reasons, such power may not be exercised preemptorily. Membership in a voluntary association is a valuable right, and it is not to be terminated without adherence to certain fundamental legal principles.<sup>41</sup> Quite apart from the provisions in applicable state statutes or cooperative bylaws and articles, a member of a cooperative is entitled to procedural due process before being expelled from the organization. The due process requirement is not derived from federal or state constitutions, but from a theory of "natural justice." Due process in this context requires an absence of bad faith, compliance with the constitution and bylaws of the association, and natural justice.<sup>42</sup> Natural justice implies fair notice of charges and a right to be heard.

This does not mean that expulsion proceedings must be conducted in accordance with strict rules applicable in judicial proceedings. Organiza-

tional disciplinary proceedings will be heard by merchants and business people who are not necessarily acquainted with judicial rules, but who know, as honorable persons, what constitutes fair and ethical practices and principles. Such proceedings are necessarily somewhat summary. But although it is not necessary that an organization apply the same technical judicial standards as exist in court trials, it still must adhere to basic principles of fairness and due process that laymen can understand and administer.<sup>43</sup>

### ***Judicial Review***

Courts traditionally have been reluctant to interfere in the internal affairs of voluntary organizations. An expulsion action, however, is not immune from judicial review in appropriate circumstances. Traditional reluctance is set aside where there exists a strong likelihood that an important economic interest is being damaged by an improper inhouse proceeding.<sup>44</sup> Because membership in a cooperative is often an economic necessity, courts seek to advance the interests of justice by reasonably safeguarding the member's opportunity for earning a livelihood while not impairing the organization's standards and objectives.<sup>45</sup> In addition, although expelled members are usually required to exhaust internal remedies before appealing to the courts, such is not the rule where the attempted action is void because a member was denied due process.<sup>46</sup>

### ***Grounds for Challenging an Organization's Expulsion Procedure***

#### ***Inadequate notice and hearing***

At a minimum, a cooperative or any other voluntary organization must give members facing expulsion fair notice of the charges against them and an opportunity to respond in a hearing. The courts repeatedly have invalidated the expulsion of members from various types of organizations when the members were not given any formal charges, notices, or hearings on the proposed expulsions.<sup>47</sup> Even if the expelled member is given a hearing, the member must also have been given adequate notice of the charges against him prior to the hearing. In two cases involving the attempted expulsion of members of livestock associations, the courts struck down the expulsion actions even though the members were given hearings prior to expulsion. In both cases the courts held that the members were not informed of all the charges against them, or were otherwise given inadequate notice.<sup>48</sup>

#### ***Failure to follow procedural guidelines or the absence of expulsion provisions***

Not only must an association establish procedural guidelines governing the expulsion of members that fulfill the requirements of natural justice, it must also follow those guidelines. It is the duty of the association to see to it that the bylaws governing an expulsion action are followed. For example, a member facing expulsion does not waive his right to a hearing by failing to request one. Rather, the association has the duty to see to it that

a hearing is held.<sup>49</sup> If an association's bylaws require 30 days notice prior to an expulsion hearing, anything less than 30 days is inadequate and is grounds for setting aside an expulsion.<sup>50</sup>

### *Lack of fair play and impartiality*

Due process of law requires more than the superficial following of procedural guidelines. Impartiality and fair play are also critical. The case of *Van Daele v. Vinci*<sup>51</sup> involved the expulsion of two cooperative members who were dissatisfied with the cooperative management. Before being expelled, the members had filed a derivative class action suit against the cooperative's board of directors for financial losses suffered by the cooperative due to the mismanagement of the cooperative's building program.<sup>52</sup>

In retaliation for filing the class action suit, the cooperative's board of directors expelled the plaintiffs from the cooperative. The plaintiffs were charged with disrupting cooperative business, impeding the resolution of problems associated with the cooperative's construction program, spreading false rumors, and making untrue statements about the cooperative's directors and officers.<sup>53</sup>

The Illinois Supreme Court concluded that the cooperative had correctly followed its expulsion bylaws. But the court also concluded that the proceedings were not conducted in good faith. In fact, the proceedings were an attempt to silence and censor dissident association members. A hearing before the tribunal must be fair and impartial. To do otherwise is a denial of essential rights. A private organization, especially if it has some public stature or purpose, may not expel or discipline a member and adversely affect substantial property, contract, or other economic rights unless such action results from proceedings conducted in an atmosphere of good faith and fair play.<sup>54</sup>

Procedural due process, however, is not automatically violated by the fact that the members of the board of directors who hear the case are also the same persons who preferred charges against the member facing expulsion.<sup>55</sup> To assume in advance that such a body would not give the accused member a fair hearing is to deny the reputation for justice and fairness enjoyed by most commercial and mercantile associations.<sup>56</sup>

An expulsion may also be set aside when a cooperative member is expelled without just cause. In *Benson Cooperative Creamery Association v. First District Association*,<sup>57</sup> the plaintiff, a stockholder of the defendant cooperative, marketed all its skim milk through the cooperative. The plaintiff then signed a master processor's contract with the National Farmers Organization (NFO) for the purchase of whole milk. Although the NFO contract did not affect plaintiff's skim milk marketing, the defendant cooperative demanded that the NFO contract be rescinded.<sup>58</sup> When the plaintiff refused, the defendant stopped picking up plaintiff's skim milk and expelled the plaintiff from the organization.<sup>59</sup>

On appeal, the Minnesota Supreme Court reversed a lower court decision and found that there was nothing in the defendant's articles or bylaws that prohibited plaintiff's contractual arrangement with NFO.<sup>60</sup> The essence of plaintiff's membership in the defendant cooperative was the right to market its perishable product through defendant's facilities. Defendant had the

right to refuse plaintiff's milk only upon showing of reasonable cause. Plaintiff's contract with NFO as to whole milk did not constitute sufficient cause. Plaintiff had contributed to the defendant's capital fund, which helped make it possible for defendant to carry on its business operations, and it was unreasonable to deprive plaintiff of an outlet for its product without reasonable cause or justification.<sup>61</sup>

On the other hand, the defendant in *Benson* could have effectively terminated the plaintiff's membership upon plaintiff's refusal to rescind its contract with NFO if defendant's bylaws or articles had contained the express power to do so in such circumstances.<sup>62</sup> Further, expulsion probably would have been approved, even in the absence of such provisions, if the defendant could have established an express understanding between the parties that plaintiff would not enter into such contracts as the NFO arrangement. It was the total absence of such governing bylaws or articles and any express understanding that made defendant's conduct so unconscionable. The decision in *Benson*, however, does not give any guidance as to what would suffice as an express understanding that the cooperative member would not enter into contracts with third parties.

## **Antitrust Implications**

### *Per se violations*

The expulsion of cooperative members in the face of inadequate procedural safeguards has also raised the specter of antitrust violations. Cooperative organizations have justified the expulsion of certain persons from membership on the basis of the need for self-regulation, so that the organization will be protected and public confidence maintained. Court decisions in the 1940s, however, often discounted the justifications offered by these organizations and ruled that such exclusions were group boycotts constituting "per se" violations of the antitrust laws.<sup>63</sup>

The issue of a group boycott resulting from the suspension of an association member was addressed in *McCreery Angus Farms v. American Angus Association*.<sup>64</sup> The case involved the suspension of a partnership from the American Angus Association, the sole entity in the United States for the registration of pedigreed purebred Black Angus cattle.<sup>65</sup> The suspension of the partnership was based in part on anonymous letters received by the association questioning the purity of the partnership's Black Angus show herd.<sup>66</sup> Although a hearing was conducted prior to disciplinary action, the partnership was not given full prehearing notice of the charges against it, including the existence of the anonymous letters. The association's board of directors recommended that the partners be expelled or suspended from the association for at least two years. Eventually, an indefinite suspension was imposed. In arriving at its conclusion the board took into consideration the anonymous letters that charged the partnership with unethical practices.<sup>67</sup>

The partnership sought injunctive relief, contending that its indefinite suspension constituted a group boycott and a per se violation of sections 1 and 2 of the Sherman Antitrust Act.<sup>68</sup> The association countered with the argument that its conduct was covered by an exception to the per se

rule. Arguing that not all group boycotts are to be judged by the per se rule, it urged the application of the less stringent rule-of-reason standard where the association's action is a reasonable response to a legislative mandate for self-regulation.<sup>69</sup>

The court, however, refused to apply the rule-of-reason standard because the association had not afforded the partnership sufficient procedural safeguards, including full disclosure of the charges against it and an opportunity to respond appropriately.<sup>70</sup> The court stated that ad hoc, informal, and pro forma committee procedures bordering on the arbitrary were outmoded and dangerous.<sup>71</sup> Although courts are reluctant to interfere in the internal affairs of private associations, courts cannot ignore the monopolistic power that such associations exercise over their members. The defendant association's rules did not set forth even the most basic and elemental requirements of a fair hearing.<sup>72</sup>

### *Rule-of-reason standard*

Recent antitrust decisions, however, have tended to subject organizations to the lesser, more flexible rule-of-reason standard with regard to self-regulation.<sup>73</sup> The so-called "rule of reason" standard is a general inquiry into whether, under all the circumstances, the challenged practice is unreasonably restrictive of competitive conditions.<sup>74</sup> Circumstances considered by the courts include the organization's intent and purpose in taking the challenged action, the competitive conditions within the industry, and the relative competitive positions of the affected parties.<sup>75</sup> Taking all the circumstances into consideration, self-regulation may justify otherwise illegal boycotts.

Recently, antitrust implications of expelling cooperative members without procedural due process were addressed by the U.S. Supreme Court in *Northwest Wholesale Stationers, Inc. v. Pacific Stationery and Printing Co.*<sup>76</sup> The defendant was a purchasing cooperative composed of approximately 100 office supply retailers. The plaintiff was a wholesaler-retailer of office supplies and a cooperative member. The cooperative expelled the plaintiff without any notice and hearing or even any explanation.<sup>77</sup>

The plaintiff in *Northwest* brought suit in U.S. District Court alleging a section 1 Sherman Act violation. Plaintiff contended that its expulsion, without procedural due process, constituted a group boycott that limited plaintiff's competitive abilities and was a per se violation of the Sherman Act.<sup>78</sup> The District Court refused to apply the per se rule and examined the defendant's conduct under the rule-of-reason analysis. The court, finding no anticompetitive effect in the record, granted defendant summary judgment.<sup>79</sup>

The Ninth Circuit Court of Appeals reversed the District Court and found that the uncontroverted facts supported a finding of per se liability. The court ruled that plaintiff's expulsion constituted an anticompetitive, concerted refusal to deal with the plaintiff on equal footing. The court noted that section 4 of the Robinson-Patman Act provides cooperatives with a mandate for self-regulation. Normally, in light of such a legislative mandate, the court would apply the rule of reason in evaluating the cooperative's expulsion practices. The court concluded, however, that the rule-of-reason

analysis would be appropriate only if the cooperative had procedural safeguards to prevent an arbitrary expulsion. Because the defendant had not provided plaintiff with procedural safeguards, plaintiff's expulsion was a per se violation of the Sherman Act.<sup>80</sup>

On appeal the U.S. Supreme Court determined that the issue was not procedural protections. Instead, the issue was whether the decision to expel the plaintiff was a group boycott or a concerted refusal to deal, which would mandate a per se invalidation. Group boycotts meriting per se violation treatment under section 1 of the Sherman Act usually involve joint efforts by firms to disadvantage competitors by denying them the relationships they need with suppliers or customers to remain competitive. This is done by coercing suppliers and customers not to deal with the disadvantaged competitors and by cutting off the boycotted firm from access to necessary supplies, facilities, or markets. Boycotting firms frequently are economically dominant in the relevant market. In addition, the boycotting firms cannot justify their conduct by contending that they were attempting to enhance overall efficiency and make markets more competitive.<sup>81</sup>

The expulsion of a cooperative member does not necessarily imply anti-competitive animus and raise the probability of anticompetitive effect unless the cooperative possesses market power or exclusive access to an element essential to effective competition.<sup>82</sup> Before a per se rule will be applied, a threshold determination must be made that the complained of activity, such as a member's expulsion, will likely have predominantly anticompetitive effects. Because the plaintiff did not present such evidence the rule of reason, rather than the per se rule, should have been applied. The Supreme Court reversed the Ninth Circuit Court of Appeals and remanded the case for further proceedings consistent with its opinion.<sup>83</sup>

## **Expulsion and Satisfaction of Property Interests**

### **In General**

Like any business, a cooperative requires working capital as well as sufficient reserves to cover losses. Capital and reserves can be accumulated by a variety of means. For example, capital stock cooperatives will sell stock, and unincorporated cooperatives will sell membership certificates. In addition, cooperatives retain sums from business done through the cooperative by patrons, thereby gradually accumulating working capital and reserves. Although these gains or savings are variously described as net earnings, net margins, profits, and surplus, they will be referred to herein as patronage dividends.<sup>84</sup> Patronage dividends may be paid in cash only, but they are more frequently paid in a combination of cash and equity credits, or patronage credits. This practice allows the cooperative to retain funds needed for working capital.<sup>85</sup> The retention of patronage dividends is pursuant to the contractual agreement between the cooperative and its patrons as embodied in the cooperative-enabling statute, bylaws, and marketing contracts.<sup>86</sup>

Litigation frequently has arisen between cooperatives and their members over the right of the member patrons to withdraw retained patronage dividends. The problem of equity redemption is a serious issue now facing

cooperatives and their members,<sup>87</sup> and it involves not only the redemption of membership stock, but the return of patronage dividends and net margins. Except where state statutes dictate otherwise, courts have been reluctant to compel cooperatives to retire retained patronage dividends, or any other property interest, to members or former members, on demand. Bylaws and articles of incorporation typically leave payment decisions to the sound discretion of the board of directors. Unless there is evidence of fraud or abuse of discretion, decisions of the board of directors are not subject to judicial review.<sup>88</sup> Should this same reasoning apply as to the property interests of expelled cooperative members?

When cooperative members are expelled, whether from a stock or non-stock cooperative, they naturally want to receive their financial or property interests in the cooperative. But, membership fees and stock purchases do not represent debt owed by the association to the members, and neither do amounts deducted from the sale of members' products for capital purposes.<sup>89</sup> Furthermore, the courts have consistently held that patronage dividends are not dividends in the usual sense of the word, but are refunds (until allocated) due to all patrons.<sup>90</sup> An expelled cooperative member no longer has any interest in the financial condition of the cooperative, except to the extent that he or she may continue to do business with the cooperative as a nonmember, or to the extent financial investment is retained by the cooperative. If, however, the cooperative experiences financial difficulties, the expelled member's interest is also jeopardized. Of course, the same arguments would hold true for all former members or estates, whether their relationship with the cooperative was terminated by expulsion, voluntary withdrawal, or death.

## Payments to Expelled Members

### *Time of Payment*

Although some state enabling statutes require cooperatives to satisfy certain property interests of expelled members within a specified period of time, many do not. Where statutes address the question, cooperatives are often given the option either to pay the expelled member immediately or to make payment over an extended period of time.<sup>91</sup> The timing of equity redemption is another matter often left to the discretion of the cooperative's board of directors. In the absence of abuse of discretion, fraud, breach of trust, or illegality on the part of the directors, the courts will not intervene in the board's decision. Furthermore, unless state law requires otherwise, it is not necessary that cooperative bylaws distinguish between present and former members as to the satisfaction of property interests. In *Sanchez*, the court held that expelled members were entitled to receive repayments of retained equities in the same manner as continuing members, which was at the end of the crop year.<sup>92</sup>

### *Appraisal of Interests*

Certain state statutes permit the board of directors of a cooperative to appraise the value of an expelled member's interest in the cooperative and

further provide that such appraisals are conclusive.<sup>93</sup> Courts have been reluctant to inquire into such appraisals so long as they have been carried out in accordance with applicable state statutes and with the cooperative's bylaws and articles of incorporation.<sup>94</sup> However, courts have held that it is the bylaws in existence at the time the member joins the cooperative that determine the method of evaluating a member's interest.<sup>95</sup>

In *Lambert v. Fisherman's Dock Cooperative, Inc.*<sup>96</sup> the plaintiff was expelled from the defendant fisherman's cooperative, in accordance with the cooperative's bylaws, when the plaintiff ceased to be engaged in the fishing industry.<sup>97</sup> When plaintiff became a member, the cooperative bylaws provided that upon termination of membership the stockholder was entitled to receive the "fair book value" of his shares. The bylaws were subsequently amended to provide that upon termination the member would receive only the original purchase paid for the stock. When the plaintiff was expelled he demanded the fair book value of his shares, contending that the amended bylaws were invalid because they violated a contract, infringed upon a vested right, and exceeded the power reserved to the majority to amend bylaws.<sup>98</sup>

On appeal, the New Jersey Supreme Court held that the reserved right to amend the bylaws of an association is limited and may not be used to impair or destroy a contract or vested right. The property interests acquired by plaintiff were determined at the time he joined the cooperative and were not subject to divestment by subsequently amended bylaws.<sup>99</sup>

### Forfeiture of Interests

In some instances, the expulsion of a member can result in the forfeiture of the member's property interests in the cooperative. Forfeiture, however, is dependent upon the classification of the equity interest involved. In *Adams v. Sanford Growers Credit Corporation*,<sup>100</sup> the issue was whether an incorporated cooperative marketing association was required to redeem the stock of an expelled member. The cooperative contended that the expulsion of a member resulted in a forfeiture of the member's interest in the cooperative.<sup>101</sup>

The association's bylaws provided that upon sufficient cause, the board of directors could withdraw the marketing privileges of any stockholder. Furthermore, if the privileges were withdrawn, the stockholder would be considered expelled and his equity interest in the association would be adjusted as in the case of a withdrawing member. Stockholders withdrawing from the association could dispose of their stock only by a unanimous consent of the board of directors. If such consent was given and the withdrawing stockholder failed to find a purchaser satisfactory to the board, the board was to appraise the value of the stock and repurchase it from the withdrawing member. The bylaws, however, did not provide for the forfeiture of a withdrawing or expelled member's stock, and, therefore, the court in *Adams* refused to uphold the forfeiture. However, in dicta the court did state that the cooperative was authorized to enact a forfeiture bylaw provision if it chose to do so.<sup>102</sup>

It may be possible to contract for the forfeiture of a member's stock interest. In *Bessette v. St. Albano Co-operative Creamery, Inc.*,<sup>103</sup> the defendant cooperative expelled the plaintiff-member for refusing to deliver

contracted milk products to the cooperative and ordered the forfeiture of the member's stock.<sup>104</sup> The court held that even if state cooperative law was silent on the question of stock forfeiture, the outcome was controlled by the fact that the member's stock certificate reiterated a bylaw provision authorizing the forfeiture upon breach of contract to deliver. The court held the stock provision to be an enforceable contract.<sup>105</sup> One commentary has suggested that in the absence of a state statute providing otherwise, members who are expelled from an association, or at least an unincorporated association, are not entitled to any compensation for their property interests.<sup>106</sup>

A number of courts have held that a cooperative member is not entitled to patronage dividends, or to share in the association's profits, if the member breaches his contractual or membership obligations.<sup>107</sup> Naturally, such breaches may also give rise to the member's expulsion from the cooperative.

In contrast, other courts have held that notwithstanding the termination of membership in an association, former members are entitled to patronage dividends or to their pro rata shares in the profits of the association.<sup>108</sup> In *Sanchez v. Grain Growers Association*,<sup>109</sup> the court distinguished between surplus funds and funds that had not been declared surplus. The court held that once the surplus or cooperative earnings have been allocated and taxed to the members, they belong to the members.<sup>110</sup>

## Conclusion

The expulsion of a cooperative member is a serious event fraught with consequences for all concerned. For the expelled member it may mean the loss of critical markets and necessary supplies, which make the difference between continuing in business or financial insolvency. For the cooperative, the expulsion of a member may result in protracted litigation as to the validity of the action. If a court determines that the expulsion is wrongful, the cooperative may be enjoined from expelling the member, or, if the expulsion has already occurred, be required to reinstate the member. Even more important, the cooperative, in appropriate circumstances, may also be held liable for any damages sustained by the wronged member.<sup>111</sup> Depending on the market dominance of the cooperative and the anticompetitive effect of the expulsion action, a cooperative that expels a member may find itself guilty of antitrust violations.

To lessen the possibility of adverse consequences, cooperatives should establish procedural guidelines governing the expulsion of members. Although such guidelines do not have to reach the level of judicial due process, they should be sufficient to protect the rights of individual members. At the very least, a member facing expulsion should be given an adequate notice of the charges and adequate time to prepare a response. Furthermore, there should be full disclosure to the accused of the evidence to be used against him, and the accused should be given a hearing before a fair and impartial panel.

Finally, it would be wise for a cooperative to have some plan to satisfy the financial interest of an expelled member. The failure of cooperatives to enact timely equity redemption plans has already been the source of much discussion and debate. Cooperatives have been severely criticized for not sat-

isfying the financial interests of former members who no longer receive any financial benefit from the organization, and there have been calls for federal legislation to solve the problem.<sup>112</sup>

## Notes

1. L. Hulbert and M. Neely, *Legal Phases of Farmer Cooperatives*, FCS Information 100, at 2 (USDA Farmer Cooperative Service, 4th ed. 1976).

2. *Id.* at 16.

3. *Id.* at 17.

4. Typical of such statutes is the following Alabama provision:

. . . Each association, under its by-laws, may also provide for any or all of the following matters:

(11) The conditions upon which and the time when membership of any member shall cease;

(12) The automatic suspension of the rights of a member when he ceases to be eligible to membership in the association and the mode, manner and effect of the expulsion of a member; . . .

Ala. Code § 2-10-58 (1975).

See also J. Baarda, *State Incorporation Statutes for Farmer Cooperatives*, ACS Cooperative Information Report 30, at 401-04 (USDA Agricultural Cooperative Service, 1982).

5. See, e.g., Iowa Code Ann. § 499.18 (West 1946). See also Baarda, *supra* note 4.

6. Hulbert, *supra* note 1, at 79.

7. *Id.*

8. 38 Del. Ch. 375, 152 A.2d 303 (1959).

9. 152 A.2d at 303.

10. 152 A.2d at 304.

11. 152 A.3d at 305.

12. 152 A.2d at 307.

13. See, e.g., Pa. Stat. Ann. tit. 15 §§ 12115(b), 12116(a) (Purdon 1976). See also Baarda, *supra* note 4.

14. See, e.g., Hawaii Rev. Stat. § 421-10(a)(c) (Repl. 1976). See also Baarda, *supra* note 4.

15. I.R.C. §§ 1381-88.

16. 7 U.S.C. §§ 291-92.

17. See, e.g., Hawaii Rev. Stat. § 421-10(a) (Repl. 1976).

18. *Lambert v. Fisherman's Dock Cooperative, Inc.*, 61 N.J. 596, 297 A.2d 566 (1972).

19. *Burley Tobacco Grower's Co-op Association v. Tipton*, 227 Ky. 297, 11 S.W.2d 119 (1928); see also Hulbert, *supra* note 1, at 101.

20. *Hiroshi Kaneko v. Jones*, 235 P.2d 768 (Ore. 1951). The court did not hold that the cooperative member was actually expelled from the cooperative. Rather, the membership was voluntarily relinquished and abandoned by the member when he ceased to be a producer and became disassociated from the cooperative's activities. However, the cooperative's bylaws did provide for the expulsion of members upon breach of a contract, and the court made it clear that the cooperative's board of directors could have passed such a resolution. *Id.* at 771.

21. *California Bean Growers' Association v. Rindge Land and Nav. Co.*, 199 Cal. 168, 248 P. 658 (1926); *Milk Producer's Association v. Webb*, 97 Cal. App. 650, 275 P. 1001 (1929).

22. 31 Misc.2d 938, 221 N.Y.S.2d 872 (1961).

23. *Id.*

24. *Id.* at 874.
25. *Id.*
26. See *Schneider v. Springman*, 25 F.2d 255 (6th Cir. 1928); *Urban Properties Corporation v. Benson*, 116 F.2d 321 (9th Cir. 1940); *Murray Realty Co. v. Regal Shoe Co.*, 265 N.Y. 332, 193 N.E. 164 (1934).
27. *Murray Realty Co. v. Regal Shoe Co.*, 265 N.Y. 332, 193 N.E. 164 (1934).
28. *Urban Properties Corporation v. Benson*, 116 F.2d 321 (9th Cir. 1940) (the case was decided under the Chandler Act of June 22, 1938 C.575, 52 Stat. 840, which was repealed by the Bankruptcy Act of 1978, P.L. 95-598, 92 Stat. 2549).
29. *Id.* at 322.
30. 11 U.S.C. § 541(a)(1) (1982).
31. 11 U.S.C. § 542(a) (1982).
32. 11 U.S.C. § 363(1) (1982).
33. 11 U.S.C. § 1107(a) (1982).
34. 11 U.S.C. § 525 (1982).
35. 199 Va. 848, 102 S.E.2d 345, 349 (1958).
36. 102 S.E.2d at 348.
37. 102 S.E.2d at 349-51.
38. Iowa Code Ann. § 499.18 (West 1946).
39. *Yarbrough v. Yarbrough*, 518 P.2d 1368 (Col. App. 1973).
40. *Gottlieb*, *supra* note 35, at 351.
41. *Swital v. Real Estate Com'r.*, 116 Cal. App.2d 677, 254 P.2d 587 (1953).
42. *Normal v. Cleveland Assn. of Life Underwriters*, 39 Ohio App.2d 25, 315 N.E.2d 482 (1974).
43. *McCreery Angus Farms v. American Angus Association*, 379 F.Supp. 1008 (S.D. Ill. 1974), *aff'd. without op.* 506 F.2d 1404 (7th Cir. 1974).
44. *Van Daele v. Vincl*, 282 N.E.2d 728, at 731 (Ill. 1972).
45. *Id.*
46. *Swital*, *supra* note 41, at 589.
47. See *Swital*, *supra* note 41; *Stevenson v. Atlantic City Real Estate Board*, 103 N.J.L. 615, 139 A. 11 (1927); *Nametra, Inc. v. American Soc. of Travel Agents, Inc.*, 28 Misc.2d 291, 211 N.Y.S.2d 655 (1961).
48. See *McCreery*, *supra* note 43; *Milson v. East Buffalo Live Stock Association*, 88 App. Div. 619, 84 N.Y.S. 795 (1903).
49. *Jackson v. American Yorkshire Club*, 340 F.Supp. 628 (N.D. Iowa, 1971).
50. *Nametra, Inc. v. American Soc. of Travel Agents, Inc.*, *supra* note 47.
51. *Van Daele*, *supra* note 44.
52. *Id.*
53. *Id.* at 730.
54. *Id.* at 731.
55. *Green v. Board of Trade of the City of Chicago*, 51 N.E. 599 (Ill. 1898).
56. *Id.* at 601.
57. 170 N.W.2d 425 (Minn. 1969).
58. *Id.* at 426.
59. *Id.*
60. *Id.* at 427.
61. *Id.* at 428.
62. *Benson Cooperative Creamery Association v. First District Association*, 276 Minn. 520, 151 N.W.2d 422 (1967).
63. 2 E. Kintner, *Federal Antitrust Law, Practices Prohibited by the Sherman Act 174-75* (1980).
64. 379 F. Supp. 1008 (S.D. Ill. 1974).
65. *Id.*
66. *Id.* at 1015-16.
67. *Id.*

68. *Id.* at 1016, 1018.

69. *Id.* at 1018. Specifically, the rule-of-reason standard applies where the organization can show:

1. There existed a legislative mandate for self-regulation;
2. The collective action was intended to
  - a. accomplish an end consistent with the policy justifying self-regulation;
  - b. was reasonably related to that goal;
  - c. was no more extensive than necessary; and,
3. The association provided procedural safeguards to prevent arbitrary restraints and to furnish a basis for judicial review.

See also *Denver Rockets v. All-Pro Management, Inc.*, 325 F.Supp. 1049, 1064-65 (C.D. Cal. 1971).

70. *Id.* at 1018.

71. *Id.* at 1011.

72. *Id.* at 1019.

73. Kintner, *supra* note 62, at 174.

74. W. Holmes, 1983-84 Antitrust Law Handbook 13 (1983).

75. *Id.*

76. 53 U.S.L.W. 4733, 105 S.Ct. 2613, 86 L.Ed.2d 202 (1985).

77. *Id.* at 4734, 105 S.Ct. at 2615, 2616, 86 L.Ed.2d at 206.

78. *Id.* at 4734, 105 S.Ct. at 2616, 86 L.Ed.2d at 207.

79. *Id.* at 4734, 105 S.Ct. at 2616, 86 L.Ed.2d at 207.

80. *Id.* at 4734, 105 S.Ct. at 2626, 86 L.Ed.2d at 207, 208.

81. *Id.* at 4736, 105 S.Ct. at 2619, 86 L.Ed.2d at 211.

82. *Id.* at 4736, 105 S.Ct. at 2620, 86 L.Ed.2d at 212.

83. *Id.* at 4737, 105 S.Ct. at 2621, 2622, 86 L.Ed.2d at 213, 214.

84. Guenzel, *The Relationship Between Cooperatives and Their Members in Litigation*, 21 S.D.L. Rev. 628, 646-47 (1976).

85. *Id.* at 647.

86. Centner, *Cooperatives: A Search for Equitable Relief from the Equity Redemption Problem*, 3 J. Agric. Tax'n and L. 120, 122 (1985); as to the fact that cooperative bylaws constitute a contract between the cooperative and its members. See also *Sanchez v. Grain Growers Association of California*, 126 Cal. App.3d 665, 674, 179 Cal. Rptr. 459, 460 (Dist. Ct. App. 1981); *Lambert v. Fisherman's Dock Cooperative*, *supra* note 18; *In re Great Plains Royalty Corp.*, 471 F.2d 1261, 1264 (5th Cir. 1973).

87. *Id.* at 121.

88. *Lake Region Packing Association Inc. v. Furze*, 327 So.2d 212 (Fla. 1976).

89. Hulbert, *supra* note 1, at 102.

90. Guenzel, *supra* note 84, at 647; see also text at footnote 110.

91. See Baarda, *supra* note 4, 410-411; see also Centner, *supra* note 86, at 131.

92. Sanchez, *supra* note 86.

93. See Baarda, *supra* note 4, at 408-09.

94. *Avon Gin Co. v. Bond*, 198 Miss. 197, 22 So.2d 362 (1945).

95. See *Lambert v. Fisherman's Dock Cooperative, Inc.*, 61 N.J. 596, 297 A.2d 566 (1972); *Whitney v. Farmer's Grain Co.*, 110 Neb. 157, 193 N.W. (1923); *Loch v. Paola Farmers Union Co-op Creamery and Store Association*, 130 Kan. 136, 285 P. 523 (1930); *reh'g. den.*, 130 Kan. 522, 287 P. 269 (1930).

96. 61 N.J. 596, 297 A.2d 566 (1972).

97. *Id.* at 568.

98. *Id.*

99. *Id.* at 571.

100. 135 Fla. 513, 186 So. 239 (1938).

101. 186 So. at 240.

102. 186 So. at 241; *see also* Clear Water Citrus Growers Association v. Andrews, 81 Fla. 299, 87 So. 903 (1921). The issue was whether the voluntary withdrawal of a cooperative member severed the former member's interest in the cooperative's property and assets. The association's bylaws provided that upon retirement a member forfeited all rights and interests in the cooperative. The Florida Supreme Court upheld that forfeiture clause.

103. 107 Vt. 103, 176 A. 307 (1935).

104. 176 A. at 308.

105. 176 A. at 309–10.

106. Hulbert, *supra* note 1, at 509.

107. *Rusconi v. California Fruit Exchange*, 100 Cal. App. 750, 281 P. 84 (1929); *Loomis Fruit Growers' Assoc. v. California Fruit Exchange*, 128 Cal. App. 265, 16 P.2d 1040 (1932).

108. *See Bogardus v. Santa Ana Walnut Growers Assoc.*, 41 Cal. App.2d 939, 108 P.2d 52 (1940); *Driscoll v. East-West Dairymen's Assoc.*, 52 Cal. App.2d 468, 126 P.2d 467 (1942).

109. 126 Cal. App.3d 665, 673, 176 Cal. Rptr. 655, 659 (Dist. Ct. App. 1981).

110. *Id.*

111. *Trautwein v. Harbourt*, 40 N.J. Super. 247, 123 A.2d 30, *cert. den.* 22 N.J. 220, 125 A.2d 233 (1956).

112. *Centner, supra* note 86, n. 22 at 124.