Cooperative Mergers and Consolidations: A Consideration of the Legal and Tax Issues

by

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COOPERATIVE MERGERS AND CONSOLIDATIONS: A CONSIDERATION OF THE LEGAL AND TAX ISSUES

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I. INTRODUCTION

The financial crisis in rural America has been well documented. Farmers faced with large debt service at high interest rates and low prices for their crops are financially threatened. The businesses that serve farmers either through the provision of supplies and services or through the marketing of their products are also in financial trouble. Cooperative marketing and supply associations are not exempted from the general financial crisis that engulfs our rural areas. From 1976 to 1985, 1994 cooperatives were removed from the lists of the United States Department of Agriculture, Agricultural Cooperatives Service.[1] The reasons for removal from the list, which presumably means the cooperative is no longer in existence, and the number of cooperatives for each reason in parenthesis are: (1) gone out of business (773); (2) merger or consolidation (357); (3) acquisition (242); (4) other (622).[2] The "other" category includes cooperatives that were inactive, no longer operating as a cooperative, originally

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1. Letters from Charles A. Kraenzle, Director of the Cooperative Management Division of the Agricultural Cooperative Service, to Kathryn J. Sedo (Aug. 13, 1986 and Sept. 9, 1986). During the same time period, 1976 to 1985, 76 cooperatives were added to the list of the Agricultural Cooperative Service. Letter from Charles A. Kraenzle, Director of the Cooperative Management Division of the Agricultural Cooperative Service, to Kathryn J. Sedo (Sept. 9, 1986). In 1985, the Service had 5617 cooperatives on its list. *Id.*

2. Letter from Charles A. Kraenzle, Director of the Cooperative Management Division of the Agricultural Cooperative Service, to Kathryn J. Sedo (Aug. 13, 1986).

misidentified as a cooperative, or no longer in business without any reason being provided.[3] The majority of cooperatives in the other category were inactive cooperatives.

The initial response of any business to financial adversity is to contain expenses. If cost containment is unsuccessful, cooperatives have two options: (1) some form of merger or acquisition or (2) dissolution or bankruptcy. All states and the District of Columbia have incorporation laws governing agricultural cooperatives,[4] and many of these statutes contain provisions regulating the merger, acquisition, and dissolution of cooperatives.[5] This Article will explore the legal issues surrounding merger and acquisition of cooperatives.

II. CHARACTERISTICS OF COOPERATIVES

Cooperative associations are member owned and controlled.[6] They may be either stock or nonstock associations, although generally they issue stock. In the agricultural context, for the most part, members of the cooperative are farmers or agricultural

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3. *Id.*

4. For a detailed analysis of state incorporation statutes for cooperatives and their provisions, see J. BAARDA, STATE INCORPORATION STATUTES FOR FARMER COOPERATIVES (Cooperative Information Report No. 30).

5. At least twenty-eight states refer to merger or acquisition in their cooperative incorporation statutes. *See* ALASKA STAT. § 10.15.400 (1985); ARK. STAT. ANN. § 77-1028-29 (1981); CAL. CORP. CODE § 12530 (West Supp. 1987); COLO. REV. STAT. § 7-55-112 (1986); CONN. GEN. STAT. ANN. § 33-206 (West 1987); HAW. REV. STAT. § 421-21.5 (1985); IDAHO CODE § 22-2622A (1977); ILL. ANN. STAT. ch. 32, para. 470 (Smith-Hurd Supp. 1987); IND. CODE ANN. § 15-7-1-8 (Burns Supp. 1986); IOWA CODE ANN. § 499.69 (West Supp. 1987); KY. REV. STAT. ANN. § 272.301, 272.305 (Michie/Bobbs-Merrill 1981 & Supp. 1986); ME. REV. STAT. ANN. tit. 13 § 1951 (1981); MD. CORPS. & ASS'NS CODE ANN. § 5-527(a) (1985); MINN. STAT. § 308.15(4) (1984); MONT. CODE ANN. § 35-17-501 (1985); NEV. REV. STAT. § 81.130 (1982); N.J. STAT. ANN. § 4:13-10 (West 1973); N.C. GEN. STAT. §§ 54-159, 54-160 (1982); N.D. CENT. CODE § 10-15-41(1985); OR. REV. STAT. § 62.610 (1985); PA. STAT. ANN. tit. 15, § 12129 (Purdon Supp. 1987); S.D. CODIFIED LAWS ANN. § 47-18-1 (1983); TENN. CODE ANN. § 43-16-147 (1980); UTAH CODE ANN. § 3-1-30 (1982); VT. STAT. ANN. tit. 11, § 1061 (1984); VA. CODE ANN. § 13.1-339 (1985); WASH. REV. CODE ANN. § 23.86.220 (West Supp. 1987); WIS. STAT. ANN. § 185.61 (West Supp. 1986).

6. I. PACKEL, THE LAW OF THE ORGANIZATION AND OPERATION OF COOPERATIVES 4-5 (1970). Packel describes cooperatives as having the following characteristics:

- control and ownership of each member is substantially equal;
- members are limited to those who will avail themselves of the services furnished by the association;
- transfer of ownership interests is prohibited or limited;
- capital investment receives either no return or a limited return;
- economic benefits pass to the members on a substantially equal basis or on the basis of their patronage of the association;
- members are not personally liable for obligations of the association in the absence of a direct undertaking or authorization by them;
- death, bankruptcy or withdrawal of one or more members does not terminate the association; and
- services of the association are furnished primarily for the use of the members.

Id.

producers. Each member of the cooperative has one vote regardless of the number of shares owned or amount of equity in the cooperative.[7] Dividends on stock or equity are limited, generally by statute.[8] Any surplus or profit[9] that is generated by the cooperative is distributed among the members according to their respective patronage of the cooperative and *not* according to the amount of equity that the member may have in the cooperative.[10] Thus, a cooperative is owned by its member-patrons who democratically control it and share in its surplus based on their use of the cooperative.

The most common types of cooperatives serving agricultural producers are marketing and supply cooperatives.[11] A marketing cooperative operates, as a rule, by purchasing the products of the farmer or agricultural producer. It may then store, pool, process and market the product. At the end of the year, an accounting is made to the member-patrons and the surplus, which is the net savings after expenses and dividends are paid, is distributed to member-patrons in cash and some form of equity credit or stock in the cooperative. This distribution of cash and equity credit is called a patronage dividend.[12]

A supply cooperative, which may or may not be operated as part of a marketing cooperative, provides goods and services that are used in farming operations.[13] Fertilizer, seeds, gasoline and other petroleum products, equipment, pesticides, and insecticides are a few of the types of products available to farmers on a

7. I. PACKEL, *supra* note 6, at 106-07; *see also* T. WHITNEY, AGRICULTURAL COOPERATIVES 18 (Practicing Law Institute Corporate Law and Practice Course Handbook Series No. 306, 1979).

8. *See, e.g.*, N.D. CENT. CODE § 10-15-20 (1985) (limiting dividends to six percent). While North Dakota limits dividends to six percent per annum, many states restrict dividends to eight percent a year. *See, e.g.*, MINN. STAT. § 308.06 (1984) (limiting dividends to eight percent). *See generally* BAARDA, *supra* note 4, at 112-13 (statutory dividend limitations). This eight percent limitation is also the rate contained in the Capper-Volstead Act. Capper-Volstead Act, 7 U.S.C. § 291 (1982). For a discussion of the Capper-Volstead Act, see *infra* notes 71-73 and accompanying text.

9. Because of the unique structure of cooperatives it is more accurate to term the excess revenue that a cooperative generates as surplus rather than profit. I. PACKEL, *supra* note 6, at 186-92. The excess income of cooperatives belongs to the members of the cooperative since the excess revenue results either from members paying too much for goods and services that they purchased or members receiving too little for goods or services that they contributed to the cooperative. *See id.* In either event the surplus that results is not a profit in the sense that the word is generally used.

10. T. WHITNEY, *supra* note 7, at 17.

11. *See generally* K. LIMVERE, ECONOMIC DEMOCRACY FOR THE NORTHERN PLAINS: COOPERATIVES AND NORTH DAKOTA 57-64 (1980) (discussing types of cooperatives).

12. *See* T. WHITNEY, *supra* note 7, at 18. The distribution of patronage dividends is usually controlled by Subchapter T of the Internal Revenue Code. *See* 26 U.S.C.A. §§ 1381 to 1388 (1982 & Supp. 1987). Cooperatives that meet the requirements set forth in subchapter T may deduct the amounts paid out as patronage dividends from their taxable income. *Id.* § 1382(b)(1)(1982).

13. *See* K. LIMVERE, *supra* note 11, at 57. Supply cooperatives are also referred to as consumer cooperatives. *Id.* at 57-58. Supply cooperatives often act not only as a purchasing cooperative, but also participate in the production of the products that are provided to members. *Id.* Thus, a fertilizer cooperative may extend to the mining and manufacturing of fertilizer. *Id.*

cooperative basis. Member-patrons purchase the products at market price. At the end of the year, the cooperative issues patronage dividends representing its surplus in cash and equity certificates or stock.[14]

III. UNIFICATION OF COOPERATIVES

A. DEFINITIONS

Cooperatives are unified in one of two ways. A merger is the combining of two or more cooperatives into one cooperative in which one of the cooperatives survive and the other cooperatives do not survive.[15] This can occur as a result of the surviving cooperative purchasing the stock of the acquired cooperative or as a result of the surviving cooperative purchasing the assets of the acquired cooperative.[16] A unification may also take the form of a consolidation. A consolidation occurs when two or more cooperatives combine to form a new cooperative, none of the "old" cooperatives surviving.[17]

The form that the unification takes has legal and tax implications. As often is the case, the legal and tax consequences may dictate the form of the proposed unification.

B. LEGAL REQUIREMENTS

Most cooperatives are incorporated associations subject to individual state cooperative incorporation statutes. Many of these state incorporation statutes have provisions regulating the merger and consolidation of cooperatives.[18] If the cooperative incorporating statute does not have a provision governing merger and consolidation, the cooperatives may have to look to the state's business corporation statute for guidance.[19]

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14. *See* T. WHITNEY, *supra* note 7, at 17- 18.
15. *See* E. KINTNER, PRIMER ON THE LAW OF MERGERS 27 (1973).
16. *See id.*
17. *See id.*
18. *See supra* note 5.
19. At least thirty-seven states provide that in the absence of specific provisions in the cooperative incorporation statutes that the general incorporation statutes will apply except when the provisions are inconsistent with the cooperative incorporation statutes. *See* ALA. CODE § 2-10-72 (1975); ARIZ. REV. STAT. ANN. § 10-702 (1977); ARK. STAT. ANN. § 77-1018 (1981); CAL. FOOD & AGRIC. CODE § 54180 (West 1986); COLO. REV. STAT. § 7-55-116 (1986); CONN. GEN. STAT. ANN. § 33-206 (West 1987); DEL. CODE ANN. tit. 3, § 8505 (1985); FLA. STAT. ANN. § 618.24 (West 1977); GA. CODE ANN. § 65-222 (Supp. 1986); HAW. REV. STAT. § 421-21.5 (1985); IDAHO CODE § 22-2620 (1977); ILL. ANN. STAT. ch. 32, para. 470 (Smith-Hurd Supp. 1987); IND. CODE ANN. § 15-7-1--28 (Burns Supp. 1987); KAN. STAT. ANN. § 17-1628 (1981); KY. REV. STAT. ANN. § 272.211 (8) (Michie/Bobbs-Merrill Supp. 1986); LA. REV. STAT. ANN. § 3:149 (West 1973); MD.

Generally there are four statutory requirements for a merger or consolidation of cooperatives: (1) a plan of merger or consolidation; (2) approval of the plan by the board of directors of each cooperative; (3) approval of the plan by the members of each cooperative; and (4) filing of the plan with the appropriate state filing office.[20]

The plan of merger or consolidation is the most important document.[21] It contains the agreements between the merging or consolidating cooperatives, the procedures to carry out the agreements, and the effect of the merger or consolidation on all the members of each cooperative. As a general rule the plan also contains the names of the cooperatives, the name of the surviving entity, any necessary amendments to the articles of incorporation and bylaws of the surviving cooperative or the articles of incorporation and bylaws of the consolidated cooperative, the composition of the board of directors, the functioning of the merged or consolidated cooperative, a valuation of equities, and a procedure for exchange of equities.[22]

Each cooperative involved in the merger or consolidation generally appoints members to a committee which negotiates the content of the plan.[23] Once the negotiations are completed, the plan must be approved by the board of directors of each cooperative.

After approval of the consolidation or merger by the boards of directors, the next step is usually approval of the plan by the membership of the involved cooperatives.[24] Whether a simple

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CORPS. & ASS'NS CODE ANN. § 5-527(a) (1985); MASS. GEN. LAWS ANN. ch. 157, § 3 (West. Supp. 1987); MINN. STAT. § 308.05 (1) (1984); MO. ANN. STAT. § 274.290 (Vernon 1963); MONT. CODE ANN. § 35-16-101 (1985); NEB. REV. STAT. § 21-1414 (1983); N.H. REV. STAT. ANN. § 27:301:51 (1977); N.J. STAT. ANN. § 4:13-12 (West 1973); N.Y. COOP. CORP. LAW § 5 (Concol. Supp. 1987); N.C. GEN. STAT. § 54-117 (Supp. 1985); OHIO REV. CODE ANN. § 1729.27 (Anderson 1985); OKLA. STAT. ANN. tit. 2, § 361w (West 1973); PA. STAT. ANN. tit. 15, § 12129 (Purdon Supp. 1987); R.I. GEN. LAWS § 7-7-20 (1985); S.C. CODE ANN. § 33-47-40 (Law. Co-op. 1987); TENN. CODE ANN. § 43-16-144 (1980); TEX. AGRIC. CODE ANN. § 52.004 (Vernon 1982); VA. CODE ANN. 13.1-339 (1985); WASH. REV. CODE ANN. § 24.32.310 (1969); W. VA. CODE § 19-4-29 (1984); WYO. STAT. § 17-10-125 (1987).

20. Larson, *Legal Requirements of Mergers for Cooperatives,* MOVING FOOD, Feb.-Mar., 1985 at 24-25. *See generally* BAARDA, *supra* note 4, at 119-20 (discussing statutory requirements for mergers and consolidations).

21. Larson, *supra* note 20, at 25.

22. *Id.* In preparing the plan for merger or consolidation, a review of the following documents is necessary: the articles of incorporation and amendments; minute books; stock books and stockholders' or membership lists; tax returns and related tax documents; annual stockholder reports and audits; appraisals; surveys, and similar reports; collective bargaining agreements; employment agreements; employee benefit plans; license and franchise agreements and patents; leases; suppliers' and customers' contracts; loan agreements; revenue bond financing documents and mortgages; litigation files; and all other material contracts of each cooperative. R. Morris, Legal Checklist for Acquisition by a Cooperative Considering Merger, *reprinted in* Proceedings of the Legal-Finance Conference 38 (July 8-9, 1981) (University Center for Cooperatives, University of Wisconsin-Extension).

23. *See* Larson, *supra* note 20, at 25.

24. *See, e.g.,* N.D. CENT. CODE § 10-15-41 (1985) (requiring approval of stockholders for merger or consolidation).

majority or a larger majority is needed to approve the plan is provided in the appropriate state statute.[25] Because not all state cooperative incorporation statutes have specific provisions for membership approval, or for merger and acquisitions in general, some thought must be given in those states without specific requirements as to whether membership approval is necessary, or appropriate, even if not necessary.

C. MEMBERSHIP APPROVAL AND SECURITIES LAW CONSIDERATIONS

Approval by the stockholders for the merger or consolidation of cooperatives is expensive and time consuming. Moreover, stockholder approval may trigger Security Exchange Commission (SEC) filing requirements.[26] For these reasons, many regular business corporations avoid stockholder approval if possible. Whether or not it is possible *and* appropriate in a cooperative merger to avoid a vote of the membership depends on state statutory provisions and the facts of the particular situation.

1. *Membership Approval*

Techniques have been developed in the regular business corporation area to avoid approval by the stockholders of the surviving corporation and possibly even the acquired corporation

25. At least fifteen states require approval of the plan by two-thirds of the members voting at a meeting. *See* ARK. STAT. ANN. § 77-1030 (1981); COLO. REV. STAT. § 7-55-112 (1986); IDAHO CODE § 22-2622A; ILL. ANN. STAT. ch. 32, paras. 111.20(d), 470 (Smith-Hurd Supp. 1987); IOWA CODE ANN. § 499.64 (West Supp. 1987); KY. REV. STAT. ANN. § 272.311 (Michie/Bobbs-Merrill 1981); ME. REV. STAT. ANN. tit. 13, § 1951 (1981); MINN. STAT. ANN. § 308.15(4) (West Supp. 1987); MONT. CODE ANN. § 35-17-503 (1985); N.C. GEN. STAT. § 54-161(a) (1982); S.D. CODIFIED LAWS ANN. § 47-18-1 (1983); VT. STAT. ANN. tit. 11, § 1061(3) (1984); VA. CODE ANN. § 13.1-339 (1985); WASH. REV. CODE ANN. § 23.86.220 (West Supp. 1987); WIS. STAT. ANN. § 185.61 (West. Supp. 1986); *see also* BAARDA, *supra* note 4, at 119-20 (membership voting requirements for approval of plan). At least three states require approval of the plan by two-thirds voting power. *See* CONN. GEN. STAT. ANN. § 33-478 (West 1987); HAW. REV. STAT. § 421-21.5 (1985); MD. CORPS. & ASS'NS CODE ANN. §§ 3-105(d), 5-527(a) (1985).

Furthermore, at least three states require approval of the plan by a majority of the members voting at a meeting and, in addition, approval of the plan by a majority of the shareholders entitled to vote. *See* ALASKA STAT. § 10.15.410 (1986); IND. CODE ANN. § 15-7-1-8 (Burns Supp. 1987); UTAH CODE ANN. § 3-1-35 (1982). At least four states require approval of the plan by a majority of the members voting at a meeting. *See* N.J. STAT. ANN. § 4:13-10 (West 1973); N.D. CENT. CODE § 10-15-41 (1985); OR. REV. STAT. § 62.610(3) (1985); PA. STAT. ANN. tit. 15, § 12129(a) (Purdon Supp. 1987). At least one state requires approval of the plan by a majority of the shareholders entitled to vote. CAL. CORP CODE §§ 152, 1103 (West 1977 & West Supp. 1987).

26. *See* 15 U.S.C. § 77e(c) (1982) (unlawful to use any means of interstate commerce to offer to sell or offer to buy securities unless a registration statement is filed); 17 C.F.R. § 230.145(a) (2) (1986) (there is an offer to sell when stockholders vote on a merger or consolidation). For a discussion of § 230.145 and filing exemptions, see *infra* notes 37-52 and accompanying text.

in certain types of mergers. These types of mergers are designated as "forward triangular" mergers or "reverse triangular" mergers.[27] While an exhaustive discussion of triangular mergers is beyond the scope of the Article, a brief discussion of the concept may be useful because triangular mergers serve other purposes as well.[28]

A forward triangular merger occurs when the subsidiary of the surviving cooperative acquires another cooperative by exchanging stock in the surviving cooperative for the stock of the acquired cooperative.[29] A reverse triangular merger occurs when the subsidiary of the surviving cooperative is merged into the acquired cooperative and thus both the surviving cooperative and the acquired cooperative continue in existence.[30]

In theory, general business corporations can avoid a vote of the stockholders of the surviving corporation in either type of triangular merger assuming that enough authorized stock is available to complete the merger.[31] Since the surviving corporation is usually the sole shareholder of its subsidiary, it can approve the merger of its subsidiary and the acquired cooperative without membership approval.[32] Furthermore, it is also possible, in theory, to avoid a vote of the stockholders in the corporation that is acquired in a reverse triangular merger. Because the corporation survives, albeit as a subsidiary of the surviving corporation, a vote of the stockholders to merge or dissolve may not be needed.

However, what is possible in theory is not always available in practice, especially when the merger involves cooperatives. As previously mentioned, most state cooperative statutes require a vote of the members to approve a merger.[33] Furthermore, if the

27. *See generally* Ginnings & Jones, *Triangular Mergers in Texas*, 12 HOUS. L. REV. 307, 308-09 (1975) (discussing forward and reverse triangular mergers). A discussion with Ralph K. Morris of Doherty, Rumble and Butler law firm in Saint Paul, Minnesota indicates that to the best of his knowledge there has been only two cooperative reverse triangular mergers, and all the members of both cooperatives voted to approve the merger in both mergers. Telephone interview with Ralph K. Morris, member of Doherty, Rumble, and Butler law firm (1986).

28. *See* Raskin, *Triangular Mergers: A Useful Technique*, 12 COLO. LAW. 1630, 1634 (1983). A reverse triangular merger may be useful if the cooperative to be acquired has an asset, such as a lease or a contract that cannot be assigned. *Id.* at 1634. Furthermore, a reverse triangular merger may be useful if the acquiring cooperative does not want to assume a contingent or unliquidated debt of the acquired corporation, such as possible liability in pending litigation. *Id.*

29. Ginnings & Jones, *supra* note 27, at 308.

30. *See id.* at 309.

31. *See id.* at 319 n.89. If the corporation does not have enough authorized stock outstanding to complete the merger, the corporation most likely will have to amend its articles of incorporation to increase the amount of stock it is authorized to distribute. *See, e.g.*, N.D. CENT. CODE § 10-19.1-10 (1985) (articles of incorporation must include the number of shares that the corporation is authorized to issue). An amendment to the articles of incorporation generally requires approval by the board of directors and approval by the stockholders. *See, e.g.*, *id.* § 10-19.1-19 (requiring approval of board of directors and stockholders to amend articles of incorporation).

32. *See* Ginnings & Jones, *supra* note 27, at 319; Raskin, *supra* note 28, at 1630.

33. *See supra* note 25.

articles or bylaws of the acquiring cooperative need to be amended to authorize additional stock to complete the merger, then the members will be required to vote on those matters and a vote on the merger itself can be had simultaneously.[34] Moreover, if any of the cooperatives involved in the merger will be dissolved, a vote of the members is needed to approve the dissolution.[35]

Even if a vote of the members is not required by statute to approve the merger or dissolution or to amend the articles or bylaws, it can be argued that the distribution of the large amount of stock that takes place to complete the merger has such an important effect on the capital of the cooperative, and therefore on the equity of the members of the cooperative, that a vote is required.[36] Finally, and possibly most importantly, it can also be argued that avoidance of a vote of the members of a cooperative violates the principles underlying the cooperative form of business. Cooperatives are intended to be democratically controlled. When such a major decision about the future operation of the cooperative has to be made, submitting it to a member vote would conform to this democratic principle.

2. *Securities Law Consideration*

As previously stated, one of the reasons that corporations try to avoid a stockholder vote on a merger is Rule 145 of the Securities Act of 1933 (1933 Act).[37] Rule 145 provides that an "offer" or

34. *See supra* note 31.

35. *See, e.g.*, N.D. CENT. CODE § 10-15-45 (1985) (a cooperative may be dissolved if resolution for dissolution is adopted by three-fourths of vote cast thereon); *see also* BAARDA, *supra* note 4, at 123-24 (discussing membership approval of dissolution).

36. While not exactly on point, there are cases cited for the proposition that a cooperative cannot materially alter the financial provisions of its articles and bylaws to the detriment of its members, even if approved by a majority of the members as provided in the articles and bylaws. *See* Whitney v. Farmers' Co-op Grain Co., 110 Neb. 157, ___, 193 N.W. 103, 104-05 (1923); Lambert v. Fishermen's Dock Cooperative Inc., 61 N.J. 596, ___, 297 A.2d 566, 568-71 (1972); Farrier v. Ritzville Warehouse Co., 116 Wash. 500, ___, 199 P. 984, 987 (1921). The rationale of these cases appears to be that the original articles and bylaws created a contract between the member and the cooperative which could not later be altered. *See Whitney*, 110 Neb. at ___, 193 N.W. at 104; *Lambert*, 61 N.J. at ___, 297 A.2d at 568-69; *Farrier*, 116 Wash. at ___, 199 P. at 987.

37. 17 C.F.R. § 230.145 (1986). Section 230.145 provides, in relevant part, as follows:

> (a) *Transactions within this section.* An "offer," "offer to sell," "offer for sale," or "sale" shall be deemed to be involved, within the meaning of section 2(3) of the Act, so far as the security holders of a corporation or other person are concerned where, pursuant to statutory provisions of the jurisdiction under which such corporation or other person is organized, or pursuant to provisions contained in its certificate of incorporation or similar controlling instruments, or otherwise, there is submitted for the vote or consent of such security holders a plan or agreement for:
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> . . .
>
> (2) *Mergers or consolidations.* A statutory merger or consolidation or similar plan or acquisition in which securities of such corporation or other person held by such security holders will become or be exchanged for securities of any person, unless the

"offer to sell" or "sale" occurs when a merger, consolidation, or transfer of assets is submitted to shareholders for approval.[38] Thus, an informational filing must be made with the SEC and a continuing duty to file regular reports is created whenever a vote of the stockholders is required to complete the merger, consolidation or transfer of assets,[39] unless the transaction is exempt under provisions of the 1933 Act.[40]

Even if a vote is required, it may be possible to avoid a filing in certain circumstances. Pursuant to the 1933 Act cooperative securities that are exempt from federal taxation under section 521 of the Internal Revenue Code[41] are also exempt from the provisions of the 1933 Act.[42] Because section 521 only applies to producer cooperatives and because few producer cooperatives meet the

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sole purpose of the transaction is to change an issuer's domicile solely within the United States; or

(3) *Transfers of assets.* A transfer of assets of such corporation of other person, to another person in consideration of the issuance of securities of such other person or any of its affiliates, if:

(i) Such plan or agreement provides for dissolution of the corporation or other person whose security holders are voting or consenting; or

(ii) Such plan or agreement provides for a pro rata or similar distribution of such securities to the security holders voting or consenting; or

(iii) The board of directors or similar representatives of such corporation or other person, adopts resolutions relative to paragraph (a) (3) (i) or (ii) of this section within 1 year after the taking of such vote or consent; or

(iv) The transfer of assets is a part of a preexisting plan for distribution of such securities, notwithstanding paragraph (a) (3) (i), (ii), or (iii) of this section.

Id.

38. *Id.*

39. *See* 15 U.S.C. § 77e (1982). Section 77e provides, in relevant part, as follows:

(a) Sale or delivery after sale of registered securities unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly—

(1) To make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or

(2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale.

. . . .

(c) Necessity of filing registration statement

It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security, or while the registration statement is the subject of a refusal order or stop order or (prior to the effective date of the registration statement) any public proceeding or examination under section 77h of this title.

Id.

40. *See id.* § 77c (listing exempt securities).

41. I.R.C. § 521 (1982).

42. 15 U.S.C. § 77c(a)(5)(1982).

stringent requirements of section 521, the exemption is not particularly useful.[43]

Other exemptions to the filing requirements of the 1933 Act do exist. The 1933 Act and Rule 145 do not apply to transactions which are completely within one state.[44] Moreover, the 1933 Act allows the SEC to adopt rules exempting relatively small transactions.[45] For the most part, transactions in which the amount of the securities involved is less than $1,500,000 are relieved of the full filing requirement and need only file an offering statement.[46] Furthermore, transactions involving securities in an amount less than $100,000 are required to provide even less information in the offering statement.[47] The usefulness of these exemptions will, of course, depend upon the size and location of the proposed mergeı or consolidation.

Rule 145 is also inapplicable if state law provides for a hearing to determine the fairness of the transaction involved and the cooperative elects to have such a hearing at the state level.[48] The

43. *See* I.R.C. § 521 (1982). Section 521 of the Internal Revenue Code provides that farmers' cooperatives that meet the requirements of that provision are entitled to certain deductions. *See id.* These requirements include: (1) the cooperative must be a farmers', fruit growers' or like association organized and operated on a cooperative basis to market the products of members or other producers or to purchase supplies and equipment for the use of members or other persons; (2) if the cooperative is a stock cooperative, substantially all its voting stock must be owned by producers; (3) the dividend rate on stock cannot exceed the greater of the legal rate of interest in the state of incorporation or eight percent per annum; (4) financial reserves are limited to those allowed by the state law or what is reasonable and necessary and such reserves must be allocated to members unless the cooperative includes them in taxable income; (5) business done with nonmembers may not exceed fifty percent of the cooperative's business and purchases for patrons who are neither members nor producers may not exceed fifteen percent of the cooperative's total purchases. *Id.*

Because these requirements are burdensome, very few agricultural cooperatives have retained their exemption pursuant to § 521 and many have utilized the provisions of subchapter T of the Internal Revenue Code for tax purposes. *See I. R. C.* §§ 1381-88 (1982).

44. 15 U.S.C. § 77c(a) (11) (1982). The 1933 Act only applies to interstate transactions. *See id.* Although the 1933 Act exempts interstate transactions, state security or "blue sky" laws might still apply. For a discussion of blue sky laws, see *infra* notes 63-64 and accompanying text.

45. *See* 15 U.S.C. § 77c(b) (1982). Section 77c(b) gives the Securities Exchange Commission authority to exempt transactions in which the amount of the securities issued is less than $5,000,000. *Id.*

46. *See* 17 C.F.R. § 230.254(a)(1)(i) (1986); *Id.* § 230.255.

47. *See id.* § 230.257(a). Section 230.257 requires only notification and a statement of the offering attached as an exhibit. *See id.*

48. *See* 15 U.S.C. § 77c(a)(10) (1982). Subsection 77c(a)(10) provides, in relevant part, as follows:

> Except as hereinafter expressly provided, the provisions of this subchapter shall not apply to any of the following classes of securities:
>
> . . . .
>
> (10) Except with respect to a security exchanged in a case under Title 11, any security which is issued in exchange for one or more bona fide outstanding securities, claims or property interests, or partly in such exchange and partly for cash, where the terms and conditions of such issuance and exchange are approved, after a hearing upon the fairness of such terms and conditions at which all persons to whom it is proposed to issue securities in such exchange shall have the right to appear, by any court, or by any official or agency of the United States, or by any State or Territorial

hearing must be held before any state or territorial banking or insurance commission or other governmental authority expressly authorized by law to grant such approval.[49] Furthermore, the state or territory must have a statute authorizing such hearings and designating the appropriate officer to conduct them.[50] Currently, it appears that only a few states have such statutes,[51] even though these "fairness hearings" may be preferable to a filing in terms of time and expense.[52]

It may also be possible to argue that the cooperative shares which will be exchanged as a result of the merger or consolidation are not securities within the meaning of the 1933 Act,[53] and therefore the Act is inapplicable. The United States Supreme Court in *United Housing Foundation Inc. v. Forman*[54] determined that the shares of a nonprofit housing cooperative purchased by the respondents were not "securities" within the meaning of the 1933 Act.[55] In *Forman,* the respondent tenants were required to buy stock in the housing cooperative to acquire an apartment in the cooperative.[56] In order to attract tenants, the owners of the

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> banking or insurance commission or other governmental authority expressly authorized by law to grant such approval. . . .

Id.

49. *Id.*

50. *Id.*

51. *See* CAL. CORP. CODE § 25140 (West 1977) (procedure for fairness hearing); N.C. GEN. STAT. § 7A-30 (1985) (same); OHIO REV. CODE ANN. § 1707.04 (Anderson 1985) (same); OR. REV. STAT. § 59.095 (1985) (same).

52. For a more detailed discussion of fairness hearings, see generally Glickman, *The State Administrative Fairness Hearing and Section 3(a)(10) of the Securities Act — Some Questions,* 45 ST. JOHN'S L. REV. 644 (1971); Mann, *The Section 3(a)(10) Exemption: Recent Interpretations,* 22 U.C.L.A. L. REV. 1247 (1975); Rapp, *The Interface Between Securities Act § 3(a)(10) and Ohio Revised Code § 1707.04: Utilitarian Considerations for Ohio Mergers and Corporate Reorganization Transactions,* 27 CLEV. ST. L. REV. 1 (1978).

53. *See* 15 U.S.C. 77(b)(1) (1982). Subsection 77(b)(1) defines security. *Id.* Subsection 77(b)(1) provides, in relevant part, as follows:

> (1) The term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a "security". . . .

Id.

54. 421 U.S. 837 (1975).

55. United Hous. Found. v. Forman, 421 U.S. 837, 847 (1975).

56. *Id.* at 841-42. In *Forman* the respondents were residents of Co-op City, a housing cooperative in New York City. *Id.* at 844. To receive an apartment in Co-op City, a tenant had to purchase 18 shares of stock in Riverbay Corporation, a nonprofit cooperative corporation formed to operate Co-op City. *Id.* at 841-42.

cooperative circulated an informational bulletin that estimated the cost of living in the cooperative lower than the actual price.[57] Because the bulletin was misleading, the tenants alleged that the owners violated the antifraud provisions of the 1933 Act.[58] The Court stated that the test to determine if the shares were securities was whether there existed an investment in a common venture premised on a reasonable expectation of profits to be derived from the enterpreneurial efforts of others.[59] The Court reasoned that, because the respondents purchased the stock for the purpose of obtaining living quarters and not as an investment with the hopes of obtaining profits, the stock did not constitute securities pursuant to the 1933 Act.[60]

The rationale of the *Forman* decision has been used by at least two other courts to determine that membership stock of a privately owned housing cooperative and a producer cooperative were not "securities" within the meaning of the 1933 Act.[61] While the rationale used in these decisions is easily applied to the stock that members purchase to become members or the stock which is issued as part of the members' patronage dividend, stock issued for other reasons or to nonmembers does not as easily fall within this rationale. Therefore, any cooperative relying on the rationale of *Forman* and subsequent decisions would do well to carefully review the case law or request a "no-action" letter from the SEC before proceeding.[62]

57. *Id.* at 843-44. In 1965, Riverbay circulated an informal bulletin that estimated the monthly costs for living in a Co-op City apartment at $23.02 per room. *Id.* at 843. By 1974, the average monthly rental payment was $39.68 per room. *Id.* at 844.

58. *Id.* at 844-45; *see* 15 U.S.C. § 77q(a) (1982) (unlawful for any person in offer or sale of securities to employ any means to defraud). Riverbay Corporation moved to dismiss the respondents' complaint on the basis that the stock of Riverbay that was purchased by the respondents were not securities within the meaning of the Securities Act of 1933. *Forman,* 421 U.S. at 845; *see* 15 U.S.C. § 77(b)(1) (1982) (defining securities). For the text of § 77(b)(1), see *supra* note 53.

59. *Forman,* 421 U.S. at 852.

60. *Id.* at 858.

61. *See* Grenader v. Spitz, 537 F.2d 612, 613 (2d Cir. 1976) (stock in housing cooperative was not securities), *cert. denied,* 429 U.S. 1009 (1976); B. Rosenberg & Sons, Inc. v. St. James Sugar Coop. Inc., 447 F. Supp. 1, 3 (E.D. La. 1976) (stock in nonprofit sugar cooperative was not securities).

62. It is possible to request from the Securities Exchange Commission (SEC) a "no-action" letter. A no-action letter is a response by the SEC to a request asking for interpretive advice or a statement that, on the basis of the facts given, the staff of the SEC would not recommend that the SEC take any enforcement action.

There have been numerous "no-action" requests by cooperatives in which the staff of the SEC has indicated that the cooperative did not have to register pursuant to the 1933 Act. *See, e.g.,* Front St. Supermarkets, Inc., [1982-1983 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,352 (Oct. 15, 1982) (membership shares in nonprofit supermarket were not securities); Seafood Producers Coop., [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,804 (Nov. 18, 1981) (nonprofit supply and production cooperative could sell stock without registering); United Suppliers, Inc., [1977-1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,147 (Mar. 14, 1977) (cooperative could implement capital plan without registration); Wine and Spirits Coop., Inc., [1977-1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,109 (Feb. 8, 1977) (sale of membership in a cooperative did not require

Even if the cooperative successfully avoids having to meet the 1933 Act's requirements, the securities or "blue sky" laws of the individual states may apply.[63] Many states, however, have partial or total exemptions for cooperative securities, some of which are much broader than the SEC exemptions.[64]

D. Antitrust Issues

1. *Premerger Notification and Waiting Period*

If a merger, acquisition, or consolidation between two large cooperatives is proposed, the antitrust implications must also be considered. The Clayton Act prohibits acquisitions and mergers that tend to create concentration and a decrease in the level of

registration); National Rural Util. Coop. Fin. Corp., [1971-1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,707 (Jan. 6, 1972) (membership certificates in a nonprofit cooperative do not need to be registered); SCDF Inv. Corp., [1971-1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,531 (Sept. 29, 1971) (cooperative could issue securities without registration upon assurance that the investment was made without expectation of investment return). Other requests by cooperatives for no action have been denied when it appeared that some profit motive might exist or the stock was easily transferable. *See, e.g.*, Family Farm Coop. Inc. (Sept. 30, 1983) (WESTLAW) (membership interest in cooperative was securities); Garden State Coop. Group Inc. (Dec. 16, 1982) (WESTLAW) (same); Wheatbelt Merchandising Group Inc., [1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,446 (May 30, 1980) (same).

63. *See, e.g.*, N.D. Cent. Code §§ 10-04-01 to -19 (1985 & Supp. 1987) (blue sky laws).

64. Some states provide for a blanket exemption for all cooperative securities. *See, e.g.*, N.D. Cent. Code § 10-04-05(9) (Supp. 1987) (exempting securities of any cooperative formed pursuant to North Dakota statutes). Other states have more limited exemptions, such as exemptions only for stock issued to evidence membership or issued as a patronage exemption. *See, e.g.*, Kan. Stat. Ann. § 17-1261(k) (Supp. 1986) (exempting securities issued to evidence membership or issued as a patronage divided by a cooperative). Furthermore, while a few states exempt cooperative securities by attorney general opinions or agency rules, other states contain no exemptions for cooperative securities. In the states that have no exemption for cooperatives, cooperatives must look to other exemption provisions to determine if they apply or argue that the cooperative stock is not a security pursuant to the *Forman* test. *See Forman*, 421 U.S. at 852. For a discussion of *Forman*, see *supra* notes 54-62 and accompanying text.

Research indicates that while Utah exempts cooperative securities only by attorney general opinion and Pennsylvania exempts cooperatives solely by agency rule, 34 states have statutory exemptions for securities or transactions of cooperatives, at least in some limited form. *See* Ark. Stat. Ann. § 67-1248(12) (1980); Colo. Rev. Stat. § 7-55-115 (1986); Conn. Gen. Stat. Ann. § 36-490(a)(15) (West 1987); Del. Code Ann. tit. 6, § 7309(a)(12) (1974); Fla. Stat. Ann. § 517.051(7) (West Supp. 1987); Ga. Code Ann. § 97-108(5) (Harrison Supp. 1986); Haw. Rev. Stat. § 485-4(14) (1985); Idaho Code § 30-1434(12) (Supp. 1987); Ill. Ann. Stat. ch. 121½, para. 137.3(S) (Smith-Hurd Supp. 1987); Kan. Stat. Ann. § 17-1261(k) (Supp. 1986); Ky. Rev. Stat. Ann. § 292.400(12) (Michie/Bobbs-Merrill Supp. 1986); La. Civ. Code Ann. art. 51.708(5) (West Supp. 1987); Me. Rev. Stat. Ann. tit. 32, § 10502(1)(M) (Supp. 1986); Mass. Gen. Laws Ann. ch. 110A, § 402(a)(12) (West Supp. 1987); Mich. Comp. Laws Ann. § 451.802(b)(16) (West Supp. 1987); Minn. Stat. § 80A.15(2)(j) (Supp. 1985); Miss. Code Ann. § 75-71-201(12) (Supp. 1986); Mo. Ann. Stat. § 409.402(a)(5) (Vernon Supp. 1987); N.H. Rev. Stat. Ann. § 421-B:17(II)(j) (1983); N.C. Gen. Stat. § 78A-16(14) (1985); N.D. Cent. Code § 10-04-05(9) (Supp. 1987); Ohio Rev. Code Ann. § 1707.02(I) (1985); Okla. Stat. Ann. tit. 71, § 401(a)(5) (1987); Or. Rev. Stat. § 59.025(9) (1985); R.I. Gen. Laws § 7-8-31 (1985); S.C. Code Ann. § 33-49-60 (Law. Co-op. 1977); S.D. Codified Laws Ann. § 47-31-79 (1983); Tenn. Code Ann. § 48-2-103(a)(12) (Supp. 1986); Tex. Rev. Civ. Stat. Ann. art. 581-5(N) (Vernon Supp. 1987); Vt. Stat. Ann. tit. 9 § 4203(8) (Supp. 1986); Va. Code Ann. § 13.1-514(a)(12) (1985); Wash. Rev. Code Ann. § 21.20.320(16) (Supp. 1987); W. Va. Code § 32-4-402(a)(12) (1982); Wis. Stat. Ann. § 551.22(12) (West Supp. 1987).

competition in an industry.[65] In 1976, the Clayton Act was amended to provide for premerger notification in certain instances.[66] Notification is given to the Department of Justice and the Federal Trade Commission, and a waiting period is prescribed before any merger or acquisition may take place.[67] The notification and waiting period requirements were adopted because often when a merger or consolidation was challenged after the fact and found to be improper, rescinding the merger or consolidation was not a practical remedy.[68] Thus, premerger notification allows the merger to be prevented before it actually takes place.

A cooperative which is exempt under the Clayton Act or the Capper-Volstead Act is exempt from the premerger notification requirements.[69] The criteria for exempt status under the Clayton Act includes agricultural organizations that do not have capital stock or are not conducted for profit.[70] In the Capper-Volstead Act,

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65. *See* 15 U.S.C. § 18 (1982). Section 18 provides, in relevant part, as follows:

> No person engaged in commerce or in any activity affecting commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no person subject to jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another person engaged also in commerce or in any activity affecting commerce, where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.
>
> No person shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no person subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of one or more persons engaged in commerce or in any activity affecting commerce, where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition, of such stocks or assets, or of the use of such stock by the voting or granting of proxies or otherwise, may be substantially to lessen competition, or to tend to create a monopoly.

Id.

66. Hart-Scott-Rodino Antitrust Improvements Act of 1976, Pub. L. No. 94-435, 90 Stat. 1383 (codified in scattered sections of 15 U.S.C., 18 U.S.C., and 28 U.S.C.).

67. 15 U.S.C. § 18a(b) (1982). Section 18a proscribes a 30 day waiting period prior to merger or acquisition; however, the Department of Justice or Federal Trade Commission may within their discretion extend the waiting period for an additional period of not more than 20 days. *Id.* § 18a(e). In addition, the United States district court may extend the established 30 day waiting period until the court determines notification has been achieved. *Id.*

68. *See* Kintner, Griffin & Goldston, *The Hart-Scott-Rodino Antitrust Improvements Act of 1976: An Analysis,* 46 GEO. WASH. L. REV. 1, 12 (1977). When a merger or consolidation was consummated but subsequently declared illegal no practical remedy existed. *Id.* Proponents of premerger notification and waiting period requirements stated that although antitrust agencies were generally successful in challenging mergers, no adequate remedy existed once the merger was declared illegal. *Id.* Trying to undo the illegal merger was frequently compared to trying to unscramble an egg. *Id.*

69. 15 U.S.C. § 18a(c)(5) (1982) (a listing of transactions that are exempt from the requirements of premerger notification and waiting period).

70. *Id.* § 17. Section 17 provides, in relevant part, as follows:

> Nothing contained in the antitrust laws shall be construed to forbid the existence and operation of labor, agricultural, or horticultural organizations, instituted for the purposes of mutual help, and not having capital stock or conducted for profit, or to forbid or restrain individual members of such organizations from lawfully carrying out

the exceptions were expanded to include associations of agricultural producers,[71] corporate or otherwise, with or without stock, that operate for the mutual benefit of its members, that do not deal in the products of nonmembers to an amount greater in value than such as are handled by it for members, and that either: (1) allow only one vote per member; or (2) pay no more than eight percent per annum in dividends on stock.[72] This exemption does not extend to other types of cooperatives, such as consumer or worker cooperatives, or to agricultural producer cooperatives not meeting the stated criteria.[73] In addition, the exemption applies only to cooperatives that merge or consolidate with other exempt cooperatives.[74] Moreover, the requirements that all members of an exempt cooperative be agricultural producers and that all parties to a merger or consolidation be exempt cooperatives have been strictly construed by the United States Supreme Court.[75]

> the legitimate objects thereof; nor shall such organizations, or the members thereof, be held or construed to be illegal combinations or conspiracies in restraint of trade, under the antitrust laws.

Id.

71. *See* 7 U.S.C. § 291 (1982). Section 291 defines agricultural producers. *Id.* Section 291 provides, in relevant part, as follows: "Persons engaged in the production of agricultural products as farmers, planters, ranchmen, dairymen, nut or fruit growers. . . ." *Id.* Additional clarification of this definition can be found in court decisions. *See, e.g.*, National Broiler Mktg. Ass'n. v. United States, 436 U.S. 816, 823-29 (1978) (presence of nonproducers in the marketing association removed it from the protections of the Capper-Volstead Act).

72. 7 U.S.C. § 291 (1982). At least 75% of the cooperative association must be owned or controlled by agricultural producers in order for the cooperative to be considered composed of agricultural producers. *Id.* § 2.

73. *See id.* § 291. In addition to exempting agricultural producer cooperatives that meet its criteria from the premerger notification and waiting period requirements of the Clayton Act or the Capper-Volstead Act, § 291 also exempts marketing agencies or associations owned by agricultural producer cooperatives. *Id.*

For a more complete discussion of cooperative antitrust immunity, see Rowley & Beshore, *Chicken Intergrators' Price-Fixing: A Fox in the Capper-Volstead Coop*, 24 S.D.L. REV. 564 (1979); Warlich & Brill, *Cooperatives Vis-a-Vis Corporations: Size, Antitrust and Immunity*, 23 S.D.L. REV. 561 (1978).

74. Rowley & Beshore, *supra* note 73, at 568. In addition to merger between an exempt and a nonexempt cooperative, other activities that are beyond the scope of an agricultural producer cooperative's legitimate purposes are not granted exempt status under the Clayton Act or the Capper-Volstead Act, generally these unprotected activities are categorized as predatory practices. *See, e.g.*, Maryland & Virginia Milk Producers Ass'n, Inc. v. United States, 362 U.S. 458, 465-66 (1960) (agricultural cooperatives are protected when lawfully carrying out their legitimate objectives, but are not protected if engaging in predatory trade practices); Alexander v. National Farmers Org., 687 F.2d 1173, 1182 (8th Cir. 1982) (farm cooperatives are exempt under federal laws as long as they do not resort to predatory practices), *cert. denied*, 461 U.S. 937 (1983); Pacific Coast Agric. Export Ass'n v. Sunist Growers, Inc., 526 F.2d 1196, 1202, 1205 (9th Cir. 1975) (farm cooperatives are not immunized by the Clayton Act nor by the Capper-Volstead Act when they engage in competition-stifling or predatory practices), *cert. denied*, 425 U.S. 959 (1976).

75. *See, e.g.*, National Broiler Mktg. Ass'n v. United States, 436 U.S. 816, 822-24 (1978) (all parties must comply with the merger requirements of the Capper-Volstead Act, and in addition, comply with the narrow definition of agricultural producer); Case-Swayne Co., Inc. v. Sunkist Growers, Inc., 389 U.S. 384, 391, 395-96 (1967) (Congress intended only actual producers of agricultural products to qualify for exempt status and in order to keep their exempt status, agricultural producers must not unite with nonproducer interests), United States v. Borden Co., 308 U.S. 188, 204-05 (1939) (producers of agricultural products, as defined in the Capper-Volstead Act,

In addition, the notification and waiting period requirements apply to any nonexempt transaction: (1) in which at least one party is engaged in commerce or in any activity affecting commerce;[76] (2) that involves parties of significant size;[77] and (3) that would result in the acquisition of at least fifteen percent or $15,000,000 of the voting securities or assets of the acquired party.[78] Thus, cooperatives not involved in interstate activities or whose business volume does not meet the threshold requirements need not be concerned with the established premerger notification and waiting period. The practical effect of the jurisdictional thresholds and exemptions is that only the largest cooperative mergers or consolidations will be required to comply with the premerger notification and waiting period requirements.

2. Department of Justice Merger Guidelines

If a cooperative is not exempt from the antitrust laws and is large enough to require premerger notification, it will at a minimum, have to comply with the 1984 United States Department of Justice Merger Guidelines.[79] Briefly, the purpose of the Merger Guidelines is to identify those mergers and acquistitions that are likely to produce or enhance market power.[80] To determine whether an enhancement of market power will occur, the Merger Guidelines is to identify those mergers and acquisitions that are the level of concentration in the relevant market.[81] The Merger Guidelines contain a procedure that: (1) defines the relevant market; (2) computes the market share; (3) applies preliminary decision rules to approve acquisitions that are unlikely to produce

may combine with each other but will lose their exempt status if agricultural producers unite with persons outside their defined, exempt group).

76. 15 U.S.C. § 18a(a)(1) (1982).

77. *See id.* § 18a(a)(2). Subsection 18a(a)(2)(A) requires premerger notification and a waiting period if any voting securities or assets of a person engaged in manufacturing that has annual net sales or total assets of at least $10,000,000 are being acquired by a person with annual net sales or total assets of at least $100,000,000. *Id.* § 18a(a)(2)(A). Subsection 18a(a)(2)(B) requires premerger notification and a waiting period of any voting securities or assets of a person *not* engaged in manufacturing that has annual net sales or total assets of at least $10,000,000, and are being acquired by a person that has annual net sales or total assets of at least $100,000,000. *Id.* § 18a(a)(2)(B). Subsection 18a(a)(2)(C) requires premerger notification and a waiting period if any voting securities or assets of a person with annual net sales or total assets of at least $100,000,000 are being acquired by a person with annual net sales or total assets of at least $10,000,000. *Id.* § 18a(a)(2)(C).

78. *Id.* § 18a(a)(3).

79. See U.S. Department of Justice Merger Guidelines, 49 Fed. Reg. 26,827 (1984) [hereinafter Merger Guidelines].

80. *See* Bronsteen, *A Review of the Revised Merger Guidelines,* 29 ANTITRUST BULL. 613, 615 (Winter 1984) (detailed discussion of the Merger Guidelines).

81. *See id.* The fundamental concern of the Merger Guidelines is the proposed acquisition's size and potential market concentration. *Id.*

market power or enhance market share; (4) examines additional factors in more complex cases; and (5) considers relevant defenses.[82] The Merger Guidelines are designed to allow cooperatives to predict the merger enforcement policy of the Department of Justice.[83] It must be cautioned, however, that the Merger Guidelines do not bar the Department of Justice's ability to take action as it deems necessary to achieve the purposes of the law.

While Department of Justice challenges to cooperative mergers and acquisitions do exist,[84] they appear to be relatively infrequent. Generally, these challenges tend to involve the acquisition by a cooperative of a noncooperative business.[85] While acquisitions by cooperatives of noncooperative businesses are beyond the scope of this discussion, it is clear that most of the issues raised herein concerning mergers between cooperatives, apply equally to cooperative and noncooperative mergers and consolidations.

E. Tax Considerations

In any contemplated merger or consolidation one must be aware of the federal and state tax laws that could result in tax liability. Absent a statutory exemption, the exchange of stock in one corporation for stock or property in another corporation is a taxable event. Cooperatives are subject to the tax laws regarding mergers, consolidations and reorganizations just like any other corporation.[86] Fortunately, it is possible to structure most cooperative mergers and consolidations so that one of the statutory exemptions will apply.

As previously mentioned, cooperative mergers may take two forms: (1) acquisition of the stock of the acquired cooperative; or

82. *See* Merger Guidelines, *supra* note 79, at 26,827-34, 26,837 (detailed discussion of the factors the Department of Justice addresses in determining whether an enhancement of the market will occur); *see also* Bronsteen, *supra* note 80, at 615-27 (summary of the factors that the Department of Justice addresses in determining whether an enhancement of the market will occur).

83. *See* Merger Guidelines, *supra* note 79, at 26,827 (purpose and underlying policy assumptions of Merger Guidelines).

84. *See, e.g.*, Maryland & Virginia Milk Producers Ass'n, Inc. v. United States, 362 U.S. 458, 460-61 (1960) (United States challenged cooperative merger in an antitrust action); United States v. Borden Co., 308 U.S. 188, 190 (1939) (United States challenged combination and conspiracy in an antitrust action); United States v. Western Farmers Ass'n, 1969 Trade Cas. (CCH) ¶ 72,958 (W.D. Wash. 1969) (cooperative acquisition challenged by the United States).

85. *See, e.g.*, *Maryland & Virginia Milk Producers Ass'n, Inc.*, 362 U.S. at 461-62. (agricultural producer cooperative attempted to acquire a business that was not an agricultural producer cooperative); United States v. Rice Growers Ass'n of Cal., 1986-2 Trade Cas. (CCH) ¶ 67,287 (E.D. Cal. 1986) (a rice growers cooperative attempted to acquire a noncooperative rice milling corporation); *Western Farmers Ass'n*, 1969 Trade Cas. (CCH) ¶ 72,958 (a farmers cooperative attempted to acquire a noncooperative processing plant).

86. *See* Clark & Erickson, *Taxation of Cooperatives*, 229-2d Tax Mgmt. (BNA) A-1, A-28 (1984) (discussing cooperative reorganizations and the tax effects involved).

(2) acquisition of the assets of the acquired cooperative. Generally, tax considerations will favor choosing the acquisition of stock method.

Section 368 of the Internal Revenue Code (IRC) defines seven types of corporate reorganizations, including mergers and consolidations, that are "tax-free."[87] The seven types of reorganizations are as follows: (1) statutory merger or consolidation;[88] (2) the acquisition of one corporation by another corporation solely through the exchange of voting stock;[89] (3) the acquisition of one corporation by another corporation solely through the exchange of voting stock for all, or substantially all, of the assets of the acquired corporation;[90] (4) the transfer by one corporation to another corporation of a controlling interest in the assets of the acquired corporation;[91] (5) recapitalization;[92] (6) change in identity, form, or place of the corporate organization;[93] and (7) the transfer by one corporation of all or part of its assets to another corporation in a bankruptcy proceeding.[94] In addition to conforming with one of these seven statutory forms, the business enterprise must continue and there must be continuity of ownership interest after the reorganization.[95]

The presence of "boot," such as cash or other property, as part of the exchange does not remove the corporate reorganization

87. *See* I.R.C. § 368 (1982 & Supp. III 1985) (types of corporate reorganization that will result in a tax-free transaction if all of the statutory requirements are complied with).

88. *See id.* § 368(a)(1)(A) (1982). A large majority of cooperative reorganizations are structured as statutory mergers or consolidations. *See* Clark & Erickson, *supra* note 86, at A-28. Merger or consolidation is the most common type of reorganization for cooperatives because the cooperative's unique capital structure usually does not lend itself to the other types of reorganization. *Id.* at A-28.

89. *See* I.R.C. § 368(a)(1)(B) (1982). Corporate reorganization can occur by acquiring a controlling interest in the voting stock of another corporation. *Id.*

90. *See id.* § 368(a)(1)(C). Corporate reorganization can occur by exchanging controlling interest in the voting stock of the acquiring corporation for substantially all of the properties of the acquired corporation. *Id.*

91. *See id.* § 368(a)(1)(D). Corporate reorganization can occur by transferring controlling interest of the assets of the acquired corporation to the acquiring corporation if the asset transfer transaction complies with § 354, 355, or 356 or the Internal Revenue Code (IRC). *Id. See generally id.* § 354 (exchanges of stock and securities in certain reorganizations); *id.* § 355 (distribution of stock and securities of a controlled corporation); *id.* § 356 (receipt of additional consideration).

92. *See id.* § 368(a)(1)(E).

93. *See id.* § 368(a)(1)(F).

94. *See id.* § 368(a)(1)(G). Corporate reorganization can occur by the asset transfer of one corporation to another corporation in a bankruptcy or similar case, if the acquiring corporation complies with § 354, 355, or 356 of the IRC. *Id.* For a discussion of §§ 354, 355 and 356, see *supra* note 91. Pursuant to § 368(a)(1)(G), a "bankruptcy or similar case" has been defined as a case under title 11 of the United States Code, or a receivership, foreclosure, or similar proceeding in a federal or state court. *See* I.R.C. § 368(a)(3)(A) (1982).

95. *See* 26 C.F.R. § 1.368-1(b) (1987). A requisite to a reorganization under the IRC is that the business enterprise continue under the modified corporate form. *Id.* In addition, a continuity of ownership interest on the part of those who were the owners of the acquiring corporation is necessary. *Id.*

from tax exemption.[96] This gain of additional consideration is recognized to the extent of the cash or other property received;[97] however, no loss on the reorganization would be recognized.[98]

In addition, Section 354(a) of the IRC provides that no gain or loss must be recognized if stock or securities in one corporation are exchanged solely for stock or securities in another corporation pursuant to a plan of reorganization.[99] This exemption, however, does contain limitations.[100] Section 354(a) does not apply to: (1) the principal amount of any securities received that exceeds the principal amount of any securities surrendered;[101] or (2) any stock, securities or other property received that is attributable to accrued interest on the securities surrendered.[102] Thus, unless one of the limitations apply a "stock for stock" merger would be tax-free to the stockholders.

Similarily, section 361 of the IRC provides that no gain or loss must be recognized if a corporation exchanges property solely for stock or securities in another corporation pursuant to a plan of reorganization.[103] Thus, an "assets for stock" type of reorganization would be tax-free as to the stock exchanged. No tax exemption applies, however, to the recapture of depreciation on personal or real property; therefore, the recapture provisions of the IRC apply.[104] The gain realized on the sale of these assets is ordinary income for the cooperative, and possibly for its members if the cooperative passed the gain through to them.[105] For this reason, the exchange of assets for the stock of another cooperative often leads to taxable income for the cooperative or for its members, and is therefore avoided if possible.[106]

The tax laws regarding the tax liability for triangular mergers are quite complex. Any organization contemplating a triangular

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96. *See* Clark & Erickson, *supra* note 86, at A-29. Although the "boot" or additional consideration received in the corporate reorganization will not remove the transaction from its tax-free status, the "boot" may trigger a gain on the exchange under § 356 of the IRC. *Id.*

97. *See* I.R.C. § 356(a)(1) (1982). Additional consideration received in a corporate reorganization must be recognized; however, the amount recognized must not exceed the sum of any cash received plus the fair market value of any such property received. *Id.*

98. *See id.* § 356(c). No loss on additional consideration received during a corporate reorganization must be recognized. *Id.*

99. *See id.* § 354(a)(1) (general rule for exchanges of stock or securities in reorganizations).

100. *See id.* § 354(a)(2).

101. *See id.* § 354(a)(2)(A) (excess principal amount limitation).

102. *See id.* § 354(a)(2)(B) (property attributable to accrued interest limitation).

103. *See id.* § 361(a).

104. *See id.* § 1245(a)(1) (gain from disposition of certain depreciable property is classified as ordinary income and any such gain must be recognized as taxable); *id.* § 1250(a)(1)(A) (gain from disposition of certain depreciable realty is classified as ordinary income and any such gain must be recognized as taxable).

105. *See id.* § 1245(a)(1); *id.* § 1250(a)(1)(A).

106. *See id.* § 1245(b)(3) (limiting the amount of gain that can be realized in certain tax-free transactions); *id.* § 1250(d)(3) (same).

merger would do well to consult the tax laws carefully. The most recent change in the IRC concerning triangular mergers occurred in 1971.[107] By further defining "party to a reorganization," Congress effectively overruled two United States Supreme Court cases which had determined that triangular mergers were taxable events.[108] The Internal Revenue Service, however, did not issue final regulations concerning its interpretation of these changes until 1985 — fourteen years after the statutory changes had taken place.[109] It appears that under certain limited circumstances triangular mergers may be tax-free events.[110] Therefore, cooperatives contemplating this type of merger can now structure the transaction in order to avoid tax liability.[111]

Cooperatives can request advice from the Internal Revenue Service regarding the tax consequences of proposed mergers or consolidations. Essentially all of the Revenue Rulings and Private Letter Rulings have determined these proposed transactions to be tax-free events.[112] Therefore, it is clear that cooperative mergers and consolidations can be structured to avoid taxable consequences. Similarly, triangular mergers can also be structured to avoid taxable consequences. Obviously, any merger or consolidation should be structured in order to minimize or avoid tax liability, keeping in mind the original objectives and concerns of the cooperatives involved.

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107. *See* Act of Jan. 12, 1971, Pub. L. No. 91-693, 84 Stat. 2077 (codified as amended at I.R.C. § 368(a)(2)(E), (b) (1982) (defining qualifying statutory mergers and "party to a reorganization").

108. *See* Helvering v. Bashford, 302 U.S. 454, 458 (1938); Groman v. Commissioner, 302 U.S. 82, 90 (1937).

109. 50 Fed. Reg. 42,688 (1985) (Internal Revenue Service's final regulations pertaining to statutory merger using voting stock of the corporation controlling the merged corporation).

110. *See* I.R.C. § 368(a)(2)(E) (1982). A corporation that was in control of the stock of the merged corporation before the merger occurred, can avoid taxation if: (1) after the merger the surviving corporation holds substantially all of the property of both its own corporation and the merged corporation; and (2) during the transaction the shareholders in control of the surviving corporation exchange that controlling interest of stock for an amount of stock in the controlling corporation. *Id.* Under § 368 of the IRC, a controlling corporation complies with the definition of a "party to a reorganization." *Id.* § 368(b).

111. *See generally* Braubach & McCluskey, *Triangular Reorganizations: Proposed Regulations*, 7 J. CORP. L. 1 (1981) (discussing proposed regulations concerning triangular mergers); *Report on Reverse Triangular Mergers and Basis-Nonrecognition Rules in Triangular Reorganizations*, 36 TAX L. REV. 395 (1981) (same); Ferguson & Ginsburg, *Triangular Reorganizations*, 28 TAX L. REV. 159 (1973) (general discussion regarding triangular reorganizations).

112. *See, e.g.*, Rev. Rul. 68-22, 1968-1 C.B. 142 (Internal Revenue Service advised that the stated reorganization was tax-free); Rev. Rul. 55-305, 1955-1 C.B. 345 (Internal Revenue Service advised that the stated statutory merger was tax-free); Priv. Ltr. Rul. 81-02-046 (Internal Revenue Service ruled that no gain or loss must be recognized in proposed reorganization); Priv. Ltr. Rul. 77-38-016 (Internal Revenue Service ruled that proposed triangular statutory merger would be tax-free); *see also* Clark & Erickson, *supra* note 99, at A-29 (discussing various participants in cooperative mergers or consolidations who have been successful in obtaining Internal Revenue Service approval of their transactions).

F. Objections to the Merger or Consolidation

1. *Protection for Stockholders*

Traditionally, there have been two safeguards for stockholders in any proposed merger or consolidation: (1) ratification; and (2) appraisal rights.[113] Ratification is stockholder or member approval of a plan of merger or consolidation.[114] As was stated previously, merger techniques have been developed to avoid stockholder votes for regular corporate mergers and consolidations.[115] Ratification, however, is still the general rule in cooperative mergers or consolidations thus providing cooperative members with somewhat more protection.

The other safeguard, appraisal rights for dissenters, is a stockholder's statutory right to be paid the value of his or her shares when a triggering event occurs.[116] This protection is common in business corporation statutes and rare in cooperative incorporation statutes. In a business corporation, the right of a stockholder who objects to a proposed merger or consolidation to have his or her stock appraised and to receive that amount in cash is established by individual state laws.[117] This right most certainly appeared in order to assure the fairness of the merger or consolidation, as well as to assure that no stockholder be forced to remain an owner after so profound and fundamental a change as a merger or consolidation has taken place.

In order to determine whether appraisal rights exist in a cooperative merger or consolidation, one must review the cooperative incorporation statute to see if it specifically gives dissenters such a right.[118] If the right to appraisal does not appear

113. Brudney & Chirelstein, *Fair Shares in Corporate Mergers and Takeovers*, 88 HARV. L. REV. 297, 299 (1974).

114. *Id.; see, e.g.*, N.D. CENT. CODE § 10-15-41 (1985) (requiring approval of merger or consolidation by shareholders).

115. For a discussion of techniques utilized to avoid stockholder votes, see *supra* notes 27-32 and accompanying text.

116. Brudney & Chirelstein, *supra* note 113, at 304; *see, e.g.*, N.D. CENT. CODE § 10-19.1-87 (1)(b) (1985) (rights of dissenting shareholders to obtain payment for fair value of shares in event of corporate merger).

117. All states have general corporation statutes which provide for dissenters' appraisal rights when a merger occurs and specify the triggering events. *See, e.g.*, N.D. CENT. CODE § 10-19.1-87 (1985) (rights of dissenting shareholders). At least forty-three states provide for appraisal rights in the event of a sale of assets and at least fourteen states provide for appraisal rights in share exchanges. *See, e.g.*, *id.* At least seventeen states provide for appraisal rights upon amendment to the articles of incorporation. *See, e.g.*, MINN. STAT. § 302A.471 (1986). At least twenty-two states provide that no appraisal rights exist if the shares are listed on a national stock exchange or if the corporation's shares are held by more than a certain number of shareholders. *See, e.g.*, CAL. CORP. CODE § 1300(b) (Supp. 1987).

118. At least four states have special provisions for dissenters' rights in their cooperative incorporation statutes. *See, e.g.*, IOWA CODE ANN. § 449.65 (West Supp. 1987); MONT. CODE ANN. § 35-16-211 (1985); UTAH CODE ANN. § 3-1-39 (1982); VT. STAT. ANN. tit. 11, § 1061 (1984).

on the face of the statute, several other sources should be consulted. The cooperative incorporation statute might make specific reference to the business incorporation statute and provide that the provisions of the business incorporation statute will apply if not inconsistent with the provisions of the cooperative incorporation statute.[119] Whether the business corporation statute applies may also be found in state attorney general opinions.[120] A final source to be consulted is case law. At least one state, Wisconsin, has authority which provides that no appraisal rights exist in a merger or consolidation.[121]

In all states in which there is no specific provision in the cooperative incorporation statutes making reference to the business corporation statutes,[122] or in which no judicial authority exists, the question of appraisal rights remains open. It can be argued even in states with cooperative statutes which do reference the business corporation statute that the appraisal rights provisions of the business corporation statutes do not apply to cooperative mergers. Most state cooperative statutes which reference the business corporation law make it clear that only those provisions which are not inconsistent with the cooperative statute will apply.[123] A cooperative could argue that appraisal rights in cooperative mergers and consolidations are inconsistent with provisions of the cooperative incorporation statute. At least two compelling arguments to support this contention can be made.

Many cooperative incorporation statutes provide procedures for the merger and consolidation of cooperatives.[124] In these states, if the statutes do not provide for appraisal rights, it can be argued that the lack of statutory provision for appraisal rights was a

119. For a list of states which have cooperative incorporation statutes which refer to the business corporation statutes as being applicable to cooperatives if not inconsistent or if not otherwise provided, see *supra* note 19.

120. *See, e.g.*, 5047 Mich. Op. Att'y Gen. 495, 496 (1976) (general business corporation statutes apply to nonprofit corporations).

121. *See* Pearson v. Clam Falls Coop. Dairy Ass'n, 243 Wis. 369, ___, 10 N.W.2d 132, 134 (1943) (dissenting stockholders have no right to insist on being paid their patronage dividends in cash pursuant to consolidation).

122. At least three states and the District of Columbia have no specific statutory provisions concerning shareholder appraisal rights in a cooperative merger or consolidation and do not reference the business corporation laws. *See e.g.*, D.C. CODE ANN. §§ 29-1101 to -1147 (1981 & Supp. 1987); NEV. REV. STAT. §§ 81.002-660 (1985); N.D. CENT. CODE §§ 10-15-01 to -61 (1985 & Supp. 1987); OR. REV. STAT. §§ 62.005-865 (1985).

123. *See, e.g.*, ARK. STAT. ANN. § 77-1018 (1981). Section 77-1018 of the Arkansas Statutes Annotated provides as follows: "The provisions of the general corporation laws of this state, and all powers and rights thereunder, shall apply to the associations organized hereunder, except where such provisions are in conflict with or inconsistent with the express provisions of this act [§§77-101 to 1025]." *Id.* For a list of states which have cooperative incorporation statutes which refer to the business corporation statute as being applicable to cooperatives if not inconsistent or if not otherwise provided, see *supra* note 19.

124. *See, e.g.*, N.D. CENT. CODE §§ 10-15-41, - 42 (1985) (procedures for cooperative mergers and consolidations). For a list of states which have statutory provisions for mergers and consolidations of cooperatives, see *supra* note 5.

deliberate legislative omission and that the legislature determined that the shareholder's rights are adequately protected by other means, such as ratification.

Whether or not specific statutory procedures exist for mergers or consolidations, it can be further argued that since cooperatives are democratically controlled, a member of a cooperative already has more protection for his or her rights than a stockholder in a business corporation. Moreover, since membership and the transfer of stock in a cooperative is expressly conditioned on board of director approval in most cooperative incorporation statutes,[125] providing appraisal rights for stockholders would contradict this express statutory provision.[126] Finally, it can be argued that the rationale used to uphold the validity of requiring board of director approval for all transfers of interest, that any other rule would seriously impair the ability of the cooperative to continue in business, is equally applicable here.[127] The ability of the surviving cooperative or the newly formed cooperative to continue operation would be considerably hampered if members were allowed to use the event of a merger or consolidation to "cash out." Therefore, in the absence of specific statutory or judicial authority for appraisal rights, a strong argument can be made that other provisions of the cooperative incorporation statutes are inconsistent with appraisal rights and that the democractic nature of cooperatives provides adequate protection for members.

While a convincing argument can be made that no appraisal rights exist in cooperative mergers unless provided for by statute, in at least one cooperative merger, the court determined that

125. *See, e.g.*, MINN. STAT. § 308.06(2) (5) (1986) (shares of stock shall be transferable only with the approval of the board of directors of the association).

126. *See, e.g.*, MINN. STAT. § 308.06(2) (5) (1986). The right of a cooperative's board of directors to refuse the request of a member to repurchase his or her shares or to repay equity owed the member immediately upon the termination of the membership has been upheld by numerous courts. *See, e.g.*, Knox Nat'l Farm Loan Ass'n v. Phillips, 300 U.S. 194, 200-01 (1937) (association had no duty to retire member's shares upon member's request); Sanchez v. Grain Growers Ass'n, 126 Cal. App. 3d 675, 675, 179 Cal. Rptr. 459, 460 (1981) (same); Driscoll v. East-West Dairymen's Ass'n, 122 P.2d 379, 380-81 (Cal. Ct. App. 1942) (same); Massaro v. Tampa Better Milk Producers Co-op, 200 So. 211, 211 (Fla. 1941) (same); Claassen v. Farmers Grain Coop., 208 Kan. 129, ___, 490 P.2d 376, 380 (1971) (same); Richardson v. South Ky. Rural Elec. Coop., 566 S.W.2d 779, 782-83 (Ky. Ct. App. 1978) (same); Evanenko v. Farmers Union Elevator, 191 N.W.2d 258, 261 (N.D. 1971) (same). *But see* Souris River Tel. Mut. Aid Corp. v. Atkinson (*In re* Great Plains Royalty Corp.), 471 F.2d 1261, 1264 (8th Cir. 1973) (requiring cooperative to refund patronage capital to corporation which was a member of the cooporative). The court in *Great Plains* relied on the past practice of the cooperative in regularly redeeming the stock of deceased members to hold that to refuse payment to a bankrupt corporation was discrimination. *Id.* The applicability of the rationale of the court in *Great Plains* has been questioned. *See Richardson*, 566 S.W.2d at 783-84 (expressly refusing to follow the decision in *Great Plains*). It appears that the most the court's holding in *Great Plains* can be said to stand for is the proposition that all cooperative members must be treated equally. *See generally Great Plains*, 471 F.2d at 1261.

127. *See* Pearson v. Clam Falls Coop. Dairy Ass'n, 243 Wis. 369, ___, 10 N.W.2d 132, 134 (1943) (member of cooperative could inhibit the plan for consolidation if member of cooperative could insist on cash payment).

dissenting members were entitled to immediate payment of their equity credits.[128] In *Weise v. Land O'Lakes Creameries, Inc.*, [129] the Supreme Court of Iowa reasoned that in the absence of statutory provisions which allowed two cooperatives to merge, the transaction must be construed as a dissolution of one cooperative and a sale of its assets to the other cooperative.[130] The court concluded that members who requested compensation were entitled to payment of their equity upon dissolution of the cooperative.[131] The clear lesson of this holding is that the proposed form of the merger or consolidation must be carefully scrutinized pursuant to local law to prevent unanticipated results.

2. *Fairness Doctrine*

In addition to the safeguards of ratification and appraisal rights, stockholders have turned to the courts for relief from proposed mergers and consolidations. Stockholders have used the courts to sue for injunctions to prevent mergers or consolidations[132] or for damages once a merger or consolidation has occurred.[133] Violations of the securities laws are common complaints,[134] as are accusations of conflict of interest or unfairness.[135]

Ordinarily, the business judgment rule shields corporate directors' decisions from court scrutiny.[136] As with any other court created doctrine, interpretations vary and exceptions exist. The area of corporate mergers and consolidations is no exception.

There appear to be two reasons for the active role that many courts have taken in the area of corporate mergers and consolidations. First, the "fairness doctrine" has emerged as a

128. *See, e.g.*, Weise v. Land O' Lakes Creameries, Inc., 191 N.W.2d 619, 623 (Iowa 1971).
129. 191 N.W.2d 619 (Iowa 1971).
130. Weise v. Land O' Lakes Creameries, Inc., 191 N.W.2d 619, 623 (Iowa 1971).
131. *Id.*
132. *See, e.g.*, *id.* at 621 (shareholders sought to have plan of merger invalidated on grounds that proper notice of shareholder approval meeting was not given).
133. *See, e.g.*, Mills v. Electric Auto-Lite Co., 552 F.2d 1239, 1241 (7th Cir. 1977) (shareholders sought damages to compensate for reduced earning potential of their corporate holdings).
134. *See, e.g.*, Seaboard World Airlines, Inc. v. Tiger Int'l, Inc., 600 F.2d 355, 358 (2d Cir. 1979) (alleging fraud pursuant to Securities Exchange Act and rules and regulations); *Mills*, 552 F.2d at 1240 (alleging deception by lack of disclosure in violation of Securities Exchange Act of 1934); Harriman v. E. I. DuPont de Nemours & Co., 411 F. Supp. 133, 138-39 (D. Del. 1975) (alleging fraud, material misstatements and nondisclosures in violation of securities laws); Leighton v. American Tel. & Tel. Co., 397 F. Supp. 133, 135 (S.D.N.Y. 1975) (same).
135. *See, e.g.*, David J. Greene and Co. v. Dunhill Int'l, Inc., 249 A.2d 429-30 (Del. Ch. 1968) (alleging gross unfairness based on detriment of merger to minority shareholders).
136. Nathan & Shapiro, *Legal Standard of Fairness of Merger Terms Under Delaware Law*, 2 DEL. JOUR. CORP. L. 44, 44-45 (1977) (court will ordinarily not substitute its judgment for the boards of directors of the constituent corporations unless the terms of the merger are so patently unfair as to shock the conscience of the court). The business judgment rule presumes that the actions of the board of directors are reasonable and not to be second guessed after the fact in absence of fraud or gross negligence on the part of the board of directors. *See id.*

general exception to the business judgment rule and is applied in situations involving conflicts of interests.[137] This doctrine is invoked when one corporation in a merger controls or dominates the other corporation and there is potential for self-dealing in the transaction.[138] Secondly, courts in general have been less deferential to boards of directors and have taken a much more active role in regulating the affairs of corporations in all spheres of activity, not just mergers and consolidations. For whatever reason, this active review of corporate activities often results in a de novo review of the terms of the proposed or actual merger for their overall fairness.[139]

Courts looking to the fairness of the merger or consolidation have developed several different approaches. Among them is determining whether stockholders receive cash or securities which are at least the substantial equivalent in value of the stock they surrender,[140] whether the price paid for the acquired stock is within the range of prices its stockholders would have received if the corporation had been sold in its entirety to another unaffiliated purchaser,[141] and whether the gains to be achieved as a result of the merger or consolidation are being divided equitably.[142]

While there are no reported decisions applying the fairness doctrine to cooperative mergers or consolidations, it seems safe to assume that the concepts of fair dealing and fair value which the "fairness doctrine" embody are applicable to cooperative mergers and consolidations. Because a cooperative's stock is ordinarily not transferable without the permission of the cooperative's board of directors,[143] and each member has only one vote regardless of how many shares of stock are owned,[144] it is unlikely that problems of

137. *See, e.g.*, Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971) (intrinsic fairness test, not business judgment rule, applied in transaction involving parent and subsidiary corporation).

138. *See id.* Self-dealing would occur for example, when one corporation owns a controlling interest in another corporation and makes a decision that is advantageous to itself and detrimental to the other corporation's interests. *See id.*

139. *See, e.g.*, David J. Greene & Co. v. Dunhill Int'l, Inc., 249 A.2d 427, 431 (Del. Ch. 1968); *see also* Nathan & Shapiro, *supra* note 136, at 45 (court will examine de novo the terms of the merger of two corporations if one corporation dominates the other corporation).

140. *See, e.g.*, *Dunhill*, 249 A.2d at 432; *see also* Brudney & Chitelstein, *supra* note 113, at 307 (discussing standards of fairness imposed by courts in parent- subsidiary mergers).

141. *See, e.g.*, Bell v. Kirby Lumber Corp., 413 A.2d 137, 140 (Del. 1980) (applying standard of damages based upon an amount all shareholders would have received in a third party sale negotiated at arms length); *see also* Chazen, *Fairness from a Financial Point of View in Acquisitions of Public Companies: Is "Third-Party Sale Value" the Appropriate Standard?*, 36 BUS. LAW 1439, 1439 (1981) (discussing standard of fairness based on third party sales).

142. *See, e.g.*, Mills v. Electric Auto-Lite Co., 552 F.2d 1239, 1248 (7th Cir. 1977) (applying the sharing of gains test); *see also* Brudney & Chirelstein, *supra* note 113, at 310 (discussing cases suggesting a fairness standard based on a sharing of the gains resulting from the merger).

143. *See, e.g.*, MINN. STAT. § 308.06(2)(5)(1986) (shares of stock transferable only upon approval of the board of directors).

144. *See* T. WHITNEY, *supra* note 7, at 18 (member has one vote regardless of number of shares owned).

conflict of interest could arise which trigger the exception to the business judgment rule.[145] This does not mean, however, that courts would refuse to review the merger or consolidation if some other alternative for court jurisdiction exists.

3. *Abrogation of the Merger or Consolidation*

While court challenges to corporate mergers are common, there are only a few reported decisions challenging a cooperative merger or consolidation.[146] The only decision in which dissenting members were successful in preventing the merger or consolidation of the cooperative entirely is an old decision with unusual facts.[147]

The absence of reported court challenges to mergers is especially unusual in light of the large numbers of cooperative mergers that have been reported to the United States Department of Agriculture in the past ten years.[148] Because many state cooperative incorporation statutes are silent on the topic of merger or consolidation or have incomplete procedures, any proposed cooperative merger or consolidation must be carefully approached.[149] Throughout the initial planning stages, the ratification by the boards of directors and members, and the

145. A cooperative ordinarily cannot obtain a controlling interest in another cooperative by buying up the stock of that cooperative since a member has only one vote regardless of the number of shares owned. *See* WHITNEY, *supra* note 7, at 18. Thus, since the potential for self-dealing by a controlling interestholder is not present, the conflict of interest exception to the business judgment rule is not triggered. *See* David J. Greene & Co. v. Dunhill Int'l, Inc., 249 A.2d 427, 430-31 (Del. Ch. 1968) (when persons who control the making of transaction and fixing of the terms are on both sides, business judgment rule does not apply). In theory, however, such a conflict could be created in a triangular merger since the surviving corporation is usually the sole shareholder of its subsidiary. For a discussion of triangular mergers, see *supra* notes 27-32 and accompanying text.

146. *See, e.g.*, Weise v. Land O' Lakes Creameries, Inc., 191 N.W.2d 619, 621 (Iowa 1971) (dissenting members sought invalidation of merger based on improper notice of member approval meeting); Moore v. Hillsdale County Tel. Co., 171 Mich. 388, 399, 137 N.W. 241, 245 (1912) (court determined that merger was subject to approval by all voting members of the cooperative); Pearson v. Clam Falls Coop. Dairy Ass'n, 243 Wis. 369, ___, 10 N.W.2d 132, 133 (1943) (dissenting members sought abrogation of the merger based on lack of statutory authority for consolidations of cooperatives, but court determined that the statutory provisions for cooperative mergers were broad enough to include consolidation of cooperatives).

147. *See Moore*, 171 Mich. at 399, 137 N.W. at 245. In *Moore*, a village telephone cooperative joined with another telephone cooperative, notwithstanding the dissent of some of the village cooperative's members. *Id.* at 393-94, 137 N.W. at 243. The court determined that the joining of the cooperatives was not an actual merger but rather a dissolution and sale of the assets of the village cooperative. *Id.* at 399, 137 N.W. at 245. The court further determined that a dissolution requires approval by all of the members of the cooperative. *Id.* at 399, 137 N.W. at 245. The court concluded that all members did not approve of the dissolution and then ordered the abrogation of the joined cooperatives. *Id.* at 399, 137 N.W. at 245.

148. *See* Letter from Charles A. Kraenzle, Director of the Cooperative Management Division of the Agricultural Cooperative Service, to Kathryn J. Sedo (Aug. 13, 1984) (discussing Agricultural Cooperative Service statistics on cooperative mergers, consolidations, and liquidations during the period between 1976 through 1985). For a discussion of Agricultural Cooperative Service statistics on cooperative mergers, consolidations, and liquidations during the period between 1976 through 1985, see *supra* notes 1-3 and accompanying text.

149. For a list of states which have statutory provisions for mergers and consolidations, see *supra* note 5.

implementation of the terms of the merger or consolidation once approved, cooperatives would do well to ensure that their members are informed about the terms and that the terms are equitable. Fairness of terms and education of members in addition to careful judicial scrutiny and observance of state statutes will minimize court challenges and hopefully result in victory for the cooperative should such a challenge be mounted.

IV. CONCLUSION

Cooperative mergers and consolidations are one response to a distressed farm economy. If properly structured and explained to members, a merger or consolidation can result in the continued existence of cooperatives as an alternative economic model for farm producers.

The absence of provisions or incomplete procedures for mergers or consolidations in the cooperative incorporation statutes results in confusion and speculation about how cooperatives that wish to merge or consolidate must proceed. One can only counsel caution for those seeking to advise cooperatives in light of this state of affairs.

Because cooperatives are fundamentally different from regular business corporations, resorting to procedures and doctrines of law developed for mergers and consolidations of regular corporations is generally not useful. While the applicability of securities and antitrust laws to cooperatives must also be examined, special attention must be accorded to the provisions and case law that provide for different treatment for cooperatives.

Obviously the varying state statutes have an effect on the form the merger or consolidation will take. Other laws such as securities and antitrust laws must be considered. Similarly, the federal tax laws must be consulted to minimize their impact on any merger or consolidation. These laws must be considered in light of the needs and desires of the cooperatives and their members. While any merger or consolidation is complex, their utility insures that they will continue to occur.