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STATE COOPERATIVE STATUTES — CONFLICT OF COOPERATIVE CONCEPT WITH EFFICIENCY

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ABSTRACT

Cooperative statutory provisions that provide for democratic membership control provide limitations affecting the management of cooperatives. Management provisions concerning membership requirements for directors and officers, amendments to articles of incorporation, and removal of officers may unduly restrict the management of cooperatives and contribute to the poor economic performance of Northeastern cooperatives. Minor statutory changes, or changes of a cooperative's articles or bylaws, may help improve the performance of these business operations.

INTRODUCTION

The current economic recession has been accompanied by a marked decline in the economic well-being of our nation's one hundred largest cooperatives. In 1981 their net margins decreased forty-four percent with net losses nearly doubling (Davidson and Street). Cooperatives responded to these economic conditions with a forty-four percent decrease in distribution of earnings as patronage refunds and a decrease in refunds paid in cash (*id.*).

Several factors may have contributed to the decreased net margins of these cooperatives, including high interest rates, inflation, uncertain marketing conditions, declining farm prices, over-supplies of farm products, and decreased consumption of agricultural equipment and supplies. An analysis of these factors could offer some insightful findings which could assist cooperatives in initiating and developing appropriate responses to their specific economic problems. However, there may exist a more basic problem, the constraining provisions of the various state cooperative statutes. A review of some of the mandatory provisions of the statutes of the Northeastern states suggest that these statutes are overly restrictive. Is it possible that the very provisions which breathe life into cooperatives are also operating to choke their economic well-being?

This article identifies and discusses four different provisions concerning cooperative management of the various cooperative statutes of the Northeastern states that may be unnecessarily limiting the management alternatives available to cooperatives incorporated thereunder. It is argued that the concept of cooperation does not require the inclusion of these limitations in the cooperative statutes. In addition, some cooperatives may have articles or bylaws that unnecessarily limit cooperative management. Thus, there exists the possibility that the economic perfor-

ance of cooperatives may be strengthened through statutory or other changes.

SEPARATE COOPERATIVE STATUTES

The twelve Northeastern states have adopted sixteen different sets of legislative provisions providing for the formation of agricultural cooperatives. These cooperative statutes constitute a confusing and disjointed body of state law governing cooperatives. At least one statute, New York's Cooperative Corporation Law, appears to be well drafted. The provisions are within the spirit of the cooperative concept while at the same time responsive to current legal and economic conditions. The Connecticut and Massachusetts statutes are so brief that, for the most part, they are dependent on the consistent provisions of the corporation statutes which have been specifically incorporated as applying to the cooperatives formed thereunder. The remaining statutes have retained some idealistic cooperative provisions which may be contributing to cooperative inefficiency.

The diverse and divergent provisions of the cooperative statutes are in marked contrast to present day statutory provisions governing corporations and partnerships. The Model Business Corporation Code was laboriously developed by the Committee on Business Corporations of the Section of Corporations, Banking and Business Law of the American Bar Association in 1950. This model code, with its subsequent amendments, incorporated new and amended provisions in response to recent business developments. It constitutes a modern set of rules governing the rights, powers and activities of corporations and has been adopted, with modifications, by all of the individual states (Todd).

The partnership laws have also continued to evolve and incorporate new provisions in response to sundry judicial and legislative pronouncements. The Committee on Continuing Professional Education of the American Law Institute and the American Bar Association have been instrumental in reviewing and recommending new provisions concerning partnerships. Their reports have been made available throughout our nation and state legislatures have thereby had the benefit of the expertise of some preeminent legal minds when considering amendments to their partnership statutes.

No similar development or legal evolution has occurred for the cooperative enabling statutes. The cooperative statutes of the Northeastern states have evolved from statutory provision for cooperative groups adopted in the second half of the nineteenth century and from the model provisions championed by Aaron Shapiro in the 1920s (Cobia *et al.*, p. 117). Although a majority of the cooperative statutes have been markedly amended, state legislatures have not had the assistance of any model commission or scholarly group in the retooling of the statutes to serve

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farmer cooperatives better.

COOPERATIVE CONCEPT AND MANAGEMENT

The basic cooperative principle regarding cooperative management is democratic control; the cooperative is owned and controlled by its members (Abrahamsen). However, all of the Northeastern cooperative statutes recognize a severe limitation of this control. The statutes provide either that the affairs of the cooperative shall be managed by a board of directors or that the cooperative shall be managed by directors operating together as a board. Thus individual cooperative members do not directly control the business operations of their cooperative.

In an attempt to preserve membership control of their cooperative, various provisions concerning cooperative management have been incorporated into a majority of the Northeastern cooperative statutes. Four different management provisions that affect the economic performance of cooperatives may be contributing to inefficiency: director membership requirements, directors' control of amendments to articles of incorporation, officer membership requirements and officer removal requirements.

Director Membership Requirements

The directors of a cooperative are responsible for the management of the cooperative. This management function requires directors to perform definite functions while at the same time avoiding excessive participation in day to day management decisions (Louden; Lagges). A competent, experienced and effective board of directors can be an important factor in providing management direction and control which contributes to the economic success of the business enterprise. For small firms, directors may furnish know-how and expertise which the firm cannot afford to obtain through the employment of consultants (Jain; Stokes). For large firms, there is a need for directors with substantial operating experience (Lauenstein). Diversity may also be important in imparting additional expertise for the selection of a manager and for overseeing the firm's management direction (Ferguson and Dickinson).

Eight of the Northeastern cooperative statutes have a director membership requirement which precludes cooperatives from selecting as directors qualified individuals who are not members (Appendix 1). In addition, many cooperatives contain membership requirements in their articles or bylaws. Statutory or other membership requirements are not related to competency, experience or expertise but rather an idealistic belief that a cooperative should be controlled by its members. The inability of cooperative members to select the most qualified individuals as directors operates to hinder the quality of the cooperative's management. This in turn may adversely affect the economic performance of the cooperative.

The Pennsylvania Cooperative Agricultural Association Act requires all directors to be members. The Maine, Maryland and New Jersey statutes require all directors to be members of the

cooperative or representatives of a member association. The New Hampshire, New York, Vermont and West Virginia statutes have a membership requirement but also allow for one-fifth of the board to be appointed by a public official or other directors (Appendix 1).

Although some consideration should be given to the cooperative concept of membership control, it does not follow that complete control should be legislatively mandated (Greenough and Clapman). Membership control is an item that, within certain parameters, should be determined by each cooperative in its bylaws or articles of incorporation. The New Hampshire, New York, Vermont and West Virginia statutes recognize the membership control concept while at the same time allowing the cooperative to provide in its bylaws or articles for up to one-fifth of the directors to be nonmembers. These statutes thereby enable a cooperative to have qualified nonmembers on their boards of directors.

The major shortcoming of the statutes which allow for one-fifth of the directors to be nonmembers is the inability of the membership to elect the nonmember directors. All four statutes provide that a public official or the other directors shall select the nonmember directors. A more appropriate response might be to designate a number of directorship positions without membership qualifications with directors for these positions to be elected by the entire membership.

Director membership requirements of cooperatives which are not under a mandatory statutory provision should depend upon the nature of the cooperative. Recent authorities concerning corporations suggest that a board having a diverse background including some business or management expertise may be important in providing for better management (Firstenberg and Malkiel; Greenough and Clapman; Jain; Lagges). A cooperative that has a director membership qualification in its articles or bylaws may want to consider an amendment which would provide for nonmember directors.

Amendment of Articles

Cooperatives need to be able to amend their articles of incorporation to adjust to changing times and circumstances. The failure or inability of a cooperative to alter its articles may preclude the choices available to management which may contribute to inefficiency.

Four of the cooperative statutes have mandatory provisions requiring the approval of two-thirds of the directors before the cooperative's articles may be amended by the membership (Appendix 2). This supermajority requirement thereby constitutes an additional hurdle which must be cleared before a cooperative may amend its articles. Such a requirement impedes the ability of a cooperative to make desirable and necessary changes of its articles which may contribute to inefficient business operations or practices. It is not clear that such a requirement needs to be legislatively imposed upon a cooperative. If a cooperative desires the supermajority consent of its directors for changes of its articles, it can provide for such in its articles.

Officer Membership Requirements

The board of directors should be able to select the most qualified individuals available as officers of the cooperative. Eight of the Northeastern cooperative statutes prevent directors from choosing the best candidates for officer positions (Appendix 3). The Pennsylvania Cooperative Agricultural Association Act has a membership requirement for the president and one vice-president. The New York statute requires the president and one vice-president to be members, or a member of a member corporation, and directors. The Maine, Maryland, and New Jersey statutes require the president and at least one vice-president to be members and directors. The New Hampshire, Vermont, and West Virginia statutes require the two main cooperative officers to be directors, but since up to one-fifth of their directors may be nonmembers, it would be possible for these officers to be nonmembers.

These officer membership requirements suffer an infirmity of a similar nature to the director membership requirement. It is unclear that the cooperative concept requires a legislative membership limitation regarding the offices of president and one vice-president. This requirement is one that might better be left for cooperatives to incorporate in their articles of incorporation or bylaws.

At the same time, cooperatives that are not incorporated under a statute containing an officer membership requirement may have such requirements in their articles or bylaws. These provisions should be analyzed to determine whether they are necessary and whether they are desirable.

Officer Removal Provisions

Officers and directors have different responsibilities; directors report to the membership while officers are accountable to the board of directors. Two Northeastern cooperative statutes legislate the same removal provisions for officers as for directors and thereby fail to reflect these differences in accountability (Appendix 4).

The New Jersey statute allows two-thirds of the directors to remove a member, director or officer for cause. The two requirements of supermajority and cause severely limit the board's ability and flexibility in removing officers. This limitation may adversely affect the management and efficiency of the cooperative.

The West Virginia statute allows a member to bring charges against an officer or director together with a petition signed by five percent of the membership. It may be concluded that this statutory provision presumes that officers and directors are accountable to the membership. This is only true for directors. Thereby the West Virginia provision fails to provide the board of directors with any authority to remove officers.

Effective and efficient cooperative management is dependent upon the board's authority to control the management of the cooperative. The New Jersey and West Virginia statutes, by limiting the board's ability to remove officers, may prevent a board from taking appropriate action to provide for better management.

RECOMMENDATIONS

Cooperative enabling statutes should safeguard the principles of cooperativism. At the same time, however, some of the ideals and democratic principles of cooperativism embodied in state cooperative statutes may be impeding, eroding or destroying the competitive advantage to be achieved through cooperation. Cooperative principles should be reexamined in view of current economic realities and practices to determine whether some minor adjustments might strengthen the economic performance of cooperatives.

The statutory provisions concerning director membership requirements, directors' control of amendments to articles of incorporation, officer membership requirements, and officer removal requirements have been identified as four items concerning cooperative management that may overly restrict the operations of Northeastern cooperatives. It is suggested that the amendment or repeal of these provisions would not seriously detract from the concept of cooperation but would facilitate more efficient and effective cooperative management.

In addition, any cooperative that has chosen to incorporate any of these limitations in its articles and bylaws even though they are not mandated by statute should analyze the possibility of amending these limitations. Although the members of a cooperative should be able to control their business, it does not follow that this control must exclude others. The removal of limitations that exclude qualified persons from serving as directors and officers would also facilitate better cooperative management which could contribute to more efficient performance.

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APPENDIX 1: Statutory Provisions Restricting Selection of Directors

Maine -- Uniform Agricultural Association Act

"The business of the association shall be managed by a board of not less than 3 directors. The directors shall be members of the association or officers, general managers, directors or members of a member association..."

Maryland -- Cooperatives

"Every cooperative shall have at least five directors, at least two of whom are residents of the State and each of whom is a member of the cooperative or of a member cooperative."

New Hampshire -- Cooperative Marketing and Rural Electrification Associations

"The business of the association shall be managed by a board of not less than 5 directors, elected by the members or stockholders from their own number."

"The bylaws may provide that one or more directors may be appointed by any public official or commission or by the other directors... Such directors shall not number more than one-fifth of the entire board."

New Jersey -- Agricultural Co-operative Associations

"The board of directors of an association shall consist of not less than 3 persons and the directors shall be members of the association or individual representatives of corporate members thereof."

New York -- Cooperative Corporations Law

"[T]he members shall elect from among themselves a director or directors of the first class for a term of one year; and of the third class for a term of three years."

"[O]ne or more directors may be appointed by any public official or commission or by the other directors ... [and] need not be members of the corporation; and shall not constitute more than one-fifth of the entire number of directors."

Pennsylvania -- Cooperative Agricultural Association Act

"All directors shall be members."

Vermont -- Cooperatives

"The business of the association shall be managed by a board of not less than five directors, elected by the members or stockholders from their own number."

"The bylaws may provide that one or more directors may be appointed by any public official or commission or by the other directors ... Such directors shall not number more than one-fifth of the entire board."

West Virginia -- Cooperative Associations

"The affairs of the association shall be managed by a board of not less than five directors, elected by the members or stockholders from their own number ... The bylaws may provide that one or more directors may be appointed by any public official or commission or by the other directors ... Such directors shall not number more than one-fifth of the entire board."

APPENDIX 2. Supermajority Requirement for Amendment of Articles

New Jersey -- Agricultural Co-operative Associations

"The certificate of incorporation may be amended by the affirmative vote of a majority of the members or delegates ... if the amendment has first been approved by a 2/3 vote of the directors present and acting at a duly constituted meeting..."

Rhode Island -- Producers' Cooperatives

"The articles of association of any association formed hereunder may be changed or amended. Any such change must first be approved by two-thirds (2/3) of the directors ..."

Vermont -- Cooperatives

"An amendment [of the certificate of organization] must first be approved by two-thirds of the directors ..."

West Virginia -- Cooperative Associations

"An amendment [of the articles of incorporation] must first be approved by two-thirds of the directors ..."

APPENDIX 3. Statutory Provisions Restricting Selection of Officers

Maine -- Uniform Agricultural Association Act

"The president and at least one of the vice-presidents must be members and directors, but a vice-president who is not a director cannot succeed to or fill the office of president ..."

Maryland -- Cooperatives

"The president and vice-president shall be elected from among the directors."

New Hampshire -- Cooperative Marketing and Rural Electrification Associations

"The directors shall elect from their number a president and one or more vice-presidents."

New Jersey -- Agricultural Co-operative Associations

"The president and vice president shall be appointed from among the directors."

New York -- Cooperative Corporation Law

"The president and a first vice-president shall be members of the corporation or of a member corporation, and shall be elected from among the directors."

Pennsylvania -- Cooperative Agricultural Association Act

"The president and at least one of the vice presidents must be members."

Vermont -- Cooperatives

"The directors shall elect from their number a president and one or more vice-presidents."

West Virginia -- Cooperative Associations

"The director shall elect from their number a president and one or more vice-presidents."

APPENDIX 4. Statutory Provisions Restricting Removal of Officers

New Jersey -- Agricultural Co-operative Associations

"A member, director or officer who is also a director of the association may, for cause, be expelled from membership or removed from office, by vote of not less than 2/3 of the directors ..."

West Virginia -- Cooperative Associations

"Any member may bring charges against an officer or director by filing them in writing with the secretary of the association, together with a petition signed by five percent of the members, requesting the removal of the officer or director in question. The removal shall be ... by a vote of a majority of the members ..."