Chapter II

Cooperatives

I. Nature

In order to understand the statutory provisions in relation to cooperatives, it is desirable to make a cursory examination of the general characteristics of such organizations. In general, controversial policy considerations will not be pursued. The cooperative status in relation to antitrust and price fixing laws is beyond the scope of this study.1 The taxation problem is only briefly referred to in order to highlight cooperative theory and practice.

Distribution of earnings. A cooperative is essentially a business enterprise much like other enterprises but differing primarily in underlying theory and in certain functional practices. The most outstanding feature distinguishing cooperatives from other business units, and perhaps

the only prerequisite of cooperative status, is the method of distributing "earnings." Instead of a return to the investors in the form of profits or dividends, the surpluses accruing to the cooperative at the end of an accounting period are returned to the patron-members of the organization on the basis of the amount of business transacted with the cooperative. The fundamental theory of this method of distribution is that the cooperative is conduct-

Although this is believed substantially true so far as the question of cooperative status alone is considered, it may not be a sufficient difference for all considerations. In Frost v. Corporation Commission of Okla., 278 U. S. 515, 49 S. Ct. 235 (1929), the Supreme Court held that this feature was itself not a sufficient basis for distinguishing a cooperative from other corporations and individuals, and at the same time indicated that a non-stock cooperative formed under a different act could validly be held subject to different treatment. At p. 524, the Court said: "A corporation organized under the Act of 1919, however, has capital stock, which, up to a certain amount, may be subscribed for by any person, firm, or corporation; is allowed to do business for others; to make profits and declare dividends, not exceeding eight per cent per annum; and to apportion the remainder of its earnings among its members ratably upon the amount of products sold by them to the corporation. Such a corporation is in no sense a mutual corporation."

In the same case, Justice Brandeis, dissenting, said: "That no one plan of organization is to be labeled as truly co-operative to the exclusion of others was recognized by Congress in connection with co-operative banks and building and loan associations." (Frost v. Corp. Comm., supra at 546).

As to the characteristics and requirements of cooperatives, see generally: Hulbert, LEGAL PHASES OF COOPERATIVE ASSOCIATIONS 2-3 (1941); Packel, op. cit. supra n. 1 at 3-4; Bakken, "Principles and their Role in the Statutes Relating to Cooperatives," 1954 Wis. L. Rev. 549 (1954); Bunn, op. cit. supra n. 1 at 165-166; Hanna, "Cooperative Associations and the Public," 29 Mich. L. Rev. 148, 149 (1930); Rumble, "Cooperatives and Income Taxes," 13 Law & Contemp. Prob. 534, 536 (1948); and "Big Business Without Profit," FORTUNE MAGAZINE, Aug. 1945, 153, 155.

As to the Michigan statutory requirements, see text preceding note 37 infra.
ing at cost the performed services, and hence there are no profits but only savings to the members.

In addition to the return to the members on the basis of patronage, the cooperative is generally permitted to return a limited fixed amount to the investors in the enterprise. This amount would seldom exceed eight per cent and usually would be somewhat lower. In the case of cooperatives organized on a stock plan basis, this return would closely resemble preferred dividends. If the cooperative were organized by the issuance of membership certificates, the return might be considered interest.

The returns to the members on the basis of patronage is accomplished by patronage dividends. In practice, the cooperative usually deals with its members on the basis of current prices rather than attempting at the moment to ascertain its exact cost of operations. Thus, at the end of a year or any other accounting period, the cooperative should have in its treasury some surplus funds derived from its commercial activities. These funds are then distributed by the officers of the enterprise. Without becoming involved in the controversy as to whether or not these funds are "profits," the problem confronting the cooperative is not dissimilar to that confronting the profit corporation in relation to its surplus. The directors may set aside certain reserves for contingencies. They will probably pay in cash the limited dividend authorized to be paid investment capital if in the particular cooperative such payments are authorized. They may then return the balance to the members in cash on the basis of patronage. They may decide to keep some or all of the balance in the business, in which case they may issue certificates of indebtedness or certificates of beneficial ownership to the member-

* See generally references in note 2 supra.
patrons. If the cooperative deals commercially with both members and nonmembers, there is the further problem of whether or not such patronage dividends should be paid to the nonmembers. Either decision is consistent with cooperative theory, but the contingency will usually be controlled by provisions in the statutes, articles of association, or by-laws.

Organization. The cooperative may be organized in much the same manner as any other business unit, the particular manner of association generally having no special significance on whether or not it is cooperative. The cooperative may incorporate and conduct its affairs much the same as any other corporation and be subject to essentially the same rules governing the conduct of corporations. It may organize as an unincorporated society and thus be subject to the rules and regulations of similar unincorporated societies. It conceivably could organize as a business trust, but in practice this type of organization is not greatly utilized. The mode of organization is not determinative of whether or not it issues stock. Thus, a cooperative corporation may be organized on a stock or non-stock basis. If stock is not issued, then certificates of membership


5 This statement is true insofar as it relates to the general question of the manner of organizing the cooperative, as, for example, whether to incorporate or not. As to the details of operation, the statement is probably too general. See, for example, Frost v. Corp. Comm. of Okla., supra n. 2. See generally the references cited in n. 2 supra.

The parties must, however, submit to the burdens as well as enjoy the benefits which inhere in the method or organization adopted. Schaffer v. Eighty One Hundred Jefferson Avenue East Corp., 267 Mich. 437, 255 N.W. 324 (1934).
or certificates of ownership may be issued instead. The use of stock or membership certificates as such is probably not of as great significance as the over-all structure of organization setting forth the rights and duties of the parties.

In a similar manner the particular mode of organization is not, except in a broad sense, determinative of the possible relations with other business enterprises. The cooperative may affiliate, cooperate, or combine with other units in a manner similar to that of business organizations generally. Of course, the corporate device and holding company technique are especially convenient for intercompany relations, and it is the corporate cooperative that is the chief object of our study.⁶

Relationship with members. The cooperative as distinguished from the ordinary business enterprise is organized primarily to do business with and for its members. The relationship of the members to the cooperative is somewhat unique and different from the relationship between a member and the organization of a non-cooperative enterprise. At the outset, however, it is apparent that the patron-members and the cooperative have a choice of several possibilities in the selection of this relationship. They can, for example, treat the cooperative as the agent of the members or as an independent contractor. This choice is available regardless of the type of activity carried on by the cooperative, but for purposes of illustration a marketing cooperative alone will be considered. If the agency relationship is adopted, then the cooperative acts only as the selling agent of the member who delivers products for sale. Title remains in the patron-member until

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the resale by the cooperative, irrespective of the fact that a substantial advance of the price may be made to the patron-member at the time of delivery to the cooperative, and the other rules of agency generally apply. If the cooperative is treated as an independent contractor, the usual incidents of a sale normally result upon delivery of the products to the cooperative. In this instance it generally is immaterial that the exact selling price is not determined at the time of delivery to the cooperative, but is, in effect, "kept open" for final adjustment until a resale by the cooperative or until the end of some accounting period.

Some doubt has been raised as to whether in the case of a technical sale to the cooperative the relationship is not really that of agency or trust, and contra, doubt can be raised whether in the case of technical agency, the relationship is not really that of a sale. Further study of this matter is available elsewhere⁷ and need not be elaborated here. It might be observed, however, that it is not entirely illogical and inconsistent with legal treatment to denominate a relationship as belonging in one category for certain purposes and in another for other purposes. Thus, it might be desirable to classify the relationship as that of agency to determine whether or not the cooperative makes a profit.

and, at the same time, classify it as a purchase and sale to
determine whether the cooperative has such beneficial
ownership of the commodities as to subject them to lia­
bility of attachment for debts of the organization.

Voting. The members of a cooperative are usually en­
titled to only one vote per person, irrespective of the num­
ber of shares owned in the enterprise. Thus, all members
have an equal voice in the management of the business,
and, theoretically, minority control by substantial inves­
tors is more difficult. However, it is also common practice
for cooperatives to limit the number of shares that a mem­
ber may own, thus making it desirable, if not mandatory,
to secure a large number of members and diversification
of ownership. Hence, if voter apathy exists in such cooper­
atives in a manner similar to its existence among ordinary
profit corporations, it may be equally easy for an organized
minority to acquire factual control. Hence, differences
in fact may not be as great as differences in theory. This
might be partly offset, however, by the rather common
device of limitations upon the transfer of membership,
which could tend to restrict membership to those who are
actively interested.

Taxation. The taxation problem is briefly mentioned
here to complete the cooperative picture and to focus at­

8 See generally citations in n. 2 supra.
9 Starr, "The Effects of Cooperation on the Profit Economy," 13 Law
& Contemp. Prob. 431, 435 (1948); note, "Development and Significance
of Agricultural Cooperatives in the American Economy," 27 Ind. L. J.
353, 368 (1952). But see Brandeis' dissent in Frost v. Corp. Comm. of
Okla., supra n. 2, wherein he states: "Their sin is economic democracy
on lines of liberty, equality and fraternity. To accomplish these objec­
tives, both types of cooperative corporations provide for excluding capi­
talist control. As means to this end, both provide for restriction of voting
privileges, for curtailment of return on capital and for distribution of
gains or savings through patronage dividends or equivalent devices.” 278
tention on the relation of fundamental cooperative theo-
ries to at least one significant political-economic-legal
problem. As a general rule, it can be stated with sufficient
accuracy that cooperatives are subject to most of the usual
property, sales, and other taxes in much the same manner
as any other business. It is in the field of income tax that
the cooperative's status is unique.

There are in reality two separate aspects of the income
tax problem—one is tax exemption and the other is tax
applicability. The exemption problem will be considered
first. Certain agricultural cooperatives are exempted from
all income taxes whatsoever. The requirements for exemp-
tion are set forth in the statute, and are rather onerous, so
that not all of the farmers' cooperatives take advantage
of the exemption. The exemption is not granted auto-
matically; the cooperative must apply for and receive a
letter of exemption from the Treasury Department. In
order to qualify for such exemption, the agricultural co-
operative must, among other things, do at least half of its
business with its members, return all of its receipts in ex-
cess of costs to the patrons, must not discriminate between
members and nonmembers in case there are dealings with
nonmembers, and, if organized on a stock basis, must not
pay more than the legal rate of interest in the state of in-
corporation or eight per cent, whichever is higher. Tax
exemption is primarily a question of legislative policy and
is a competent subject for Congressional determination.

More controversial, and perhaps more significant in re-

10 In Michigan a distinction is made between profit and nonprofit
corporations in regard to franchise taxes. See n. 45 infra and text follow-
ing n. 45.
12 Ibid. See generally note, 8 A.L.R. (2d) 927, 929–943 (1949), and refer-
ences cited in n. 16 infra.
spect to the total revenues involved, the effect on the business economy, and also on the intensity of the feelings engendered, is the problem of taxing as income to the cooperatives the sums returned to the members as patronage dividends. The present practice, which is specifically applicable to farmers' cooperatives by statute, is to exclude from gross revenues of the cooperative the sums which it is obligated by statutes, by-laws, or charter provisions to return to the patron-members. Generally, if revenues are derived from transactions with patrons to whom there is no pre-existing obligation to return such revenues, there is a profit in the usual sense and the cooperative is subject to the income tax to that extent. Whether the patronage dividends are returned in the form of cash or in certificates of one kind or another seems to be immaterial, the primary test being whether the cooperative is obligated to return those funds to the patron-members.

The controversial issue in this whole question depends upon the status as profits of these surplus funds which are returned as patronage dividends. The gist of the cooperative theory is that these funds are not profits but are either additional revenues withheld by the organization at the time of the sale of the members' products, or are savings withheld from the members at the time of purchase of products by the members. These additional revenues were retained, according to this theory, because of the impossibility of determining in advance the exact cost

14 See generally references in n. 15 infra. But in Fountain City Cooperative Creamery Ass'n v. Comm'r. Int. Rev., 172 F. (2d) 666 (7th Cir. 1949), patronage refunds were held taxable. See note, 97 U. of PA. L. Rev. 908 (1949).
15 See generally note, 8 A.L.R. (2d) 927, 943 et seq. (1949), and references cited in n. 16 infra.
of operation and are in reality the revenues of the members, the obligatory nature of refunding to the patrons making it clear that the cooperative is operating at cost and without a profit. Of course, no corporation is required to pay an income tax if it did not make a profit.

The opponents of cooperative theory, however, argue that cooperative practices of doing business at current prices and accumulating surpluses are so similar to the general practices of ordinary business that these funds are in fact, if not in theory, so impressed with the nature of profits that they should be taxed as such. They further contend that not so to treat them gives the cooperative an unfair advantage over its business rivals. The merits of this controversy are explored by the combatants elsewhere\(^{16}\) and need not be elaborated here.

II. HISTORY OF MICHIGAN COOPERATIVE STATUTES

The early cooperative statutes were general in nature but limited in scope. Before 1913, for example, statutes were passed providing for the incorporation of coopera-

tive booming and rafting companies,\textsuperscript{17} mechanics' and laboring men's associations,\textsuperscript{18} mutual benefit societies,\textsuperscript{19} savings associations,\textsuperscript{20} associations of growers of mint and other essential oil plants,\textsuperscript{21} and associations to promote the selling and distribution of fruit and other farm products.\textsuperscript{22} In 1913 a rather general cooperative corporation act was passed authorizing incorporation on the cooperative plan for the purpose of "conducting any agricultural, dairy, mercantile, manufacturing, or mechanical business"\textsuperscript{23} within the state. This was followed in 1917\textsuperscript{24} by


another act providing for the incorporation of the same type of cooperatives but with somewhat different provisions. The 1917 Act did not repeal the 1913 Act.

The General Corporation Act of 1921\textsuperscript{25} repealed the Acts of 1913 and 1917\textsuperscript{26} along with others and devoted a chapter to cooperatives.\textsuperscript{27} Many of the provisions of the 1913 and 1917 Acts were incorporated into the 1921 Act. Provisions were made for two types of cooperatives: (1) cooperatives for "any lawful business"; and (2) cooperatives for carrying on any "agricultural, dairy, mercantile, manufacturing or mechanical business." These latter types of cooperatives were given the option of adopting the provisions of subdivision 3, which were on the whole more rigid that the provisions applying to the first category.

The General Corporation Act of 1931\textsuperscript{28} substantially adopted the cooperative provisions of the 1921 Act. Incorporation of cooperatives for any lawful business was authorized, and the optional provisions applicable to "agricultural, dairy, mercantile, mining, manufacturing or mechanical business" were retained. Since 1931 several amendments have been made. The cooperative corporation has been more specifically defined;\textsuperscript{29} such corporations have been classified as profit and nonprofit for purposes of making reports and paying taxes to the state;\textsuperscript{30}


\textsuperscript{27} Mich. Pub. Acts 1921, No. 84, Pt. 2, c. 4; Mich. Comp. Laws 1929, secs. 10027 \textit{et seq}.


provision has been added imposing liability on persons for inducing a breach of contract with an agricultural cooperative;\textsuperscript{31} and the optional provisions mentioned above\textsuperscript{32} have been repealed.\textsuperscript{33} The provisions of the present Act will now be examined in more detail.

III. INTEGRATION WITH OTHER PROVISIONS OF THE GENERAL ACT OF MICHIGAN

The minimum requirements for a corporation to be classified as a cooperative under the Michigan statute do not vary materially from those set forth in the general discussion of cooperatives. Section 98\textsuperscript{34} of the Act,\textsuperscript{35} for example, sets forth as absolute requirements that dividends on stock or membership certificates be limited to not more than seven per cent and that not more than fifty per cent of the business be conducted with nonmembers. Section 99\textsuperscript{36} defines cooperative plan as a "mode of operation where the earnings of the corporation are distributed on the basis of, or in proportion to, the value of property bought from or sold to shareholders and/or members or other persons, or labor performed for, or services rendered to, or by the corporation." This, in short, is a requirement that the earnings be distributed on the basis of patronage with allowances made, however, for the payment of limited dividends and the retention of reserves. Thus, the

\textsuperscript{32} Refers to the optional provisions of the 1921 Act. See text supra p. 21.
\textsuperscript{34} Mich. Comp. Laws sec. 450.98 (1948).
\textsuperscript{35} \textit{i.e.}, the present General Corporation Act. In this section references to statute collections only are cited. Significant Public Acts have already been cited and can easily be obtained from the statute collections.
three requirements of limited dividends, if any, restricted operation in regard to nonmembers, and distribution of earnings on a patronage basis are the only absolute requirements of a cooperative. In addition to the absolute requirements, the Act specifically mentions certain optional provisions, such as per capita instead of stock voting, and gives the members considerable freedom in setting up their organization.

It is provided that unless otherwise specified the General Act will govern cooperatives as to the manner of corporate management, distribution of earnings, powers, and optional principles of doing business. It is thus seen that a large portion of the questions concerning this type of enterprise, such as, for example, the authority of agents, powers of the organization, and commercial questions in general can be answered by resort to general principles of corporation law without the necessity of inquiring into the peculiarities of cooperatives. By and large, the eleven sections of the General Act relating to cooperatives are provisions specifically applicable to such organizations and at variance with the statutes relating to regular commercial corporations.

It is expressly provided that the cooperative may engage in any lawful business. This provision seems especially desirable in that it clarifies the status of nonagricultural cooperatives and makes plain the authority of such organizations. Although all of the states have statutes permitting

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38 Ibid.
the incorporation of some kinds of cooperatives, not all states expressly authorize the incorporation of cooperatives for any lawful purpose. This makes for uncertainty at the outset in those jurisdictions as to the validity of a cooperative corporation for a purpose not within the express terms of the statute. The general nonprofit corporation statutes providing for incorporation of social groups seem hardly applicable for incorporation of business cooperatives, and, on the other hand, use of the profit corporation statutes seems a little inconsistent with the basic cooperative theory of operating not for profit. The Michigan Act further provides that only corporations organized under the cooperative provisions are entitled to use the word "cooperative" in their name, and although the statute does not expressly so provide, the use of the term in the corporation's name may be obligatory, as the Attorney General has concluded.

Classification. Cooperatives under the Michigan Act are classified as profit and nonprofit for the purposes of

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42 Packel, Organization and Operation of Cooperatives 46 (1947).

Some doubt on the present applicability of this distinction may arise as a result of Mich. Pub. Acts 1954, No. 144, amending Mich. Comp. Laws sec. 450.303 (1948). The same ambiguity was present in the previous amendment effected by Mich. Pub. Acts 1952, No. 183. This amendment, dealing with the franchise fee for profit corporations, begins: "Every cooperative corporation and every domestic corporation hereafter organized for profit . . . ." Although the word "profit" is not specifically used with "cooperative corporation," it is believed that this tax statute applies only to such cooperatives as are classified as profit corporations. The principle of eadem generis leads to this conclusion, namely, that the phrase "organized for profit" modifies both "cooperative corporation" and "domestic corporation." Furthermore, to hold otherwise would
paying fees and privilege taxes to the state. Under the classification set forth, a cooperative is classified as a profit corporation for these purposes if it pays limited dividends upon its stock or membership investment or if it discriminates between members and nonmembers in the distribution of its earnings. Note that either one of these provisions will result in the classification as a profit corporation. On the other hand, to classify as a nonprofit corporation, the cooperative must meet both of the following tests: (1) pay no dividends upon stock or membership investment, and (2) distribute all earnings or provide for the allocation of such earnings to members and nonmembers doing business with the corporation. It is to be noted that, although the statute does not say the distribution between members and nonmembers must be on the same basis in order to qualify as a nonprofit corporation, this necessarily must follow since it is also provided that, if the distribution is not on the same basis, the corporation is deemed a profit corporation. It is to be noted that the classification is for the purpose of making reports and paying taxes and fees and does not necessarily control other questions involving the problem of whether or not a corporation is organized for profit. At this point, it may be interesting to note that the filing fee for both profit and nonprofit corporations is two dollars per year, but the nonprofit corporations have no other fees or privilege taxes to pay, whereas profit corporations must pay an annual franchise tax. In general, the organization fee of the nonprofit cor-

result in repeal by implication of the second paragraph of Mich. Comp. Laws sec. 450.98 (1948). Statutes are generally construed so as to give effect to all provisions.

poration is just ten dollars,\(^{47}\) while the organization fee of the profit corporation is one half mill upon the authorized capital stock.\(^{48}\) The annual privilege tax for the profit corporation is four mills upon each dollar of its paid up capital and surplus but not less than ten dollars.\(^{49}\) In addition, there are other provisions for particular types of corporations.\(^{50}\)

**Earnings.** In addition to the previously mentioned requirement that the bulk of earnings must be distributed on a patronage basis,\(^{51}\) the statute expressly provides that a portion of the earnings may be reserved for future distribution.\(^{52}\) However, where this is done, there is a further requirement that the reserved earnings must be allocated or a means provided for such allocation before there can be a general distribution of earnings.\(^{53}\) This would seem to require that, before any patronage dividends in cash could be distributed, there would have to be issued participating certificates, notes, certificates of indebtedness,

\(^{47}\) Mich. Comp. Laws sec. 450.302 (1948). It will be noted that this section provides for an annual privilege fee of ten dollars. However, section 81 of the General Act (supra n. 46), as amended in 1953 (Mich. Pub. Acts 1953, No. 6), sets the annual fee at two dollars and voids contrary provisions in other statutes. As nothing is said about the organization fee in section 81, undoubtedly the ten dollar fee provided for in this section is still in effect.


\(^{51}\) See text supra p. 22.


\(^{53}\) Ibid.
or some other evidence of an interest in any reserved earnings to those entitled to such earnings. If the actual certificates were not issued at once, the plan of issuing them would have to be decided upon before there could be a general distribution of earnings. This requirement differs, of course, from the procedure in the ordinary profit corporation. In such an organization the directors have powers of wide discretion in transferring available earnings to reserve and surplus accounts to be carried there more or less indefinitely until they deem it desirable to declare a dividend to the stockholders of record at some future time. The reason for the compulsory allocation of the reserves in the cooperative, however, is not obscure. The cooperative theory being that earnings so called should accrue to those who did business with the enterprise and thus made the earnings possible, it is manifestly proper that those whose business gave rise to the earnings should be assured of them. This makes it necessary for their share to be ascertained promptly, and the statute simply requires that this be done, at the same time permitting the organization to postpone the actual cash payment to some future date. The amount of the earnings that may be reserved is not limited.

Revolving fund. The reserve fund prompts a discussion of the revolving fund method of financing coop-

54 Of course, the court is not without power to police abuses of discretion. The classic example of a court compelling the declaration of a dividend is Dodge v. Ford Motor Co., 204 Mich. 459, 170 N.W. 668 (1919). See generally, Fletcher, Corporations, sec. 5325 (1951).

eratives. Briefly stated, the revolving fund is a device whereby the bulk of the capital of the enterprise will be contributed by those members who most actively make use of the cooperative facilities. At the same time, it provides a mechanism for the gradual withdrawal of those members who cease to patronize the organization. It can be adapted to any type of cooperative corporation, but care must be used in setting up any particular revolving fund so as not only to avoid various legal pitfalls but also to circumvent many practical difficulties. 56

In essence, the plan envisions withholding from the members a certain percentage of the "earnings." These withholdings are then credited to a fund which is used in the operation of the business. Generally, certificates of some sort may and should be issued to the patrons to evidence their interest in this fund, although such procedure is not absolutely necessary if detailed and accurate bookkeeping methods are followed. When the fund has been built up to the desired level, further withholdings are used to maintain it at that point while the earlier withholdings are returned to the patrons, or, in other words, the oldest certificates, if such were issued, are retired in chronological order while the new certificates furnish the necessary capital. Thus, a flexible capital structure is achieved and contributions are made in accordance with service rendered by the enterprise in harmony with cooperative theory.

Reference has been made to legal and practical diffi-

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56 See generally: Eidam, op. cit. supra n. 55; Jensen, op. cit. supra n. 55; and Nieman, op. cit. supra n. 55.
cultures in setting up such a plan.\footnote{Supra p. 28.} Without detailing these difficulties, which are discussed elsewhere,\footnote{References cited in n. 56 supra.} a few of them will be pointed out by way of illustration. If the members' interest in this fund is made in the nature of a debt with fixed maturity dates, the cooperative may be compelled to pay out large sums of money at times when it would be most embarrassing and disadvantageous to do so. Likewise, there would at times arise problems of conflicting preference claims between members and third party creditors. Perhaps an equitable and desirable arrangement would be to make the members' claims junior to those of third party creditors, and also to make them payable at some distant future date, but at the same time reserving to the directors an option to pay them sooner. Such a hybrid interest as that suggested may, as in the case of many hybrid securities, give rise to considerable litigation if the rights of the parties are not sufficiently and definitely set out and if creditors' rights are not amply protected.

Other legal difficulties may likewise be encountered. If the stock itself is revolved there immediately arises the question of the corporation's power to redeem or purchase its own stock.\footnote{Problems herein mentioned and others are discussed in Nieman, \textit{op. cit. supra} n. 55. In Michigan the right of a corporation to purchase and redeem its own stock is recognized and regulated by statute. Mich. Comp. Laws sec. 450.10 (1948), as amended by Mich. Pub. Acts 1953, No. 156, and Mich. Comp. Laws sec. 450.37 (1948).} In cases of agricultural cooperatives, voting rights must be considered if the organization seeks income tax exemption\footnote{Int. Rev. Code sec. 521 (1954). This provision requires that substantially all of the voting stock be owned by producer members to entitle the cooperative to such exemption.} or borrowing privileges from banks for
cooperatives. Some of these difficulties could in part be offset by issuing two types of stock and revolving only the preferred or nonvoting stock. Corporate statutes generally provide for the method of changing the capital structure and in some instances may cause difficulty. However, as long as the capital stock or stated capital is not reduced but maintained at the designated level, there would seem to be no policy which should prohibit revolving the stock.

In the light of this general discussion, the possibility of adopting a revolving capital fund under the Michigan statutes will now be considered. There is no express statutory authorization of such a plan as there is in Iowa. However, the authorization of the reserve fund which prompted this discussion suggests the possibility that it be used for this purpose. It will be recalled that there is no limitation upon the amount of earnings that can be reserved. In the case of the profit corporation, the amount would probably be limited to good faith discretion in providing for depreciation, obsolescence, and economic contingencies. Would such a qualification be read into the cooperative statute? It would seem not, provided, of course, that the by-law or charter provisions made it clear that the reserve fund would be used for such purposes. This contract would then be binding on the member-patrons. Members of the cooperative are in theory using it as an agent to perform services for them and not simply investing a sum of money to procure a return on their in-

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63 See generally, Fletcher, CORPORATIONS, sec. 5325 (1931), on the problem of compelling the declaration of a dividend and p. 27 supra. The courts are very reluctant to interfere in the internal affairs of a corporation. Fletcher, sec. 2104.
vestment. The policy of the state should only require that
the members' proportionate interest be seasonably ascer-
tained, and the statute requires that this be done. Hence,
if the members agreed to contribute such sums for the op-
eration of the business for a certain period, there would
seem to be no reason for not enforcing such an agreement.

This then suggests a practical method of setting up a
revolving fund for a Michigan cooperative. A limited
amount of membership capital or capital stock may be
provided for in the articles of incorporation. Transfer of
this membership interest may be regulated in accordance
with the Act. This capital may be divided into small units
so as to make possible a large membership. Apparently,
section 5 of the corporation statute\(^6\) would be applicable
here so that at least one thousand dollars would have to be
paid in before the corporation could commence business.
Much of the operating capital in the beginning could be
secured by loans. Such loans could be facilitated in part by
the members' depositing accommodation notes with the
cooperative.\(^6\) As the business progressed, the loans could
be repaid, the reserve fund built up, and the notes re-
turned to the members. This plan would be relatively sim-
ple to establish and would be somewhat similar to that ex-
pressly authorized by the Iowa Code.\(^6\) This is not to infer


\(^6\) In Gobles Co-Operative Association v. Albright, 248 Mich. 68, 226
N.W. 876 (1929); Taylor v. Rugenstein, 245 Mich. 152, 222 N.W. 107
(1928); and Runciman v. Brown, 223 Mich. 298, 193 N.W. 880 (1928),
such notes were the subject of litigation. In the Taylor case the defense
unsuccesfully urged the statute of limitations; the maker probably real-
ized his liability since the note was pledged as collateral. In the other
two cases the maker was not liable when the note was not transferred to
a third party.

\(^6\) Iowa Code Ann. secs. 499.30 to 499.35 (1949).
that the stock itself could not be rotated, but it is believed that the rotation of the reserve fund would be simpler.

Other provisions concerning earnings. Additional provisions concerning earnings require that regulations governing their distribution be contained in the by-laws. Limited dividends not to exceed seven per cent are authorized, and such dividends may be made cumulative. The by-laws shall provide what percentage over and above such dividends shall be kept as reserves, and shall determine the manner of distribution of the surplus. It is likewise optional whether these dividends, which must be on a patronage basis, be paid to members and nonmembers or simply to members. In regard to cooperatives classified as profit, the balance of such reserve fund in excess of thirty per cent of the paid-up capital shall be considered as surplus for the purpose of determining the annual franchise tax.

The time for the distribution of the surplus earnings shall be stated in the by-laws, but such a distribution must be made at least once a year. It is further provided that, in case the cooperative fails to pay the dividend upon its paid-up capital stock for a period of five consecutive years,

68 Ibid.
69 Ibid.
70 Ibid. See p. 24 supra, and notes 45 and 49 supra. There seems to be no specific statutory provision for the determination of paid-up capital in the non-stock profit cooperative. The problem is more apparent than real, however, since section 2 of the Act (Mich. Comp. Laws sec. 450.2 (1948), as amended by Mich. Pub. Acts 1949, No. 229), defines “share of stock” as synonomous with membership in a non-stock corporation. Hence, the determination of capital as provided for in section 20 (Mich. Comp. Laws sec. 450.20 (1948)), although mentioning only stock, would be applicable to non-stock corporations. Compare the apparent meaning of “capital” here with its meaning in section 104. See Investment of Reserves, infra p. 40.
the circuit court of the county of its registered office may
dissolve the enterprise on the petition of a majority of the
shareholders. This is a ground of dissolution unique to
cooperatives. The statute undoubtedly refers to the op­
tional limited dividend which may be authorized in the
by-laws, because stock of cooperatives as such is not en­titled to a dividend, surplus distributions being primarily
based on patronage.

Membership. The Michigan statute clearly recognizes
and approves the cooperative practice of limiting mem­
bership. However, in order for restricted membership pro­
visions to be effective, a condensed statement of the re­
strictions on transfer must be printed on the back of each
stock certificate. Also, limitations on voting rights and
limitations on proxy voting, if any, must likewise appear
on the stock certificate. Although this section and others
refer expressly only to shares of stock or stock corpora­
tions, the rules are applicable to membership cooperatives
also. Section 2 of the Act defines stock and shareholders
in a generic sense so as to include membership interest and

72 Ibid. In regard to the dissolution problem, it was held in Michigan
Wolverine Student Co-Operative v. Goodyear, 314 Mich. 590, 22 N.W.
2d 884 (1946), that pecuniary losses did not justify the director's selling
all of the assets without the consent of the majority shareholders. Dis­
solution must be in conformity with statutory procedure.

73 Mich. Comp. Laws secs. 450.100 and 450.102 (1948).

74 Mich. Comp. Laws sec. 450.100 (1948). Failure to place the restric­tion on the stock certificate may render the limitation unenforceable
although the transferee has notice. Sorrick v. Consolidated Telephone
Co., 340 Mich. 463, 65 N.W. (2d) 713 (1954). In this case there was a re­
striction against any member owning more than five shares. It was held
that the purchaser was entitled to have the share of stock in controversy
transferred to his name although he had more than five shares at the
time of purchase and had knowledge of the restriction.


1949, No. 229.
members in a non-stock corporation. If the Uniform Stock Transfer Act\textsuperscript{77} is inconsistent with such limitations, the provisions of that Act are held inapplicable.\textsuperscript{78} It is to be noted, however, that restrictions on the transfer of stock in the ordinary profit corporation also are upheld if they are contained in the articles and printed on the stock certificate.\textsuperscript{79} Thus, it would seem that, as far as the validity of such restrictions is concerned, the cooperative or profit character of the corporation would make little difference. There may be a difference, however, in underlying philosophy. Except in the rather closely held profit corporation, wherein the parties seek to maintain control for themselves and nominees, restrictions on the transfer of stock would be more of a detriment than a benefit. Marketability of such stock is essential to attract capital. In the cooperative, on the other hand, where the emphasis is on service to the members, there may be many reasons for restricting membership.\textsuperscript{80}

Other provisions likewise recognize and authorize the cooperative practice of selecting members. It is provided,

\textsuperscript{77} Mich. Comp. Laws secs. 441.1 to 441.25 (1948).
\textsuperscript{78} Mich. Comp. Laws sec. 450.100 (1948).
\textsuperscript{80} See p. 16 \textit{supra}. Packel, \textit{op. cit. supra} n. 1 at 92, stresses the personal character of the ownership interest in a cooperative, and asserts that restrictions on transfer are necessary in order to exclude undesirable or hostile persons. It may also be necessary to limit membership in order to receive governmental benefits. Int. Rev. Code sec. 521 (1954) requires that substantially all the voting stock be owned by producers in order for agricultural cooperatives to qualify for income tax exemption. A similar requirement would seem to exist for eligibility for loans from banks for cooperatives, 12 U.S.C.A. secs. 1141j and 1134c (1945 and 1954 Supp.).
for example, that either the articles or by-laws may provide for qualifications of shareholders or members, limitations or regulations on the transfer of such membership, and also for the terms or conditions under which, if at all, such membership or stock may be transferred. It is further provided that no transfer, sale, or assignment shall be valid unless in conformity with such provisions, and even that no attachment or transfer by operation of law shall be valid unless in accordance with them. These sections give the cooperatives extensive privileges in limiting membership to those who have an active interest in the enterprise.

An interesting case illustrating the flexibility of membership provisions and methods of cooperative operation is that of Edmore Marketing Association v. Skinner. In this case the defendant signed a contract with the cooperative providing that the contract would take effect upon the signing of similar agreements by at least fifty per cent of the growers of commercial acreage of potatoes in the marketing area. After a number of years of compliance, defendant sold his potatoes to others, and the cooperative brought an action for breach of contract. It was held that the method of computation used by the cooperative in ascertaining that the required percentage of the growers had signed contracts was defective, and therefore the agreement was ineffective, plaintiff not having showed that the condition precedent had been met. The contract further stipulated that the defendant would become a member of the cooperative when his contract took effect. Since his contract never took effect, it was held that he was not a member, having exercised no other rights of membership.

82 Ibid.
and hence recovery by the cooperative could not be based on by-law provisions.\textsuperscript{84}

\textit{Organization}. The shareholders or members are given wide discretion in setting up the organization of their cooperative. They may adopt and amend by-laws, determine the manner of distributing earnings on a cooperative basis, limit and define the powers and duties, as well as determine the number of directors and officers, and, in short, determine practically all questions concerning the internal organization and functioning of the enterprise.\textsuperscript{85} In addition, they may delegate all their powers to the directors, with the exception of the powers to amend the articles and to elect or dismiss directors.\textsuperscript{86}

The construction and effect of the by-laws of a cooperative have been considered by the Michigan judiciary in several instances. A by-law giving the board of directors the power to remove an officer "for the best interest of the company" has been recognized as valid and given full effect as against one with knowledge.\textsuperscript{87} Although in the particular case the complaining party was apparently a member, the by-law was said to be binding on both members and nonmembers alike so long as they had actual knowledge. It also was indicated that a managing officer would not be chargeable with knowledge as a result of his office.\textsuperscript{88} It has been held that a by-law is not binding on a nonmember who has no knowledge of it,\textsuperscript{89} but is enforceable.

\textsuperscript{84} Ibid.
\textsuperscript{86} Ibid.
\textsuperscript{87} Rundell v. Farmers' Co-Operative Elevator Co. of Corunna, 210 Mich. 642, 178 N.W. 21 (1920).
\textsuperscript{88} Ibid.
\textsuperscript{89} Harley v. Hartford Fruit Growers and Farmers Exchange, 216 Mich. 146, 184 N.W. 507 (1921).
against the cooperative on the insistence of a member.\textsuperscript{90} In a case involving this latter proposition, the by-laws provided that the cooperative should act as the agent of the members in marketing their produce. It was further provided that daily pools of products should be the method of disposition and that each member's interest should be ascertained daily upon the selling of the pool. The plaintiff member recovered his entire interest in such a pool after showing that his products were sold and cash received therefor. He did not have to share losses arising out of the sale of subsequent pools.\textsuperscript{91}

In regard to the status of contracts entered into between the incorporators and third parties prior to the act of incorporation, the fact that the proposed corporation is a cooperative is of no significance. Section 8\textsuperscript{92} of the General Act provides that such contracts shall not be deemed invalid because they were made prior to the filing of the articles. An earlier statute to the same effect was significant in \textit{Hart Potato Growers Association v. Greiner}.\textsuperscript{93} In this case, the court said that such a pre-incorporation contract would become effective at the time of signing by the incorporators or, if not then, at least at the time the corporation adopted or ratified it.\textsuperscript{94} In construing the present statute\textsuperscript{95} in another case\textsuperscript{96} the court held that, when the corporation became liable, the contract was exclusively between it and the other party, the promoter incurring no

\textsuperscript{91} \textit{Ibid.}
\textsuperscript{92} Mich. Comp. Laws sec. 450.8 (1948).
\textsuperscript{93} 236 Mich. 638, 211 N.W. 45 (1926).
\textsuperscript{94} \textit{Ibid.}
\textsuperscript{95} Mich. Comp. Laws sec. 450.8 (1948).
\textsuperscript{96} In re Montreuil's Estate, 291 Mich. 582, 289 N.W. 262 (1939).
liability in the absence of a personal pledge. In effect, a statutory agency\(^\text{97}\) or possibly a novation is accomplished.

*Amendment.* An amendment to the articles or by-laws may be proposed by one tenth of the membership according to express statutory provision.\(^\text{98}\) Since the provision refers to one tenth "of the entire number of shareholders"\(^\text{99}\) it seems apparent that the required percentage refers to per capita membership and not to financial or stock interest. Although the required percentage approval necessary for adoption is not stated in this section, it would seem that a majority approval would be sufficient. In case of a stock plan cooperative, section 43 providing for approval by a majority of the voting stock would seem to apply.\(^\text{100}\) In case of a non-stock cooperative, approval would be by a majority of the members.\(^\text{101}\) Although these stat-

\(^{97}\) See note, 38 Mich. L. Rev. 1266 (1940).


\(^{99}\) Ibid.

\(^{100}\) Mich. Comp. Laws sec. 450.43 (1948), as amended by Mich. Pub. Acts 1953, No. 155. This section also provides that if such an amendment changes the rights or preferences of the holders of any class of shares, then the amendment must be approved also by a majority of the shares so changed.

utes confer the power to amend on the designated majorities without specifically authorizing the members to determine a different requirement in the articles or by-laws, a different provision in the articles requiring a higher percentage of approval would probably be valid. Paragraph 2 of section 4 autorizes the articles to contain “other provisions consistent with the laws of this state for regulating the business of the corporation and for the conduct of its affairs, and any provisions creating, defining, limiting and regulating the exercise of the powers of the corporation or of the directors or of the shareholders, or for the purpose of creating and defining rights and privileges of the shareholders among themselves.”

It is to be noted that the statute providing for initiating the amendment is permissive in language. This suggests that the members might provide in the articles or by-laws other means by which amendments could be proposed, as, for example, by the board of directors. As for the time of voting, the statute provides that the amendment so proposed shall be voted on at the next annual meeting. This language is not permissive and therefore seems to exclude approval at any other time. However, the statutes setting forth the percentage approval required for adoption refer to meetings “duly called and held” and to “any regular meeting, or at any special meeting, called for that purpose.” Thus, construing all the statutes together, the following conclusions seem valid. One tenth only a majority approval, would supersede this section unless the corporation were existing by authority other than the General Act.

of the membership may propose an amendment, and such amendment shall be voted on at the next annual meeting. The members are powerless to deny this right to one tenth of the membership or to provide any time for voting on such a proposed amendment other than at the next annual meeting. On the other hand, the members may provide in the articles or by-laws other methods of proposing amendments, and may also designate the time when such proposals may be submitted to the membership.

Investment of reserves. Cooperatives are authorized to invest a portion of their reserve fund in the capital stock or membership capital of another corporation or cooperative. For such action a majority of those present or represented at the meeting is required. Of course, there must be a quorum present; the number constituting a quorum is to be fixed by the by-laws and need not be a majority. Although the statute is not explicit, it would seem that, if stock instead of per capita voting were practiced, the decision would be controlled by a majority vote in interest. It is to be noted that the amount of investment is limited to twenty per cent of the aggregate of the corporation’s capital.

The exact effect of this limitation is a little obscure owing to the ambiguity of the term capital. In section 20 of the Act, “capital” apparently signifies the item on the liability side of the balance sheet and is determined according to the procedure therein specified. On the other

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107 Ibid.
hand, section 5\textsuperscript{111} of the Act, which specifies the minimum amount of capital with which the corporation may begin business, apparently uses the term to mean the assets which have been contributed by the shareholders. General usage is of little help because of the customary looseness\textsuperscript{112} with which such terms as capital and capital stock are used, and also because it is the particular statutory meaning that is controlling.

If capital is used in the restricted sense to mean simply the balance sheet item, exclusive of reserves, surplus, and other possible accounts contributing to the net worth\textsuperscript{113} of the company, then the amount that may be invested in other businesses will be somewhat limited and rigid. However, if capital is used in a broader sense so as to include substantially all of the net worth, the amount available for such investment will be correspondingly greater. Under this latter interpretation, the amount that could be invested, although limited to twenty per cent of the capital, would be restricted only by the cooperative's ability to make and retain surplus earnings. There would be even less restriction if capital were construed to mean all the assets irrespective of liabilities.

Of these possible interpretations, it is believed that the second is the one intended. The third is unlikely because "capital" generally connotes something less than the entire assets. The first is unlikely because of context. It is


\textsuperscript{112} See generally, Fletcher, CORPORATIONS sec. 5080 (1931).

\textsuperscript{113} In this sense, net worth is equivalent to the difference between the assets and the liabilities exclusive of the shareholders' interest. Cf. "Net worth is equal to the difference between the assets and liabilities, which in the case of a corporation is equal to the capital stock plus surplus or minus deficit." Montgomery, FINANCIAL HANDBOOK 102 (1937).
to be noted that the statute in setting up the limitation refers to twenty per cent "in the aggregate"\textsuperscript{114} of the corporation's capital. If capital simply meant the balance sheet item, the phrase "in the aggregate" would be surplusage. It seems that the statute envisions a totaling of the items representing net worth or assets contributed or produced by the shareholders. This conclusion is fortified by additional reasoning. Section 20\textsuperscript{115} of the Act permits the capital item to be increased by transferring to it other portions of the net worth of the company. With such a provision in effect, it would be of no avail to restrict "capital" in section 104 to a specific balance sheet item when the corporation could by a resolution of the board increase it by transferring these other items to it. This result also seems most consistent with cooperative theory and practice of maintaining flexible capital structures and with the expressed legislative approval of permitting cooperation and coordination among cooperatives. The proposed Act avoids this ambiguity by the use of an appropriate definition.\textsuperscript{116}

It is clear, however, that the statute does limit somewhat the amount of corporate pyramiding that can be done in the cooperative field. Although a cooperative can increase its holdings or control over other firms by increasing its capital, still only twenty per cent of such amount can be so invested. Thus, every cooperative must be an operating company, and the holding company\textsuperscript{117} as such cannot exist in the cooperative field under Michigan statutes. The additional requirement that at least fifty per cent of its busi-

\textsuperscript{114} Mich. Comp. Laws sec. 450.104 (1948).
\textsuperscript{116} Part II, Proposed Act, sec. 209.
\textsuperscript{117} Obviously, this refers to the holding company whose sole purpose is to acquire stock in and control other corporations.
ness be conducted with members\(^{118}\) makes this clear. This result is justified because of the cooperative concept which envisions performance of service for its members.

On the other hand, however, the statute under consideration does permit inter-company affiliations and coordinations to a fairly large extent. Thus, local cooperatives can collectively organize a regional cooperative for bulk selling, shipping, buying, or other services. Likewise, the initiative can be exerted in the opposite direction, the central cooperative encouraging the formation of intermediate and local organizations. The only restriction is the twenty per cent limitation on investment, the other eighty per cent being used to carry on business.

**Purchase of business.** The outright purchase of businesses is expressly authorized, and payment in stock instead of cash is approved.\(^ {119}\) The statute,\(^ {120}\) however, refers only to issuing par stock for the purchase and, therefore, apparently prohibits the issuance of no par stock for such a transaction. This conclusion seems correct since the legislature has made provision for no par stock elsewhere.\(^ {121}\) It would seem that the intentional inserting of the phrase "at par value" negatives any approval of summating the transaction with no par stock. It is expressly provided that the issuance of such stock for the fair market value of the purchased business is equivalent to payment in cash.\(^ {122}\)

Although there is no express provision for the merger or consolidation of cooperatives, there would seem to be


\(^{120}\) Ibid.


no reason why such corporations could not take advantage of section 52\textsuperscript{123} of the General Act. Since there is no provision in the cooperative sections, there would seem to be no conflict, and hence the more general provisions would be applicable. However, in many cases, essentially the same results can be achieved by the outright purchase of another business, and this procedure is much simpler. Action taken under the merger statute,\textsuperscript{124} for example, requires the approval of two thirds of all the shareholders in each corporation, whereas for the purchase and sale of assets there is required only a majority approval of the shareholders unless the articles provide otherwise.\textsuperscript{125}

_Mode of operations._ The Michigan Act expressly permits an agricultural cooperative to conduct business with its members and others on any type of recognized basis that is desirable.\textsuperscript{126} Thus, it may enter into "any and all necessary contracts with stockholders, members or other persons respecting the terms of such transaction, and may deal in such commodities upon commission or brokerage basis, by agency agreements, or upon a warehouse storage plan."\textsuperscript{127} Outright buying and selling is also approved by the introductory clause: "Every cooperative corporation engaged in buying, handling, selling . . . ."\textsuperscript{128}

The purpose and effect of this statute is a little obscure

\textsuperscript{123} Mich. Comp. Laws sec. 450.52 (1948).
\textsuperscript{124} Mich. Comp. Laws sec. 450.52 (1948).
\textsuperscript{125} Mich. Comp. Laws sec. 450.57 (1948), as amended by Mich. Pub. Acts 1951, No. 239, for the sale of assets. As to the purchasing corporation, it would seem that the decision of the board would be sufficient unless the by-laws provided otherwise or the articles had to be amended. The amendment procedure is discussed p. 38 _supra._
\textsuperscript{127} Ibid. See text discussion, "Relationship with members," p. 14 _supra_. For an example of an agency contract, see Cole v. Fruit Association, 260 Mich. 617, 245 N.W. 534 (1932).
except in so far as it is thought necessary and desirable for the state expressly to approve institutional practices. A cooperative by nature must necessarily enter into business transactions with its members and, unless the power to enter into agency, brokerage, or warehouse storage agreements is otherwise restricted, there seems to be no reason why such power should be expressly conferred. There is also the question as to the reason for limiting these provisions to agricultural cooperatives, and the effect, if any, of such limitation. It seems unlikely that the express confirmation of such power in agricultural cooperatives necessarily denies it in other cooperatives. All cooperatives under the statute\footnote{Mich. Comp. Laws sec. 450.98 (1948).} must do at least fifty per cent of their business with members. This necessarily entails making contracts, and the type of such contracts is not limited. Furthermore, the statute does not solve the problem\footnote{See text discussion, "Relationship with members," p. 14 supra.} as to whether such contracts constitute an agency, trust, or purchase relation, because it simply authorizes all types. It would seem that this statute could be repealed without any hardship on cooperatives, but, that if it were thought desirable to retain it, its application should not be restricted to agricultural organizations.

*Inducing breach of contract.* The Act gives to the cooperatives a cause of action against anyone who induces another to breach his contract with such a corporation.\footnote{Mich. Comp. Laws sec. 450.109 (1948).} Under these provisions, the cooperative is entitled to a five hundred dollar penalty assessed against the offender, reasonable attorney fees, costs arising out of the litigation, and also an injunction against further interference. This section is not limited to agricultural cooperatives. Insofar as the legislative policy is the furtherance of cooperatives,
a statute of this kind is desirable and advantageous. The express formulation of the basis for an action in this area concerning the interference with contractual relations results in a high degree of certainty. Likewise, the setting forth of the remedies available increases certainty and undoubtedly results in a greater accumulation of remedial rights than might be available under the common law.

Miscellaneous. In this section consideration is given to a few problems not specifically covered by statute. The problem of the authority of the corporation and of its agents has received judicial attention. In general, it can be said that the question of ultra vires in these two instances is treated the same as in general corporate law. In *David Stott Flour Mills v. Farm Bureau*, the organization was successful in avoiding liability because of the lack of authority of the agent. In this case, the court permitted a last minute change in pleading because it said a more liberal rule should apply to nonprofit corporations than to individuals. The justification of such an attitude is not apparent. The court approved the jury’s finding of no estoppel on the part of the defendant corporation, and affirmed the requirement of the lower court that for an estoppel there must not only be an apparent authority of the agent, but reliance by the third party to his detriment after due diligence. For ratification, the court required that knowledge of the unauthorized acts be brought home to the corporation and an acceptance of their bene-

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132 See generally Prosser, *Torts* 972 (1941); Hulbert, *op cit. supra* n. 2, at 194.
133 237 Mich. 657, 213 N.W. 147 (1927). The exact nature of defendant corporation is not clear. It was organized under Pub. Acts 1903, No. 171, which was a general act for the incorporation of nonprofit organizations and, although obviously including social and fraternal groups, apparently was not limited to organizations of that kind.
fit. Although the case\textsuperscript{134} illustrates the applicability of general agency doctrines, the requirements to overcome the actual lack of authority seem rather stringent.\textsuperscript{135}

The defense of ultra vires was successfully pleaded by a cooperative insurance company which had issued an endowment policy contrary to its authorized powers.\textsuperscript{136} The court stated that, although the defense of ultra vires is not looked upon with favor, a contract clearly ultra vires statutory authority may not be enforced. The corporation in this case was organized under a general act authorizing incorporation only for designated purposes. Insurance is a matter of public interest and is closely regulated. Section 11 of the General Corporation Act restricts the availability of the defense of ultra vires.\textsuperscript{137} In the first type of case under the statute, only the corporation can plead ultra vires in an action between it and an officer or director or other persons having actual knowledge. In the second type of case involving suits between the corporation and shareholders, either party can avail himself of the defense.\textsuperscript{138}

The effect of this statute in the field of cooperation, where the bulk of business is done with members, is to leave many instances where the defense of ultra vires is still available. It is to be doubted that most members of cooperatives or of other corporations, particularly of the larger ones, have actual knowledge of the corporation's limited powers, and hence the advisability of allowing the

\textsuperscript{134} Ibid.


\textsuperscript{137} Mich. Comp. Laws sec. 450.11 (1948).

\textsuperscript{138} Ibid. Note that this statute does not change the result in the Anderson case, note 136 supra.
defense simply on the basis of membership is to be questioned. Of course, the hostile attitude of the judiciary may further limit the actual application of the doctrine, but, at least as to cooperatives, the present statute does not seem to go far enough in its restrictions. The proposed Act corrects this defect.

The liability of a cooperative for the torts of its agents should be a foregone conclusion and would scarcely merit attention were it not for the case of *Flueling v. Goeringer*. In this case, a cooperative taxicab company was held not liable for the negligence of its member-operator. The corporation, however, acted only as a service company for the owner-members. Its activities were confined to receiving service calls, fixing rates, apportioning territory, and maintaining equipment. The court stated that there were no funds out of which the corporation could satisfy a judgment. This proposition should be of no more consequence in determining liability here than in any other instance. The financial responsibility of the defendant is not the legal test of liability. In spite of the apparent poor reasoning, however, the case probably was decided correctly. It appears that the cooperative was not engaged in running the cabs but simply was performing service for the cab owners. The tort, therefore, did not occur in the course of the cooperative's activities, but instead occurred in a related but disconnected field of endeavor. Therefore, the nonliability of the cooperative correctly followed.

That the above reasoning is the correct rationale of the

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140 Part II, Proposed Act, sec. 216.
142 See generally Packel, *op. cit. supra* n. 42, at 169; Hulbert, *op. cit. supra* n. 2, at 239.
Flueling case may be suggested by the older case of Logan v. Agricultural Society of Lenawee County. In this case, a spectator at a horse race sponsored by the defendant recovered a judgment for injuries resulting from defendant's negligence. The fact that the defendant was not organized primarily to make money was of no consequence. The court pointed out that it was not a charitable or eleemosynary organization and asserted that, when it invited the public, it had the same duties as others similarly situated.

There would seem to be no justification for holding cooperatives not liable for the torts of their agents or employees arising out of activities carried on by the cooperative. Insofar as the Flueling case has cast any doubt as to such liability, a specific statutory provision imposing liability is desirable.

IV. Conclusion

The inclusion of separate cooperative provisions as an integral part of the General Corporation Act is a convenient and satisfactory method of providing for the incorporation of such organizations. By integrating the cooperative and regular corporation sections, much needless duplication is eliminated, since the cooperative sections need contain only provisions that are not applicable to other corporations.

Separate provisions for cooperatives serve a useful purpose and should be maintained so long as such organizations are approved. Lack of such express approval makes

143 156 Mich. 537, 121 N.W. 485 (1909). The fact that the defendant was not a cooperative but a nonprofit corporation for the advancement of agriculture does not detract from the validity of the comparison.

144 Ibid.

145 Part II, Proposed Act, sec. 201.
for uncertainty at the outset, and such uncertainty is not decreased as cooperative practices are forced into a profit corporation framework. The provision for the incorporation of cooperatives for any lawful purpose is desirable, as there would seem to be no more reason for restricting the purposes of such organizations than there is for restricting other corporations.

The foregoing analysis, however, does suggest a few ambiguities that might be eliminated. A specific attitude on the legality of a revolving capital fund would make for more certainty on this important item.\(^{146}\) Section 103\(^{147}\) concerning amendments could be clarified by stating whether or not the statutory method of proposing amendments is exclusive, and it should also state the required percentage of approval for adoption.\(^ {148}\) Section 104,\(^ {149}\) concerning the investment of reserves, seems sufficiently liberal to meet the legitimate requirements of cooperative operations, but the restriction is obscure owing to the uncertainty of the term "capital." The insertion of a definition would eliminate the difficulty.\(^ {150}\)

It is not clear that section 108,\(^ {151}\) authorizing the cooperative to enter into various types of contracts with its members, serves any necessary purpose. If it does, however, there would seem to be no valid reason for restricting its application to agricultural cooperatives.\(^ {152}\) Further limitations on the defense of ultra vires are thought desirable,\(^ {153}\)

\(^{146}\) Part II, Proposed Act, sec. 212.


\(^{148}\) Part II, Proposed Act, sec. 208.


\(^{150}\) Part II, Proposed Act, sec. 209.


\(^{152}\) Part II, Proposed Act, sec. 214.

\(^{153}\) Part II, Proposed Act, sec. 216.
and a statutory imposition of tort liability would do no harm.\textsuperscript{154}

No provision is made in the Michigan Act for the withdrawal of members as there was in the Uniform Agricultural Cooperative Act.\textsuperscript{155} This, however, is probably just as well, since such matters can conveniently be regulated by the parties themselves in their contracts, by-laws, or articles. No specific provisions are made concerning damages for breach of contract, although, as indicated,\textsuperscript{156} provision is made for actions against those inducing the breach of such contracts. The Uniform Act contained provisions covering both of these situations,\textsuperscript{157} but, unless there is some reason to believe that the common-law remedies are inadequate protection for the cooperative, additional provisions need not be added.

Provision was made in the Uniform Act for the recording of marketing contracts.\textsuperscript{158} Recordation was constructive notice of the association’s title or right to all subsequent purchasers, encumbrancers, or persons dealing with the members in reference to such product, and the association’s right or interest was made superior to the subsequent interest.\textsuperscript{159} The Michigan Act contains no such provision. The desirability of including such a statute is primarily a question of legislative policy and should be determined after a factual study of the economic status of agriculture

\textsuperscript{154} Part II, Proposed Act, sec. 201.
\textsuperscript{155} Uniform Agricultural Cooperative Act sec. 18. This act was withdrawn in 1943.
\textsuperscript{156} See text, “Inducing Breach of Contract,” p. 45 \textit{supra}.
\textsuperscript{157} Uniform Agricultural Cooperative Act secs. 18 II and 19. The act was withdrawn in 1943.
\textsuperscript{158} Uniform Agricultural Cooperative Act sec. 18 IV. The act was withdrawn in 1943.
\textsuperscript{159} \textit{Ibid}. 
and the advantages to be derived from such legislation. Two problems may be suggested.

Under Michigan law, a farmer may sell a crop to be grown in the future and title passes upon germination. In the absence of a recording statute, a subsequent purchaser or mortgagee has no way of ascertaining the prior sale, and therefore apparently receives nothing from the transaction except a cause of action against the seller or mortgagor. Insofar as the first sale is to a cooperative, a statute of the above type would cover this situation and

160 Michigan Sugar Co. v. Falkenhagen, 243 Mich. 698, 220 N.W. 760 (1928); In re Miller, 244 Mich. 302, 221 N.W. 146 (1928); Dickey v. Waldo, 97 Mich. 255, 56 N.W. 608 (1893). That the Uniform Sales Act did not change this result is suggested by the Falkenhagen case which arose subsequent to the enactment of the Uniform Act. Section 5 of the Sales Act (Mich. Comp. Laws sec. 440.5 (1948)), treats a sale of future goods as a contract to sell the goods. The effect of section 25 of the Act (Mich. Comp. Laws sec. 440.25 (1948)), was not discussed. For a discussion of this section see n. 161 infra.

161 See Michigan Sugar Co. v. Falkenhagen, 243 Mich. 698, 220 N. W. 760 (1928). See generally, Hulbert, op. cit. supra n. 2, at 134, and particularly at 136 et seq. It is possible that section 25 of the Uniform Sales Act (Mich. Comp. Laws sec. 440.25 (1948)), providing that where a seller retains possession of goods after sale and then sells to a bona fide purchaser, the transaction shall have the same effect as if expressly authorized by the owner, would protect the second purchaser. On the other hand, it may be held inapplicable to a sale of future crops because of the impossibility of delivery. See Hulbert, p. 138, and Pacific Wool Growers v. Draper & Co., 158 Ore. 1, 73 P. (2d) 1391 (1937), holding that the second purchaser acquired title. There was also an element of estoppel against the association.

Presumably, section 7 of the Uniform Fraudulent Conveyance Act (Mich. Comp. Laws sec. 566.137 (1948)), would not change the result, because any presumption of fraud arising out of the seller's retention of possession would be rebutted by the nature of the subject matter, a growing crop. It is to be noted that this section provides for the recordation of bills of sale in those instances where the seller is to retain possession. Recording under this section does not charge anyone with constructive notice but simply rebuts the presumption of fraud. Thus, it is very likely that the second purchaser gets no title.
render certain the title of the cooperative. It would also include others as, for example, an executory contract to sell at a future time. In the absence of such a statute in this case, the cooperative may be left with a cause of action for breach of contract against the member, and legal title may be acquired by the second purchaser.\textsuperscript{162}

The granting of such broad protection to agricultural cooperatives as was done in the Uniform Act primarily represents a policy based upon the desirability of furthering such organizations. Irrespective of the cooperative considerations, however, provision might well be made for the recordation generally of contracts involving the sale of future crops in order adequately to protect or warn subsequent bona fide purchasers and mortgagees.

In general, the present provisions are fairly adequate, sympathetic, and liberal toward cooperative practices. Cooperatives are given wide discretion in setting up their organization, in selecting a basis for the conduct of business, in the distribution or retention of earnings, and in the control over membership.

\textsuperscript{162} This conclusion is supported by Tobacco Growers Co-Operative Association v. Harvey & Son Company, 189 N.C. 494, 127 S.E. 545 (1925), in which case subsequent lienors were held entitled to enforce their claims independently of the cooperative with which the growers had entered into contracts to sell their crops. See also Hulbert, \textit{op. cit. supra} n. 2, at 135.