

Legal Memo

Date: December 7, 2018
To: Sustainable Solano
From: Christina Oatfield, Grassroots Finance Attorney
Re: Legal Structure Roadmap for Solano Farmers Cooperative

Dear Sustainable Solano,

This memorandum describes possible legal structures for a cooperative and associated legal considerations for a Solano County agricultural producer cooperative formed to further your goals of promoting access to, consumption of, and awareness of local food in Solano County, California. Such a cooperative would work in partnership with existing organizations, such as Sustainable Solano, Solano Grown, local residents, institutional food purchasers, local government agencies, and others, as described in more detail at the end of this memo. We've learned from your interviews and meetings with farmers in Solano County that there are many producers of a diverse array of fresh fruits and vegetables (among other agricultural products) who struggle with the logistics of selling and delivering their produce to buyers in the Bay Area and we think that a produce distribution cooperative could help address their needs while increasing access to local food in Solano County (and beyond).

As we discussed, a working vision for the cooperative would be to develop it in multiple stages. The first stage would involve forming an agricultural producers' cooperative with interested Solano County farmers as members of the main member class, meanwhile, a public awareness campaign utilizing the Solano Grown brand would promote the cooperative and local food consumption in and around Solano County. Later, provided that the farmer members agree to it, the cooperative would convert to a multi-stakeholder cooperative by amending the cooperative's articles and bylaws to add additional member classes, which could include workers, household consumers, and possibly even local nonprofit organizations. The inclusion of these additional members would leverage additional financial capital and community engagement to create several community food centers across the county, each of which might include local produce distribution facilities as well as retail food services (e.g. groceries, restaurants, delis).

This memo describes legal considerations for the formation of an agricultural cooperative under federal and California law, bearing in mind the possibility of forming a simple agricultural producers' cooperative that may later evolve into a multi-stakeholder cooperative.

As the cooperative's business plan evolves and at various stages of operations, it's advisable to consult with an attorney about the legal aspects of forming the cooperative and complying with applicable laws.

Sincerely,

Christina Oatfield

Legal Overview of Cooperatives

Under California law, cooperatives can be organized as corporations, like other businesses. But there are some unique features of cooperatives. In a cooperative, members typically purchase a membership share, which entitles members to use the services of the cooperative, to vote in elections for the Board of Directors of the cooperative (and to vote in other major decisions of the cooperative), and to a portion of any profits or surplus revenue. When a cooperative has profits or surplus revenues, those are typically distributed out to members in proportion to each members' patronage or business done with the cooperative. In a cooperative each member typically has one vote, even if some members do more business with the cooperative than others. So while all members are entitled to one vote in the cooperative, one agricultural producer member who sells a larger volume of product through the cooperative is generally entitled to a proportionally larger patronage dividend or profit share compared to a member who sells less product through the cooperative. Thus, members are invested in the success of the entire cooperative, not just in their own farm enterprise.

Cooperatives can choose to offer other benefits to members, including, but not limited to, discounts on services provided by the cooperative, invitations to special events, or even participation in group insurance plans.

Two Options for Cooperative Corporations under California Law

California law provides at least two legal structures for cooperatives that Solano farmers can choose from: 1) the Cooperative Corporation Law found in the California Corporations Code beginning at § 12200, and 2) the Nonprofit Cooperative Association Corporation law found in the California Food and Agricultural Code beginning at § 54001. The Nonprofit Cooperative Association law was designed specifically for cooperatives that sell agricultural products, however, if the Solano farmers ultimately prefer to have a multi-stakeholder cooperative, then the more general Cooperative Corporation Law may be more suitable.

The purposes and activities of any California Nonprofit Cooperative Association Corporation (NCAC), must be tailored to agricultural purposes and members must be engaged in the agricultural business, unlike cooperatives formed under the general Cooperative Corporation Law which allows for any lawful business purposes to be the basis of forming the cooperative. A NCAC can be formed by three or more people, a majority of whom are residents of California, for any of the following purposes:

- (a) The production, marketing, or selling of the products of its members.
- (b) The harvesting, preserving, drying, processing, canning, packing, grading, storing, handling, shipping, or utilization of any product of its members, or the manufacturing or making of the byproducts of any product of its members.

- (c) The manufacturing, selling, or supplying to its members of machinery, equipment or supplies.
- (d) The financing of the activities which are specified by the purposes listed above.
- (e) Any combination of the purposes listed above. (California Food and Agricultural Code § 54061)

This type of cooperative can sell products that can include horticultural viticultural, aquacultural, forestry, dairy, livestock, poultry, bee, or farm products (California Food and Agricultural Code § 54004). It must primarily use its resources to reduce operations costs for its members and otherwise engage in furnishing services or facilities to its members (California Food and Agricultural Code § 54179). These cooperatives may only admit as members, or issue common stock (i.e. voting stock) to people who are 1) engaged in the production of a product which is to be handled by or through the association, or 2) that use or employ any service or facility offered by the association, including people leasing land from the association (California Food and Agricultural Code § 54231). It can otherwise have non-member investors who are lenders or holders of non-voting preferred stock.

In addition to the general provisions that must be included in articles of incorporation, a NCAC's articles must expressly identify the corporation as a Nonprofit Cooperative Association Corporation.

The Cooperative Corporation Law accommodates cooperatives in many different industries, thus, a multi-stakeholder cooperative could fit into this legal mold easily. The rest of this memo will focus on advantages available to cooperatives, most of which apply to cooperatives that could be formed under either the Cooperative Corporation Law or the NCAC, unless otherwise specified.

Securities Law

Securities laws exist at both federal and state levels to protect investors from overly risky or fraudulent investments. Securities laws apply to situations where investments are made where an investor contributing funds expects to receive their investment back, sometimes with a return (i.e. interest or dividends, etc.). Under securities laws generally, when a business makes an investment opportunity available to anyone, it must disclose all material information about the business and the investment offering to prospective investors and it must either register the offering with the federal Securities and Exchange Commission (SEC) as well as a state agency that regulates securities, or it must qualify for an exemption from registration or permitting requirements at both level of government. However, asking banks and other similar regulated financial institutions for a loan does not trigger the securities regulations discussed in this memo. Additionally, asking for grants or donations where the donor does not expect to receive money in return later does not fall under securities regulation. Because bank loans are seldomly available to beginning stage businesses, a new agricultural cooperative will need to consider other sources of capital, such as from individuals and institutions that are not in the business of making investments, which will require consideration of securities regulations.

Under California law, a NCAC can sell securities to its members and to the general public in California without first qualifying for a permit from the Department of Business Oversight (the California department that regulates securities) pursuant to California Corporations Code § 25100(m). It's

important to note that this securities permit exemption under California law is an advantage enjoyed by cooperatives formed as Nonprofit Cooperative Association Corporations, and not as a general cooperative corporation. If the Solano farmers wanted to form an agricultural cooperative that could raise investment funds from many different individuals and institutions (not just financial institutions such as banks or credit unions) then forming as a NCAC could result in very significant cost and time savings as far as securities law compliance. Under California law there are numerous other exemptions from securities permitting requirements, however, the exemption afforded to agricultural producer cooperatives is significantly broad. Most other exemptions are available only where there is no public advertising of the securities offering, such as when only close friends, family, or business colleagues invest in the business.

There is a securities permit exemption available for general Cooperative Corporations under California law, however, this exemption only allows up to \$1,000 per individual to be invested and the exemption applies to sales of memberships or voting shares in the cooperative, so it cannot be utilized to sell debt securities (i.e. taking loans from community members) (California Corporations Code § 25100(r)).

Under federal securities law, there is also an exemption for agricultural producer cooperatives that are tax-exempt under Title 26 US Code § 521 (Securities Act of 1933 § 3(a)(5)(B)(i)). This is a section of the tax code specifically for agricultural cooperatives, and it has some similar and some very distinct criteria from the California NCAC law described in this memo. There are circumstances in which § 521 tax treatment can be very advantages for a cooperative, but this tax status comes with restrictions and requirements on engaging with non-members as patrons of the cooperative that some cooperatives find unattractive, therefore, some agricultural cooperatives opt against § 521 tax status. However, under federal securities laws there are other exemptions from SEC registration requirements that a small local business might use, such as the intrastate offering exemption available for securities offerings conducted entirely within one state (SEC Rules 147 and 147A found at 17 CFR § 230.147 and § 230.147A). Further, California securities permitting exemption for NCACs is not contingent upon any particular federal tax treatment. Therefore, an agricultural cooperative need not comply with Internal Revenue Code § 521 tax treatment in order to utilize exemptions from securities registration and permitting requirements.

In summary, if the farmers cooperative wants to utilize community investing as a fundraising strategy then it may find that the California NCAC comes with the significant advantage of a securities permit exemption. However, if the farmers choose to form a different corporation type, then a community investment campaign is still a possibility by way of other less liberal securities permit exemptions or by spending the extra time and costs required for obtaining a securities permit. To conduct a securities offering with a California regulatory permit generally entails several months of advance planning and working with an attorney to apply for the permit, but actual costs and wait times vary considerably.

Further Reading

For a more in-depth analysis of securities offerings in the agricultural context, including reasons why farm enterprises might opt for community capital over institutional financing, as well as case studies of community investment offerings in California agriculture, see Oatfield, Christina, "Guide to Grassroots Financing for California Farmers" September 2017, published by the Sustainable Economies Law Center and available at this link: https://www.theselc.org/grassroots_finance_for_farmers

Tax Advantages

There is not a significant tax advantage to forming a NCAC compared to a cooperative formed under California's more generic Cooperative Corporation Law. The federal tax options discussed in this section can apply to both types of California cooperative corporations, depending on how the corporation operates. There are two portions of the Internal Revenue Code that provide rubrics for cooperative taxation: Title 26 US Code § 521 and Title 26 US Code Subchapter T. Agricultural cooperatives can choose between the two, among other choices. A major advantage of cooperative taxation under either of these rubrics is that surplus revenue that is returned to members in the form of patronage dividends are not subject to the "corporate double tax" meaning that the cooperative corporation is not taxed on the surplus funds that it returns to members, but the members are taxed as individuals for that dividend.

Internal Revenue Code § 521

This code section was designed specifically for agricultural cooperatives, though many agricultural cooperatives choose not to use it. It has some significant disadvantages for cooperatives that purchase agricultural products from non-members, because these non-members must receive the same economic benefits as members (i.e. a patronage dividend) in order to be taxed under this subchapter. For agricultural cooperatives that do little to no business with non-members, or who do not mind extending the benefits of patronage distributions to non-members, there can be benefits to conforming to the requirements of § 521 because under this section there are additional tax deductions that can be made beyond deductions available under the other cooperative tax rubric discussed next (Frederick, Donald A. et al, "Income Tax Treatment of Cooperatives," USDA Rural Development, Cooperative Information Report 44, Part I June 2013, pages 8-10). Not also that § 521 cooperative must operate "on a cooperative basis" (Title 26 USC § 521(b)(1)) like all Subchapter T cooperatives discussed next.

Internal Revenue Code Subchapter T

This subchapter was designed for a wide array of cooperatives, and it applies to agricultural cooperatives as well. Cooperatives opting for taxation under this rubric must operate "on a cooperative basis" which means that three basic principles are followed by the cooperative, including: subordination of capital, democratic control, and allocation of surplus revenue in proportion to member patronage (*Puget Sound Plywood, Inc. v. Commissioner*, 44 T.C. 305 (1965)). In this context, subordination of capital means that members have substantial control of the cooperative, not equity investors. Democratic control generally is interpreted as meaning that each member has one vote. Finally, surplus revenues (revenues minus expenses) should be allocated in proportion to the patronage or business done by each member, rather than in proportion to their capital invested.

Some agricultural cooperatives choose Subchapter T taxation and not § 521 taxation because Subchapter T does not require that patronage refunds be distributed to non-members who do business with the cooperative, and many agricultural cooperatives often buy products from non-members but do not want to extend the benefit for patronage refunds to non-members who do not buy membership shares and otherwise participate in the cooperative as members.

There are some advantages to Subchapter T taxation compared to generic C Corporation taxation or S Corporation taxation. C Corporations typically have to pay the notorious “corporate double tax” meaning that the corporate entity must pay taxes on profits and then individual shareholders must pay taxes personally for the dividends they receive from those profits. S Corporations are taxed as “pass-through” entities meaning that the corporation does not pay taxes on profits but the profits or losses are passed onto the individual shareholders who pay taxes, whether they receive a cash dividend or not. A cooperative taxed under Subchapter T avoids the double tax on profit it allocates to its members, but has the benefit of being able to hold onto unallocated profits to reinvest them in the business, without its members being liable on their personal taxes for that profit. In the case of an S Corporation choosing to hold onto profits in the corporation’s account, individual shareholders are still taxed on those profits even if those profits were never paid out to shareholders. Thus, one year a shareholder could end up owing a lot of tax on earnings he/she never personally received because those earnings were reinvested into the business. A cooperative can hold onto surplus revenue in a collective account without having to allocate those earnings to members’ individual tax bills, however, these retained funds would be subject to corporate tax. However, when a cooperative has surplus it would like to allocate to members, that amount is tax-deductible to the cooperative, thus avoiding the corporate double tax for patronage distributions to members. Thus, under Subchapter T a cooperative can simultaneously use features that resemble some of the best of both worlds of corporation and pass-through taxation. This can be very strategic for early stage cooperatives in capital-intensive industries (such as food distribution) where it’s wise to retain significant portions of revenues to be reinvested into the business in the following year.

California Tax Law

Corporations in California must generally pay income taxes (among other applicable taxes) similar to an ordinary business, with the minimum annual tax set at \$800 as of this writing. A NCAC may pursue a tax exemption on its California taxes pursuant to California Food and Agricultural Code § 54042 if the cooperative is located in an area with high unemployment and at least 90% of the cooperative’s members are, or have been, within the previous 12 months unemployed or dependent on public social services for their income, among other requirements as described in that statute.

Further Reading

For a clear and brief discussion of 26 USC § 521, see Williamson, Lionel, “The Farmer’s Cooperative Yardstick: Should Your Cooperative be “Exempt” or “Non-Exempt”” University of Kentucky College of Agriculture Extension, Publication AEC-53, April 1987, available at:

<https://www.uky.edu/Ag/AgEcon/pubs/aec53.pdf>

For a more thorough analysis of cooperative tax options, see Frederick, Donald A. et al, “Income Tax Treatment of Cooperatives,” USDA Rural Development, Cooperative Information Report 44, Part I June 2013 available at: <https://www.rd.usda.gov/files/cir44-1.pdf>

For a legal primer on Subchapter T, see Kustov, Dmitriy, “Dmitriy Kustov on Worker Cooperatives and Patronage Dividends,” 2012-09 Lexis® Federal Tax Journal Quarterly 1, § 1.01 available at:

<http://cp5.cpasitesolutions.com/~kustovcp/files/publications/LexisFederalTaxJournal%20Sept%202012%20Issue%20Cooperatives.PDF>

For a cartoon video about accounting and taxation under Subchapter T, see Orsi, Janelle, “How Money Moves Through a Worker Cooperative” available this link:

<https://www.youtube.com/watch?v=T3QuEWYAKil&feature=youtu.be>

Cooperatives and Antitrust Laws

Under US antitrust laws, businesses generally cannot conspire with one another to set prices for their mutual benefit. However, the 1922 Capper-Volstead Act (codified at Title 7 USC §§ 291 - 292) provides a less stringent application of antitrust laws for agricultural producer cooperatives. It provides that agricultural producer cooperatives may exist for farmers to work together, including by setting prices together, among other things, without violating antitrust laws unless the activity of a cooperative rises to the level where it “monopolizes or restrains trade in interstate or foreign commerce to such an extent that the price of any agricultural product is unduly enhanced” (7 USC § 292). This means that agricultural producer cooperatives are not entirely exempt from antitrust laws but that antitrust laws can only be applied to them if their business becomes an extremely powerful monopoly. To enjoy the protection under this Act, the cooperative or association must ensure that 1) no member of the association is allowed more than one vote, 2) the association does not pay dividends on stock or membership capital in excess of 8% annually, and 3) members contribute the majority of the value of products sold by the cooperative (7 USC § 291). These requirements for use of the Capper-Volstead Act are in line with other cooperative laws and widely recognized principles of cooperatives.

The protections against antitrust laws under Capper-Volstead clearly apply to an agricultural producer cooperative whose members consist only of those who are “engaged in the production of agricultural products as farmers, planters, ranchmen, dairymen, nut or fruit growers” (7 USC § 291), however, it’s unclear whether these protections would apply to multi-stakeholder cooperatives. Courts have ruled that agricultural cooperatives that include even a single member who is in the food packing or distribution business but is not engaged in producing agricultural products does not enjoy protection from antitrust regulation under the Capper-Volstead Act (*National Broiler Mktg. Assn v. United States* 436 U.S. 816 (1978) at 827-829, *In re Mushroom Direct Purchaser Antitrust Litig.* 621 F (2009) at 283). The US District Court for the Central District of California has concluded that the intention of Congress in enacting Capper-Volstead was to help farmers protect themselves from “the predatory middleman, the speculator who bought crops in the field and returned but a small percentage of their eventual worth to the grower” (*Case-Swayne Co. v. Sunkist Growers Inc.* 389 U.S. 384 (1971) at 393). Thus, the Solano farmers should avoid accepting as members any packing, processing, or distribution enterprises, unless such enterprises pack and distribute produce as part of a farm enterprise that entails growing crops or raising livestock. Similarly, it would be advisable to avoid inviting institutional buyers to be members of the cooperative in order to maintain protection under Capper-Volstead.

However, there is no case law clearly interpreting Capper-Volstead with regards to the participation of other types of members, such as employees of the cooperative, or end consumers who purchase products

of the cooperative. In the US Supreme Court ruling on *National Broiler*, Justice Brennan issued a concurring opinion which further discussed the intent of Congress in enacting Capper-Volstead and which may offer an argument that workers could perhaps be members of an agricultural producer cooperative without compromising protection under Capper-Volstead. Brennan pointed out that the antitrust law known as the Clayton Act provided exemptions for agricultural producer cooperatives and labor unions (an Act which Capper-Volstead intended to clarify). As Brennan wrote, in reference to the Clayton Act, “[t]his legislation linked industrial labor and farmers as the kind of economic units of individuals for whom it was thought necessary to permit cooperation -- cartelization in economic parlance -- in order to survive against the economically dominant manufacturing, supplier, and purchasing interests with which they had to interrelate” (*National Broiler Mktg. Assn v. United States* 436 U.S. 816 (1978) at 830). Thus, while the question of employee members in an agricultural producer cooperative remains unclear, Justice Brennan’s opinion offers a hint that Capper-Volstead protection could arguably apply to an agricultural cooperative that includes a class of a worker-members because the intent of antitrust laws was to prevent predatory practices by big industry actors that were harmful to small farmers and workers. Indeed, since the passage of the populist Capper-Volstead Act in 1922, and since the 1978 *National Broiler* case was argued, workers in the food system have experienced stagnating wages, making them among the lowest paid workers in today’s economy, and one could make the argument that protecting workers from the vast power and predatory practices of large agriculture and food industry giants is well within the spirit of Capper-Volstead. Similarly, since an ultimate goal of antitrust laws is to protect consumers from price fixing by industry giants, one could argue that inclusion of consumers as voting members in a multi-stakeholder cooperative does not violate antitrust laws. These arguments are no a sure bet, however, so the farmers’ cooperative should proceed with caution and seek legal advice when forming its membership and governance structure, especially when including any members who do not clearly fall into the category of farmer, rancher, dairy producer, or fruit/nut grower.

Further Reading

For analysis about the Capper-Volstead Act see Volkin, David “Understanding Capper-Volstead,” U.S. Department of Agriculture, Rural Business and Cooperative Development Service, Cooperative Information Report 35, June 1985, available at: <https://www.rd.usda.gov/files/cir35.pdf>

Food Safety Modernization Act (FSMA)

A concern raised by farmers repeatedly has been the administrative costs and hassles associated with the Food Safety Modernization Act (FSMA). FSMA regulates both farms and facilities that hold, pack, or process food. FSMA contains two main parts: the Produce Safety Rule and the Preventive Controls Rule. The Produce Safety Rule is more directly relevant to farms because it regulates the growing, harvesting, and packing of produce. The Preventive Controls Rule is generally designed for food manufacturing and for facilities that pack and hold produce, and farms are expressly exempt from this rule (21 CFR §117.5(k)(1)). Thus, in the context of the Solano farmers’ cooperative, individual farmers must be primarily concerned with the Produce Safety Rule. Meanwhile, the cooperative’s facilities used for holding, packing,

and distributing produce and other farm products must be concerned with the Preventive Controls Rule. There are numerous exemptions and partial exemptions from requirements under the Produce Safety Rule available for small farms and farms that grow products posing fewer food safety risks.

However, it appears there is no practical applicable exemption from FSMA's Preventive Controls Rule for a farmers' cooperative facility such as the one envisioned for Solano County farmers at this time. Thus, a produce distribution cooperative would have to comply with the requirements of FSMA. Some individual farmer-members of the cooperative may enjoy exemptions from FSMA's Produce Safety on their own farms, but any packing and distribution facilities operated by the cooperative would likely need to fully comply with the Preventive Controls Rule, which would entail registering with FDA, being subject to inspections, having a written and approved food safety plan tailored to the facility, employee training, and detailed record-keeping. Additionally, the cooperative, in complying with the Preventive Controls Rule, may need to ensure that its suppliers (i.e. its farmer members) are implementing good agricultural practices on their individual farms. Prospective farmer members of the cooperative whose farms are exempt or qualified-exempt from FSMA's Produce Safety Rule should not be too fearful that selling to the cooperative could trigger having to pay for expensive food safety audits or other costs of FSMA compliance because the rules on this matter do not necessarily prohibit a distributor regulated by FSMA from purchasing produce from an exempt or qualified-exempt farm. However, the rules require the buyer to consider the farm's history of compliance and use of good agricultural practices (Title 21 CFR § 117.410). Therefore, exempt and qualified exempt farms may still be able to sell to a produce distributor, such as the envisioned cooperative, without having to bring their individual farms into full FSMA compliance. But in these cases, the exempt or qualified-exempt farm should maintain thorough records of any food safety-related training, testing, plans, inspection notes, and other food safety practices implemented on their farm to help make the case that the farm has a strong track record on food safety.

There are rigorous trainings offered through various non-governmental organizations on FSMA compliance. It's advisable that the cooperative to send its staff to such food safety trainings before beginning operations.

On the topic of food safety, it should be noted that California law requires many small farms to follow the Small Farm Food Safety Guidelines published by the California Department of Food and Agriculture (CDFA). Farms that must comply with the CDFA guidelines include all farms that sell at certified farmers' markets (California Food and Agricultural Code § 47020(c)), all farms that operate a CSA ((California Food and Agricultural Code § 47061(a)(1)(B)(i)) , and all farms operating on land that is not zoned primarily as agricultural land, which includes many urban farms and community gardens (California Health and Safety Code § 114376). Thus, under California law, even many small farms that are entirely exempt from FSMA are still subject to some important food safety requirements, which contain some similar (not identical) practices as required of FSMA covered farms. Adhering to California's Small Farm Food Safety Guidelines and maintaining thorough documentation of compliance can help small farmers who are members of the cooperative sell their produce to the cooperative while avoiding some of the more costly audits and other requirements that other wholesale buyers may impose on farmers.



Further Reading

FDA has an information page about the Preventive Controls Rule, with links to additional resources, at this link: <https://www.fda.gov/food/guidanceregulation/fsma/ucm334115.htm>

California's Small Farm Food Safety Guidelines are available at this link: <https://www.cdfa.ca.gov/is/i & c/sffsg.html>

USDA Grants Available to Agricultural Cooperatives

Agricultural cooperatives are given preference in applying for certain USDA grants, such as for value added food production. Further, USDA provides Rural Cooperative Development Grants to nonprofits that provide technical assistance to agricultural cooperatives, so in some regions there is additional government-funded assistance available to agricultural cooperatives for business planning, legal support, technical information, and other needs.

Further Reading

See USDA's Rural Development webpage for current information on grants available. <https://www.rd.usda.gov/>

Legal Steps Involved in Agricultural Cooperative Development

Phase 1: Simple Farmers' Cooperative

At least a few weeks before the local food distribution enterprise is ready to begin operations, a simple cooperative corporation can be formed with interested farmers as members. If the ultimate vision of the cooperative is to be a true multi-stakeholder cooperative with multiple types of members (e.g. agricultural producers plus consumers, workers, or other groups) participating in elections and in profit sharing, then it might be advisable to form a cooperative corporation under California's Cooperative Corporation Law (the framework designed for various models of consumer and worker cooperatives). However, there are benefits to forming a NCAC for reasons discussed in the section of this memo about securities law. Therefore, the cooperative initially might choose to form as a NCAC under California law.

If the farmers choose to first form a NCAC but later decide to transition to a general Cooperative Corporation Law co-op, so as to accommodate a multi-stakeholder cooperative, the cooperative could plan to shift from a NCAC cooperative to a cooperative corporation law cooperative later. This could likely be accomplished by some amendments to the cooperative's Articles of Incorporation and Bylaws, which could be done by an attorney for a similar amount of time and costs associated with forming a new cooperative corporation (California Food and Agricultural Code § 54083).

The corporation (whether a NCAC or generic cooperative corporation) can be formed with a class of investor members, in addition to agricultural producer members, if desired. The investors would be there for the sole purpose of raising capital from supportive individuals and institutions who could earn a modest dividend or interest on their investment. The corporation's Articles and Bylaws can be written such that investors only vote on rare and major decisions such as any possible merger, dissolution, or sale of substantially all assets. Otherwise, decisions would be made by a board of directors elected by the agricultural producer members. In the early stages, of the group of farmer members is very small and engaged, the corporation can be structured such that all farmer members can be elected to the board. As the corporation's membership grows, it may be more efficient to have a smaller board elected by the agricultural producer members. Board members may be compensated or not, depending on the cooperative's preferences and funding available. Some boards are more actively engaged in the management of the cooperative while other boards delegate most responsibilities to paid staff.

To form a corporation, a group of founding members can draft Articles of Incorporation and Bylaws to file with the Secretary of State of California. There is an initial filing fee plus an annual Statement of Information that must be filed for small fees (as of this writing the initial filing is \$100 and the annual Statement of Information is \$25). Additionally, California has a minimum franchise tax of \$800 per year for corporations, including cooperatives. It's advisable to work with an attorney familiar with corporate law on the Articles of Incorporation and Bylaws and to work with a CPA on accounting and tax filings.

Phase 2: Multi-stakeholder Cooperative

When the cooperative is prepared to bring more member classes into its decision-making and profit sharing system, it could consider restructuring to include the following groups of member classes:

- Farmers
- Workers
- Individual or Household Consumers
- Investors
- Nonprofit Organizations

It's important to consider antitrust regulations when adding additional member classes. See the section on Cooperatives and Antitrust Laws above, and consult with an attorney on specific changes in membership structure and about any other questions as they arise since the addition of some non-farmer members could trigger regulation or litigation under US antitrust laws.

When adding additional member classes the farmers will need to decide how to allocate profit and loss sharing and voting power among the different classes. In California cooperative law, voting power within a member class must be equal, meaning each member receives one vote (California Corporations Code § 12404). However, different classes of members can hold different powers. For example the farmer

member class could have the power to elect a majority of the board members and the consumers might only get to elect one board member. Or, as another example, the cooperative's organizing documents could require that certain major decisions be approved by each member class.

A note about including investors as members: California corporate law allows for cooperatives to have preferred shareholders who have very few voting powers, however, they must have the right to vote on matters that would materially affect their proprietary rights in the cooperative (California Corporations Code §§ 12330(a) - (b)). Thus, investor members would not need to be involved in routine business decisions, however, they should have the right to approve or reject decisions such as authorizing additional member classes in the cooperative, authorizing additional shares to be sold, or amending major governance provisions of the bylaws that affect their financial interest in the cooperative. The cooperative could consider bringing on investors with such limited voting rights in order to access capital from the community, but also to ensure that farmers remain largely in control of the cooperative.

A note about including nonprofit organizations as members: including one or more nonprofit organizations as members can be advantageous for helping to ensure the cooperative stays on mission. Nonprofit organizations could be part of a special membership class that could hold the right to veto or approve of certain article or bylaw amendments (California Corporations Code § 12330(d)), giving the nonprofit the right to ensure that the cooperative doesn't sell out to a larger agribusiness, for example. In addition or instead, the nonprofits could be given the right to elect one or more board members who would represent the broader community or the food movement. This could also help ensure that the cooperative adheres to certain policies or principles. For example, the farmers' cooperative has discussed wanting to supply local food to the local community within Solano County, but it's been suggested that selling produce to upscale restaurants in the central San Francisco Bay Area and to large tech company campuses is more lucrative. If the cooperative chooses to pass a policy requiring that a certain amount of food distributed by the cooperative goes to local food banks, schools, or other institutions, special powers given to nonprofit members could help ensure these commitments are honored, while allowing farmers to drive more general business decisions of the cooperative.

Examples of Agricultural Cooperatives, Multi-stakeholder Cooperatives

There are not many multi-stakeholder cooperatives in the US, and many of the examples that exist in the food and agricultural context are still in early stages. This memo does not provide a comprehensive report of multi-stakeholder cooperatives, but a few notable examples include the following:

- **Our Table Cooperative** in Oregon is a multi-stakeholder cooperative that operates a farm, grocery store, and small food distribution business with member classes for workers, consumers, and regional producers. Workers elect 3 out of 7 members of the board of the cooperative; consumers elect one board member, regional food and agricultural producers elect one, and there are two board members elected by the members at large. Additionally, Our Table Cooperative has raised over \$1 million over the last five years largely from non-voting shareholder members.

- **Poudre Valley Community Farms** in Colorado a multi-stakeholder cooperative that is raising money to purchase farmland to support the next generation of farmers. It is structured with two main member classes: consumers and farmers. Consumers elect 3 out of 5 members of the board of the cooperative; agricultural producer members elect one and other institutions elect one.
- **Organic Valley** is a national farmer-owned organic dairy cooperative. Though not a multi-stakeholder cooperative, it is notable because of its sales of non-voting investor shares to the general public to finance its operations. Organic Valley is an example of an agricultural cooperative that opts for taxation under Internal Revenue Code § 521 and uses the federal securities registration exemption for agricultural producer cooperatives.

Further Reading

For an overview of cooperatives in general with several case studies on multistakeholder cooperatives, see Lund, Margaret, "Solidarity as a Business Model," Cooperative Development Center at Kent State University, date unknown, available at:

<http://www.uwcc.wisc.edu/pdf/multistakeholder%20coop%20manual.pdf>

Collaboration with Local Organizations, Government

To meet its goals, the Solano agricultural cooperative should maintain close collaborations with local government and local nonprofit organizations of various types. Excellent partnership opportunities have already been identified with the following two organizations:

Sustainable Solano

Sustainable Solano is an educational nonprofit organization with tax-exempt status under IRC § 501(c)(3). Promoting sustainable and local food is a primary activity of the organization, and it has been working to develop a vision for a group of food hubs in each of Solano County's major cities that serve as hubs for local food activities such as CSAs deliveries, cooking classes, community education, and large kitchens where chefs and community members can cook wholesome nutritious meals. These food centers will increase access to seasonal, locally-produced food and ultimately better health and well-being for residents county-wide. As a 501(c)(3) nonprofit, Sustainable Solano can engage in some limited economic development activities, such as incubating a local food distribution cooperative, so long as those economic development activities further Sustainable Solano's nonprofit mission. As mentioned in the section of this memo on USDA grants, nonprofit organizations such as Sustainable Solano can secure USDA grants for cooperative development and local food promotion, among other agriculture-related projects. If Sustainable Solano continues to partner with an agricultural cooperative, Sustainable Solano must ensure that after an initial incubation phase, it engages with the cooperative only in such a way as to avoid using its nonprofit resources (funding and other assets such as its brand, goodwill, facilities, etc) to benefit the cooperative, unless Sustainable Solano is compensated at fair market value for its services. In any business dealings between the two entities beyond an initial incubation phase, the board of Sustainable

Solano must ensure that dealings are done “at arm’s length” and with the best interests of Sustainable Solano as a priority. Thus, a mutually beneficial partnership between Sustainable Solano and the farmers’ cooperative would be legally sound, so long as Sustainable Solano abides by some ground rules for nonprofits engaging with private enterprises.

Solano Grown

Solano Grown is a California nonprofit organization with tax exemption under Internal Revenue Code § 501(c)(6). It was formed in 2008 by the County of Solano to hold onto the Solano Grown brand which has been used to market agricultural products from Solano County. Use of this brand would be highly desirable for the farmers’ cooperative and could be achieved through a simple licensing agreement between Solano Grown and the cooperative. As a 501(c)(6) organization, Solano Grown can lawfully enter into such a licensing agreement. The cooperative and Solano Grown will need to negotiate terms and consider questions such as whether the agreement will involve licensing fees, the length of the agreement, etc. Another issue to consider will be if users of the brand will need to adhere to any quality standards, and if so, who will enforce those quality standards. It may be unlikely that the Solano Grown organization will be willing to make an exclusive licensing agreement with the cooperative, so the cooperative may need to consider whether it would be willing to agree to use a brand that other farms in the county may also use. In this case the cooperative may want to be sure that any its licensing agreement will allow the cooperative to simultaneously use its own brand alongside the Solano Grown brand to market its products, or perhaps the licensing agreement could allow the cooperative to use the Solano Grown brand with a modification that is exclusive to the cooperative, or to producers who meet certain quality standards. Examples of modification of the brand could be use of phrases such as “Solano Grown - Sustainably” or “Solano Grown - Cooperative.”